Effective Regulation

Proactive Engagement

Sustainable Solutions

CPAB
CCRC

CANADIAN PUBLIC
ACCOUNTABILITY BOARD
2012 PUBLIC REPORT

WORLD-CLASS AUDIT REGULATION

Effective Regulation – Sustainable Solutions

Report on the 2012 Inspections of the Quality of Audits Conducted by Public Accounting Firms

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Section One – The State of Auditing in Canada

Introduction

Public confidence in the integrity of financial reporting is fundamental to the effective operation of our capital markets[1]. This confidence depends on quality financial audits, particularly during uncertain economic times. During these times, auditors need to be particularly vigilant, consistently exercising their independence, objectivity and heightened level of skepticism; characteristics investors expect in quality audits. The investing public trusts auditors to attest to the integrity of the financial statements—it is a trust that is bestowed upon auditors around the world.

Investor confidence

CPAB believes investors should continue to have confidence in the integrity of public company financial statements audited in Canada. Audit methodologies at the firms are generally sound, and the majority of audits are well done. CPAB's 2012 inspection results show overall improvement in audit quality. CPAB's inspections resulted in only five restatements of financial statements (two per cent of files inspected).

Overall inspection results

Overall there was a 30 per cent decline in audit deficiencies[2] in the audit files inspected, indicating a reduced risk of restatements. In almost all cases, when audit firms performed the additional audit work required by CPAB to remedy deficiencies, there was no restatement of the financial statements. However, this does not mean that there was no risk of a restatement. In corporations with strong internal controls, the chances of a material misstatement remaining undetected may be low; however, there is still a risk.

While inspection results are better than in 2011, there was considerable difference among firms in the degree of improvement. A number of firms, still need to make significant improvement. Since the inspection results were finalized in the late fall of 2012, CPAB has been actively involved with the leadership of these firms regarding the root causes of the inspection findings. CPAB believes that the recent additional actions taken by these firms in response to CPAB's findings will produce the necessary improvements.

While the decrease in the number of audit deficiencies is encouraging, CPAB believes firms must commit to continuous improvement at all levels of their organizations to ensure that this trend continues. This includes, in some cases, a

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[1] This report contains important information for the investor community, audit committees and audit firms, as well as other regulators, each of whom has an important role to play in effective operation of Canada's capital markets.

[2] An audit deficiency is defined as the failure to obtain sufficient appropriate audit evidence for a material account balance or transaction stream.

shift in audit firm culture to encourage collaboration and enhanced accountability in order to improve audit quality. CPAB believes a multidisciplinary team approach to the audit, where different expertise is brought together and held accountable, would best serve the needs of both public companies and the investing public.

Action plans yield positive results

To address the disappointing inspection results in 2011, the Big Four firms were required by CPAB to implement action plans to improve audit quality. These plans contributed to an overall improvement in the 2012 inspection results, however, not all of the Big Four firms demonstrated the same level of improvement. Firms that focused on the drivers of consistency in audit execution performed better.

These results are encouraging. Since most of the action plans were only implemented late in 2011, not all the audit files CPAB inspected in 2012 benefited from the changes the plans brought about. CPAB therefore expects audit quality will continue to improve in 2013, as firms will have been able to fully implement their action plans in advance of the 2012 audits. Furthermore, firms have also been able to assess the success of their individual plans based on experience to date and have refined the plans accordingly. CPAB has provided its observations on the plans, to assist the firms in this regard.

Looking ahead, further improving and sustaining audit quality depends upon the effectiveness of the firms' actions under the plans, which cover such areas as changing organizational structure to enhance accountability for quality, and making sustainable process changes that incorporate additional quality monitoring throughout the entire audit process.

In addition to their action plans, firms are also implementing CPAB's other mandatory recommendations. CPAB will continue to monitor the implementation, sustainability and effectiveness of these actions as part of its 2013 inspection program, and take action as necessary.

Other Four National Network firms/Regional/Local firms

The inspection results at the Other Four National Network firms were mixed. While some firms demonstrated solid improvement in audit quality, others did not. Consequently, these firms, where needed, are being required to implement action plans for 2013.

CPAB was pleased to note improvement in the quality of audits in a number of the six large Regional firms. These improvements primarily resulted from the firms focusing on audits of reporting issuers that were within their comfort zone (i.e., within their area of expertise relating to the industry/sector of the reporting issuer and/or the nature of the transactions). This approach is very helpful in enabling firms to better execute their audits because they are familiar with the industries. Firms that undertake a rigourous engagement acceptance review process prior to undertaking audits outside of their traditional comfort zone are more successful in achieving audits of consistent quality than firms that do not.

Consistent audit execution enhances audit quality

CPAB's 2012 inspections found that firms' audit methodologies generally meet Generally Accepted Auditing Standards (GAAS) requirements. While all firms are capable of executing quality audits, and do so regularly, consistent audit execution is a challenge for firms, to varying degrees. CPAB believes this is the root cause of the majority of audit deficiencies identified.

CPAB's 2012 inspections indicate that the Big Four firms that focused on consistency of audit execution and provided on-site support to their people—for example, by making national resources available at the local office level to deal with audit issues that emerged, or by changing roles and accountabilities to focus on quality—showed the most improvement. CPAB encourages all firms to continue to focus on audit execution as an important way to enhance audit quality.

Deficiencies similar to those found by other regulators

CPAB's 2012 inspection findings are comparable to those of other audit regulators around the world. Consistent findings include concerns about professional skepticism, supervision and review, substantive analytical procedures (predicted results compared to actual results) and the quality of audit evidence in audit files.

Again, while CPAB's inspection results noted these same issues, firms are capable of and demonstrated many examples of quality work in these areas; consistency of execution is the key.

CPAB's 2012 inspection findings are summarized in Section Three of this report.

Key considerations to improve audit quality

CPAB believes that inconsistent application of professional skepticism, coupled with inadequate supervision and review, contributed to many of its more significant 2012 inspection findings. To further improve audit quality, CPAB believes firms need to:

- **Execute consistently**: Firms that placed a greater emphasis on drivers of consistency of audit execution showed the most improvement in audit quality.
- **Develop and implement action plans to support consistency**: The action plans that led to improved results were the ones that made resources more readily available at both the national and local levels and brought additional resources to bear on complex issues that emerged during the audit.
- **Reinforce an accountability culture to support consistency**: Shared accountabilities enhance audit quality. As audits become more complex, it is not realistic to hold one or two individuals accountable, when many factors affecting quality, such as access to resources, may be beyond their control. Audit quality is a team effort.
- **Strike the appropriate balance between commercialism and professionalism**: Because audit firms are both a business and a profession, firms must always be conscious of this potential conflict and make sure it does not impair audit quality.

CPAB's 2013-2015 Strategic Plan

CPAB has developed a new strategic plan for 2013-15, which will enable CPAB to best fulfill its mandate in two ways: through inspections and by engaging stakeholders who contribute to audit quality. Broader stakeholder engagement (especially focused on audit committees and reporting issuer management), along with timely communication of CPAB information on key drivers of audit quality and audit risks, will help those stakeholders perform their key roles. The improved inspection methodology will include enhanced root-cause analysis, broader risk assessment and expanded value-added recommendations.

CPAB undertook several initiatives in 2012 that support this plan, including:

- Launching, with the Canadian Institute of Chartered Accountants (CICA), the Enhancing Audit Quality (EAQ) initiative
- Hosting the second Audit Quality Symposium
- Publishing a Special Report on Auditing in Foreign Jurisdictions

To implement its strategic plan, CPAB will focus on four priorities to further enhance audit quality: thought leadership; enhanced stakeholder engagement; enhanced risk management; and focused, effective inspections. CPAB's 2013-15 strategic plan is available at www.cpab-ccrc.ca.

