

# The Most Prominent Observations of the Supervision on Registered Accounting Firms for the Years 2020 and 2021

- » Auditors Supervision Department
- » Financial Statements and Auditors Division

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# Introduction

In 2018, the Capital Market Authority (CMA) issued its first rules to regulate the auditors of ESAS, namely Rules for Registering Auditors of Entities Subject to the Authority's Supervision (Rules)<sup>(1)</sup>. The purpose of the Rules was to establish the standards and conditions required for the auditors of Entities Subject to the Authority's Supervision (ESAS), including the conditions for registration and the continuing obligations of the registered auditors.

The goal of this report is to provide an overview of the significant audit supervision findings with regard to Registered Accounting Firms (RAFs) that audit ESAS. We expect this report to be of interest to all RAFs, as well as ESAS, audit committees, investors, and other stakeholders interested in enhancing audit quality and the quality of financial reporting. This report incorporates data on the landscape of RAFs and information obtained through the CMA's supervision activities.

This report has been published to support CMA's goal of providing the auditors and other relevant parties with valuable information that is easily accessible. The CMA has expectations that RAFs and other interested parties in auditing the financial statements of ESAS will consider the results presented in this report, as the CMA continues its efforts to enhance the audit quality with the aim of creating a safer and efficient financial market to attract investors.

The report is presented in the following sections:

- I. Executive Summary.**
- II. Overview of the Registered Accounting Firms.**
- III. Inspections:**
  - 1) Firm-Level Inspections;
  - 2) Engagement-Level Inspections.
- IV. Remediation.**
- V. Lessons Learned.**

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(1) On 08-06-2022, CMA board has approved the amendment to the rules for Registration Auditors of ESAS.

## I. Executive Summary

2021 was the third year of the CMA's supervisory efforts over the RAFs. As of 31 December 2021, the total number of registrations included 13 accounting firms and 41 certified public accountants (CPAs)

The CMA inspected (10) RAFs until 2021, covering a sample of audit engagements of financial statements for the financial years ended 31 December 2018, 31 March 2019, 31 December 2019, 31 March 2020, 30 September 2020, 31 December 2020, and 31 March 2021. The CMA inspection focused on audits of financial statements of listed companies and funds.

Until 2021, CMA staff inspected (74) audit engagement files, which included (275)<sup>(1)</sup> Focus Areas.

The CMA staff Identified certain deficiencies in a number of those reviewed files. Also, CMA staff identified common quality control issues across the inspected RAFs. These related to human resources, engagement performance, and monitoring, which they are required elements of a firm's system of quality control<sup>(2)</sup>.

Inspections Program	Until 2021
Firms Inspected	10
Audits Inspected	74
Focus Areas Inspected	257

**Findings from our auditor inspection program do not necessarily indicate that the audited financial statements werematerially misstated:**

