Canadian Public Accountability Board
Conseil canadien sur la reddition de comptes

OCTOBER 2024

CPAB Audit Quality Insights Report: 2024 INTERIM INSPECTIONS RESULTS

The Canadian Public Accountability Board (CPAB) oversees public accounting firms that audit Canadian reporting issuers. This interim report highlights our initial observations on our audit quality assessments of engagement files and the firms' systems of quality management from our 2024 regulatory assessment work to date.

We continue to observe a strong correlation between firms with a robust system of quality management and lower levels of significant findings identified through our file inspections. One of the most significant concerns in our preliminary inspection findings is deficiencies in the auditor's identification and assessment of the risks of material misstatement, which is critical to ensuring the appropriateness of the audit procedures performed. We also have findings related to non-compliance with both the independence standards and the licensing requirements of the practice of public accounting.

This report also provides some observations looking forward on the current economic and geopolitical environment and artificial intelligence applications in the audit, as well as insights on CPAB public disclosures, and our activities on climate. Overall considerations for audit committees are included as year-end audit preparations begin. CPAB welcomes the opportunity to discuss this report with audit committees and other capital market participants.

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 50 of the 66 files planned for inspection across Canada's four largest audit firms and identified significant inspection findings[1] in four of those files. This compares to 10 files with significant inspection findings across 63 inspections in 2023. We also inspected 16 files at other firms and identified six files with significant findings. The full results for all firms inspected in 2024 will be included in our annual report in March 2025.

Five restatements have been required since our 2023 annual report related to the remediation of significant findings. In 2023, there were six restatements. Where a restatement is required, the firm must work with the reporting issuer to complete the restatement as soon as possible, usually within the next quarterly reporting cycle.

Firm system of quality management evaluations

All audit firms are required by the Canadian Standard on Quality Management 1 (CSQM 1) to design, implement and operate a system of quality management and to evaluate it at least annually. Our 2024 system of quality management evaluations for the four largest firms are currently underway and will focus on the firms' self-evaluations. We will publish our findings in our 2024 annual report in March 2025.

Through our file inspections, we have observed a strong correlation between firms that use internal coaching programs and/or perform inspections of in-process audit engagements and lower levels of significant findings, provided they are deployed effectively at the right time and on the engagements that require them the most.

[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.

Effective deployment requires a system of quality management that can adjust to changing circumstances. For example, internal or external inspections of completed audit engagements may identify areas where the firm's audit methodology is not being applied as intended or engagement team members do not have the necessary skills or experience. It is important for firms to respond quickly to these inspection findings and identify the audits that may require additional support.

In September 2024, we published **Strengthening audit quality through systems of quality management** to provide insights into practices observed at firms with robust controls and processes in three areas: governance and leadership; risk assessment; and monitoring and remediation. While all components of CSQM 1 are important, we have observed that these three areas are the building blocks for the standard.

Common themes in preliminary inspection findings

The common themes we identified in our preliminary 2024 inspection findings to date relate to:

- Identifying and assessing the risks of material misstatement.
- Use of an auditor's expert.
- Fraud.
- Supervision and review process.
- Ethical requirements, including independence.
- Compliance with licensing requirements to practice public accounting.

Identifying and assessing the risks of material misstatement

Identifying and assessing the risks of material misstatement in financial statements is foundational to performing a quality audit as it provides the basis for planning and performing the audit. The Canadian auditing standard addressing an auditor's responsibility to identify and assess these risks was revised effective for 2022 calendar year-ends to better align with the increasing complexity of business models and use of technology in business processes, while emphasizing an iterative and dynamic approach to risk assessment. In March 2024, we published **Identifying and assessing the risks of material misstatement: Strengthening audit quality** to provide more detail on the deficiencies identified in our 2023 inspections in applying the revised standard.

We continue to identify findings related to the implementation of the revised standard across a range of audit areas including revenue, business combinations, financial instruments and inventory. Examples include:

- Risk assessment procedures are biased towards obtaining evidence to support a lower risk assessment or exclude the identification of a potential fraud risk.
- No re-evaluation of the initial risk assessment as the audit progresses and new information becomes available, for example when misstatements indicative of internal control deficiencies are identified.