CPAB's Inspection Universe

- *163 Canadian accounting firms and 133 foreign firms currently participate in CPAB's audit regulatory program*
- *These firms audit approximately 4,000 reporting issuers and 3,000 investment funds.*
- *CPAB annually inspects the Big Four firms, which audit 98 per cent of reporting issuers by market capitalization*
- *10 other firms are subject to annual inspection because they audit over 100 reporting issuers; these firms represent 1.5 per cent of reporting issuers by market capitalization*
- *The remaining firms, which are primarily subject to triennial inspection, represent 0.5 per cent of reporting issuers by market capitalization*

In general for each firm, CPAB inspects audit files relating to higher-risk audit areas of more complex public companies or companies where the firm may have less expertise, so there is a greater likelihood that CPAB will identify audit quality issues.

CPAB does not focus on identifying areas of the audit file where auditors performed to or beyond the required standards. CPAB sees many examples of quality audit work where engagement teams exhibited a high degree of professional skepticism and required management to adjust the financial statements or amend disclosures as a result of the audit. Therefore, CPAB's Public Report does not represent a balanced scorecard.

Section Two – Audit Environment Continues to be Challenging

CPAB believes the audit environment continues to be challenging, with several issues facing the profession. These include:

- *Enhancing professional skepticism*
- *Globalization of auditing – use of other auditors*
- *The role of the audit committee*
- *Striking the appropriate balance between commercialism and professionalism*

It is CPAB's view that audit committees can and should be key contributors to audit quality. The Enhancing Audit Quality initiative has provided an opportunity for robust discussion on various audit reform proposals being discussed internationally, with a view to developing Canadian positions on these audit quality proposals.

Enhancing professional skepticism

A healthy degree of professional skepticism is fundamental to—and the foundation of—an effective, quality audit. It is not good enough to simply accept management's views without challenge. Effective auditors weigh what management tells them against what they know of the client's business, together with their knowledge of the broader business environment. By so doing they can evaluate management's views in the context of available internal and external evidence and derive an independent position, which may conflict with or confirm management's position.

CPAB's inspections reveal an ongoing need for firms to enhance the professional skepticism of their staff. Firms must ensure their people appreciate the importance of professional skepticism and they must embed appropriate processes and behaviours in their methodologies and cultures. CPAB believes firms should:

- Ensure that senior members of the engagement team are rotated frequently enough to avoid complacency or the threat of familiarity. This is particularly important for non-partners who are not currently subject to mandatory rotation requirements.
- Increase the visibility and effectiveness of senior engagement team members during all audits. There is a critical need for a firm's most experienced auditors to transfer their knowledge to more junior staff members. Not only does this reduce the learning curve of less experienced staff, it also enhances their effectiveness. A firm's most experienced auditors should lead from the front. This means they must: be visible to both the client and the engagement team; review all significant areas of the audit file; avoid electronic off-site reviews, which result in less face

time with other team members; engage staff in discussions about audit risk and audit quality and challenge their judgments, and; never accept substandard work.

- Require engagement teams to be less accepting and more challenging in their approach to an audit. This can start with the interactions between partners and managers and their field staff.
- Enhance the training of professionals in exercising professional skepticism. This could include core training that emphasizes questioning, listening and probing skills.
- Encourage all team members to challenge the status quo, including reinforcing the danger of assuming that, because the audit approach to an area has been determined in prior years, it does not need to be revisited in light of current facts and circumstances.

Globalization of auditing – use of other auditors

Given the prominence of Canada's resource industry and the increasing number of Canadian companies operating in foreign jurisdictions, it is not surprising to note that a significant amount of audit work on Canadian reporting issuers is carried out in a foreign jurisdiction by a firm other than the one signing the audit report. In such circumstances, the other auditor (referred to as the component auditor) works on behalf of and under the direction of the referring office in Canada (referred to as the group auditor). While foreign audit firms may be members of the same global network as the group auditor, they are still separate firms for the purposes of applying GAAS.

The audit report on the consolidated financial statements signed by the Canadian audit firm relies, to varying degrees, on the work of component auditors in foreign jurisdictions. In some cases the component auditors may actually do the majority of the audit work.

Firms must ensure that group and component auditors jointly identify business customs and practices in the foreign jurisdiction that are different from those encountered when auditing in Canada, and determine how these give rise to specific risks that must be mitigated. In order to effectively fulfill its mandate as Canada's audit regulator, CPAB strongly believes it should have direct access to the audit work performed by component auditors.

CPAB has communicated to audit firms its requirements relating to performing audits in foreign jurisdictions. These requirements include:

- The need to identify, by country, differences in business practices, legal structures, regulations and customs, and to communicate these to engagement teams together with suggested audit responses.

- Clearly communicating identified risks to the component auditor who, in turn, provides the group auditor with working papers documenting the executed audit procedures to mitigate those risks.

- Providing CPAB with access to component auditor working papers in key focus areas, as requested by CPAB. If the group auditor is unable to provide access to CPAB, they must identify the laws or regulations in the foreign jurisdiction prohibiting such access.

CPAB issued a Special Report on Auditing in Foreign Jurisdictions in 2012, which is available at www.cpab-ccrc.ca.

The audit committee – a key contributor to audit quality

CPAB believes that audit committees can—and should—be key contributors to audit quality. Effective audit committees and auditors build confidence in the integrity of financial reporting. By doing so, they reduce financing costs and contribute to an efficient allocation of capital to fuel economic growth.

The audit committee plays a critical role in creating the right environment for quality auditing. It is the audit committee's responsibility to create an environment that accommodates an open discussion in a culture of integrity, respect and transparency between management and the auditors.

Audit committees are responsible for overseeing the work of the auditors. Among other things, they need to understand the audit strategy, be satisfied that it addresses the major risks, and make sure the auditors exercise appropriate professional skepticism. They also need to ensure that the auditor has an appropriately independent mindset from management and is truly objective. Ultimately, this will enable the audit committee to draw conclusions about the effectiveness of the audit.

Audit committees should ask their auditors what they are doing to promote consistency of audit execution, whether additional resources are available if needed to do the audit, and who in the audit firm is accountable for the quality of the work done. Audit committees should consider meeting the engagement quality control review partner (second partner reviewer) as part of the audit process to understand what they did to ensure quality and address any issues that arose.

CPAB believes it is appropriate for audit committees to have a frank discussion with their auditors about what is considered to be a reasonable fee for audit services. However, if the quality of the audit is affected by a fee that is less than reasonable, the audit committee is doing a disservice to the shareholders. Audit committees need to ensure that audit fees are fair and that they are obtaining a quality audit. Investors want and expect a quality audit.

Audit committees can contribute to the solutions to many of the audit quality issues being debated internationally. This includes the risk that, over an extended period of time, audit firms may develop a close institutional relationship with their clients that could negatively impact auditor independence and professional skepticism.

Audit committees have told CPAB they want more transparency with respect to inspection findings in order to improve the effectiveness of their oversight role. In 2013 CPAB will be reviewing how it can increase transparency of inspection findings to audit committees in a way that will have a positive impact on audit quality.

Striking the appropriate balance between commercialism and professionalism

In today's uncertain economy, enterprises are looking for ways to reduce costs. As a result, greater focus is placed on containing or reducing the cost of services, including the audit. This places the audit at risk of becoming a commodity to be tendered to the lowest bidder. When CPAB discusses this issue with audit firms they often say that certain firms are quoting on audit work at a steep discount. This does not auger well for the health of the audit practice among the audit firm's lines of business. Stagnant or declining revenues from the audit practice threaten to weaken the audit practice within the firm. This means that resources needed to finance training, career development and practice aids may be directed elsewhere and the overall quality of auditing may suffer.

