



**PROTOCOL  
FOR AUDIT FIRM  
COMMUNICATION  
OF CPAB INSPECTION FINDINGS  
WITH AUDIT COMMITTEES**

**March 2014**

### Background

1. The Canadian Public Accountability Board (CPAB) was established in 2003 as Canada's independent audit regulator. CPAB's mission is to contribute to public confidence in the integrity of financial reporting of reporting issuers (RI) in Canada by effective regulation and the promotion of quality, independent auditing. CPAB carries out its mission primarily by conducting inspections of the audit firms over which it has oversight responsibility.

There are 165 Canadian audit firms and 135 foreign audit firms currently participating in CPAB's audit regulatory program. These audit firms audit approximately 7,000 RIs (including investment funds). Annually, CPAB currently inspects 14 firms that audit 100 or more RIs. These audit firms audit 99.5 per cent of RIs in Canada by market capitalization. The remaining audit firms, that audit 0.5 per cent of RIs in Canada by market capitalization, are subject to periodic inspection.

2. CPAB's work primarily involves assessing the execution of methodologies, policies and quality control processes of the audit firms that participate in its oversight program.

The main focus of CPAB's inspections is on the quality of the audit work carried out by the audit firms. These inspections include approximately 200 – 250 audit files across 35 – 40 audit firms annually. File selections are based on the evaluation of risk factors for RIs and also consider audit firm-specific factors such as prior inspection results, partner experience, geographical distribution of offices and industry specialization. CPAB does not inspect the entire audit file. Instead, file inspection procedures cover between two and four specific focus areas which 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 illiquid financial instruments, and business combinations).

Following each inspection, CPAB issues a private report which summarizes findings on the audit firm's quality control processes, individual file reviews and includes mandatory recommendations to improve audit quality which must be implemented within a specified time period. Additional information about CPAB's inspection process can be found at [www.cpab-ccrc.ca](http://www.cpab-ccrc.ca).

3. Annually CPAB publishes its Public Report on inspections of the quality of audits conducted by public accounting firms (Public Report). This report provides a summary of audit firm level inspection themes, recurring issues, trends and emerging issues. Findings are described without identifying the firms or RIs whose audit files gave rise to the findings. Audit committee members are anticipated to read CPAB's Public Reports and periodic newsletters issued for audit committees and discuss the audit quality issues with their auditor to understand how the audit firm and audit team are responding to these issues.

4. Audit committees are key contributors to audit quality and play a critical role in creating the right environment for quality auditing. Audit committees are responsible for overseeing the work of the external auditor and have indicated to CPAB they would like more transparency with respect to inspection findings in order to improve the effectiveness of their oversight role. This Protocol has been developed with the objective of having a positive impact on audit quality by enhancing the ability of the audit committee to evaluate the quality and effectiveness of the audit through an increase in the transparency of inspection findings.

**Inspection findings to be communicated by audit firms to audit committees under this Protocol**

5. CPAB findings specific to the inspection of an individual RI are of most relevance to its audit committee and can directly improve both audit quality and the audit committee's oversight of the auditor.

The reporting of inspection findings under this Protocol has two components:

- Reporting to audit committees of the findings in CPAB's annual Public Report (see paragraph 6).
- The reporting of findings specific to the inspection of an individual RI (see paragraph 7).

CPAB believes that audit firm communication of RI specific inspection findings, combined with CPAB's public reporting, will assist audit committees in their oversight role and improve audit quality.

6. Under this Protocol, audit firms will send CPAB's annual Public Report to audit committees. All RI audit committees will receive this information electronically on an annual basis.
7. In the event that CPAB has inspected the audit file of a RI, the audit firm will provide the audit committee with the following information:
  - (i) A description of the focus areas selected for inspection by CPAB.
  - (ii) An indication of whether or not there are any significant inspection findings.
  - (iii) Any significant inspection findings as reported by CPAB per CPAB's Engagement Findings Report (EFR) including a description of actions taken by the firm in response to the findings and CPAB's disposition.

A copy of this communication will concurrently be provided to CPAB by the audit firm.

