

# Strengthening audit quality through systems of quality management

A strong system of quality management has a positive impact on audit quality. The Canadian Standard on Quality Management (CSQM) <sup>1</sup>, effective December 15, 2022, aims to strengthen systems of quality management at audit firms through a proactive and tailored approach. The public interest is served by the consistent performance of quality audit engagements.

The Canadian Public Accountability Board (CPAB) has observed a strong correlation between firms with a robust system of quality management and a lower level of significant findings identified through our file inspections. A strong system of quality management operates in a continual and iterative manner and is responsive to changes in the nature and circumstances of the firm and its engagements.<sup>2</sup> This starts with its ability to obtain real-time information that enables them to proactively identify firm-wide and engagement-level risks. It also includes a consistent and ongoing commitment by firm leadership to monitor and remediate responses to those risks.

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<sup>1</sup> CSQM 1 is part of a suite of new standards, including CSQM 1, *Quality management for firms that performs audits or review of financial statements, or other assurance services engagements*, CSQM 2, *Engagement quality reviews* and Canadian Auditing Standards (CAS) 220, *Quality management for an audit of financial statements*.

<sup>2</sup> CSQM 1, paragraph 6.

There are eight components of a firm’s system of quality management included in CSQM 1.<sup>3</sup> While all components are important, this publication provides insights into practices observed at firms with robust controls and processes in three areas—governance and leadership, risk assessment, and monitoring and remediation—as we have observed that these are the building blocks for CSQM 1.

This publication should be read in conjunction with CPAB’s previous publications, which include relevant observations:

- Annual Report ([2023](#) and [2022](#)).
- Audit Quality Insights Report: Interim Inspection Results ([2023](#) and [2022](#)).
- System of quality management call to action: Strengthening audit quality ([2022](#)).

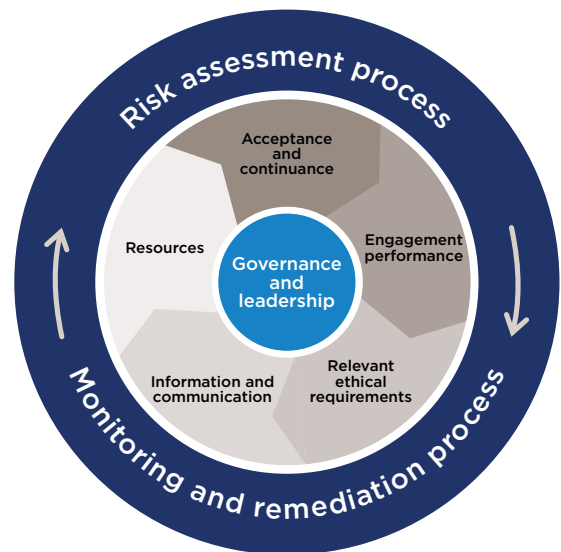
We expect firm leadership to review and distribute this publication to individuals with operational and functional responsibilities relating to their system of quality management.

## CSQM 1 overview

The design of a firm’s system of quality management will vary depending on the nature and circumstances of the firm. The standard requires firms to:

- Use the quality objectives included in CSQM 1 to identify and assess quality risks that are applicable to their firm based on its size, nature and circumstances and relative engagements. Firms should also consider if firm-specific quality objectives are required and if so, identify and assess quality risks for those objectives.<sup>4</sup>
- Design and implement a response to identified quality risks.<sup>5</sup>
- Perform monitoring activities to evaluate findings and identify deficiencies.<sup>6</sup>
- Design and implement remediation activities based on deficiencies identified.<sup>7</sup>

### The firm’s system of quality management



<sup>3</sup> CSQM 1, paragraph 6.

<sup>4</sup> CSQM 1, paragraph 24.

<sup>5</sup> CSQM 1, paragraph 26.

<sup>6</sup> CSQM 1, paragraph 36 and 40.

<sup>7</sup> CSQM 1, paragraph 42.

### What is a firm response?

CSQM 1 requires firms to apply a risk-based approach to design, implement and operate the components of the system of quality management. This requires firms to establish quality objectives, define quality risks and design, implement and operate responses to address quality risks.<sup>8</sup>

Responses can consist of policies, procedures or controls.