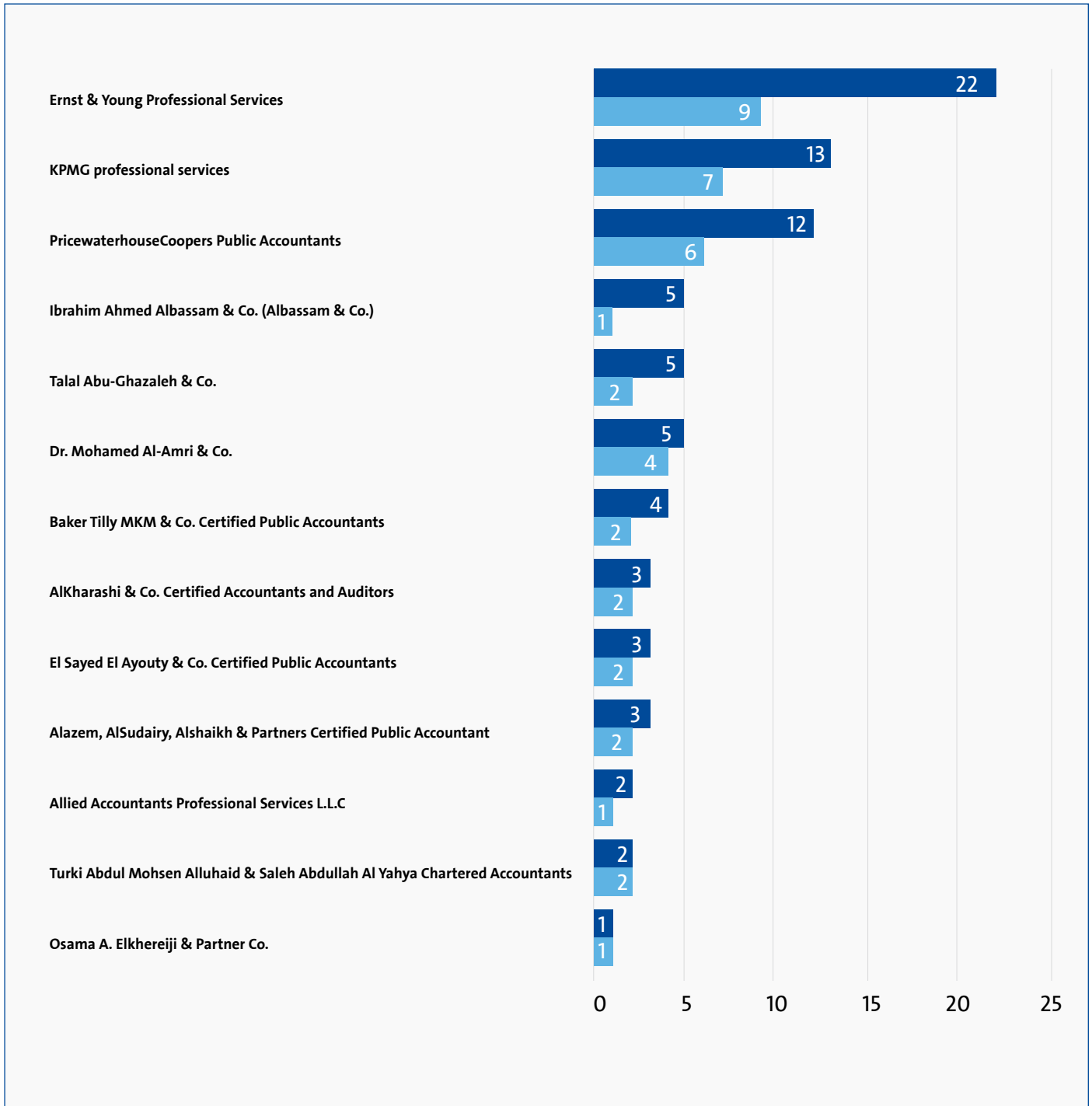
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(1) Focus Areas are the elements in the financial statements and the procedures of audit .

(2) Starting from 15-12-2022 both International Standard on Quality Management 1 (ISQM1) and International Standard on Quality Management 2 (ISQM2) will replace International Standard on Quality Control 1 (ISQC1).