A key to achieving audit quality is resolving the inherent conflict between professionalism and commercialism. No one would dispute that the risks associated with audits of public companies are increasing. Logic would dictate that, as risks increase, audit fees would increase. However, if audit committees and other stakeholders do not recognize the value of an audit—seeing it as a controllable cost rather than an important value-added service where quality is a differentiator—it risks becoming a commodity based solely on price. If firms are accepting lower fees in the face of higher risk, then they are implicitly accepting lower margins and lower profitability. CPAB is concerned that audit firms may try to inappropriately maintain profitability at the expense of audit quality.

While this approach may result in short-term gain, it may also lead to long-term pain if capital markets were to lose confidence in the quality of audits in Canada. Audit committees are responsible for setting the compensation for the audit. They should ensure the auditor has sufficient resources to carry out an effective audit. Substantial fee reductions may lead the auditor to seek greater efficiencies, which can reduce the extent of the audit work, compromising the quality of the audit.

CPAB has seen situations where firm leadership delivers messages about audit quality, while, at the same time, audit leadership is promoting the need to achieve greater efficiencies in audit work. Such mixed messages are confusing to the audit practice, and may ultimately lead to a decline in audit quality. One example of reduced audit work arises when firms employ substantive analytical procedures as a primary form of audit evidence. Unfortunately, these procedures are sometimes neither well understood nor properly applied, meaning the audit evidence obtained is not sufficiently robust to provide the necessary audit assurance in the area being audited. In this case, the audit is more efficient, but is less effective and audit quality declines.

Enhancing Audit Quality – 2012 CPAB Audit Quality Symposium

At CPAB's 2011 Audit Quality Symposium, key stakeholders agreed it was important to develop a Canadian perspective on audit quality issues being debated internationally. The goal was to identify solutions to address audit quality concerns and add Canada's voice to the international discussion.

The 2011 symposium prompted CPAB and the CICA to launch the Enhancing Audit Quality (EAQ) initiative in 2012. A blue-chip steering group, chaired by David Brown, CM, QC (former Chair of the Ontario Securities Commission), was formed to exercise an overview function, coordinate the initiative, and make sure the process is transparent and serves the public interest. Working groups were also established to address three priority areas: the auditor reporting model; auditor independence and the role of audit committees. All three working groups have issued consultation papers, which have added significantly to the audit quality debate in Canada and internationally.

CPAB's 2012 Audit Quality Symposium, *Navigating the Way Forward,* focused on international developments in audit regulation and on the Canadian EAQ initiative. The event brought together thought leaders, policy makers, corporate directors and investors to discuss issues relating to the deliberations of the three working groups.

Auditor reporting model: This working group, chaired by Mark Davies, CPA, CA (Chair, Auditing and Assurance Standards Board) focused on the information value of the auditor's report and on expanded assurance by auditors in parts of Management's Discussion & Analysis (MD&A), quarterly financial statements and other information. In its consultation paper, the working group recommended including an auditor commentary in the auditor's report because it would provide financial statement users with useful information, and may lead to positive changes to financial statement disclosures and audit quality. CPAB supports this approach and believes investors will benefit from greater insights provided by auditors.

Auditor independence: This working group, chaired by Peter Mills, QC (Corporate Director) focused on proposals relating to auditor appointment and rotation, and on the services auditors provide, to improve independence, objectivity and professional skepticism.

In its consultation paper, the working group rejected mandatory audit firm rotation and mandatory tendering of the audit because of the potential negative consequences to audit quality and associated corporate governance. Specifically, the governance impact of mandatory audit firm rotation would be to reduce the audit committee's accountability and responsibility for assessing auditor performance and determining when to rotate or tender the audit, while mandatory tendering of the audit would reduce the audit committee's consideration of the appropriate timing for tendering of the audit.

The working group has instead recommended that the audit committee perform a periodic mandatory comprehensive review of the audit firm's performance, with a focus on audit quality. This alternative is preferred by the working group because it enhances auditors' and audit committees' focus on audit quality and the exercise of professional skepticism.

CPAB also opposes mandatory firm rotation. This is a blunt instrument that undermines the role of the audit committee as the client of the auditor. CPAB believes the working group proposal for a periodic comprehensive review by the audit committee is a practical and effective solution that would, at an institutional level, mitigate familiarity and self-interest threats to and between audit firms and the companies they audit.

Audit committees: This working group, chaired by Tom O'Neill, FCPA, FCA (Corporate Director, former CEO PwC) examined the reporting relationships among audit committees, management, auditors, audit regulators and shareholders, and how the application of professional skepticism by both audit committees and auditors might best be enhanced and promoted.

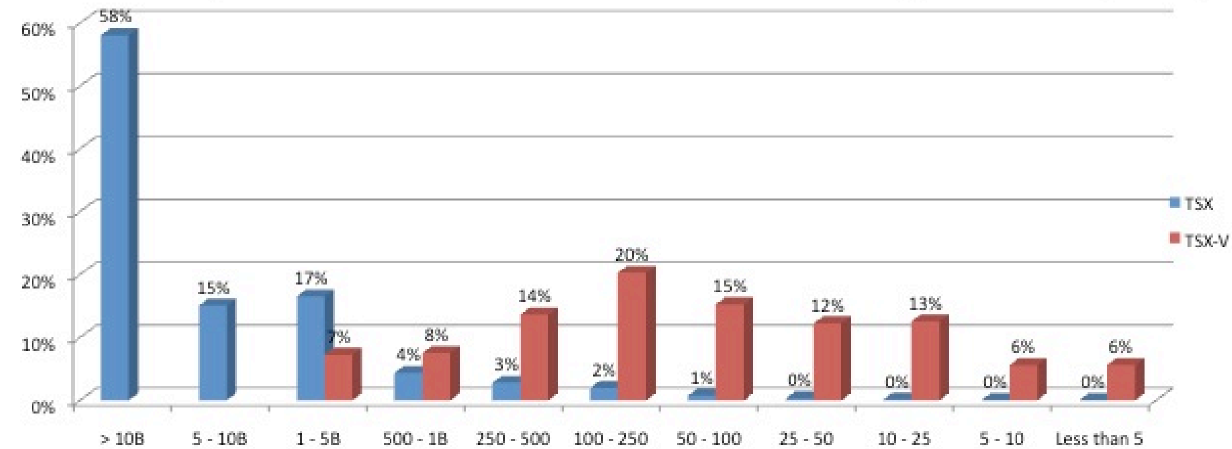
Based on feedback received by the audit committee working group and at CPAB's 2012 Audit Quality Symposium, there is support for more guidance and tools to be developed for audit committees to oversee the work of the auditor. In 2013 CPAB will enhance its engagement with audit committees, including communications to help audit committees perform their oversight role more effectively.

Audit committees have also told CPAB the effectiveness of their oversight role can be enhanced with greater transparency of inspection findings. In its consultation paper, the audit committee working group has proposed that CPAB and audit firms develop a protocol to increase the inspection information available to audit committees. Specifically, the working group discussion paper suggests that audit firms be permitted to share inspection information with their clients' audit committees via a prescribed communications protocol.

CPAB understands and supports the desire for greater transparency. Enhanced transparency in the communication of inspection results, and about the key drivers of audit quality, would help stakeholders in the audit process perform their roles more effectively. That being said, it is essential that transparency be enhanced in a way that preserves the effectiveness of CPAB's regulatory approach and does not create unintended consequences for audit quality or for reporting issuers.

To this end, CPAB is currently working with audit firms on a protocol that will strike the appropriate balance, with a view to providing information that will help audit committees fulfill their oversight responsibilities, enhance audit quality and promote a culture of continuous improvement.

