



CANADIAN PUBLIC ACCOUNTABILITY BOARD  
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

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## **Canada’s audit regulator reports continued improvement in quality of public company audits in 2014**

TORONTO, March 31, 2015 – In its 2014 report on the annual inspections of Canadian audit firms released today, the Canadian Public Accountability Board (CPAB) said the quality of audits generally improved relative to the previous year, largely due to the effectiveness of action plans implemented by the Big Four firms beginning in 2012, and later on by the 10 other firms CPAB inspects annually.

“CPAB is encouraged that accounting firms in Canada are continuing to move in the right direction when it comes to audit quality,” said Brian Hunt, CEO, CPAB. “At the same time, there is still more to be done if firms are to deliver consistent, sustainable high quality audits over the long term. In 2015, we’ll continue to monitor quality initiatives and seek action where we see the greatest need for improvement.”

CPAB identified 32 files containing significant inspection findings in the 174 audit files reviewed in 2014. The majority of findings in both 2014 and 2013 required the audit firm to carry out additional audit procedures to verify there was no need to restate the financial statements due to 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.

“We encourage all firms to commit to continuous improvement at every level of their organization to safeguard this positive trend and, ultimately, investor confidence. Firm action plans will play a critical role, as will addressing the recurring inspection themes in this report and in individual firm reports,” said Hunt.

CPAB took a number of actions to maintain high standards of audit quality in 2014, including:

- Launching a new Protocol requiring audit firms to share a copy of our annual inspections reports with the audit committees of their clients as well as any file-specific significant inspection findings.
- Expanding our relationships with audit committees by issuing additional publications that address key issues and risks facing audit firms and meeting with members across the country.
- Upholding the required development and adherence to annual firm action plans designed to improve audit quality.

While no new audit quality themes emerged this year, CPAB’s inspections indicate that challenges persist in the following areas:

### **Auditing complex accounting estimates**

The application of accounting policies to prepare financial statements involves a number of estimates and judgments. Since these can be complex, and may be influenced by management bias, CPAB chooses these areas for inspection and continues to report findings.

### **Auditing in foreign jurisdictions**

Auditing in foreign jurisdictions has been a challenge for a number of years. CPAB has seen the Big Four firms increase their focus in this area, including defining procedures for this kind of audit work, which has resulted in improved execution and better quality audits. At the same time, CPAB continues to face limitations when it comes to accessing and evaluating component auditor work in certain jurisdictions.

### **Understanding and evaluating internal controls**

The report highlights the need for auditors to have a better understanding of internal control systems to effectively conduct an audit. CPAB's inspections of higher risk audit areas identified numerous instances where internal controls work was not well done. All firms need to critically re-evaluate how they approach an internal controls-based audit and ensure that appropriate training and guidance is provided to engagement teams.

### **Applying professional judgment and professional skepticism**

Areas requiring the most professional judgment and needing involvement of the most experienced auditors featured prominently in CPAB's 2014 inspection findings. In many cases, up to 80 per cent of the audit work is conducted by staff with fewer than five years' experience. This lack of experience needs to be complemented with appropriate involvement of engagement leadership to ensure the delivery of a quality audit.

### **Journal entry testing**

Reviewing journal entries – a fraud detection procedure – was the most common inspection finding in the 10 other annually inspected firms in 2014. Procedures are not as comprehensive as they should be and opportunities to identify errors or fraud may be missed and financial statements may be misstated as a result.

### **Decommissioning obligations**

Many resource companies incur decommissioning obligations related to costs necessary to deal with the environmental impact of their operations. A number of inspection findings related to insufficient or inappropriate audit work performed on the judgments regarding liability recognition.

### **Use of management's experts**

CPAB noted divergent practices in how firms assess and audit the work of management's experts, most often as applied to value mining, and oil and gas properties and related goodwill balances for impairments and business combinations, as well as for depletion calculations.

### **Materiality**

CPAB noted instances where engagement teams determined materiality on a basis that was inconsistent with the business context. If materiality is not appropriately determined, sample sizes might be too small and, as a result, insufficient audit work may be performed.

The audit firms inspected by CPAB annually account for roughly 99.5 of the total market capitalization of all public companies trading in Canada. CPAB's 2014 report on inspections, and November 2014 Big Four report on inspections are available at [www.cpab-ccrc.ca](http://www.cpab-ccrc.ca).

### **About CPAB**

The Canadian Public Accountability Board (CPAB) is Canada's audit regulator responsible for the regulation of public accounting firms that audit Canadian reporting issuers. CPAB operates independently from the provincial regulatory authorities who oversee the accounting profession. A world-class audit regulator and a champion of audit quality, CPAB contributes to public confidence in the integrity of financial reporting, which supports Canada's capital markets. CPAB operates from offices in Montréal, Toronto and Vancouver.

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