



CPAB Audit Quality Insights Report: 2023 INTERIM INSPECTIONS RESULTS

The Canadian Public Accountability Board (CPAB) oversees public accounting firms that audit Canadian reporting issuers. This report provides a snapshot of themes and insights from our 2023 audit quality assessment work to date.

Our preliminary 2023 regulatory assessments found that seven (13 per cent) of the 53 files inspected to date at the four largest firms had significant findings¹. This is a slightly higher level of findings for these firms than the prior year. The inspection results for other annually and non-annually inspected firms will be included in our annual report in March 2024.

This interim report highlights our observations related to progress on the implementation of the new Canadian quality management standards. It also provides insight into our activities on climate, fraud, artificial intelligence applications in the audit and public disclosures. Overall considerations for audit committees are also included as year-end audit preparations begin. CPAB welcomes the opportunity to discuss this report with audit committees and other capital market participants.

¹ Significant findings — A significant inspection finding is defined as a deficiency in the application of generally accepted auditing standards related to a material financial balance or transaction stream where the audit firm must perform additional audit work to support the audit opinion and/or is required to make significant changes to its audit approach.

How CPAB chooses files to review

CPAB's risk-based methodology for choosing files (and the specific areas of those files) for inspection is not intended to select a representative sample of a firm's audit work. Instead, it is biased towards higher-risk audit areas of more complex public companies or areas where the audit firm may have less expertise. Our inspections do not look at every aspect of every file and are not designed to identify areas where auditors met or exceeded standards. Results should not be extrapolated across the entire audit population, but instead viewed as an indication of how firms address their most challenging audit situations.

Audit quality assessments



Engagement file inspections

To date, we inspected 53 of 63 files across Canada's four largest audit firms and identified significant findings in seven of those files. This compares to eight significant inspection findings across 67 inspections in 2022. One firm that did not meet the target of no more than 10 per cent of files with significant findings in 2022 had four of the seven files with significant findings to date and will not meet the target in 2023. The inspections for other annually inspected firms are underway and will be completed later this fall.

One restatement has been required since our 2022 annual report related to the remediation of significant findings. In 2022 there were seven restatements. Where a restatement is required, the firm must work with the reporting issuer to effect the restatement as soon as possible, usually within the next quarterly reporting cycle.

Firm system of quality management evaluations

Our 2023 system of quality management evaluations for the four largest firms are currently underway. We also assess the firm's monitoring and remediation process with respect to developing or refining controls in response to deficiencies identified in 2022. We will publish our findings in our annual report in March 2024.

Under the new quality management standards, all firms must perform an initial evaluation of their system of quality management this year. Some firms are facing challenges meeting their project plan timelines and will need to invest additional resources to complete their initial evaluation by the required date.

Enforcement actions

In January 2023, we began publishing significant enforcement actions imposed as a consequence of inspection findings. To date, we have published five public censures, of which three relate to our 2022 inspection findings and two relate to 2023 inspection results for two non-annually inspected firms.

Due to the timing of our 2023 inspections and subsequent enforcement-related processes, the majority of enforcement actions imposed as a consequence of 2023 inspection findings will occur in 2024 and will be published on CPAB's website once imposed.

Common themes in preliminary inspection findings



The common themes we identified in our preliminary 2023 inspection findings to date relate to:

- The auditor's identification and assessment of the risks of material misstatement in the financial statements.
- Services provided by a service organization.
- Perpetual inventory systems.
- Audit documentation, and supervision and review.

Identification and assessment of the risks of material misstatement

The Canadian auditing standard addressing an auditor's responsibility to identify and assess the risks of material misstatement as a basis for planning and performing the audit was revised effective for 2022 calendar year-ends. This revised standard requires more robust risk identification and assessment to promote better audit responses to the identified risks.

CPAB's concerns with the implementation of the revised standard include:

- Insufficient consideration of the likelihood and magnitude of material misstatement leading to a conclusion that risk is low, or in some cases that there is no risk, even when there are clear indicators to the contrary.
- Significant untested populations of transactions and/or account balances based on an assessment that there is no risk of material misstatement. For example, we have encountered situations where reporting issuers have a large number of subsidiaries. Audit work on revenue for a significant number of the subsidiaries has not been performed, even though they represent many times materiality.
- No testing of information technology or other controls where extensive use of information technology is present. For example, when a significant amount of information is only available in electronic form and no physical documentation of transactions is produced or maintained.
- No evidence that the engagement team performed a stand back assessment to consider the results of audit procedures, contradictory information (if any) and whether the initial risk assessment remains appropriate. For example:
 - Revenue testing identified multiple instances of transactions that required correction by the reporting issuer but the engagement team did not understand the reasons for the corrections.
 - Insufficient challenge of the design of management's controls that address areas of high estimation uncertainty, and whether the controls were sufficiently robust to take into consideration the changes in the macroeconomic environment. For example, the estimation of the allowance for credit losses on loans receivable in an environment of increasing interest rates. [See concerns raised on the implementation of the Canadian Auditing Standards 540 \(Revised\) – Auditing Accounting Estimates and Related Disclosures.](#)

