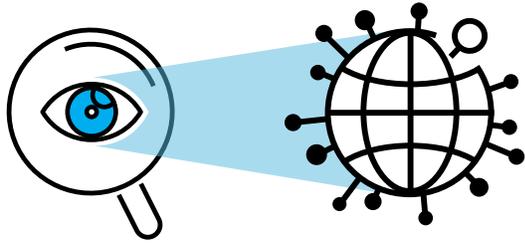


CPAB Audit Quality Insights Report: 2020 INTERIM INSPECTIONS RESULTS

The Canadian Public Accountability Board (CPAB) provides regulatory oversight of firms that audit the annual financial statements of Canadian reporting issuers. This interim report provides a snapshot of themes and insights from our 2020 audit quality assessment work to date. It also highlights our initial observations on the impact of the COVID-19 pandemic on public company audits. We have included considerations for auditors and audit committees as they prepare for their year-end audits and continue to respond to the challenges of COVID-19. We anticipate seeing additional impacts on the audits completed later this year and in the first half of 2021 in our assessments and will comment further in our annual report.

CPAB welcomes the opportunity to discuss this report with audit committees, audit firms, standard setters and professional accounting bodies.



Overseeing audit quality in a global pandemic: heightened vigilance essential

2020 has already been an extraordinary year. The COVID-19 pandemic has brought economic uncertainty and unprecedented government stimulus programs. The economic disruption has given rise to a large number of critical accounting and auditing issues including going concern/liquidity evaluation, complex valuations and accounting estimates, impairment evaluations and accounting for new government programs as well as other industry-specific issues such as estimating credit losses for financial institutions. Modifying and adapting transaction processes and financial controls to accommodate new ways of doing business has created challenges for public companies and auditors around the world. Performing audits remotely has become the new normal almost overnight and creates new risks to audit quality.

Pre-pandemic, our regulatory assessments and discussions with auditors, audit committees, regulators, investors and standard setters consistently highlighted the importance of professional skepticism, having a critical mindset and appropriate audit supervision to delivering high-quality audits. CPAB's inspections were exposing gaps in the application of these key elements and the crisis has only heightened the need for vigilance. As audits continue to be performed remotely and business challenges persist, strict adherence to auditing standards and the application of due care must not be compromised.

The four working groups established following the Canadian Audit Quality Roundtable hosted by CPAB and the Office of the Superintendent of Financial Institutions (OSFI) in late 2019 have been focused on actions that can be taken by all relevant stakeholders in fraud detection, going concern assessments, improving professional skepticism and responding to novel industries and emerging issues impacting the performance of quality audits. The impact of COVID-19 on the audit underscores the significance of this work and its relevance to all industries and sectors in Canada; implementing recommendations from these working groups will be critical to improving audit quality and reducing the risk of audit deficiencies and loss to the investing public, particularly in this time of global economic disruption.

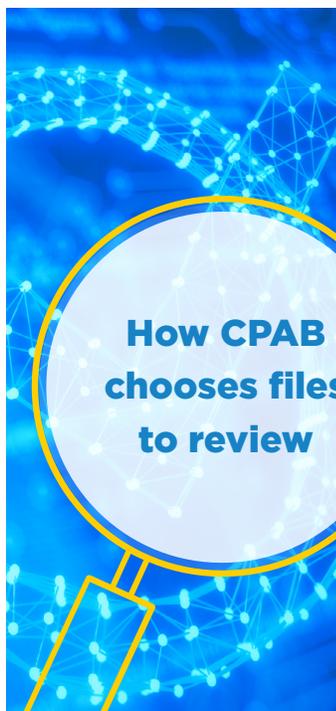
Audit quality assessments

Engagement file inspections

While CPAB's 2020 engagement file inspections were delayed for a short time as we and the firms prepared for this work to be done remotely, to date we have completed 51 of 72 planned file inspections across Canada's four largest audit firms and identified significant findings (deficiencies in the application of generally accepted auditing standards that could result in a restatement of the company's financials) in five of those files. This compares to 12 significant findings across 72 inspections in 2019.

