

# CPAB Audit Quality Insights Report: 2022 INTERIM INSPECTIONS RESULTS

The Canadian Public Accountability Board (CPAB) provides regulatory oversight of firms that audit the annual financial statements of Canadian reporting issuers. This report provides a snapshot of themes and insights from our 2022 audit quality assessment work to date. Through our preliminary 2022 regulatory assessments, three of the four largest audit firms had fewer than 10 per cent of files with significant findings<sup>1</sup> and continued to make improvements to their system of quality management. However, we continue to observe a high level of significant findings at non-annually inspected firms. The inspections for other annually inspected firms will be reported on in our annual report in March 2023. Two restatements arising from our inspections have been required since our 2021 annual report.

<sup>1</sup> 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. CPAB requires firms to carry out additional audit procedures to verify there was no need to restate the financial statements due to material error, or to substantiate that they had obtained sufficient and appropriate audit evidence with respect to a material balance sheet item or transaction stream to support their audit opinion.

This interim report also highlights our observations related to progress on the implementation of the new quality management standards<sup>2</sup>, auditor independence and objectivity. It also provides insight into our activities on firm culture and the results of thematic reviews on climate, fraud and going concern. 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.**

### 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



We have completed 61 of 67 planned file inspections across Canada's four largest audit firms and identified significant findings in seven of those files. This compares to seven significant inspection findings across 75 inspections in 2021. Three of the four firms had fewer than 10 per cent of files with significant findings. One firm had findings greater than 20 per cent. CPAB has a target of no more than 10 per cent of files inspected with significant findings.

We have also completed 12 file inspections to date at non-annually inspected firms and have identified significant findings in 11 of those files. The level of findings at many of the non-annually inspected firms continues to be unacceptably high. The inspections for other annually inspected firms are underway. They will be completed later this fall and reported on in our annual report in March 2023.

In 2022 to date, we obtained access to review component auditor working papers located in foreign jurisdictions for six engagement files selected for inspections (2021: eight). We have not identified any significant findings in foreign component auditor working papers reviewed to date (2021: two).

Two restatements have been required since our 2021 annual report (one at one of the four largest audit firms and one at another annually inspected firm). 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.

<sup>2</sup> The new quality management standards include the Canadian standard on quality management (CSQM 1), quality management for firms that perform audits or reviews of financial statements, or other assurance or related services engagements (systems of quality management are required to be designed and implemented by December 15, 2022), CSQM 2, engagement quality reviews and Canadian Auditing Standard (CAS 220), quality management for an audit of financial statements (effective date for CSQM 2 and CAS 220 is for audits of financial statements for periods beginning on or after December 15, 2022).



## Firm system of quality management evaluations<sup>3</sup>

Our 2022 quality management systems (QMS) assessments<sup>4</sup> are currently underway for the four largest audit firms and at a fifth annually inspected firm. Preliminary indications are that firms have continued to make progress in developing or refining controls to respond to deficiencies identified in 2021. Nevertheless, the level of significant inspection findings at one firm indicates that certain controls at this firm may not be designed appropriately or operating effectively. We will publish our findings in our annual report in March 2023.

To monitor progress against implementation plans, we also requested certain firms not currently subject to CPAB's QMS assessments to provide an implementation plan for the new quality management standards. Firms must ensure they have designed and implemented a strong system of quality management and a firm culture that demonstrates a commitment to quality. Critical areas of focus for these firms over the next several months are:

- Firms must have designed and implemented their system of quality management by December 15, 2022 and are required to perform an evaluation within one year. Successful implementation will require an on-going commitment from firm leadership to dedicate the necessary senior resources to develop and monitor the firm's system of quality management.
- Risk assessments to identify and assess quality risks, and to implement responses to address those risks, need to consider the nature and circumstances of the firm, including how the firm is structured and organized. This is a continual process; firms need to revisit the risk assessment to take into consideration changes in the nature and circumstances of the firm and its portfolio of reporting issuer audit clients, including the results of culture assessments. A robust risk assessment process will support the development of appropriate indicators to monitor effectiveness of a firm's responses and the ability to make changes to controls and processes in a timely manner.

