OSC Staff Notice 52-724

Considerations for Public Accounting Firms in Developing Internal Ethics Policies and Procedures

June 28, 2023

Ontario

Introduction

On September 23, 2022, the Ontario Securities Commission (OSC) announced that it would be making targeted inquiries to certain public accounting firms that conduct audits of Ontario reporting issuers (the Audit Firms).

We conducted our inquiries in response to various ethical violations by public accounting firms recently identified during investigations carried out by the Canadian Public Accountability Board (CPAB), the Canadian regulator that oversees all public accounting firms that audit Canadian reporting issuers, as well as by regulators in other jurisdictions. Auditors perform an essential gatekeeper role in Ontario's capital markets by providing investors with confidence and trust that the information presented in financial statements can be relied upon when making investment decisions. Any actual or perceived issues with the ethical integrity of auditors in performing this critical function can undermine the confidence that the investing public places in financial reporting.

Given the importance of the auditors' gatekeeper role, we wanted to assess how public accounting firms were communicating the need for strong ethical behaviour to invoke a culture of internal compliance within. On that basis, we also raised inquiries of how public accounting firms assess compliance with ethical requirements, as part of their internal policies and procedures.

Purpose

The OSC is publishing this staff notice to communicate observations and identify select areas of focus that public accounting firms should consider when assessing whether their existing policies and procedures are sufficiently robust to safeguard against ethical violations in the audits of financial statements of reporting issuers. The select areas of focus identified in this notice are scalable, allow flexibility to different types and sizes of public accounting firms and their respective practices, and are not meant to suggest a 'one size fits all' approach.

> ⚠ *The views provided in this staff notice are based on existing requirements[1] in applicable professional and regulatory standards and do not create new requirements for public accounting firms.*

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[1] For example, the Canadian Standards on Quality Management in the CPA Canada Handbook – Assurance and the CPA Ontario Code of Professional Conduct.

Executive Summary

As a result of our targeted inquiries to the Audit Firms, we are providing views on the following key areas:

Internal Ethics Policies and Procedures: We have identified practices that public accounting firms should consider as part of their ethics strategy, for example, the clear identification of leaders within the firm with 'ownership' of the ethics policy, targeted ethics education training and guidance, and the establishment of a robust internal whistleblower program.

Dating of Audit Work Performed: Public accounting firms should consider whether their practices are sufficient for monitoring compliance as it relates to the dating of working papers, timely archiving of audit files, and clarity around the determination of what constitutes 'administrative' documentation in order to limit what can be added to the working paper files subsequent to the date of the auditor's report.

Internal Professional Training Programs: Public accounting firms should consider the need for preventative and detective controls to minimize the risk of assurance staff sharing answers, along with timely communication of a 'zero tolerance' policy for such practices.

Scope

The Audit Firms we engaged with are public accounting firms that audit a significant portion of reporting issuers in Ontario. Our inquiries included requests for the following information:

- Copies of internal policies for audit professionals setting out expectations on ethical behaviour,

- Procedures in place to support and assess compliance with internal policies pertaining to ethics and other relevant ethical requirements,

- Policies and procedures in place to support the operation of internal whistleblower programs,

- Practices in place to support and assess compliance around the dating of audit work performed, and

- Practices in place to support the integrity of internal professional training programs, including preventative and detective procedures to reduce the risk that answers used to assess completion of courses by assurance staff have been compromised.

Both CPAB and CPA Ontario have important mandates that include oversight of public accounting firms who conduct financial statements audits of reporting issuers in Canada and Ontario respectively. Our cooperative engagement with CPAB and CPA Ontario on matters relating to the importance of audits being performed with integrity and in accordance with professional standards demonstrates our collective regulatory objectives.

Our work on this initiative involved discussions with CPAB and CPA Ontario to the extent permitted by our authorities to support regulatory alignment on such matters.

📖 Internal Ethics Policies and Procedures

Each of the Audit Firms had a collection of policy manuals available and accessible to employees that promote a culture of professionalism, integrity, quality control and ethics-focussed practices among its professionals. The policies in these manuals were supported by a Code of Conduct that all employees were required to review and confirm compliance with at least annually, which is a common practice for many organizations.

In addition to the code of conduct obligations, each Audit Firm also employed other policies and procedures to support a strong ethical culture. Below are some areas of focus that should be considered by all public accounting firms to assess whether their existing policies and procedures establish quality management objectives, are sufficiently robust to safeguard against ethical violations in the audits of financial statements and support compliance with the relevant ethical requirements of professional and regulatory standards:

- ***Develop an 'ethics strategy' to support development and maintenance of a strong ethical culture –*** Public accounting firms should have an overarching strategy on how to communicate the importance of ethical integrity, develop policies and guidance to support consistent ethical practices and develop procedures to monitor compliance with ethical requirements. Below are examples of areas that could be considered as part of an 'ethics strategy':

  - o ***Provide ethics education training and guidance –*** Periodic training programs for employees can reinforce the firm's ethics policies and procedures, provide employees an opportunity to understand how certain policies are applied and communicate any subsequent internal policy updates. The training materials could include, or be supplemented with, specific guidance on how to respond to various 'ethical dilemmas' that commonly occur. This would provide employees greater confidence in applying judgement in determining when information needs to be reported internally (and the potential implications of staying silent).