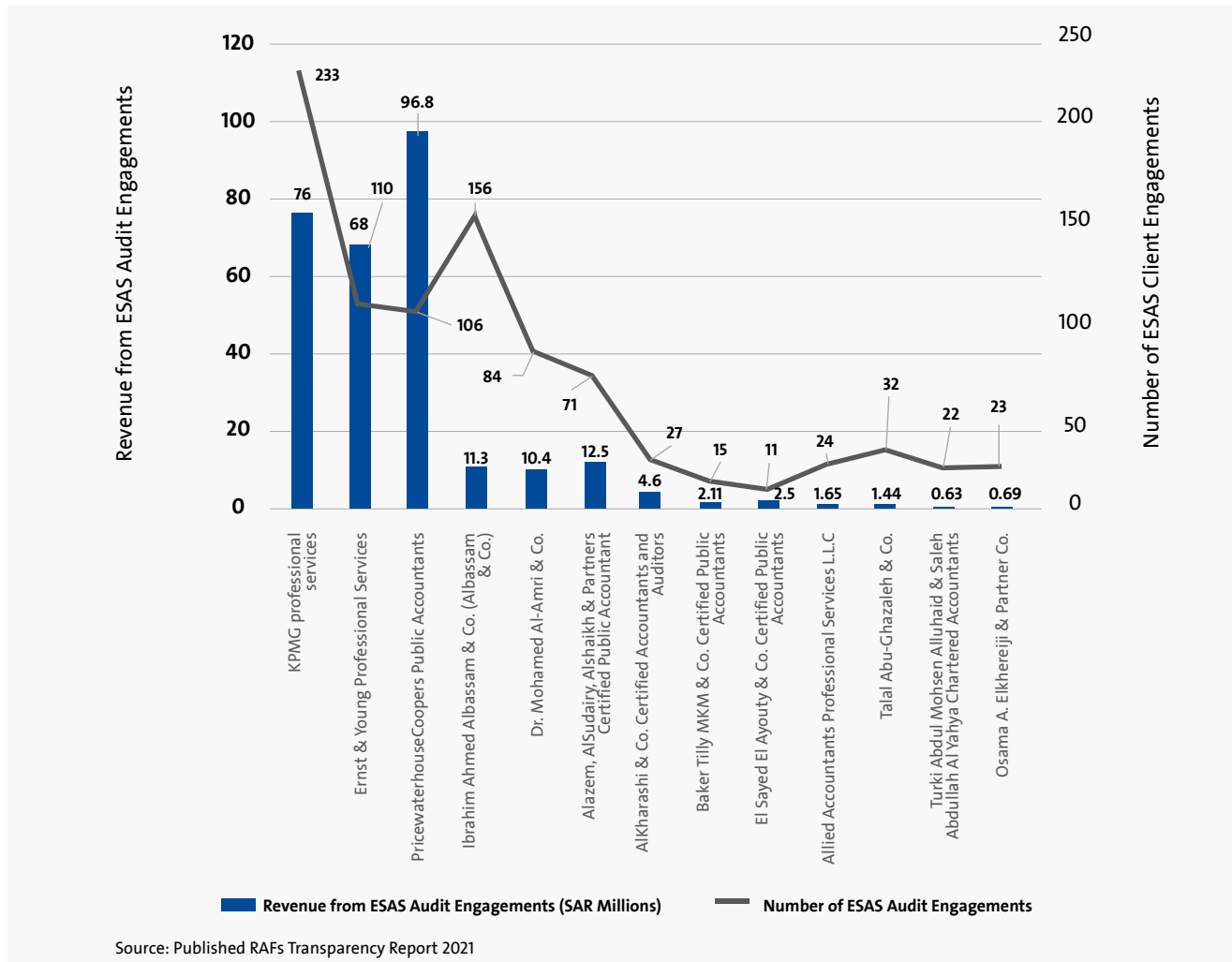
## II. Overview of the Registered Accounting Firms

As of 31 December 2021, the CMA has registered 13 accounting firms and 41 CPAs, who are partners at the 13 registered accounting firms.



■ Number of CPA Partners    ■ Number of Registered Partners

Total revenue of the 13 RAFs as of their last financial year-end was approximately Saudi Riyals (SAR) 3 billion, with approximately 10% of total revenue derived from ESAS audit engagements.



Based on the Rules, all RAFs are required to publish a transparency report annually on their websites containing information on firm legal structure & firm governance, jobs nationalization percentage, latest internal inspection results of the quality control system implemented within RAFs, details of punishment or precautionary measures imposed on the firm, details of litigation or claims, information on continuing professional education (CPE), total number of working hours of audit engagements for the ESAS and the percentage of those executed by the partners, and financial information of the RAFs last financial year. The primary deficiencies identified in these reports included:

- Boilerplate presentation.
- Missing or insufficient disclosures of the description of the RAF's legal structure.
- Missing or insufficient disclosures of the most recent internal inspection results and how such results were remediated by the RAF.
- Missing or insufficient disclosures of the total number of working hours for ESAS audit engagements, including the percentage of those executed by partners.

