

# CPAB Audit Quality Insights Report: 2024 Interim Inspections Result

By Gundi Jeffrey



*Gundi Jeffrey is an award-winning business journalist specializing in writing about the accounting profession for various publications in Canada and England. In 1985, she co-founded The Bottom Line, then Canada's only independent publication for the accounting and financial professions, serving as its executive editor.*

The Canadian Public Accountability Board (CPAB), Canada's public company audit regulator, released its [interim public report](#) on its 2024 audit quality assessment work to date. The report notes, very clearly, that "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."

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To date, CPAB inspected 50 of the 66 files planned for inspection across Canada's four largest audit firms and identified significant inspection findings<sup>1</sup> in four of those files. This, says the report, "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."

Meanwhile, *ThinkTWENTY20* is offering the highlights of this report, including both the good and bad news – and recommendations for better results in several significant areas.

That report notes that five restatements have been required since the 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**

The Canadian Standard on Quality Management 1 (CSQM 1) requires that audit firms design, implement and operate a system of quality management and evaluate it at least annually. Through our file inspections, the report says, “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.”

The report defines “effective deployment” as requiring 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, CPAB 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,” the report says, “we have observed that these three areas are the building blocks for the standard. Common themes in preliminary inspection findings.”

The common themes CPAB identified in its preliminary 2024 inspection findings to date relate to:

***Identifying and assessing the risks of material misstatement.*** According to CPAB, “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.”

CPAB pointed out that it “continues 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 that are biased towards obtaining evidence to support a lower risk assessment or exclude the identification of a potential fraud risk. As well, there is 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 CPAB 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 the auditor does not identify risks or sufficiently assess them, says the report, "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**

According to CPAB, 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."

**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.**

### **Fraud**

Fraud thematic reviews are integrated into CPAB's 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. This means, says CPAB, that “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**

CPAB notes that it continues 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.”

## **CPAB has also observed that auditors do not always consider climate-related risks when reviewing information such as board minutes, press releases or investor presentations.**

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 report points out that “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.” CPAB is “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.”

## **Looking Forward**

***Current economic and geopolitical environment:*** The post-pandemic economy continues to be very uncertain with industries being impacted differently. The report notes that 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. 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:*** CPAB points out that 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, says the report, “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.” CPAB says it has “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.”