  - o ***Develop processes to monitor and assess the need for updates to policies or guidance –*** In addition to implementing specific procedures to monitor compliance with the firm's ethics policies, developing a formalized process for evaluating ethical incidents and feedback over an extended period of time assists in determining whether there are trends that need to be addressed, or key messages that need to be reinforced or refined, in existing policies or guidance.

- o ***Consider opportunities for employee feedback –*** In assessing the effectiveness of a firm's ethics program and ethical culture, a key input can be employee feedback. The perception of the firm from an employee perspective as an ethical workplace and their views on whether the firm has successfully implemented policies or procedures are important factors in establishing a strong ethical culture. For example, issuing a survey to all employees on a periodic basis to collect feedback surrounding a variety of topics and themes, including ethical culture, can be a way to solicit feedback. In addition, employee feedback opportunities should be collected via direct reporting (to a manager, team leader, supervisor, or other designated firm personnel) and integrated into other processes such as performance reviews and employee exit interviews. These opportunities support an environment of continuous improvement and provide an additional channel for employees to raise ethical matters.

- ***Identify a leader responsible for implementing an 'ethics strategy' –*** To support a strong ethical culture it is important to establish an executive-level 'ethics leader' working individually, or with a group of senior leaders, with the ownership and responsibility of implementing, monitoring and continuously improving the firm's ethics policies and procedures. These individuals should also be responsible for ensuring an appropriate process is in place for investigating and responding to violations identified through monitoring or other reporting mechanisms, such as a whistleblower program (discussed in more detail below). The designated individual or group with this responsibility should be communicated to all employees and their performance in implementing an 'ethics strategy' should be evaluated on a periodic basis.

- ***Establish a robust internal whistleblower program –*** An established program that encourages all employees to communicate potential contraventions of policies or requirements can support a strong ethical culture by ensuring all employees know their role and responsibilities in identifying and reporting potential ethical incidents and other forms of misconduct. Employees are more likely to utilize such internal programs when there is strong awareness and training on how the program operates, including who is involved in reviewing and assessing any incident reports received, what actions were taken because of the report, and what communication they will receive as part of the process. Other information communicated broadly to employees about the internal program should include, but is not limited to, the scope of the program, types of conduct that can be reported, examples of when an employee should report an incident, a description of what information should be included in the report and how an individual is protected (i.e., confidentiality and anti-reprisal protections).

  Some key components to supporting a robust internal whistleblower program include establishing confidence that a whistleblower's identity will be protected, and ensuring any incident reported will be reviewed by the appropriate parties.

These factors can be supported in varying ways, which could include an ethics hotline or mailbox hosted by an external third party and an established process through which all incidents are escalated to designated firm personnel who are not involved in the practice of auditing financial statements, when possible.

The latter would help mitigate actual and perceived conflicts of interest of those investigating and assessing the incident reports. It is also important that designated firm personnel receiving incident reports be well educated on how to respond and what steps to take, including how to protect the whistleblower and guard against potential reprisals. It may also be beneficial to communicate other external whistleblower reporting channels made available by regulators, for example, the OSC Whistleblower Program accepts tips on possible violations of Ontario securities law[2].

> *By making potential whistleblowers aware of multiple reporting channels, including external channels, firms can foster an internal culture of compliance that promotes and welcomes internal reports of potential misconduct.*

Dating of Audit Work Performed

> *To comply with Canadian Auditing Standards, an auditor must obtain sufficient appropriate audit evidence on which to base its audit opinion before issuing an auditor's report.*

All significant audit documentation (or 'working papers') the auditor uses to support its opinion are required to be prepared and 'signed-off' prior to the dating and issuance of the auditor's report. The standards also stipulate the timeframe within which auditors must complete the administrative process of assembling the final audit file, subsequent to the date of the auditor's report.

To minimize the risk that audit professionals could include significant audit documentation after the corresponding auditor's reports are dated, public accounting firms should consider whether they have specific policies and procedures whose objectives focus on ensuring that staff understand how to apply the requirements in professional standards with respect to the dating of audit working papers and assembly of audit files. We observed that the Audit Firms generally relied on the use of electronic software to compile, assemble and evidence 'sign-off' of audit working papers.

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[2] The OSC Whistleblower Program is designed to complement – not compete with – internal reporting channels. The OSC Whistleblower Program and governing statutes, together, provide robust confidentiality and anti-reprisal protections to encourage individuals to report information about securities misconduct.