**The CMA evaluates the transparency reports submitted by RAFs and assess the possible remedial methods to addressing deficiencies in those reports. This is done by requesting the RAF to correct the deficiencies, in addition to imposing appropriate sanctions in accordance with regulations.**

### III. Inspections

The CMA's auditor inspection program (Program) commenced in 2019, with 2021 being the third year of the Program. The objective of the Program is to protect investors through enhancing audit quality. Under the Program, the CMA conducts inspections to assess RAFs' compliance with applicable laws, rules, and professional standards when performing audits of ESAS.

This section summarizes the observations and findings from the CMA inspection program, which is divided into two sub-sections:

#### 1) Firm-Level Inspections

A review of selected areas of the system of quality control applied by a RAF to assess a firm's compliance with the International Standard on Quality Control 1 (ISQC 1)<sup>(1)</sup>. The firm-level inspection includes a review of the effectiveness of the policies and procedures established by the firm over the elements of its system of quality control.

#### 2) Engagement-Level Inspections

A review of a sample of ESAS audit engagements, performed by a RAF to assess whether the firm's audit work complies with the professional standards.

Under the Program, CMA staff review selected RAFs and a sample of ESAS audit engagements performed by these firms. In selecting the firms to inspect and the audit engagements for review, we took into consideration characteristics such as the size of the firm, the nature of the business and size of the ESAS, risk profile and complexity of the audit engagement, ESAS or firm's use of experts, firm's use of foreign affiliates, industry groups, firm office locations, and information about partners of the firm. We generally select some of the more complex, demanding, and challenging audits, and some of the more significant or higher risk areas of the financial statements of the ESAS.

The selected audit engagements are not necessarily representative of the population of the audit engagements of ESAS in the KSA. As part of the CMA's auditor inspection program, CMA staff do not review every aspect of the selected audit engagements.

CMA observations are specific to the portions of the audit engagements reviewed and are not representative of the quality of work performed in the entirety of those specific engagements. The deficiencies we identified do not necessarily indicate that the financial statements of the ESAS are not fairly stated, in all material respects.

As for 2021 being the third year of our inspection procedures and approach, inspection program is evolving.

The CMA inspected 10 of the 13 RAFs until 2021, covering financial statements for the financial years ended 31 December 2018, 31 March 2019, 31 December 2019, 31 March 2020, 30 September 2020, 31 December 2020, and 31 March 2021. These firms, in aggregate, audited approximately 99% of the listed companies by market capitalization in KSA as of 31 December 2020. CMA inspections focused on audits of financial statements of listed companies and funds.

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(1) Starting from 15-12-2022 both International Standard on Quality Management 1 (ISQM1) and International Standard on Quality Management 2 (ISQM2) will replace International Standard on Quality Control 1 (ISQC1).

The CMA inspected (74) audit engagement files including (257) focus areas until 2021. And identified certain deficiencies in a number of those reviewed files. Consequently, in certain cases, the firm could potentially be unable to obtain reasonable assurance that the financial statements as a whole are free of material misstatement.

### **1. Firm-Level Inspections**

ISQC 1 requires accounting firms that perform audits and reviews of financial statements, and other assurance and related services engagements, to have a system of quality control that provides reasonable assurance that:

- (a) the firm and its personnel comply with professional standards and applicable legal and regulatory requirements, and
- (b) reports issued by the firm or engagement partners are appropriate in the circumstances.

Under the requirements of ISQC 1, accounting firms should establish and maintain a system of quality control that includes policies and procedures that address each of the following elements:

- 1) Leadership responsibilities for quality within the firm.
- 2) Relevant ethical requirements.
- 3) Acceptance and continuance of client relationships and specific engagements.
- 4) Human resources.
- 5) Engagement performance.
- 6) Monitoring.

ISA 220, Quality Control for an Audit of Financial Statements, requires firms to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- (a) the audit complies with professional standards and applicable legal and regulatory requirements, and
- (b) the auditor's report issued is appropriate in the circumstances.