## Protocol for Audit Firm Communication of CPAB Inspection Findings

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8. Audit committee members are anticipated to discuss significant inspection findings with their auditor. These discussions should include understanding:
  - The nature and root cause of the significant inspection finding.
  - The additional work performed by the audit firm to address the finding and related results.
  - The impact, if any, on previously issued or future financial statements.
  - Changes the auditor will be making to the audit approach to address the inspection finding.
9. CPAB encourages open and candid discussion of inspection findings between auditors and audit committees to assist the audit committee in their oversight of the auditor. Under this Protocol, CPAB waives the provisions of Rule 413 of CPAB's Rules to allow audit firms to communicate to audit committees whether or not there have been significant inspection findings (as defined in Section 11) and, if so, to communicate those findings, actions taken by the audit firm and CPAB's disposition.
10. It is important that audit committees understand the scope of CPAB's inspections, and the fact that CPAB does not inspect the entire audit file. CPAB's inspection findings are not intended to, and cannot, identify all weakness that may exist in an audit. In general, CPAB inspects higher-risk audit areas in the audit files of more complex public companies or companies where there is greater likelihood of identifying audit quality issues. CPAB does not report on areas of the audit file where auditors performed to, or beyond, required standards. As a result, CPAB's findings do not represent a balanced scorecard and cannot be extrapolated across the RI population as a whole.

The absence of significant findings in CPAB's inspection of an audit file should not be interpreted to mean that all aspects of the audit were fully compliant with professional standards, or that the RI's financial statements have been prepared in accordance with the applicable accounting standards.

An accompanying Q&A issued with the final Protocol provides answers to common questions which may arise with respect to implementation of the Protocol.

### **Significant inspection findings**

11. Under this Protocol, all significant inspection findings will be communicated to audit committees.

A significant inspection finding identified by CPAB is defined as a significant deficiency in the application of generally accepted auditing standards related to a material financial balance or transaction stream where the audit firm must perform additional audit work in the current year to support the audit opinion and/or is

required to make significant changes to its audit approach. CPAB requires the audit firm to respond in writing to all significant inspection findings.

### **Response to significant inspection findings**

12. At the completion of the inspection of an audit file, CPAB communicates its significant inspection findings (if any) to the audit firm.

In the normal course of responding to most significant inspection findings, the audit firm performs additional audit work in order to be satisfied the issued audit opinion remains appropriate.

If a potential material error in the RI financial statements is not identified, the audit firm would report the written communications required by this Protocol (see Section 7) to the audit committee at its next scheduled meeting. If a potential material error is identified, the audit firm will advise the RI, including its audit committee, on a priority basis.

The audit committee and the auditor should agree on the timing of when significant inspection findings should be communicated to the audit committee as some audit committees may prefer earlier notification of inspection findings.

In all cases, the audit firm will keep CPAB informed on the resolution of all significant inspection findings. As part of this process, the firm provides CPAB with evidence that the work was completed, including the results of the additional audit work. The audit firm also indicates to CPAB how its future audit approach will be changed as applicable.

### **Confidentiality**

13. Section 11(2) of the Canadian Public Accountability Board Act (Ontario) (CPAB Act) provides that all documents and other information prepared for or received by CPAB in the exercise of its mandate and all deliberations of CPAB and its employees and agents, in connection with an inspection, investigation or review panel proceeding carried out under CPAB's oversight program, are confidential. Management and Audit Committee members of RIs should take steps to ensure, except to the extent required otherwise by law, that the significant inspection findings they receive are kept confidential. Before sharing information with financial and legal advisors, RIs should ensure that the information will remain confidential, except to the extent required otherwise by law.

### **Participation in the Protocol**

14. This Protocol is a voluntary Protocol which has been developed to respond to the demand from audit committees for additional information about CPAB's inspection findings. To provide transparency on the implementation of the Protocol, audit committees and other stakeholders will be able to access a list of the audit firms

participating in the Protocol.

**Amendments to the Protocol**

15. CPAB will periodically review and consult with key stakeholders on the functioning and effectiveness of this Protocol with a view, among other things, to modifying it should that be considered necessary.

**Applicability and Effective date**

16. This Protocol is effective for CPAB audit file inspections commencing on or after March 1, 2014.