

CPAB Audit Quality Insights Report:

2019

# Fall Inspections Results

WORLD-CLASS AUDIT REGULATION

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## CPAB 2019 Fall Inspections Results

This report provides an overview of the Canadian Public Accountability Board's (CPAB) 2019 audit quality assessments completed to date of the country's four largest public accounting firms – Deloitte, Ernst & Young, KPMG, and PwC. (These firms, along with their foreign affiliates, audit about 98 per cent of all Canadian reporting issuers by market capitalization). Our assessments of all other annually inspected firms continue; we will release our final findings in our March 2020 audit quality assessment report.

Each firm provides this report to all its reporting issuers' audit committees; firms also share file-specific findings and remediation action taken with the relevant audit committee as per the Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees (Protocol). Audit committees should discuss this report and any file-specific findings, if applicable, with their external auditor.

Along with CPAB's inspections results, our report also highlights several audit quality matters that impact audit committees, regulators and investors, and that we expect will impact how future audits are performed. We'll publish more on our perspectives related to these and other regulatory matters later in 2019.

Combined, these insights are intended to assist all public company accounting firms and audit committees of reporting issuers as they begin the next audit cycle. CPAB is also available to meet with audit committees, audit firms and professional accounting organizations to discuss our perspectives in more depth.

# Audit quality assessments: some improvement over 2018

To date, our engagement file inspection findings across Canada's four largest public accounting firms indicate some improvement overall compared to 2018. Results at three firms, including the two with a higher level of significant findings in 2018, improved in 2019; one firm experienced an increase in significant findings over the prior year.

It is CPAB's expectation that audit firms should achieve a performance target of at least 90 per cent of files inspected with no significant findings by 2021. Currently, one firm is meeting this target; we have observed that this firm is also the most advanced in formalizing its quality management systems (QMS).

## Engagement file inspections results

CPAB has inspected 66 of 72 audit engagement files that will be reviewed by the end of 2019 across the four firms. To date, we have identified significant findings (deficiencies in the application of generally accepted auditing standards that could result in a restatement of the company's financials) in 12 of those files. The total number of inspection findings to date is lower than 2018.

Most of these findings required 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 required 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 their reporting issuer's next quarterly report. Where a restatement is required, the firm works with the reporting issuer and securities legal counsel to issue the restatement as soon as possible. No restatements have been required to date.



## Auditing estimates remains a challenge

More than half the significant findings to date were related to the audit of estimates; the other half were related to basic audit procedures that were either not performed (e.g. inventory counts not attended) or not performed appropriately (e.g. procedures to test revenue not sufficiently precise).

In particular, assessing financial statement amounts where estimates of fair value are required continues to be a challenge for auditors. We observed this in the audits of fair value estimates of assets acquired, liabilities assumed, and non-cash consideration transferred in business combinations.

In the audits of cannabis companies, estimating fair value of biological assets is complicated by market uncertainty and volatility related to volume and price of expected sales — the fair value amounts are often highly sensitive to relatively small changes in these key inputs and auditors are not always appropriately assessing the potential impact.

As in prior years, the audit of revenue recognized based on the percentage of work completed continues to be a concern; we are finding that auditors do not obtain sufficient and appropriate evidence to support the estimate of progress achieved.

## Foreign jurisdictions access

On the matter of access to audit work performed outside of Canada, CPAB continues to experience barriers as we conduct our inspections. Investors should be concerned when foreign laws and regulations impede or reduce the level of auditor oversight that they have come to expect in Canada. Certain countries, including China, continue to prevent CPAB from inspecting the audit work of Canadian public companies conducted in their jurisdictions. (For a detailed list of jurisdictions where CPAB has been unable to access audit working papers, please visit [www.cpab-ccrc.ca](http://www.cpab-ccrc.ca)).



# Quality management systems assessments: strengthening audit quality

Public accounting firms must do more to fully embed audit quality, consistently. CPAB expects firms to have quality management systems that manage risk, emphasize strong governance and accountability, and deploy highly trained professionals with skillsets tailored by industry and areas of expertise.

In alignment with this expectation, and to help accelerate improvement, CPAB has evolved our audit oversight methodology (supplementary to our engagement file inspections) to assess the effectiveness of the QMS at the four largest firms. This quality assessment approach underscores the need for firms to systemically embed audit quality into ongoing operations across the entire assurance portfolio.

