The Canadian Public Accountability Board (CPAB) is Canada's audit regulator, protecting the investing public's interests. As a world-class regulator focused on excellence, we deliver value by promoting quality, independent auditing. CPAB contributes to public confidence in the integrity of financial reporting, which supports our capital markets.

Our 2015 annual inspections report for Canada's Big Four public accounting firms (Deloitte LLP, EY LLP, KPMG LLP, PwC LLP) is now available (www.cpab-ccrc.ca). These firms, and their foreign affiliates, audit approximately 98 per cent of all Canadian reporting issuers by market capitalization. Each firm shares their significant file-specific inspection findings, and this report, with their clients' audit committees as per their participation in the Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees (Protocol). Information regarding the inspection of a firm, other than that specifically shared under the Protocol, remains confidential in accordance with the CPAB Rules. This information sharing is intended to encourage more robust discussions among management, the firm and audit committees, and to support audit committees in conducting their oversight responsibilities. CPAB encourages all audit committees to discuss this report and any file-specific findings, if applicable, with their audit firm.

As the information contained in the Public Report is of interest to audit committees, CPAB is pleased to provide the following highlights.
2015 inspections indicate audit quality across the Big Four firms was inconsistent and that improvement in the firms’ quality systems is required

Significant inspection findings increased across all four firms as a group compared to the prior year. CPAB inspected 93 (2014:98) engagement files and identified significant inspection findings in 24 (2014:7) of those files. Results for two of the firms were generally comparable to 2014. Two firms experienced challenges, one particularly with audits of companies with smaller market capitalizations and one more broadly.

With some exceptions, firm action plans have generally helped maintain audit quality in larger engagements. However, our inspections of smaller reporting issuer audit files show a different result (CPAB targeted companies with market capitalizations of $250 million or less for its 2015 inspections cycle). Forty-eight or 51.6 per cent of files inspected (2014: 27 or 27.5 per cent) were for companies with market capitalizations of $250 million or less. The impact of action plans on audit quality in companies with mid and smaller market capitalizations and conducted by smaller audit firm offices is not evident. This suggests that quality processes are not generating consistently good results for all firm audits.

As a result of our findings, we have required the firms to:

- For those files not yet remediated, complete planned procedures to identify if restatements are required (no restatements have been identified to date).
- Improve the effectiveness of their systems of quality control for medium and smaller market cap companies.
- Consider region-specific issues which may be impacting audit quality.
- Evaluate the underlying cause(s) of individual file significant findings.
- Conduct a comprehensive review of quality control systems and assess whether those systems have inherent weaknesses that result in inconsistent audit execution at the engagement file level.
- Amend training and learning curriculum as necessary to address inspection findings and key insights.
- Determine appropriate next steps, including revising and amending action plans as necessary, to continue to drive consistency and improve audit quality across all engagements.

CPAB will monitor the implementation, sustainability and effectiveness of these initiatives in improving audit quality and continue to conduct risk-based inspections, with a particular focus on mid to smaller market cap reporting issuers, in 2016. This work will include a deeper examination of firm quality control systems.

CPAB will also expand our interaction with audit committees, with a focus on mid to smaller market cap reporting issuers, and publish information on how to evaluate the audit firm and audit risks, how audit committees are most effectively addressing their oversight role, and on industry-specific issues to explore with their auditors.
Key Inspection Themes

Executing audit fundamentals
We identified significant findings in a number of files in the areas of basic revenue testing, inventory costing, inventory existence and depreciation. In more than one file, procedures to assess the accuracy of inventory costing were either inappropriately designed, executed, or both.

If fundamental audit areas are delegated to more junior staff, the firm must see to it that staff have the appropriate training to perform their assigned procedures and that their work is appropriately supervised and reviewed. Without adequate training and supervision, a firm’s systems for achieving quality audits could become ineffective.

Understanding business processes relevant to financial reporting
An insufficient understanding of the client’s business is the root cause behind many of the audit findings we identified. In a number of instances, CPAB identified gaps in the engagement team’s understanding of company financial reporting and audit risks, resulting in poorly designed and ineffective audit procedures.

Complex accounting estimates
The types of complex estimates and judgments can vary by industry. Estimates relating to impairment, and going concern evaluations in particular, often involve cash flow forecasts and specialists. Auditors need to consider the appropriateness of the forecasts being made.

Similarly, firms can face challenges in evaluating the work of external experts and in integrating their own internal experts into the audit process. The fact that a reputable firm acted as management’s expert does not absolve the auditor from assessing the reasonableness of assumptions developed by that expert or conclusions drawn on the basis of those assumptions.

Internal controls
CPAB’s inspections identified numerous instances where internal controls work was not well done, calling into question how internal controls are tested and the effectiveness of the audit. We also noted other situations where it was not practical to obtain sufficient appropriate audit evidence from substantive procedures alone and the engagement team did not test internal controls.

Firms need to critically re-evaluate how they approach an internal controls-based audit and provide appropriate training and guidance to engagement teams.

Professional judgment and skepticism
Areas requiring the most professional judgment and skepticism featured prominently in our 2015 inspection findings. Participation of senior engagement leaders at both the planning and issues resolution stages remains the best way to deal with these matters. To address audit team inexperience and support the delivery of a quality audit, the appropriate involvement of engagement leadership is required. Failure to do so is a contributing factor to our most common inspection findings, especially in areas where a high degree of professional judgment is required.

Effective auditors weigh what management tells them against what they know of the client’s operation, together with their knowledge of the broader business environment. This year’s findings included instances where management’s assumptions were accepted without appropriate challenge.
What to Ask Your Auditor

 Executing Audit Fundamentals
For those less complex audit areas executed by more junior staff, how have you ensured that those audit procedures were effective and executed as designed?

 Business Processes
How do you update your knowledge of the business risks and processes impacting our financial reporting?

 How do you ensure that this knowledge is effectively incorporated into your audit plan and transferred to your engagement team members?

 Complex Accounting Estimates
What was the most difficult estimate you had to deal with, and how would you characterize the estimate within the range of possibilities?

 How effective was the company’s methodology for preparing the estimate?

 What was your methodology for evaluating the estimate?

 Internal Controls
How much did you rely on the company’s internal controls and how would you rate them? Did you identify areas for enhancement?

 Professional Judgment and Skepticism
How did you demonstrate skepticism during our audit, and how did management respond when you challenged them?