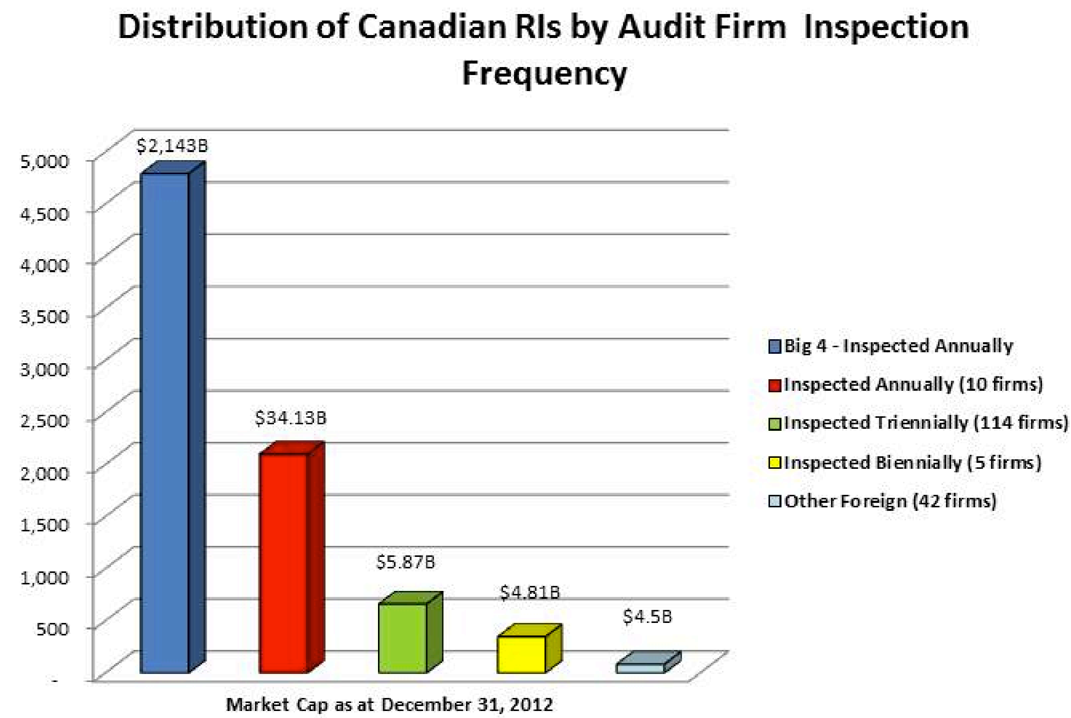
Market Capitalization of TSX and TSX-V Exchange Issuers ($CM)



Market Cap $CM											
TSX	$1,249,457 46 RIs	$324,346 44 RIs	$355,033 168 RIs	$93,270 131 RIs	$59,983 166 RIs	$41,876 258 RIs	$16,381 226 RIs	$6,907 191 RIs	$2,931 176 RIs	$688 96 RIs	$190 65 RIs
TSXV			$2,937 2 RIs	$3,041 5 RIs	$5,511 15 RIs	$8,183 58 RIs	$6,151 89 RIs	$4,925 146 RIs	$5,066 311 RIs	$2,246 320 RIs	$2,254 1,310 RIs

Percentage of market capitalization as at December 31, 2012

TSX Issuer Base: 1,567 Issuers, C$2.1 trillion in market capitalization
TSXV Issuer Base: 2,256 issuers, C$40.3 billion in market capitalization
In addition, there are 4,157 Canadian RIs that do not trade on either the TSX or TSX-V exchanges



Note: RIs allocated to the Big 4 and Inspected Annually Firms include Canadian Firms, Foreign Affilites and Member Firms

Section Three – Summary of Inspection Findings

In 2012, CPAB inspected 128 engagement files in the Big Four firms, which audit 98 per cent of reporting issuers, measured by market capitalization. CPAB also inspected 44 engagement files at 10 other firms inspected annually and 39 engagement files at 24 smaller firms.

While CPAB once again found audit deficiencies in firms of all sizes, overall there were 30 per cent fewer audit deficiencies than in the previous year.

As a result of CPAB's 2012 inspections of the Big Four firms, two restatements of financial statements were required. Three other restatements were required in non-Big Four audits. Following its 2012 inspections, CPAB has requirements in place on five firms and a restriction on two firms.

Mission, methodology and risk analysis

CPAB's mission

CPAB's mission is to contribute to public confidence in the integrity of financial reporting of reporting issuers in Canada by effective regulation and promoting quality, independent auditing. CPAB's achieves its mission by inspecting public accounting firms that audit reporting issuers in Canada and by providing the firms with recommendations for improvement.

Enhancing investor confidence in quality auditing

Annually, CPAB inspects all firms that audit more than 100 reporting issuers, representing 99.5 per cent of the total market, measured by market capitalization. There are 14 firms in this category. CPAB's inspections are designed to determine, among other things, whether the audit firm's quality control processes are operating effectively. Using a proprietary risk-based methodology, CPAB's inspections focus on the higher-risk areas in the engagements examined.

CPAB identifies the higher-risk clients of each firm and the engagements to be inspected are chosen from this subset of the overall population. CPAB's inspection methodology identifies root causes of audit deficiencies, with the goal of identifying key recommendations to improve audit quality.

Elements of quality control

In addition to evaluating engagement performance, CPAB reviews the other five elements set out in the Canadian Standards on Quality Control. These five areas, which are the foundation for good audit quality, are:

- Leadership responsibilities for quality within the firm
- Ethical requirements (including independence)
- Acceptance and continuance of client relationships and specific assurance engagements
- Human resources (including training)
- Monitoring (by firms of their quality control systems and of their application)

Treatment of audit deficiencies

When audit deficiencies are noted, audit firms are required to implement CPAB's recommendations to rectify them. CPAB follows up to ensure that the required actions are taken. If there are material Generally Accepted Accounting Principles (GAAP) deficiencies, this may lead to the restatement of previously issued financial statements.

Certain firms have characterized CPAB's findings as "a lack of documentation" or a "difference in professional judgment." This is not the case. More than 80 per cent of CPAB's 2012 inspection findings required the audit firm to carry out additional audit procedures to verify there was no need to restate the financial statements due to a material error. The remaining findings required the audit firms to add considerable 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.

Recommendations in inspection reports

CPAB provides reports on each file inspected, as well as an overall report on the firm as a whole. A participating audit firm's inspection report will, in most cases, include a number of recommendations arising from deficiencies related to engagement performance. These recommendations are applicable to either systemic/firm-wide processes or specific engagement files that were inspected. Deficiencies noted in the other elements of quality control may also result in recommendations. The inspection report separately identifies CPAB's top three to five recommendations that, when implemented, would improve audit quality.

It is important to note that CPAB's mandatory recommendations <u>must</u> be implemented by the audit firm within 180 days of the date of the inspection report. Failure to implement the recommendations to CPAB's satisfaction would give rise to disciplinary action being placed on the audit firm in the form of a Requirement, Restriction or Sanction[3]. These represent escalating degrees of discipline, each of which limits the scope of the audit work the firm can undertake until the identified deficiencies have been corrected.

When CPAB believes that the quality of auditing in an audit firm is so substandard that the investing public is at risk, CPAB places a Requirement on the firm that restricts the manner in which it operates its reporting issuer practice. A Requirement is between CPAB and the audit firm. A Restriction requires the firm to notify the securities regulators that disciplinary action has been placed on the firm and a Sanction requires that audit committees of all reporting issuer clients be notified, in addition to the securities regulators. Depending on the severity of the finding, the deadline for implementing CPAB's recommendation may be much shorter than 180 days. This is particularly true where there may be a potential restatement of the financial statements. CPAB follows up to ensure that the recommendations have been implemented satisfactorily. Following its 2012 inspections, CPAB has Requirements in place on five firms and a Restriction on two firms.

2012 Report

The 2012 Report summarizes inspections of the Big Four firms, Other Firms subject to annual inspection, Regional/Local Firms, and Foreign Firms.