### Scalability for more and less complex firms

CSQM 1 was designed to be scalable to the specific nature and circumstances of the firm. As such, firms need to identify firm-specific quality risks and related responses to those risks. The standard references firms that are more and less complex. The assessment of complexity is a continuum and can change over time. It is critical that firms continually monitor changes to their reporting issuer audit engagements and evaluate whether existing processes and controls need to be modified.

Some factors we have observed that increase a firm's risk profile related to the nature and circumstances of the firm and its reporting issuer audit engagements include:

- A high volume of reporting issuer engagements.
- A significant increase in the number of reporting issuer audit engagements.
- Complexity and/or variability in the firm's audit engagements, such as accepting audit engagements in industries where the firm may not have as much expertise.
- Reporting issuer audit engagements that operate in new or emerging risk industries
- The number of offices and engagement partners.

A firm's risk profile should be continuously monitored. This ensures that the system of quality management can adapt as required in response to changes in the firm's risk profile. The robustness of a firm's system of quality management should increase consistently as their risk profile increases. Firms with a higher risk profile should consider the design and implementation of controls as responses, particularly when quality risks are assessed as high. The nature, timing and extent of the firm's responses to address quality risks need to be based on and responsive to the reasons for the assessments given to those quality risks.<sup>9</sup> A firm should also consider their risk profile when it designs its monitoring and remediation processes.

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<sup>8</sup> CSQM 1, paragraph 23.

<sup>9</sup> CSQM 1, paragraph 26.

## Firm's approach to evaluating their system of quality management

CSQM 1 requires that the firm assign ultimate responsibility and accountability for its system of quality management to the firm's chief executive officer, managing partner or, if appropriate, the firm's board of partners<sup>10</sup> who must evaluate, on behalf of the firm, the system of quality management at least annually.<sup>11</sup> This evaluation requires the individual(s) to conclude whether the firm's system of quality management provides reasonable assurance that the objective of CSQM 1 is being achieved.<sup>12</sup> The evaluation will also provide the firm with information that can help identify and address deficiencies in its system of quality management. It is also a data point that firms should consider as part of a continuous and iterative risk assessment process, to ensure previously identified quality risks remain relevant and to identify whether the firm has additional risks requiring further consideration.

## Governance and leadership, including audit firm culture

Firm leadership sets the tone of a firm's culture and demonstrates a firm's commitment to a quality culture by being accountable for managing risks related to audit quality while ensuring alignment at all levels within the firm. This can be achieved by ensuring the importance of quality is reflected in the firm's strategic decisions and actions, including the firm's financial and operational priorities.

Examples of governance and leadership practices observed at firms with a strong system of quality management include:

- The firm's strategic plan included actions that promote audit quality and improvements to the firm's quality culture.
- Individuals had sufficient time to perform their leadership roles or operational responsibilities relating to the firm's system of quality management. Capacity assessments were performed using historical actual information to assess whether individuals have the time required to appropriately perform their leadership role.
- Leadership and individuals with responsibility for the firm's system of quality management were involved in preparing detailed root cause analysis to understand the reason for audit quality issues.
- Individuals involved in preparing root cause analyses ensured timely implementation of remedial actions that were responsive to root causes identified.

### Insights: root cause analysis

Supervision and review are often identified as a root cause when the engagement partner and other senior members of the engagement team do not have sufficient time to oversee the engagement due to competing deadlines.

### Practices observed in firms with a strong system of quality management

The root cause analysis identifies the quality risks and responses that address supervision and review such as workload and capacity for senior members of the engagement team. The firm re-evaluates whether the new information obtained from the root cause analysis is an indication that the responses are not appropriately designed or operating effectively. This could include an analysis of the data and baseline set by leadership to assess partner workload and understand capacity concerns.

<sup>10</sup> CSQM 1, paragraph 20.

<sup>11</sup> CSQM 1, paragraph 53.

<sup>12</sup> CSQM 1, paragraph 54(a).

- Leadership assessed whether any of the root causes presented contradictory information to conclusions reached in the firm's monitoring program.
- Operational leaders were involved in evaluating whether remedial actions were appropriately designed to address identified deficiencies.
- The firm's performance management process included key performance indicators (KPIs) that promote a strong audit quality culture. Partners and leadership were measured against these KPIs during the year.
- The individual assigned ultimate responsibility of the firm's system of quality management was held accountable for KPIs related to the system of quality management, including those where operational responsibility is delegated to others.
- The firm established a board with a documented mandate that included overseeing management, evaluating the performance of the individual assigned ultimate responsibility for the firm's system of quality management and providing stewardship for the firm's system of quality management.
- Board composition included directors that were independent of the firm.