The CMA inspection identified deficiencies related to human resources, engagement performance, and monitoring, which they are required elements of a system of quality control. Below are some of the deficiencies identified:

### **1.1 Human Resources**

#### **1.1.1 Performance Management**

Number of the inspected firms did not establish policies and procedures to assign appropriate personnel with the necessary technical knowledge and expertise to perform engagements in accordance with professional standards and applicable legal and regulatory requirements. As a result of that, the firms' systems of quality control appeared to not provide reasonable assurance that the firms have complied with the requirements of the professional standards.

The CMA staff observed that, for the firms' assessments of the engagement executives including the lead engagement partners, the performance ratings did not consistently contain sufficient information necessary to understand the consideration of internal and external inspection findings, including CMA inspection findings, in the performance evaluations and how the overall audit quality rating is considered in the overall performance evaluation for the engagement executives.



## **1.2 Engagement Performance**

### **1.2.1 Engagement Quality Control Reviews**

The CMA staff observed that number of the inspected firms did not establish policies and procedures to require an engagement quality control review<sup>(1)</sup> for all audits of financial statements of listed entities as identified by professional standards such as investment funds.

Also, the CMA staff observed that an engagement quality control review performed in compliance with the standards should have detected and resulted in the firms addressing certain audit deficiencies identified during the respective audit engagement inspections. As a result of that, the firms' systems of quality control appeared to not provide reasonable assurance that the firms have complied with the requirements of the professional standards.

### **1.2.2 Direction, Supervision, and Review**

The nature, timing, and extent of the direction and supervision of engagement team members and review of their work vary based on many factors, including the size and complexity of the ESAS, financial statement area of the audit, assessed risk of material misstatement, and the capabilities and competency of the individual team members performing the audit work.

The CMA staff observed on several audits that supervision and review of audit work papers was not sufficient. The CMA staff observed on several complex audit work papers that there was no documentation by the engagement personnel or evidence of review. And upon inquiry, engagement team members including engagement partners, could not explain how their reviews of the audit work papers were conducted. The deficiencies identified during the inspections suggest that certain engagement team members, including engagement partners, did not perform their reviews as thoroughly as necessary; possess the requisite skills; or devote sufficient time to their reviews.

### **1.2.3 Charging of Hours**

The firms' system of quality control appeared not to provide reasonable assurance that the firms had complied with the requirements in the professional standards, as certain partners, including engagement partners and engagement quality control reviewers, did not document the time charged to the audit engagement. Therefore, the firm's system of quality control did not provide reasonable assurance that these individuals had performed sufficient reviews of the audit documentation to be satisfied that sufficient appropriate evidence had been obtained to support the conclusions reached and for the auditor's report to be issued.

### **1.2.4 Timely Archiving of Workpapers**

Number of the inspected firms did not establish sufficient policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the audit engagement reports had been finalized. As a result of that, the firms' systems of quality control appeared to not provide reasonable assurance that the firms have complied with the requirements of the professional standards.

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(1) Engagement quality control review: A qualified individual evaluates the significant judgments made by the engagement team and the conclusions reached, on or before the date of the engagement report.

### **1.2.5 Communication with Those Charged with Governance**

An effective two-way communication between the auditor and those charged with governance<sup>(1)</sup> is an important component to help ensure an effective ESAS audit. These required communications provide the auditor an avenue to communicate the responsibilities of the auditor in relation to the financial statement audit and those responsibilities of management or those charged with governance; obtain information relevant to the audit from those charged with governance; and to provide timely observations arising from the audit that are significant and relevant to their responsibilities at ESAS; among others.

Number of the inspected firms did not establish policies and procedures designed to provide it with reasonable assurance that communications with those charged with governance procedures are performed. As a result of that, the firms' systems of quality control appeared to not provide reasonable assurance that the firms have complied with the requirements of the professional standards.

The CMA staff observed on several audits that auditors did not communicate their views about the significant qualitative aspects of the accounting practices of the ESAS, including accounting policies, accounting estimates, and financial statement disclosures; planned scope and timing of the audit, including significant risks identified by the auditor; and auditor independence. The number of deficiencies identified during the inspections suggest that the firms' guidance and tools supporting the communications with those charged with governance need to be enhanced to meet the requirements of the professional standards.