In 2012 CPAB once again augmented its inspections of firms reviewed every three years by using a risk-based approach to identify reporting issuers for inspection. Since these firms are typically very small, with only one or two partners auditing reporting issuer clients, CPAB primarily focuses on the quality of the audit work by reviewing an audit file. These desk inspections supplement the inspections of smaller firms carried out by provincial regulatory bodies on CPAB's behalf.

Improved risk analysis

In 2012, CPAB refined its risk analysis to better identify high-risk reporting issuers and determine the appropriate number of audit files to inspect at each firm. In addition to analyzing the financial information generated by external databases (e.g., liquidity, solvency, earnings, quality of assets), the risk analysis considers other factors, such as operations in foreign jurisdictions and past inspection results both at

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[3] Requirements, Restrictions and Sanctions may include one or more of the following:

a. Additional professional education
b. The design, adoption or implementation of policies to ensure compliance
c. Assignment of a reviewer to oversee work
d. Termination of one or more audit engagements
e. Appointment of an independent monitor
f. Prohibition from accepting new reporting issuer audit clients
g. Prohibition of designated individuals from doing reporting issuer audits
h. Public censure
i. Termination as a participating firm
j. Other (as required)

the firm and at the specific partner level. As in 2011, the 2012 inspections comprised focused reviews that delved into the audit work in such high-risk areas as valuations (especially non-traded financial instruments), impairments, revenue recognition, income taxes and going concern. Once again, in 2012, one material transaction stream was chosen in each file to assess the audit work where often there was reliance on internal controls.

In addition, CPAB focused its inspection efforts on larger, more complex audit engagements and increased its inspection of smaller high-risk reporting issuers that were audited by offices outside the major centres in Canada.

Key issues to improve audit quality

CPAB believes that a lack of consistent application of professional skepticism, coupled with a lack of consistent adequate supervision and review, contributed to many of its more significant inspection findings in 2012. To improve audit quality, CPAB believes firms must: establish a consistent accountability culture; develop and implement action plans; and execute audits consistently.

Establish an accountability culture

In many firms, the engagement partner is solely accountable for audit quality and audit performance on an audit engagement. This view oversimplifies the audit process and ultimately, CPAB believes, may not enhance audit quality. CPAB believes shared accountabilities are required to enhance audit quality.

Accountability for quality should begin with the audit firm's CEO and filter down to the most junior member of the audit team. Each firm must develop a supportive environment where "doing it right" is valued and actively supported by the firm's leadership. In addition, individuals who are held accountable must have the authority to deal with quality issues that affect audit performance.

Develop and implement action plans

In 2011 and 2012 CPAB required a number of firms to develop action plans to improve audit quality. These plans contained a number of actions to permanently change behaviours and better embed audit quality into each engagement. Firms recognized the status quo was not acceptable and responded positively to CPAB's requirement to implement action plans. CPAB wanted and expected real cultural change if the firms were to achieve the desired results over the long term.

CPAB closely monitored the action plans during its 2012 inspections and has seen improvement across most of the firms that developed them. Since firms implemented their plans at different times, some were able to undertake more initiatives in 2012 than others. However, progress has been made and will continue as the plans' longer-term measures take effect.

CPAB is encouraged that many firms have decided to incorporate their action plans into their cycle of continuous improvement. This is essential to achieving sustainable improvement in audit quality. CPAB fully supports this and encourages other firms to follow suit. CPAB also encourages firms that have not developed action plans to do so as soon as possible. This is an important way to enhance audit quality and establish a quality culture within the organization.

Execute consistently

CPAB's inspections indicate that a large majority of audits are of acceptable quality. The challenge is to ensure that all audits are of high quality.

CPAB encourages firms to develop processes or systems to ensure that partners and professional staff have sufficient time to consistently complete a quality audit. Firms should also emphasize the importance of quality supervision and review of audit work, particularly in high-risk areas.

CPAB believes firms should also fully utilize the skills and knowledge of the firm's most experienced practitioners, through visibility and consultation across all audit engagements.

Inspection findings

CPAB issues an Engagement Findings Report (EFR) during an inspection where it identifies an audit deficiency in an audit file. The EFR contains two types of findings: EFR 1 and EFR 2.

EFR 1 and EFR 2 Findings

An EFR 1 is a significant finding that requires the audit firm to respond in writing.

An EFR 1 finding means CPAB has identified a significant GAAS or GAAP deficiency that:

- *Relates to a material financial balance or transaction stream*
- *Has the potential to result in a material misstatement in the financial statements*
- *Will be included as a file-specific finding in the inspection report*

An EFR 2 is also a significant finding that is communicated in writing to the firm, but it does not require a written response. EFR 2 findings often lead to the inclusion of systemic or firm-wide engagement performance issues (e.g., inadequate audit work on internal controls) in the inspection report.

Big Four inspection results

In 2012, CPAB inspected 128 engagement files in the Big Four firms and is pleased to report that there has been an overall improvement in audit quality. This year's inspection results showed a 33 per cent decline in audit deficiencies. However, not all of the Big Four firms demonstrated the same level of improvement. Inspite of this, less than two per cent of the files inspected resulted in restatements.

Common inspection findings

Audit of accounting estimates

The application of accounting policies to prepare financial statements involves a number of complex estimates and judgments. Examples include impairment of long-lived assets, provisions for inventory obsolescence, warranty provisions, costs related to long-term construction contracts, fair values of complex financial instruments, and fair values of assets acquired in a business combination. Estimates relating to impairment and going-concern evaluations usually require the preparation of a cash flow forecast. Since these estimates can be complex, and may be influenced by management bias, CPAB often chooses these areas for a focused inspection of the audit work performed.

Deficiencies noted by CPAB in the audit of estimates included: insufficient consideration of the risks of material misstatement arising from estimation uncertainty; inadequate or inappropriate audit procedures to address those risks; and insufficient professional skepticism, through a failure to either challenge management to corroborate their representations or respond to indicators of management bias by extending or modifying the planned audit procedures.

Most EFR 1 findings related to impairment assessments which, in many cases, involved fair value determinations and the audit of financial projections. In certain cases, the determination of fair values required the involvement of valuation specialists. CPAB found a number of instances where the auditor did not apply appropriate professional skepticism to management's estimates. In one case, the impairment analysis of a long-lived asset included overly optimistic and unrealistic revenue forecasts that had been reviewed by the firm's own valuation experts.

CPAB believes audit work in this area would improve if more senior members of the engagement team were involved in determining the audit approach and reviewing the audit work in detail to ensure that the engagement team exercised an appropriate level of professional skepticism. CPAB also believes the engagement quality control reviewer or second partner should be more involved in reviewing the audit of estimates in order to objectively evaluate the engagement team's approach and conclusions in light of their experience.

Substantive analytical procedures

Effective substantive analytical procedures predict financial results based on independent data, and then compare the prediction to actual results. Explanations, which must be corroborated, are obtained for variances above a predetermined precision. The predictive nature of the process limits the areas in which substantive analytical procedures can be applied effectively.

Many auditors rely on substantive analytical procedures as a more efficient way to obtain sufficient appropriate audit evidence, instead of relying on tests of details (often applied in the audit of revenues). In almost all cases, CPAB finds that substantive analytical procedures are not done well because:

- The area being audited was not sufficiently predictable, based on the inputs (e.g., while interest income is predictable based on interest rates; other types of revenues may have too many variables to be predictable)
- The independent data used for predicting was not in fact independent or, if it was, it was not tested for validity
- The predetermined precision against which variances were compared was set at a level too high to identify material differences
- The follow-up on variances was not appropriately corroborated

Auditors often do not understand what constitutes appropriate audit evidence to corroborate management’s responses to variances from expectations. As a result, without performing additional audit procedures, the audit work is often insufficient to support the auditor’s conclusion.