A strong system of quality management is supported by a firm culture that demonstrates a commitment to quality and reinforces the importance of the profession's public interest responsibility. CSQM 1 states that quality management is not a separate function of the firm, but an integration of a culture that demonstrates a commitment to quality with the firm's strategy, operational activities and business processes.<sup>13</sup> Firm leadership must ensure that all employees are aware of, and are held to account for, their shared responsibility for a high-quality culture.

Examples of actions by firms to demonstrate its commitment to a quality culture include:

- Periodic gathering of information on its culture through employee engagement or cultural surveys.
- Firm leadership communicated the importance of firm-wide survey participation and actively monitored participation during the survey period to ensure the firm achieved a high participation rate.
- Leadership leveraged the survey to solicit additional information from individuals on completeness of root causes and effectiveness of past actions to improve audit quality.
- Leadership evaluated employee engagement or cultural survey results to identify trends and develop an action plan to address identified issues.
- Leadership leveraged information from the surveys to assess whether there were missing or ineffective responses to quality risks in the firm's system of quality management.
- KPIs related to improving the firm's quality culture were developed. These were assessed periodically throughout the year and incorporated into individual performance evaluations.

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<sup>13</sup> CSQM 1, paragraph A30.

**Example KPIs for engagement partners and firm leadership**

Engagement partners	Firm leadership
<p>Engagement partners have defined KPIs in place that align to the firm’s quality objectives. These KPIs should be specific to each partner’s individual role on engagements and incorporated into engagement partner evaluations.</p> <p>Specific KPIs could include:</p> <ul style="list-style-type: none"> <li>• External inspection and internal quality monitoring results with no significant findings.</li> <li>• Positive real time or in-flight monitoring results.</li> <li>• Partner involvement on engagements meets or exceeds the minimum hours defined by the firm.</li> <li>• No restatements.</li> <li>• Compliance with the following firm and/or professional requirements within defined timelines:               <ul style="list-style-type: none"> <li>◦ Firm continuance processes for the next year’s audit are completed on a timely basis. For example, the continuance is completed for the next year’s audit within 30 days of audit report signoff for the previous year.</li> <li>◦ Completing all required training.</li> <li>◦ Completing engagement budgets to identify resource requirements early. For example, budgets are completed no later than May 31 for a December 31 year end.</li> <li>◦ Completing engagement reviews on a timely basis. For firms with milestone programs, this would comply with milestone deadlines.</li> <li>◦ Completing mandatory consultations.</li> <li>◦ Engagement documentation is assembled and archived. For example, the file is archived within 15 days of audit report date to demonstrate expectation of contemporaneous documentation.</li> <li>◦ No independence violations.</li> </ul> </li> </ul>	<p>Leadership has audit quality-related KPIs that are specific to their leadership role.</p> <p>These should be aligned with the engagement partner KPIs; however, they may need to be in aggregate for the firm/office and incorporated into firm leadership’s performance evaluations.</p> <p>Specific KPIs could include:</p> <ul style="list-style-type: none"> <li>• Goals for timely completion of capacity assessments or workload reviews for all engagement partners.</li> <li>• Low attrition rate in the firm’s assurance practice.</li> <li>• Targets related to overall external inspection findings and internal quality monitoring results (for the audit practice as a whole).</li> <li>• Positive results and trends from cultural or engagement surveys.</li> <li>• Design and implementation of effective firm-wide action plans.</li> </ul> <div data-bbox="987 1306 1305 1625" data-label="Image">  </div>

## Risk assessment process

A robust risk assessment process is critical to appropriately design and implement a strong system of quality management. By establishing quality objectives and identifying firm-specific quality risks, a firm can focus on its most significant issues. This involves continually re-evaluating responses to ensure they respond to the firm's quality risks and address all root causes.