We note the level of commitment demonstrated by the firms to improve their QMS and to link them to CPAB's five audit quality assessment criteria: accountability, risk management, talent management, resource management, and oversight. Our 2019 work has focussed on assessing firm risks, control design and operating effectiveness, along with reviewing firm documentation, specific to those five criteria. As part of this we consider the objective, resources, methodologies, type of risk, and severity of findings related to each control.

In March 2019 CPAB reported our initial findings, pointing to certain weaknesses and control gaps at all firms requiring remediation. Each firm has now provided CPAB with updated control descriptions, and is re-testing their design, and where possible, operating effectiveness. In certain cases, our file inspections findings indicate specific deficiencies in the firms' QMS.

While there is more work to do before we can complete our final assessments, some firms have noted the benefit of implementing certain practices which are expected to have a longer-term positive impact on audit quality outcomes:

- **Enhanced oversight:** Leveraging internal systems and exploring opportunities to provide leadership with more visibility into the status and changes in risks of individual engagements to proactively initiate intervention, where necessary.
- **Greater consistency:** Establishing more formalized, clearly defined and consistent firm controls and processes across offices, including matters requiring escalation to leadership.
- **Increased accountability:** Developing and communicating detailed roles and responsibilities that include accountability for audit quality (at all levels) to build a more consultative and collaborative culture.
- **Risk responsiveness:** Actively recognizing that firm QMS must continually evolve to identify both new and changing risks centrally for overall evaluation across the assurance portfolio, and to escalate matters identified at the engagement or office level within the firm for resolution.
- **Talent commitment:** Allocating dedicated resources or deploying internal audit teams to assess and test the design and operating effectiveness of firm QMS against CPAB's five audit quality assessment criteria.

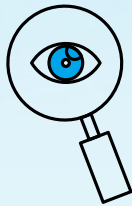
We will publish our final findings and overall evaluation of firms' QMS (acceptable, acceptable with opportunities for enhancement, needs improvement, requires significant improvement, no control in place) in March 2020.

# The future of audit quality:

## Regulatory insights

Advancing quality as business and the audit evolve will require heightened vigilance and thoughtful responsiveness to emerging issues, technologies and industries, and the investing public's expectations regarding the scope and value of the audit. CPAB is examining several critical audit quality matters concerning the future of the audit, the profession and regulatory oversight.

### Detecting fraud



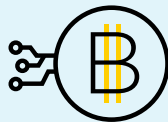
CPAB is conducting a thematic review of the issue of fraud and the work performed by auditors in this regard, including how auditors are complying with current standards, and what might need to change to address users' expectation that auditors will detect fraudulent financial reporting. Our discussions with investors, forensic specialists, standard setters, other regulators and audit firms will help us better understand investor expectations and good practices.

### Assessing going concern



Stakeholders are asking if auditors are doing enough to identify and report on companies at risk of insolvency. It's an important question — we've seen significant entities around the world receive a clean audit opinion, only to report financial difficulty shortly after. CPAB is exploring the matter of going concern, the expectations of stakeholders, and practical improvements that could be made in this area.

### Auditing crypto-assets



There are currently 48 Canadian reporting issuers active in the crypto-asset industry. In response to an urgent need for guidance on addressing typical risks associated with these companies, in December 2018 CPAB published **Auditing in the Crypto-Asset Sector** outlining our expectations of audit firms across several higher risk areas. We continue to actively monitor developments regarding audits in this evolving space.

To date, we have inspected the audits of seven crypto-asset reporting issuers across all the firms we oversee and found significant findings in six out of seven files reviewed. Remediation by the firms is complete or in progress.

### Harnessing Audit Quality Indicators



Historically, it's been a challenge for audit committees to evaluate audit quality. Audit Quality Indicators (AQIs) respond by providing meaningful quantitative measures of the external audit.

In 2019, CPAB engaged with audit firms and audit committees to explore the most frequently used AQIs and their impact on driving quality improvements. Based on discussions to date, AQIs can improve the depth of discussion among the audit committee, management and the auditor by providing a range of effective measures to match the unique needs of each audit committee.



## About CPAB

Charged with protecting the investing public's interests, CPAB oversees public accounting firms that audit Canadian reporting issuers. We promote sustainable audit quality through proactive regulatory oversight, dialogue with domestic and international stakeholders, and practicable insights that inform capital market participants.

To learn more visit  
[www.cpab-ccrc.ca](http://www.cpab-ccrc.ca)

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