In October 2022, we published [System of quality management call to action: Strengthening audit quality](#), a communication to all audit firms registered with CPAB which provided more detail on the importance of culture to a firm's system of quality management, preliminary observations on the implementation of the new quality management standards and an example to illustrate the iterative nature of a firm's system of quality management.



## Enforcement actions<sup>5</sup>

Requirements to make improvements to quality control processes were imposed on one of the four largest audit firms in 2021 in response to the level of significant findings in our 2020 inspection. This firm showed improvement in our 2021 inspection, and certain requirements were either modified or removed in 2022. The firm is continuing to show sustained improvement in our preliminary 2022 inspection results. A decision regarding further modification and/or potential removal of remaining requirements will be made in 2023.

Enforcement actions imposed by CPAB are specifically tailored on a case-by-case basis depending on the nature of violations identified during an inspection or investigation. Escalation of CPAB's enforcement actions will increase in proportion to the seriousness of the violation(s), which may include restrictions on a firm's practice, assignment of an external monitor or reviewer to oversee the firm's compliance with professional standards, or termination of a firm's ability to conduct public company audits.

<sup>3</sup> The inspection of the system of quality management for all annually inspected firms includes an evaluation against CPAB's quality management systems (QMS) assessment model (Quality Management Systems assessments: Strengthening Audit Quality) for the four largest annually inspected firms and one other annually inspected firm; and an evaluation of compliance with the Canadian standard on quality control (CSQC 1) for firms that perform audits and reviews of financial statements, and other assurance engagements. Collectively referred to as system of quality management.

<sup>4</sup> CPAB issued updated QMS assessment criteria and key concepts in our June 2020 publication [Quality Management System assessments: Strengthening audit quality](#) to encourage firms to implement targeted improvements to the design and operation of their systems of quality control.

<sup>5</sup> Enforcement actions include undertakings, requirements, restrictions and sanctions.

# Auditor objectivity and independence



We continue to have inspection findings related to:

- The sufficiency and appropriateness of audit evidence.
- Compliance with relevant ethical requirements, including independence.



## Audit evidence

Our most common inspection findings to date relate to the quality of audit evidence obtained by auditors. These findings should have been identified and corrected through effective supervision and review by more senior members of the engagement team.

Examples of deficiencies include:

- Insufficient testing of the data inputs and outputs of an automated tool used to evaluate revenue. Specifically:
  - Investigation of differences identified when testing the completeness and accuracy of the information used as data inputs into the automated tool was limited to inquiry with management with no corroboration to other sources of audit evidence.
  - Investigation of items identified as unusual by the automated tool was limited to inquiries of management about the nature of those exceptions. The auditor did not evaluate the impact of the unusual items to ensure the nature, timing and extent of further audit procedures was responsive to the assessed risks of material misstatement at the assertion level.
- Insufficient evidence was obtained to support the fair value of amounts included in the preliminary purchase price allocation for a significant business acquisition to take into account all relevant information, whether corroborative or contradictory.
- Auditors did not appropriately evaluate the information obtained from third party organizations, including the significance of these organizations to the reporting issuer's internal controls over financial reporting. A sufficient understanding of the significance of the services provided by the service organization is critical to ensure risks of material misstatement are appropriately identified, assessed and addressed.



## Ethical requirements, including independence

We continue to have significant findings related to the identification and evaluation of threats to independence due to non-audit services provided by the auditors to reporting issuers. The independence findings we have observed are most prevalent for new reporting issuer audit engagements or where there is a change in the independence requirements because the entity becomes a reporting issuer during the engagement period through an initial public offering or other transaction.

In March 2022, we published **Audit Evidence: Strengthening audit quality**, a communication to all audit firms registered with CPAB identifying concerns over the quality and sufficiency of audit evidence obtained and the importance of the application of professional skepticism. We also shared our concerns related to compliance with relevant ethical requirements, including independence.