Another area where we identified an increased level of significant findings is the insufficient identification and assessment of the risks of material misstatement related to the consolidation process. This includes the aggregation risk that undetected misstatements in components not subject to audit procedures may exceed materiality for the financial statements as a whole in a group audit engagement. The auditor needs to assess whether it is necessary to test the operating effectiveness of internal controls over the consolidation to address the risk of material misstatement in the components that are out-of-scope for audit procedures. The auditor's approach to assessing and responding to aggregation risk will continue to be a focus of our inspections as we evaluate audit firms' implementation of the revised Canadian auditing standard for group audits that is effective for 2024 calendar year ends.

When risks are not identified or sufficiently assessed by the auditor, this results in the auditor not obtaining sufficient and/or appropriate audit evidence to address the risk of material misstatement. The International Auditing and Assurance Standards Board (IAASB) is currently developing an integrated project on audit evidence and risk response. CPAB supports the IAASB's efforts in this area and will be actively engaging with the IAASB and other key stakeholders to provide feedback based on our inspections.

Use of an auditor's expert

One area where the preparation of the financial statements often involves an expert in a field other than accounting is the estimation of the allowance for expected credit losses for financial assets. In these circumstances the auditor may determine that they need their own expert if complex financial models are used to estimate these allowances. We have identified concerns with the engagement team's oversight of the expert's work. In some cases, the engagement team has not appropriately evaluated the relevance and reasonableness of the findings or conclusions of the expert, such as the impact of identified model limitations on the conclusion that the models were fit for use.

Fraud

Fraud thematic reviews are integrated into our inspections of audit files to better understand how auditors are identifying and responding to the risk of fraud. We are particularly concerned that some auditors are not incorporating information such as whistleblower reports, complaints, and short seller reports, when identifying and responding to the risks of material misstatement due to fraud. In these circumstances the reporting issuer may engage a third party, typically a law firm, to investigate and determine whether there is sufficient merit to the claim to warrant further action. If the investigation concludes that no further action is required on the part of the reporting issuer, our findings indicate that some auditors conclude that there is no fraud risk without considering how audit procedures should be tailored to identify potential fraud if the other information was legitimate.

Supervision and review process

The audit engagement partner has overall responsibility for ensuring that the work of less experienced engagement team members is directed, supervised and reviewed by more experienced engagement team members. The engagement partner must personally review the documentation of significant matters and judgments. We continue to believe that the deficiencies we find in our inspections should have been identified and corrected either through the supervision and review process as the engagement progressed or by the engagement quality review prior to the release of the audit opinion.

Ethical requirements, including independence

We continue to have significant findings related to the identification and evaluation of threats to independence caused by non-audit services provided by auditors. A recurring finding is related to auditors performing the evaluation of the design, implementation and operating effectiveness of controls to support management's certification in accordance with National Instrument 52-109, *Certification of Disclosures in Issuers' Annual and Interim Filings* (NI 52-109). The independence standards do not prohibit a firm from providing a nonrecurring service to evaluate a discrete item or program as a specified auditing procedures engagement, but does prohibit a service that is in substance the outsourcing of an internal audit function.

Another recurring finding is non-compliance with the rotation requirements for the lead engagement partner and the engagement quality reviewer resulting in a breach of the independence standards. The rules for when an individual must step out of the lead engagement partner or engagement quality reviewer roles for a reporting issuer and how long they must wait before they can reassume those roles are specifically laid out in the rules of professional conduct. We have observed that firms that are not in compliance with the rotation requirements typically do not have processes and controls within their system of quality management that are sufficiently robust to effectively manage the complexity of the independence standards.