CPAB believes relying on substantive analytical procedures is appropriate only in relatively limited circumstances, such as when there is an ability to develop sufficiently precise expectations based on verifiable data. CPAB therefore believes audit firms should reconsider the use of substantive analytical procedures as a primary source of audit evidence. A few firms have reduced the application of substantive analytical procedures, while others now require pre-approval of their use.

Audit work on internal controls

Given the complexity of control systems in many enterprises, taking a controls approach can require an expert in controls testing. Frequently, engagement teams don’t involve an expert, even though there is insufficient expertise resident within the engagement team to effectively undertake a controls approach.

CPAB often finds that the key control is not identified properly. Similarly, often the control testing itself is flawed because: the wrong control was tested; the testing did not cover the entire audit period; or the impact of a control not operating effectively was not adequately addressed. CPAB encounters situations where auditors have relied on systems descriptions prepared by management without performing their own objective evaluation of those controls relevant to the audit.

Two of the most common deficiencies identified are:

- Relying on a sign-off signature as documentary evidence that a control was working, without further review of other evidence to demonstrate that the control operated effectively

- Relying on inquiry, without examining corroborating evidence, to verify that a control was operating as designed

CPAB believes all firms must reassess the guidance and training provided on taking a controls approach to an audit, since it is clearly not being carried out effectively. Firms should also consider designating certain individuals as controls specialists, who would approve the controls approach in an audit that relies extensively on control systems.

Inspections of Other Firms

In 2012, CPAB inspected 44 engagement files at 10 Other Firms inspected annually. CPAB also inspected 39 engagement files at 24 Regional/Local firms and three files at three Foreign firms.

Common inspection findings

Substantive analytical procedures

CPAB identified a significant number of files with deficiencies in the approach adopted to audit revenue. These findings are predominately the result of poorly designed and executed substantive analytical procedures. CPAB's findings and concerns about substantive analytical procedures employed by smaller firms are similar to those expressed in the section of this report dealing with the Big Four firm inspections.

Group audits

Many firms audit reporting issuers with operations around the world. In so doing, they rely on component auditors to perform large parts of these engagements. Unlike large international firms, which have affiliates around the world with a common methodology, most non-network firms rely on foreign firms within loose network affiliations or non-affiliated local foreign firms.

CPAB has found that firms generally failed to assess their ability to act as the group engagement team in situations where substantially all operations were conducted in a foreign jurisdiction. Firms also did not adequately assess the qualifications and experience of component auditors, with respect to both auditing and accounting in the reporting framework.

Firms need to perform a robust assessment of the extent of their involvement in the planning and supervision of a component auditor's work. They must also consider whether sufficient access to a component auditor's working papers can be obtained.

Use of management's expert

Reporting issuers frequently employ experts in other fields to determine amounts in the financial statements. This often includes experts in estimating resource reserves, valuing financial instruments or valuing tangible or intangible assets.

CPAB has found that firms of all sizes frequently fail to assess the competence, capabilities and objectivity of experts and to understand the methodology used to develop estimates and valuations. Firms must also recognize that the reliability of the underlying source data provided to the expert must be tested by the firm and consistent with their overall understanding of the business.

Impairment testing

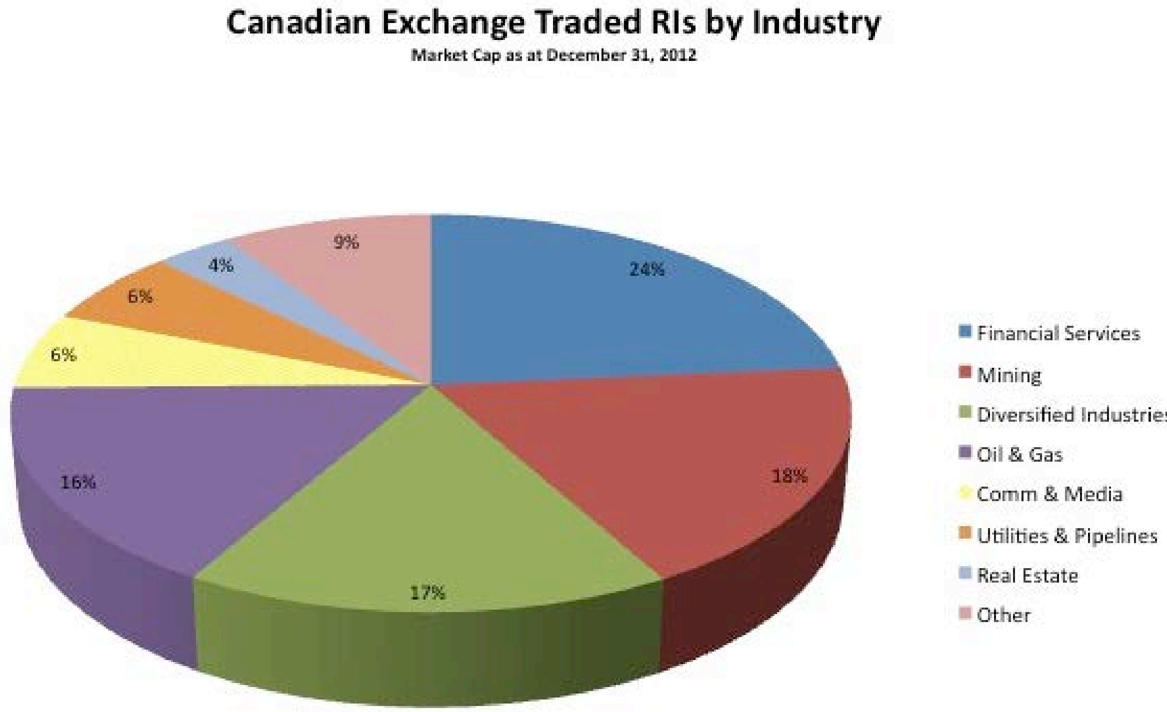
Firms must frequently audit management's assessment of fair value for the purposes of determining possible impairment of assets. This is typically determined by analyzing cash flow projections.