### **1.2.6 Testing Journal Entries**

The CMA inspection results indicate deficiencies in firms' systems of quality control related to the testing of journal entries and other adjustments for evidence of possible material misstatement due to fraud. The CMA staff identified multiple audit deficiencies where firms did not sufficiently test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including journal entries and other adjustments made at the end of a reporting period and the need to test journal entries and other adjustments throughout the period. The deficiencies identified during the inspections suggest that certain of these deficiencies may have resulted from the engagement teams' failures to develop an adequate understanding of, and effectively implement, the auditing standards. The deficiencies in this area may have also resulted from an approach to journal entry testing that lacks a critical assessment of risk throughout the execution of journal entry testing procedures.

## **1.3 Monitoring**

### **1.3.1 CMA Information Submissions**

The CMA registration and inspection processes require RAFs to provide periodic information for the CMA to conduct its mandated oversight responsibilities effectively and efficiently. The process for the registration of the firms required multiple reviews by the CMA staff to obtain the required information from certain firms. In addition, the inspections of certain audits identified instances where the firm provided information to the CMA that was not consistent between the periodic information submission and the submissions for the planning and fieldwork phases of the inspections.

A firm's system of quality control should provide it with reasonable assurance that the firm has complied with all regulatory requirements, including establishing policies and procedures to ensure the accuracy and completeness of information included in information submissions to the CMA, including registration, annual

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(1) The term those charged with governance has been defined in ISA260: Communicating with those charged with governance.

data, and inspection submissions. This will be a continuing focus of the Program and an expectation of the CMA of all registered accounting firms.

### **1.3.2 Internal Inspections**

Number of the inspected firms did not establish sufficient policies and procedures to provide it with reasonable assurance that its monitoring processes relating to the system of quality control including a periodic inspection of a selection of completed engagements are relevant, adequate, and operating effectively. As a result of that, the firms' systems of quality control appeared to not provide reasonable assurance that the firms have complied with the requirements of the professional standards.

The CMA staff observed that internal inspection programs are not consistently identifying audit deficiencies during the reviews of certain focus areas of ESAS audits, as the CMA inspections have identified audit deficiencies not identified by internal inspection reviewers, in focus areas that were previously reviewed by firms' internal inspection reviewers.