Compliance with licensing requirements to practice public accounting

The increase in remote audit work in response to pandemic restrictions has changed how audits are conducted and has significantly reduced the geographic connection between reporting issuers and their auditors. We are concerned that not visiting the reporting issuer's physical locations and meeting in person with management and staff makes it more difficult to fully understand the business and exercise appropriate professional skepticism when conducting the audit. We have also observed that auditors performing engagements remotely are not considering whether they are in fact practicing public accounting in a jurisdiction where they are not properly registered or licensed. In most jurisdictions this is a contravention of the law and can have significant repercussions for both the auditor and the reporting issuers they audit.

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 complete 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

Current economic and geopolitical environment

The post-pandemic economy continues to be very uncertain with industries being impacted differently. Industries such as commercial real estate have been significantly affected by the continuation of hybrid work arrangements requiring less office space and the growth of web sales reducing the demand for in store shopping. While interest rates are starting to come down, the impact is not being immediately felt. Disruptions to supply chains and global trade continue due to conflicts and climate events, and more than 70 countries and territories are holding national elections in 2024[2]. This environment creates significant challenges for auditors in assessing the reasonability of estimated cash flows to support impairment testing and going concern assessments.

Artificial intelligence applications in the audit

Significant advancements in applications leveraging artificial intelligence (AI) technologies have emerged over the past two years. While they have the potential to improve the efficiency, accuracy and insights of the audit, they also create risks that must be effectively managed. In September 2024, CPAB published **The use of AI in the audit – balancing innovation and risk** to provide an overview on how AI-enabled tools could enhance audit quality and outline how we expect firms and auditors to manage the risks related to using these tools.

CPAB public disclosures

CPAB is working with the relevant legislative and regulatory bodies to implement the rule and legislative changes related to CPAB's increased regulatory disclosures and other changes that address operational effectiveness and administrative practices.

The planned rule and legislative changes will be effective once CPAB has obtained all approvals from the relevant provincial government and securities regulators. This approach ensures a uniform implementation of the rule amendments across all provinces and territories in Canada, subject to local legal frameworks. Whether such amendments are made, and the timing of such changes, are subject to the discretion of the relevant government or regulatory body.

Climate thematic review

The 2024 inspections mark the third year of CPAB's climate thematic review, and while an increasing number of engagement teams are considering climate-related factors during their risk assessment activities, they are not consistently discussing these risks with management or audit committees. We have also observed that auditors do not always consider climate-related risks when reviewing information such as board minutes, press releases or investor presentations. CPAB supports the ongoing work by national and international standard setters to deliver standards for sustainability assurance engagements and sustainability-related disclosures and where appropriate, shares perspectives on these standard setting activities.

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[2] International Foundation for Electoral Systems.

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
Group audits	• How has the overall scope and timing of the audit changed in response to the new Canadian auditing standard for group audits? • How has the auditor considered the aggregation risk that undetected misstatements in subsidiaries or business units not subject to audit procedures may exceed materiality for the financial statements as a whole? • To what extent does the auditor plan to test the operating effectiveness of group wide controls to address aggregation risk? • Are there components impacted by economic or geopolitical instability and if so, how has the audit approach been modified to address the risks?
Economic risks	• What significant estimates and judgments are most sensitive to changes in the economic environment? • Was there a need for the auditor to involve specialists in the audit? • Did the auditor identify any contradictory information that would call into question the reasonableness of future oriented information used in management's estimates?
Use of artificial intelligence in audits	• What automated tools and techniques did the auditor use in the audit and to what extent did they incorporate artificial intelligence (AI) technologies? • If an AI-enabled tool was used, how was the AI algorithm trained and tested to come to its conclusions? • How has the auditor ensured that confidential reporting issuer information has not been shared?
Non-audit services provided by the auditor	• For any non-audit services, what threats to the auditor's independence have been identified and what safeguards have been applied to reduce the threats to an acceptable level? • To what extent was professional judgment required to conclude that the safeguards were sufficient to reduce the threats to an acceptable level? Was there consultation with the firm's independence experts? • Have the factors considered in concluding the safeguards were sufficient been discussed with the audit committee?

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 2024, related for the most part to the country's four largest audit firms. We will publish our annual audit quality insights report in March 2025.

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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