



The Issue

The Canadian Public Accountability Board (CPAB) issued a special report in 2012 summarizing CPAB's significant findings, recommendations to improve audit quality, and CPAB's future activities relating to auditing in foreign jurisdictions.

Many audit firms took action to improve their audits of reporting issuers (RIs) with operations in foreign jurisdictions, including development of guidance, modification to how audits were planned and executed, and increased oversight.

In 2014, CPAB inspected the audit files of 30 RIs with operations in foreign jurisdictions, to assess progress since the 2011 inspections. The scope encompassed a variety of foreign jurisdictions including China, Mexico, Africa, and South America. Files selected for review included audits performed by the national accounting firms, as well as other regional and local audit firms registered with CPAB.

Overall findings

CPAB noted general improvement in the quality of foreign jurisdiction RI audits compared to 2011.

Many audit firms have responded to CPAB's earlier recommendations and have improved how they tailor their audit procedures to address foreign jurisdiction risks. Although progress has been made we believe continued attention is required to ensure that audits of these entities appropriately identify and respond to significant risks, especially those that are unique to the foreign jurisdiction. Areas of attention include:

- Identifying and responding to country specific risks.
- Understanding laws and regulations and addressing the risk of fraud.
- Determining the appropriate use of the work of component auditors.
- CPAB access to component auditor working papers.

Identifying and responding to country specific risks

Each country has its own unique rules, regulations, business practices and customs.

What an auditor understands to be true in their own country is not necessarily the case abroad. As a result, audit procedures that are effective in Canada may not be as effective in a foreign jurisdiction. The audit approach to be taken should be based on the risks of that jurisdiction and the inherent risk of the company.

A number of audit firms have developed guidance on business customs and practices in countries where their clients have significant operations. This guidance describes business customs and practices that might give rise to audit risks (including fraud risks) in a particular country and suggests audit procedures to respond to those risks. In our inspections we noted instances where the engagement team effectively used such guidance to identify and address risks related to business customs and practices.

We also noted several instances where engagement teams did not appear to fully understand the business customs and practices and, as a result, did not sufficiently tailor appropriate audit procedures. Concerns include:

- Audit firms not obtaining an understanding of different business customs and practices resulting in audit procedures that are not specific to the risks.
- Several instances where engagement teams lacked a basic understanding of foreign jurisdiction tax regimes (both direct and indirect taxes) necessary to address any unrecorded or undisclosed tax exposures.
- Engagement teams possessing neither the language skills nor experience with the foreign jurisdiction, resulting in overreliance on management representations and a lack of professional skepticism.

Laws and regulations and the risk of fraud

Understanding laws and regulations is essential to the effective planning and execution of the audit.

In some foreign jurisdictions, assessment of compliance with laws and regulations can depend on how the legal system protects property rights and the strength of contract law. For example, property rights and registrations may vary among jurisdictions, impacting the steps followed to establish property ownership.

We observed the evaluation of laws and regulations and response to the risk of fraud in the following ways:

- Engagement teams reviewed internal and external sources of guidance on laws and regulations specific to the country, enabling the audit team to better tailor audit procedures to respond to specific foreign jurisdiction risks.

- Engagement teams tested the operating effectiveness of entity level controls over fraud and/or designed control testing to cover bribes and illegal payments.

We also noted instances where engagement teams did not provide evidence of their consideration of the legal and regulatory framework. As a result, the review of laws and regulations was cursory and engagement teams did not explicitly address the risk of fraud. Areas of concern include:

- Boilerplate identification of laws and regulatory regimes, many of which had no financial statement impact.
- Where there was a significant risk of fraud, no audit procedures were performed to test for compliance with applicable anti-fraud, anti-bribery, and anti-corruption legislation or illegal payments.
- No consideration of the business rationale or support for unusual transactions and overreliance on management representations without appropriate corroboration.

Use of the work of component auditors

In most cases, audits of RIs with foreign operations will involve the use of auditors located in the foreign jurisdiction (component auditor).

The group auditor is responsible for determining whether sufficient audit evidence was obtained from the work performed on all significant components including work performed by component auditors. The group auditor should have a plan for how they will use the component auditor and the planned interaction through the audit. Group auditors should clearly outline how they were comfortable that sufficient audit procedures were performed on all areas of significant risk. This could involve a visit to the foreign jurisdiction to meet with the component auditor and/or reviewing the component auditor's work.

We noted certain audit files included a detailed onsite review of component auditor working papers by the group engagement team together with detailed group auditor instructions and component auditor responses. Detailed memoranda by the engagement team and retention of select key component auditor working papers provided persuasive evidence of the group auditor's understanding of both the foreign jurisdiction and work performed by component auditors.

Our general observation is that when component auditors are used, the extent of group auditor involvement in supervising and reviewing the work of the component auditor was not well explained. Areas of concern include:

- Lack of detailed instructions issued to the component auditor, resulting in boilerplate audit clearance by the component auditor which calls into question the sufficiency and appropriateness of audit procedures performed.

- Limited evidence of the nature and results of the discussion of significant matters with the component auditor and/or review of component auditor working papers, including the results of local site visits, resulting in the appearance of limited oversight by the group auditor.
- Confusion between the group auditor and component auditor regarding responsibilities and audit scope, leading to gaps in audit work.
- Component auditors not following group auditor instructions or global firm methodologies.

Access to working papers

CPAB continues to face challenges when it comes to accessing and evaluating component auditor work in certain jurisdictions.

While in certain instances we were able to gain access to component auditor working papers, we were generally disappointed with the number of instances where we were denied access and are concerned that important stakeholders including audit committees may not be fully aware of such access restrictions.

We are finalizing memoranda of understanding to grant CPAB access in a number of jurisdictions. There will remain some where we will need the support of other regulators. We are actively engaging with the relevant regulators to achieve appropriate access and this process is ongoing.

Final thoughts

We have observed improvements in the audits of entities with significant operations in foreign jurisdictions. Although progress has been made, continued attention is required to ensure that audits of these entities sufficiently identify and respond to significant risks, especially those that are unique to the foreign jurisdiction.

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