### 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



## Firm culture

Over the last year we completed and reported enforcement actions following two major investigations, one related to the involvement of audit staff in improper answer sharing in connection with tests for mandatory internal training courses and the other related to backdating of work paper sign-offs. In both cases the firm self-reported the actions to CPAB. There was also a significant SEC enforcement decision that has implications for Canadian reporting issuers. These situations underline the importance of ensuring a firm's leadership is driving the right behaviours and fostering a corporate culture that has investors and the integrity of Canada's capital markets at its core. **CPAB's 2022-2024 strategic plan** recognizes the importance of firm culture and includes a commitment to integrate audit firm governance and culture into our regulatory assessments in alignment with the new quality management standards.



## Climate thematic review

During the 2022 inspection cycle, CPAB launched its inaugural climate thematic review. This review focused on obtaining an understanding of how auditors are evaluating the impact of climate-related risks in their financial statement audits.

Our observations are summarized as follows:

- Each of Canada's four largest audit firms had specific guidance and training materials to support auditors in considering and addressing climate-related risks in their financial statement audits.
- The quality of the resources provided to the audit practice varied across the firms.
- In most audits inspected by CPAB to date, there was no change to the audit approach to respond to the climate related audit risks.
- In instances where climate-related factors were considered by auditors as part of their risk assessment, the extent and quality of work performed varied significantly.

It is important to note that sustainability reporting and assurance standards are still being developed. Our work in this area will help us understand the current state to inform our future activities, including contributing to the development of sustainability reporting and assurance standards.



## Fraud and going concern

We also published our observations from our fraud and going concern thematic reviews in May 2022 (**2021 Fraud thematic review** and **2021 Going concern thematic review**). The results of our fraud thematic reviews suggest that auditors could do more to enhance the quality of their fraud risk identification and assessments. Our going concern review discusses ways in which auditors could do more to proactively assess going concern, highlights good practices and considers the alignment of accounting and auditing standards in the context of our findings.

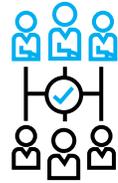
### CPAB public disclosures recommendations

CPAB launched a public consultation in 2021 to request input into potential changes to the information that we disclose about the results of our regulatory assessments. In September 2022, CPAB published recommended changes to information disclosure that will take place in a phased approach. In the first phase, beginning in 2023, CPAB will change our approach to disclosing information relating to enforcement actions.

For more information visit [cpab-ccrc.ca/insights/disclosures](https://cpab-ccrc.ca/insights/disclosures)

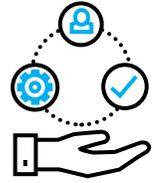
# Considerations for audit committees

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



Issue	What to ask the auditor
<p><b>Use of service organizations</b></p>	<p>Where the reporting issuer uses the services of one or more service organizations:</p> <ul style="list-style-type: none"> <li>• Did the auditor evaluate the nature of the services provided by service organizations and the significance of those services on the reporting issuer’s internal controls?</li> <li>• Where the services provided by the service organization were significant, how did the auditor evaluate the design and implementation of relevant controls at the service organization, including management’s oversight of the activities?</li> <li>• Did the auditor identify any gaps or deficiencies in the internal controls at the service organization? If so, how were these addressed in the audit approach?</li> </ul>
<p><b>Independence</b></p>	<ul style="list-style-type: none"> <li>• What threats to independence have been identified related to non-assurance services provided or to be provided?</li> <li>• How have the significance of the threats to independence been evaluated?</li> <li>• What safeguards have been or are planned to be implemented to reduce the identified threats to an acceptable level?</li> </ul>
<p><b>Climate</b></p>	<ul style="list-style-type: none"> <li>• Did the auditor consider climate-related risks as part of their audit planning? If so, how did that ultimately impact planned audit procedures? If not, why not?</li> <li>• Did the auditor identify any significant estimates that would be impacted by climate-related risks that were not identified by management?</li> </ul>

## Additional CPAB resources



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

## About this report

This report provides insights from CPAB's interim audit quality assessments for 2022 (related for the most part to the country's four largest audit firms). We will publish our annual audit quality insights report in March 2023.

## About CPAB

The Canadian Public Accountability Board (CPAB) is Canada's 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.

To learn more visit  
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