These results suggest the overall rate of significant findings is lower than the previous year. However, these results are subject to change as we complete the balance of our inspections. We will comment on the results of our additional planned file inspections, including any impacts of the COVID-19 pandemic, in our annual report.

To accelerate audit quality improvements CPAB expects firms to meet a target of 90 per cent of engagement files inspected with no significant findings by the end of 2021. Given our inspections results so far, and the potential additional impacts on the audit going forward, more work is needed to achieve this target consistently.



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. As a result, there is a greater likelihood of encountering audit quality issues. 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.

Common themes: estimates, quality of audit evidence, supervision

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

Examples of gaps include:

- Insufficient challenge of fair value estimates of assets acquired, liabilities assumed, and non-cash consideration transferred in business combinations.
- Audit of revenue recognized based on the percentage of work completed where the auditors did not obtain sufficient and appropriate evidence to support the estimate of progress achieved.
- Insufficient work to support the forecasted cashflows and discount rates used to estimate the recoverable amounts when testing for impairment.
- Lack of testing of the reliability of documents and reports provided by management.
- Insufficient or incorrect understanding of the underlying accounting and business processes resulting in audit procedures that would not identify a material misstatement if one should exist.
- Audit procedures performed on groups of transactions, but not reconciled to the amounts reported in the financial statements; certain transactions not tested as a result.
- Lack of consideration of contradictory evidence – concluding that there were no indicators of asset impairment where documentation existed in either publicly available information or in the audit file of these asset impairment indicators.
- Misstatements, individually less than materiality, identified through the performance of audit procedures not appropriately summarized and reported to the audit committee.

How firms 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 their 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. No restatements have been required to date from matters arising from this year's inspections.

Audit firms that participate in the **Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees** share this report and public company specific findings and remedial action taken with the reporting issuer's audit committee. Audit committees are encouraged to discuss this report and specific findings, if applicable, with their auditor.

Quality management systems assessments

Our 2020 quality management systems assessments are proceeding although we have noted some delays in the implementation and/or testing of new or enhanced controls to address gaps identified in 2019. We will publish our assessments and findings in our annual report in March 2021.



Access to audit working papers outside Canada

CPAB assisted the Canadian Securities Administrators in the development and publication of the October 2019 recommended amendments to National Instrument 52-108 to improve access to audit work performed outside Canada.

Certain foreign auditors and countries continue to prevent CPAB from inspecting the audit work of Canadian public companies conducted in their jurisdictions. We are concerned about the potential impact on auditor oversight, and ultimately the investing public, and are continuing to meet with the Canadian Securities Administrators to resolve this critical matter.

For a detailed list of jurisdictions where CPAB has been unable to access audit working papers, please visit www.cpab-ccrc.ca.

Auditing in a COVID-19 environment: areas of focus for auditors and considerations for audit committees

Areas of focus for auditors

The current environment is uncharted territory for auditors as the pandemic continues to raise challenges to how the audit is performed. It is CPAB's expectation that auditors operate with heightened diligence in their adherence to auditing standards and the ethical practices required of the profession as they prepare year-end audits and plan for 2021. The following must be key areas of focus:



Understanding **how the reporting issuer's environment and business operations have changed** and the impact on the audit approach and areas of focus including:

- Re-aligning the audit plan to changes and **revisiting the auditor's risk assessment**.
- Assessing the efficacy of internal control structures due to **personnel changes** (e.g., segregation of duties, omitted processes or capacity constraints).
- Revisiting the efficacy of **information technology general controls** where new systems have been put in place in an accelerated timeframe.
- Assessing the reliability of evidence obtained electronically including appropriate testing of internally generated documents and reports provided by management.



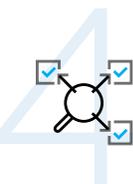
Increasing the emphasis by the auditor related to **fraud**.