Services provided by a service organization

We continue to have inspection findings in audits of reporting issuers using third-party service organizations to perform significant aspects of their business activities. Examples of audit deficiencies include:

- Insufficient understanding of the significance of the services provided by the service organization and their effect on the reporting issuer's internal controls.
- Reliance on a service auditor report without appropriately considering whether the controls at the service organization tested by the service organization auditor address the relevant risks at the reporting issuer.
- Insufficient or no testing of the controls at the reporting issuer that are necessary to ensure the controls at the service organization operate effectively (complementary user entity controls).

Perpetual inventory systems

A number of reporting issuers use perpetual inventory systems to track the existence and condition of inventory. Management evaluates the reliability of the perpetual inventory system through a regular cycle of physical counts of portions of the inventory throughout the year (cycle counts). Examples of audit deficiencies include:

- Limited or no procedures to obtain evidence on the frequency, completeness and accuracy of the cycle counts performed by management.
- The engagement team either does not observe management's count procedures, or attendance is limited to cycle counts performed at or near the balance sheet date. In some instances, the engagement team performed test counts independent of management's cycle counts which provided no evidence of the overall reliability of the inventory system.
- No evaluation of the effectiveness of controls over changes to the financial records based on cycle count results. Depending on the significance of the inventory balance being tested, the engagement team may need to request that management perform a full physical count.

Audit documentation, and supervision and review

The quality of audit documentation is a recurring issue that raises concerns about the effectiveness of the supervision and review by senior members of the engagement team. We observed an increase in instances where there is insufficient documentary evidence to understand: the nature, timing and extent of procedures performed; the results of those procedures and evidence obtained; and significant professional judgments made in reaching conclusions. Oral explanations provided by engagement team members do not represent adequate support for the work performed.

How firms are required to respond to CPAB findings

Most of the significant findings require the firm to carry out additional audit procedures to determine the need, if any, to restate the financial statements due to material error. The remaining findings require firms to add evidence to the audit file to show they had obtained sufficient and appropriate audit evidence with respect to a major balance sheet item or transaction stream. CPAB expects firms to remediate file deficiencies before the reporting issuer's next quarterly report. Where a restatement is required, the firm is expected to work with the reporting issuer to issue the restatement as soon as possible. Audit firms that voluntarily participate in the Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees (Protocol) share this report and public company-specific findings and remedial action taken with the reporting issuer's audit committee. CPAB encourages audit committees to discuss this report and specific findings, if applicable, with their auditor.

Looking forward



Climate thematic review

During the 2023 inspection cycle, CPAB is continuing its efforts to understand and assess how auditors are evaluating the impact of climate-related risks in their financial statement audits. This marks the second year of CPAB's climate thematic review.

Our observations to date this year are:

- Based on the audits inspected by CPAB to date, an increasing number of engagement teams are considering climate-related factors during their risk assessment activities.
- The extent and quality of climate-related risk assessments continues to vary across files and firms, however audit teams at firms which had implemented a required template or detailed examples were more likely to perform a more detailed risk assessment of climate-related risks.
- Engagement teams are not consistently discussing climate-related risks with management or those charged with governance as part of their risk assessment activities. The content of these discussions ranged from in-depth conversations of the reporting issuer's climate risk management activities to limited, high-level discussions.
- In most files inspected, engagement teams did not identify a material risk related to climate.

Audit firms need to do more to prepare their teams to consider and address climate-related risks in their audits by providing enhanced training and resources. It is also important that audit firms have ongoing discussions with management and those charged with governance on this topic.

Increased monitoring of this area, including identifying reporting issuer audits that are more likely to be impacted by climate-related risks in the nearer term will allow audit firms to better prepare their teams to adapt and change their audit approaches to respond to climate related risks appropriately.