The use of electronic software, and the expectation that working papers are prepared and assembled in electronic format, in many cases allowed the Audit Firms to institute automated processes of only allowing sign-offs to be currently dated (i.e., audit professionals are prevented from backdating sign-offs).

Although the above policies and automated sign-offs in electronic software are common tools, additional types of procedures could also be employed. The following are key areas that all public accounting firms should consider to strengthen their policies, controls, and mechanisms for monitoring compliance as it relates to the dating of working papers:

- *Continuous evaluation of electronic software controls –* Public accounting firms should obtain a comprehensive understanding of their electronic documentation systems (both internally developed and off the shelf audit software packages) and periodically evaluate the risk of backdating of working paper sign-offs to be confident that any preventative controls in place to support that sign-off cannot be compromised. If issues are identified, additional procedures should be put in place to monitor compliance and prevent the compromised feature from being taken advantage of by audit professionals.

- *Processes and controls to assess 'administrative' documentation added subsequent to the date of the auditor's report –* There should be a limited number of instances when documentation is added subsequent to the date of the auditor's report. To support consistent documentation practices, public accounting firms should implement processes and procedures to emphasize that documentation added subsequent to the date of the auditor's report is limited and is required to be administrative in nature (i.e., it does not constitute evidence which forms part of the basis of supporting the auditor's opinion). In addition to developing policies on what types of documentation would be considered 'administrative', implementing procedures to monitor this area will support compliance with standards and reduce the risk of new evidence being included after the auditor's report that would impact the auditor's opinion.

- *Centralized mechanism for timely archiving of audit files and maintenance of 'final versions' –* Public accounting firms should employ processes and implement controls to monitor the timely archiving of final audit files. Processes and controls should also be in place to prevent archived audit files from being modified without appropriate consultation and approval by one or more designated individuals who were not part of the audit team.

Internal Professional Training Programs

Ongoing professional development and training programs are mandatory for professional accountants to maintain the professional competence necessary to effectively perform their role and to strengthen public trust in the accountancy profession. In Canada, the provincial accounting bodies that grant the Chartered Professional Accountant (CPA) designation also establish the baseline requirements that professional accountants must undertake on an annual basis to maintain their professional designations.

> *Canadian quality control standards for public accounting firms require that firms establish policies and procedures, along with sufficient monitoring to ensure that their assurance staff have the necessary competence and capabilities to perform audits.*

To support compliance with the above requirements, many public accounting firms administer internal training programs for their audit professionals. Many of these training programs include a mandatory testing component, which must be completed independently, for the individual to obtain a credit for completion.

We observed that the Audit Firms primarily used systems-based platforms to deliver, track and record completion of mandatory training, including the testing component. These platforms typically provide the users with an automated reminder prior to training of the importance of independent completion of the course and the concluding assessment. In addition, we found that the Audit Firms primarily relied on their internal whistleblower programs to identify and report violations of the requirement for staff to independently complete training assessments.

Some of the Audit Firms employed additional procedures to support compliance with their policies related to professional training. The following are examples of key areas where public accounting firms should consider employing additional procedures:

- ***Implementation of preventative controls to minimize the risk of assurance staff sharing answers to training module assessments –*** In addition to warning messages at the beginning of training modules, public accounting firms should consider employing other preventative controls to mitigate the risk of sharing of answers to training assessments such as randomizing the questions used in the assessment process (from a larger pool of possible questions), and / or not disclosing the correct answers upon completion of the assessment. If an external provider is used to support internal training, public accounting firms should understand what tools the provider implements to limit the opportunity for answer sharing and assess whether additional procedures should be considered.

- *Implementation of appropriate detection level controls (other than reliance on internal whistleblower program) –* Public accounting firms should consider employing more proactive and direct procedures aimed at detecting instances of unethical behaviour, for example - the use of key terms to periodically conduct an electronic search of system drives and assurance staff emails to identify possible instances of answer sharing.

- *Appropriate communication of violations and consequences –* If instances of answer sharing are identified, it is important that public accounting firms communicate internally and on a timely basis zero tolerance for such unethical behavior and that the firm has investigated and taken corrective action. Communication of this nature promotes strong ethical culture.

Conclusion

All public accounting firms should adopt policies and procedures that encourage and support strong ethical behaviour from their employees. The capital markets place absolute confidence in public accounting firms to perform their gatekeeper role with integrity, which includes the application of strong ethical and independent decision making. If there are actual, or perceived, concerns with ethical behaviour at public accounting firms, this can significantly impact and undermine the confidence the investing public places on the assurance opinions issued by specific firms, and the profession in general.

We strongly encourage public accounting firms to review and apply the areas of focus outlined in this notice in developing appropriate ethical policies and procedures. We also remind public accounting firms the importance of reporting material ethical breaches that could impact the quality of assurance services to appropriate regulatory organizations on a timely basis to ensure protection of the public interest. We will continue to monitor this area and consider the need for further steps if additional or ongoing concerns are identified in the future.

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