- CPAB's thematic review on [fraud](#) provides a number of considerations for auditors that are particularly relevant to the current environment, including understanding the reporting issuer's fraud risk management program, assessing the operation of the whistleblower program and increasing the involvement of fraud specialists.



Maintaining **professional skepticism** and a critical mindset in evaluating the reliability of audit evidence including:

- Effective challenge of management's forecasted cash flows and other key assumptions incorporated into valuation models and impairment tests.
- Adapting the approach to going concern evaluation to be consistent with current economic challenges. This means that going concern-related audit work may need to be more extensive and may require different evidence. It is important that the going concern analysis continues up to the date of the auditor's report. CPAB's thematic review on [going concern](#) provides a number of considerations for auditors.



Understanding how **component auditors** have adapted the audit approach to new circumstances and exploring different ways for the group auditor to exercise sufficient oversight if unable to meet in person with component auditors and therefore unable to review audit documentation onsite.



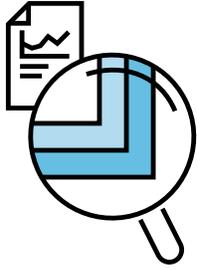
Ensuring effective **supervision and review** to drive consistent audit quality through the entire audit.

- Adapting supervision and review to the current environment where more junior staff are working remotely from multiple locations.
- Increasing the coaching and time spent by partners and more senior members of the engagement team.

Considerations for audit committees

In our conversations with audit committee chairs, directors note the challenges COVID-19 has brought to their oversight of the quality of their company's financial reporting. Active engagement with the auditor is particularly important during these times to better understand the audit approach, new and ongoing challenges and the firm's quality management systems and processes. While we acknowledge that the situation is highly fluid, and that new issues and risks will emerge over time, CPAB encourages audit committees to consider the following areas that could impact the quality of public company audits in Canada and discuss with their company management and audit teams.

ISSUE	POTENTIAL QUESTIONS FOR THE AUDITOR
<p>Probing underlying assumptions and the sufficiency of disclosures related to accounting estimates and going concern, and audit work surrounding these areas.</p>	<ul style="list-style-type: none"> • Where in the range are our key estimates? • How does this compare to other companies in the industry? • What contradictory evidence has been identified and how did you assess this information?
<p>Understanding changes to the auditor's fraud risk assessment and the related audit plan.</p>	<ul style="list-style-type: none"> • What changes were made to the audit plan to respond to increasing risk of fraud in the current environment? • How does the audit plan approach the review and testing of new or amended internal controls? • Did the engagement team use forensic specialists in the audit?
<p>Proactively monitoring audit milestones and forward-looking audit quality indicators (e.g., planned engagement partner and/or supervision hours) to identify and address issues early on.</p>	<ul style="list-style-type: none"> • How have you adequately adjusted your estimated audit effort to reflect the accounting and auditing issues arising from the pandemic? • What are the planned partner/manager hours this year? How does this compare to prior years? • Are there any potential delays in meeting audit engagement milestones?
<p>Meeting more frequently with management and auditors to understand business changes and ensure that the audit plan is effectively adapted to new conditions and to provide information to aid auditors to update the audit plan (e.g., incentive plan changes).</p>	<ul style="list-style-type: none"> • Have any internal controls been changed due to the pandemic? • When will the company's internal controls be tested for operating effectiveness? • How long will it take to remediate internal control deficiencies?
<p>Working with auditors and management on key audit matters disclosures that are impacted by COVID-19.</p>	<ul style="list-style-type: none"> • Which significant risks have been considered for inclusion as key audit matters in the auditor's report? • Which significant risks have been excluded and why? • Are the key audit matters specific to the facts surrounding the audit?



Additional CPAB resources

Additional resources related to CPAB's regulatory oversight activities during COVID-19 are available at: www.cpab-ccrc.ca/insights/covid-19.

About this report

This report provides insights from CPAB's interim audit quality assessments for 2020 (related for the most part to the country's four largest public accounting firms). We will publish our annual audit quality insights report in March 2021.

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
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