Examples of risk assessment processes observed at firms with a strong system of quality management include:

- Investing significant resources to complete its initial risk assessment process and updated the risk assessment through the year. Factors considered in both the initial risk assessment process and the subsequent updating of the process include: engagement level data; internal and external file inspections; root cause analysis; and deficiencies identified through the firm's monitoring and remediation activities.
- Leadership continuously obtains evidence to support whether previously identified quality risks remain relevant, evaluate if new quality risks were required, and considered whether responses implemented to address quality risks remained sufficient and appropriate.
- Soliciting input from a variety of sources to understand the pervasiveness of issues identified. This information was used to assess whether responses need to be modified or if new responses need to be added.
- Regularly comparing internal monitoring data with external regulator findings to maintain consistency and address discrepancies. Recurring themes were identified to assess whether there were systemic issues that could indicate the firm has additional quality risks.
- Grading quality risks based on their severity and impact and used this to tailor the firm's response to address the risk. For example, implemented a specific control to address a significant or high-rated quality risk (vs. a lower-rated response which could be addressed with a policy or process).

**Quality objectives** consist of objectives in relationship to the components of the system of quality management that are to be achieved by the firm.

This includes establishing specific quality objectives included in CSQM 1 and assessing whether additional quality objectives are required due to the nature and circumstances of the firm and its engagements.

## Monitoring and remediation process

The firm's monitoring and remediation process provides critical information about the design, implementation and operation of the system of quality management. This information is required so that firms can take appropriate and timely action to respond to deficiencies identified through the risk assessment process.<sup>14</sup> The monitoring and remediation process is also a key input into completing the firm's annual evaluation of its system of quality management.

Examples of monitoring and remediation processes observed at firms with a strong system of quality management include:

- A documented assessment of the independence and objectivity of the individual assigned oversight for the monitoring and remediation process. This assessment considers whether the individual is independent of operational responsibilities within the firm's system of quality management.
- Performing capacity assessments to ensure individuals had sufficient capacity to perform their assigned responsibilities.
- Monitoring at multiple points during the year so that findings are identified, communicated and remediated in a timely manner.
- The testing team concluded on the design, implementation and operation of remediated responses before year end. This information is considered in the firm's annual evaluation of its system of quality management.
- Training provided to those performing monitoring and remediation activities to ensure consistent testing of responses.
- Leveraging firm sampling methodology and testing templates used for financial statement audits in monitoring processes.
- Obtaining evidence to demonstrate the testing team exercised professional skepticism and appropriately challenged control owners to support conclusions on design and effectiveness of the controls and processes.
- Establishing processes to identify and evaluate the severity and pervasiveness of deficiencies as they arose.
- Documenting a remediation plan that clearly identified what was remediated, the date by which remediation was due and who was responsible for the remediation.

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<sup>14</sup> CSQM 1, paragraph 35(b).



## Key takeaways for firms

As required by CSQM 1 and described throughout this publication, a strong system of quality management operates in a continuous and iterative manner and is responsive to changes in the nature and circumstances of both a firm and its engagements. Firm leadership drives improvements to audit quality within the system of quality management and needs to constantly reassess if there have been changes to the firm’s nature and circumstances, as well as determine how best to respond to those changes.

Key takeaways for firms	
<b>Tone at the top:</b>	Firm leadership and engagement partners commit to setting an appropriate tone that promotes a quality culture.
<b>Governance framework:</b>	Establishing a governance structure that ensures appropriate oversight of the firm’s system of quality management.
<b>Risk assessment:</b>	Performing a continuous and iterative risk assessment process throughout the year.
<b>Monitoring and remediation:</b>	Proactive monitoring is performed and remediated on a timely basis.



## Appendix A – Illustrative scenarios

These scenarios are based on observations from CPAB’s system of quality management assessments. Facts have been modified or excluded to safeguard the identities of the audit firms.

### Scenario one: Leadership has accountabilities and responsibilities relating to the firm’s system of quality management

#### Background

A three-partner firm has implemented CSQM 1. The firm is located in one office, and audits more than 50 reporting issuers in addition to performing a number of audits for private companies. The responsibility for CSQM 1 included:

- One partner was designated as the individual assigned ultimate responsibility and accountability for the firm’s system of quality management.
- The partner assigned ultimate responsibility delegated the operational responsibility for the firm’s system of quality management to one of the other partners.
- Both partners have a portfolio of public and private audit engagements and the partner with operational responsibility is also the firm’s Quality Leader (and is a response owner for some of the firm’s CSQM 1 responses).
- The firm did not define responsibilities and accountabilities for specific aspects of the system of quality management, including compliance with independence requirements and oversight of the monitoring and remediation process.