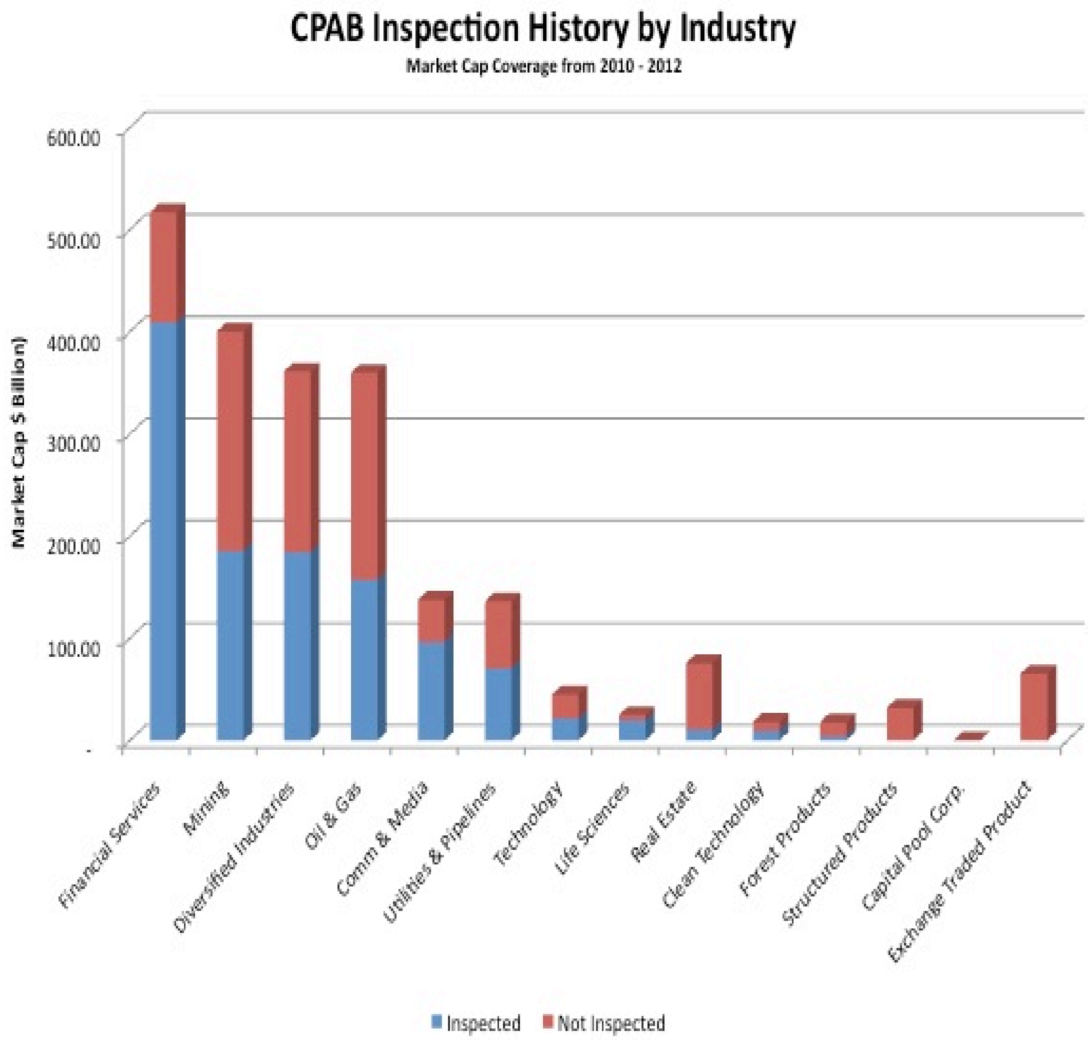
CPAB has found that firms of all sizes do not sufficiently analyze whether projections are based on reasonable and supportable assumptions and discount rates. Firms need to exercise a high degree of professional skepticism when analyzing projections prepared by management, as CPAB has seen instances where they were overly optimistic.

Reliance on internal controls

Smaller reporting issuers often lack effective controls that can be relied on, due to limited resources and the opportunity for management override. Firms should therefore place very limited reliance on internal controls when auditing smaller reporting issuers.

In limited cases, smaller reporting issuers may have effective controls, which auditors may rely upon if they have been tested appropriately. When assessing the effectiveness of internal controls, firms frequently fail to identify and test controls that mitigate audit risks at the assertion level. Due to their inexperience in taking a reliance-on-controls audit approach, smaller firms must proceed with caution when they intend to rely on internal controls.


Canadian Exchange Traded RIs by Industry
Market Cap as at December 31, 2012
24%
18%
17%
16%
6%
6%
4%
9%
Financial Services
Mining
Diversified Industries
Oil & Gas
Comm & Media
Utilities & Pipelines
Real Estate
Other


CPAB Inspection History by Industry
Market Cap Coverage from 2010 - 2012
Market Cap $ Billion)
600.00
500.00
400.00
300.00
200.00
100.00
-
Financial Services
Mining
Diversified Industries
Oil & Gas
Comm & Media
Utilities & Pipelines
Technology
Life Sciences
Real Estate
Clean Technology
Forest Products
Structured Products
Capital Pool Corp.
Exchange Traded Product
Inspected
Not Inspected

Section Four – CPAB's 2013-2015 Strategic Plan

CPAB's 2013-15 strategic plan focuses on four priorities:

- *Thought leadership*
- *Enhanced stakeholder engagement*
- *Risk management*
- *Focused, effective inspections*

CPAB is also working with audit firms to increase the transparency of inspection findings.

CPAB's 2013-2015 strategic plan is designed to enhance the organization's effectiveness in the face of heightened challenges to audit quality. The core issue to be addressed by the strategic plan is to ensure audit firms reduce the rate of audit deficiencies in a manner that is sustainable in the longer term.

To address this core issue, CPAB is undergoing a strategic transition. This will help the organization fulfill its regulatory mandate by enhancing its inspection methodology and reporting, and by contributing to sustainable improvement in audit quality through increased involvement with a broader range of stakeholders.

CPAB will focus on four priorities: thought leadership; enhanced stakeholder engagement; risk management; and focused, effective inspections.

Thought leadership

CPAB believes it can help enhance audit quality and investor protection by raising key stakeholders' awareness of all aspects of audit quality and by engaging them in a dialogue on related issues. Among other means, this can be achieved through research and publication of discussion papers on current issues affecting audit quality. CPAB will continue to seek opportunities to collaborate with other stakeholders on initiatives to advance audit knowledge and practice. The organization will also leverage the information it acquires from its inspections to advise on and influence standards formulation, risk identification and business practices. Through thought leadership, CPAB is in a unique position to contribute to the state of audit quality, audit committee effectiveness and international audit regulatory development.

Enhanced stakeholder engagement

Audit firms and financial statement preparers are not the only participants in the audit process. Audit committees, institutional investors and financial analysts also play important roles. When stakeholders have better information on audit quality issues and engage in a dialogue about CPAB's inspection findings, all stakeholders, including CPAB, can perform their roles more effectively. CPAB will therefore continue to proactively engage other stakeholders, and will continue to clearly articulate its concerns to audit firms and audit committees.

Risk management

Strategically, it will be important for CPAB to implement processes to keep abreast of the many risk factors affecting audit quality. These include: research and analysis of the reporting issuer population (specifically identifying outliers); ongoing environmental scanning; root-cause-focused inspections; and key stakeholder engagement. These measures will help embed risk discipline in the fabric of the organization.

Focused, effective inspections

CPAB's current inspection methodology provides a sound basis for evaluating audit quality. However, changes in the operating environment require this methodology to better evaluate underlying factors that are affecting audit quality, to ensure CPAB's regulatory actions are targeted and effective. CPAB will therefore enhance its inspection methodology to better identify the root cause of quality shortfalls, including such factors as competence, accountability and audit firms' organizational structure. CPAB's inspection methodology will also include broader risk assessment and recommendations/requirements.

Increased transparency

CPAB believes greater transparency in reporting file inspection findings and deficiencies in elements of quality control will enhance audit quality, encourage audit partners and firm leadership to focus more on continuous quality improvement, and raise awareness of noteworthy audit issues at the audit committee level and beyond. CPAB is working with audit firms to develop a protocol designed to provide information that will improve an audit committee's ability to effectively oversee the work of the auditor.

CPAB's 2013-15 strategic plan is available at www.cpab-ccrc.ca

Appendix A: Scope of the 2012 Inspection Program

During 2012, CPAB inspected 61 firms and inspected 236 engagements, as follows:

	Number of Firms		Number of Engagements	
	2012	2011	2012	2011
Big 4 Firms	4	4	128	114
Other Firms Inspected Annually	10	10	44	41
Other Firms[1]	24	56	39	87
Sub-total	38	70	211	242
Follow-up inspections[2]	23	18	25	21
Total	61	88	236	263

In addition, provincial professional accounting bodies inspected 51 firms in 2012 (62 firms in 2011) that audit reporting issuers. This report does not cover the findings from their inspections.

[1] In 2011 CPAB performed targeted inspections of 14 firms with audits of reporting issuers in foreign jurisdictions and inspected 24 files. These 14 firms are included in the 2011 total for Other Firms. CPAB also performed fewer desk inspections in 2012 than in 2011. In 2012, CPAB redeployed its inspection resources to inspect more files at annually inspected firms and to focus on audits in foreign jurisdictions and group audits, where it conducted an additional 25 limited procedure inspections that have not been included in the totals above.

[2] In a follow-up inspection CPAB verifies that the firm has implemented the inspection recommendations and only inspects a new audit file in a situation when there is a Requirement on the firm.