Fraud

The fraud landscape in Canada and around the world continues to evolve with the emergence of new risks including advancements in technology, climate change and emerging industries. Over the past few years,

CPAB has integrated [fraud thematic reviews](#) into our regular inspections of audit files at annually inspected firms. Furthermore, the discussions between audit committees and their auditors play an important role in the prevention and detection of fraud.

In September 2023 CPAB marked its 20th anniversary by hosting an Audit Quality Symposium focused on the evolving fraud risk landscape. The symposium provided an opportunity for key stakeholders from a variety of backgrounds to discuss emerging fraud risks and how Canadian capital market participants can adapt to these new challenges.

Dialogue at the symposium reiterated that all stakeholders share a collective role in responding to evolving fraud risks. As fraud risks continue to evolve, so too must our responses.

A detailed summary of the event and key takeaways will be shared in late October.

Use of artificial intelligence applications in the audit

Over the past year there has been a significant advancement in the general availability of applications incorporating artificial intelligence (AI), many of which could be used by auditors and management of Canadian reporting issuers. While the potential of these technological advancements to improve the effectiveness and efficiency of the audit is significant, it also creates risks that must be managed. The management of audit quality risks from information technology applications should be built into each audit firm's system of quality management. Practical risk considerations include reliability and explainability of the algorithms used by these tools, confidentiality of the data that may be input into a tool and ensuring audit teams are exercising professional skepticism without overreliance on technology.

More information is available on CPAB's [website](#).

CPAB public disclosures

In September 2022 CPAB published [disclosure recommendations](#) and indicated its intention to make significant changes to the information we disclose about the results of our oversight of participating audit firms that audit Canadian reporting issuers.

In January 2023 CPAB implemented its first phase of changes. Specifically, CPAB now publishes, on our website and distributes through our CPAB Bulletin:

1. Significant enforcement actions imposed on a firm.
2. Recommendations which were included in a firm report but not addressed by the firm within a reasonable period of time.

Two of CPAB's disclosure recommendations require rule/legislative changes before they can be implemented. CPAB is currently holding a [public consultation](#) on these rule changes, and we invite all stakeholders to share their views.

Following the public consultation, CPAB will review and consider feedback received and finalize proposed rule amendments before pursuing legislative changes. CPAB intends to complete these activities in 2024.

For more information visit cpab-ccrc.ca/insights/disclosures.

Considerations for audit committees

CPAB welcomes the opportunity to discuss this report with audit committees. Below are some areas for audit committee consideration.

Topic	What to ask the auditor
Risk assessment	<ul style="list-style-type: none"> • Are there areas of the audit where the auditor has concluded there are no risks of material misstatement? If so, why? • Did the auditor's risk assessment identify any account balances, transactions and/or disclosures where testing of controls was necessary? • Were there any changes to the initial risk assessment from planning based on the results of procedures performed?
Climate	<ul style="list-style-type: none"> • How did the auditor consider climate-related risks as part of their audit planning and how did that impact planned audit procedures? • Did the auditor identify any climate-related risks that were not identified by management? • Did the auditor consider the use of specialists/experts where significant climate-related risks were identified?
Fraud	<ul style="list-style-type: none"> • Did the auditor identify any gaps or deficiencies in the fraud risk management program? If so, how were these addressed in the audit approach? • What procedures did the audit team perform to identify and address emerging fraud risks? • How did the audit team conduct their fraud inquiries and obtain an understanding of management's fraud risk management program? • What emerging fraud risks or trends are auditors most concerned about?
Use of artificial intelligence in audits	<ul style="list-style-type: none"> • Does the auditor have a policy regarding the use of artificial intelligence tools in the audit? • Does the reporting issuer have a policy related to the use of artificial intelligence within the company? • If artificial intelligence tools are being used, what steps are taken to protect the confidentiality of the company's data?

Additional CPAB resources

Additional resources related to CPAB's regulatory oversight activities are available at: www.cpab-ccrc.ca/insights.

About this report

This report provides insights from CPAB's interim audit quality assessments for 2023, related for the most part to the country's four largest audit firms. We will publish our annual audit quality insights report in March 2024.

About CPAB

The Canadian Public Accountability Board (CPAB) is Canada's independent, public company audit firm regulator. Charged with overseeing audits performed by registered public accounting firms, CPAB contributes to public confidence in the integrity of financial reporting and is committed to protecting Canada's investing public. CPAB promotes audit quality through proactive regulation, dialogue with domestic and international stakeholders, and practicable insights to inform capital market participants. CPAB has offices in Montreal, Toronto and Vancouver.

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