#### Governance and leadership considerations

We identified the following concerns over the firm’s compliance with the requirement to assign responsibility for the firm’s system of quality management:

- There is a capacity risk since the partners had operational and quality responsibilities as well as responsibilities relating to the firm’s system of quality management. In this scenario, some partners already had 1,500+ chargeable hours included in their annual workload. There was no assessment performed on the significance of the non-chargeable workload, as those hours were not accurately tracked in the past and no estimate was performed for the year. As such, the firm did not have information to assess whether partners had sufficient capacity to perform their quality responsibilities including responsibilities for the firm’s system of quality management. Firms should perform capacity assessments for partners which include all chargeable and non-chargeable assignments for the individual and include an assessment of whether there are any periods of compression for that individual.
- The firm did not clearly define the roles and responsibilities for the individual assigned ultimate responsibility and accountability for the firm’s system of quality management or the individual assigned operational responsibility for the firm’s system of quality management. In addition, the firm did not define KPIs which specifically relate to each of these individuals’ roles. These are required to ensure that individuals are aware of and are held accountable for their responsibilities.

- The firm did not assign responsibility for compliance with independence requirements and oversight of the monitoring and remediation process as required by CSQM 1.<sup>15</sup> Firms with limited partner pools should consider how to address this requirement, such as leveraging individuals from the audit or quality practice who are independent of the firm's system of quality management (i.e., they are not a response owner). The firm should also assess the capacity requirements for these roles and ensure individuals with other responsibilities have time available to discharge these responsibilities.

## Scenario two: Individual inspection indicative of systemic issue

### Background

A firm performed a root cause analysis on an external inspection with a significant inspection finding that relates to the audit of estimates. Auditing estimates was a recurring issue for the firm. The root cause analysis primarily relied on information obtained from the engagement team, which identified that there is a need for new audit tools and templates, as well as training in the specific areas related to the significant inspection findings.

### Root cause analysis considerations

We identified a concern with the firm's compliance with monitoring and remediation requirements, and provided recommendations to address this concern:

- The firm primarily relied on discussions with the engagement team which does not provide a comprehensive root cause analysis. Recurring inspection findings are indicative of other weaknesses in the firm's system of quality management.
- While additional training and/or modifying audit tools can be a first step, the firm should also solicit feedback on actions taken previously to improve audit quality, including the historical effectiveness of training programs, tools and templates.
- The firm should consider engagement-level data such as assessing whether there were compression concerns, by reviewing all chargeable and non-chargeable hours incurred by the engagement team.

### Risk assessment considerations

The firm should consider all information obtained as part of root cause analysis and use this information to assess whether there are additional quality risks that should be incorporated in their risk assessment. For example, if the root cause analysis identifies conflicting demands encountered by the engagement team, the firm should consider if there is a risk that the engagement team does not have sufficient time to perform a quality engagement. This quality risk could be addressed by including a response that ensures key team members do not have compression concerns during the engagement period.

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<sup>15</sup> CSQM 1, paragraph 20(c).

### Scenario three: Firm leadership is responsible for audit quality

#### Background

A firm has four partners operating out of two offices. This firm audits over one hundred reporting issuers, along with a large portfolio of private company audits. The firm is in the process of growing their private company audit practice.

To address the quality risk relating to leadership oversight of engagements, the firm has implemented a weekly all-partner meeting. A standing meeting agenda is used which includes discussing concerns relating to specific engagements. Information relating to engagement progress, changes in scope, risk or other matters, is obtained from various sources within the firm and reviewed by leadership. Action plans are developed for engagement teams requiring support.

#### Monitoring and remediation considerations

We identified a concern with the firm's compliance with monitoring and remediation requirements, and provided recommendations to address this concern:

- The firm's monitoring of this response consisted of reviewing recurring meeting invites. However, this is not sufficient to demonstrate operation of the response. The firm should have implemented frequent, periodic testing to ensure that the response operates as intended. Monitoring activities should be designed considering the level of evidence obtained to support operation of the response. In this example, the response tester could have observed and attended the weekly partner meetings periodically during the year as well as inspected meeting minutes and action plan documentation.
- In addition, given that the firm has a growing portfolio of audit engagements, the firm should consider if additional activities may need to be included. For example, this may include activities that ensure the completeness of the audit portfolio discussed at the meeting, the completeness and accuracy of the information used to identify where action plans are required, identifying specific triggers that require discussion at the partner meeting or implementing formal tracking of action plans.

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