Appendix B: Description of CPAB's Inspection Process

CPAB's mission is to contribute to public confidence in the integrity of financial reporting of public companies in Canada by effective regulation and by promoting quality, independent auditing. The primary means of assessing the quality of audits is through the inspection of selected high-risk sections of audit files and the elements of quality control noted below. The following sets out the key elements of CPAB's inspection process.

Risk-based approach

CPAB has developed a composite risk model to identify and assess reporting issuers and audit firms that may represent the most significant risks to the investing public. This model is used to mitigate risk throughout the inspection process. CPAB develops risk profiles for individual reporting issuers based on a number of quantitative and qualitative factors (reporting issuer composite risk). Reporting issuers are then matched with their audit firms, which results in an audit firm reporting issuer composite risk. This risk is further refined, based on individual audit firm risk factors (e.g., prior inspection results, concentration of partners, degree of technical support) to derive the firm-level reporting issuer inspection risk assessment. This risk assessment is used to select the audit firms to be inspected in the non-annually inspected firm category. It also drives the resource allocation for all inspections. The identification of specific files to be inspected is based primarily on the composite risk of the reporting issuer. The risk assessment process is managed by CPAB's risk management team, with input from the inspection team assigned to the inspection and CPAB management. The risk management team also conducts environmental scans throughout the year and reporting issuers of interest (due to such factors as negative media coverage, questionable accounting, high profile) may be selected for inspection.

During 2012, CPAB's 31-member inspection staff was supported by seven contract consultants who primarily specialize in the areas of taxation, IFRS, valuations, and information technology.

Elements of quality control

Before each inspection, CPAB asks the audit firm for information relating to the following six elements of quality control:

- Leadership and tone at the top
- Independence and ethics
- Client acceptance and continuance
- Human resources and professional development
- Engagement performance
- Quality monitoring

CPAB reviews information provided with respect to each of these elements and selects those that merit attention in the current year's inspection. CPAB is particularly interested in changes to processes relating to the each of the six elements. CPAB maintains an evergreen document for firms inspected annually to have a record of processes followed to comply with each element. The primary focus of inspections is on the quality of the audit work as evidenced in the audit files (which, in most cases, are electronic). For example, if CPAB identifies audit deficiencies in an audit file, CPAB will ask to see performance evaluations and training taken by the audit staff. If CPAB identifies audit deficiencies and the reporting issuer is outside the audit firm's comfort zone, CPAB will ask to see the client acceptance procedures that were performed.

Inspection of files

A few weeks prior to the inspection of a specific file, a CPAB GAAP specialist performs a technical review of the financial statements. This technical review flags potential accounting issues for the attention of the file inspector. If the technical reviewer identifies a potential material non-GAAP issue, the file inspector is required to follow up on the matter and, ultimately, have the issue cleared by the technical reviewer. The technical reviewer will also identify specific areas of the financial statements to be considered for a focused, detailed review. Technical reviews are mandatory for non-Big Four firm inspections. The technical review is optional for the Big Four firms, based on the internal financial statement review performed by the firm and the composition of the engagement team.

CPAB also asks the engagement team to prepare an engagement profile, which describes key metrics of the engagement, such as the names of senior engagement team members, specialists used and the hours booked to the engagement. It also identifies key deliverables, including dates.

The inspection begins with a meeting between the CPAB inspection team and the engagement team. This provides CPAB with background on the audit engagement and includes a high-level discussion of the audit approach to the focus areas.

CPAB does not inspect the entire audit file; its file inspection procedures cover two to three focus areas to assess the quality of audit work. These areas are generally material high-risk financial statement items that require more complex estimates and judgments (e.g., impairment of long-lived assets, fair values of financial instruments, provision for warranties). When there is reliance on internal controls, CPAB selects a transaction stream, such as revenues, to assess the quality of audit work. The inspection of a focus area covers the various stages of the audit process: planning, execution, evaluation of results, financial presentation and disclosure, and reporting to the audit committee.

In addition to the focus areas, core areas are reviewed for each file. These include such items as materiality, risk assessment, fraud, related-party transactions and communications with the audit committee.

Types of findings

EFR 1 findings

Before the CPAB inspection team drafts an EFR 1 finding, the file inspector will confirm with the engagement team that the inspector has been able to review all the available audit evidence. The file inspector then discusses the finding with the inspection team leader. Other CPAB staff with expertise in the particular area in question may also be consulted. Once the inspection team determines that an EFR 1 should be issued, it is required, as a further quality control check, to discuss the matter with a senior CPAB executive. The file inspector then drafts the EFR 1 and has it approved by the team leader and CPAB senior executive before it is presented to the engagement team.

CPAB expects to receive a firm's written response to an EFR 1 finding within ten business days.

Disposition of EFR 1 findings

Once CPAB reviews the engagement team's response to the EFR 1 finding, CPAB completes the disposition section of the EFR 1. In the majority of cases, CPAB requires the engagement team to perform more audit work in the current year, to be satisfied there is not a material error in the financial statements that requires restatement. The engagement team must also provide CPAB with evidence and the results of the additional audit work undertaken. If it is decided that a restatement is necessary, CPAB requires the audit firm to advise the reporting issuer, including its audit committee. CPAB follows up to make sure the restatement has occurred. Another type of disposition requires the engagement team to add considerable evidence to the audit file of the audit work that was performed but not evidenced in the audit file.

It is important to note that the audit firm is required to implement CPAB's recommendations. Failure to do so could lead to disciplinary action. Audit firms are also required to implement CPAB's recommendations on a timely basis.

EFR 2 findings

EFR 2 findings are most often included in the inspection report as part of the engagement performance element of quality control. Examples include: lack of professional skepticism, inadequate supervision and review, testing of internal controls, substantive analytical procedures and audit of estimates.

Disposition of EFR 2 findings

EFR 2 findings are provided to the firms for their consideration in future audits.

Inspection reporting

At the conclusion of the inspection, CPAB holds an exit meeting with the firm to discuss the overall inspection results. CPAB then issues its inspection report, which is a private communication between CPAB and the firm. The inspection report includes the findings and recommendations to improve audit quality. In each inspection report, CPAB highlights the top three to five recommendations that it believes will have the most impact on improving audit quality.

The audit firm must implement the recommendations to CPAB's satisfaction within a prescribed period of time, which is typically 180 days, although it may be sooner if required. For example, CPAB will often identify certain actions that the audit firm must take in connection with the audit of the next set of calendar year-ends. In all cases, CPAB follows up to ensure its recommendations have been implemented to CPAB's satisfaction.

Disciplinary actions

In situations where CPAB believes the audit firm has committed a violation event, as defined under CPAB's rules, it will evaluate the event(s). If CPAB believes the audit firm is not performing up to professional standards and is therefore placing the public at risk, CPAB can impose three types of disciplinary actions: a Requirement, a Restriction or a Sanction.

Information about a Requirement stays between CPAB and the audit firm. A Restriction requires the firm to notify Canadian securities regulators where the audit firm's reporting issuers are registered. A Sanction requires the audit firm to also notify all of its reporting issuers' audit committees. Common types of disciplinary actions include: prohibiting the firm from taking on any new reporting issuer audits; requiring the firm to engage an external monitor to review its audit work prior to the release of an audit opinion; prohibiting a partner from acting as the engagement partner on a reporting issuer audit; and requiring partners and staff to take training in areas where they are deemed to be deficient. The CPAB Board of Directors must approve a resolution to impose a disciplinary action on a firm.

CPAB terminates a disciplinary action only after it has conducted a follow-up inspection, including inspecting an engagement file. CPAB must be satisfied that the audit firm has met the conditions imposed by the disciplinary action. The CPAB Board of Directors must also approve the termination of a disciplinary action on a firm. CPAB currently has seven outstanding disciplinary actions.