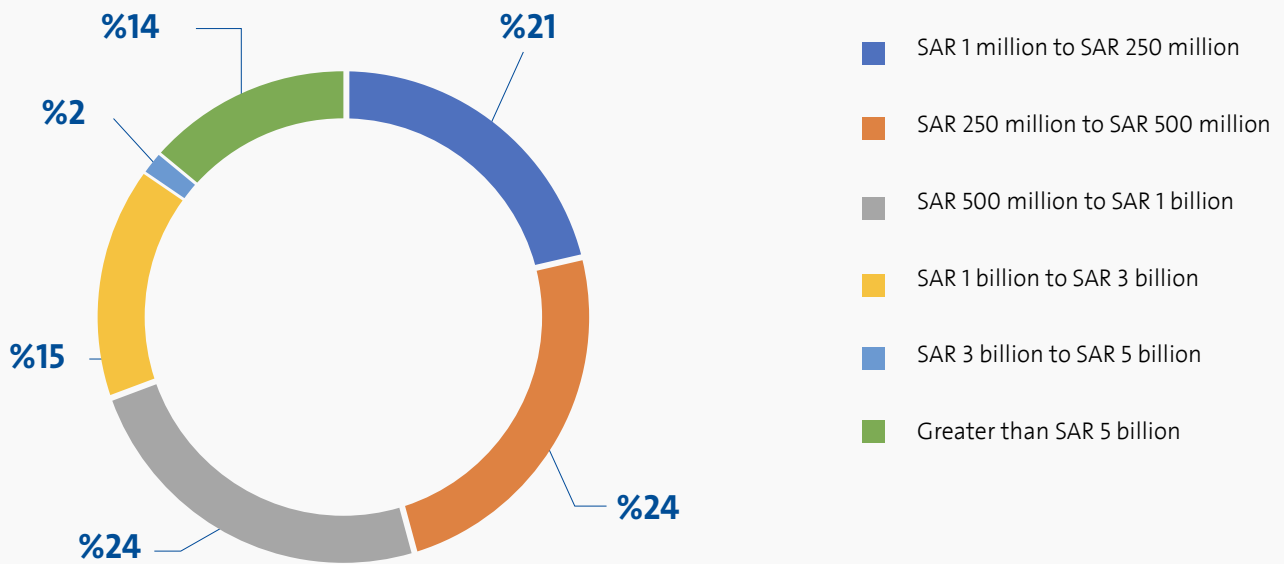
## **2. Engagement-Level Inspections**

### **2.1 Coverage:**

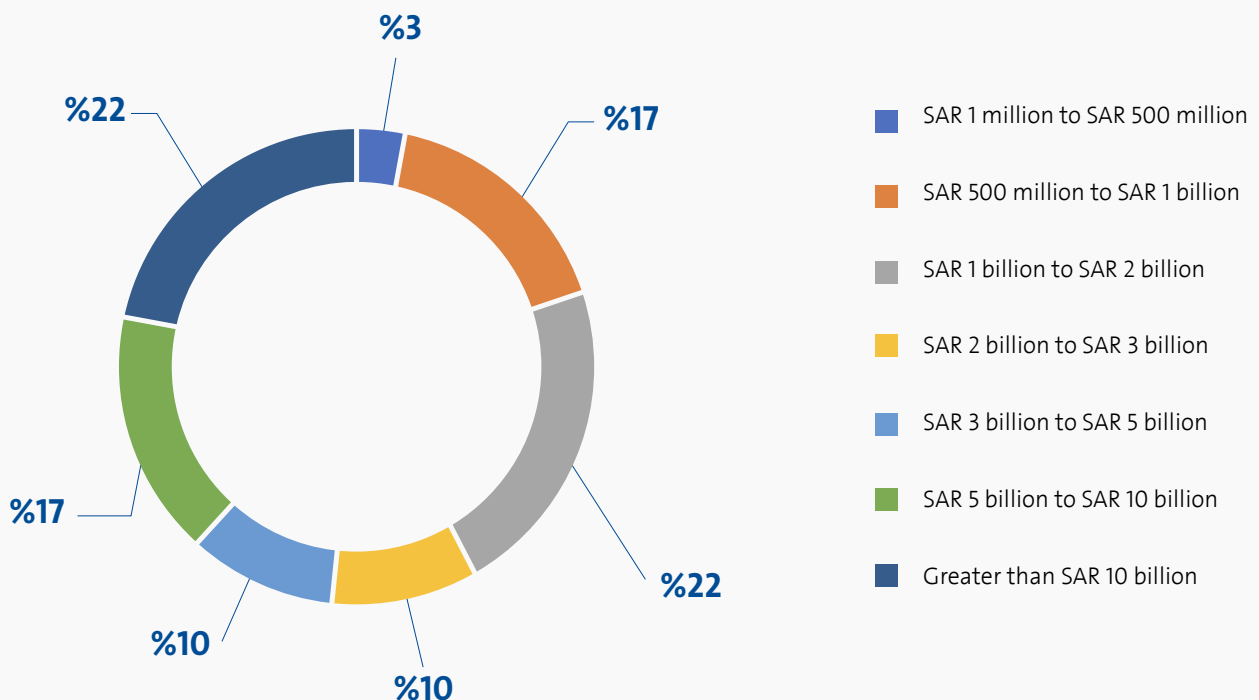
Until 2021 inspection, a total of 74 audit engagements were selected, of which four were joint audits of four listed companies. The 66 ESAS (60 listed companies and 6 Funds). The listed companies selected for inspection had an aggregate market capitalization of SAR 840 billion as of 31 December 2020.

The figures below categorize the ESAS that were selected for inspection using their relative market capitalization, revenues and total assets as of 31 December 2020.

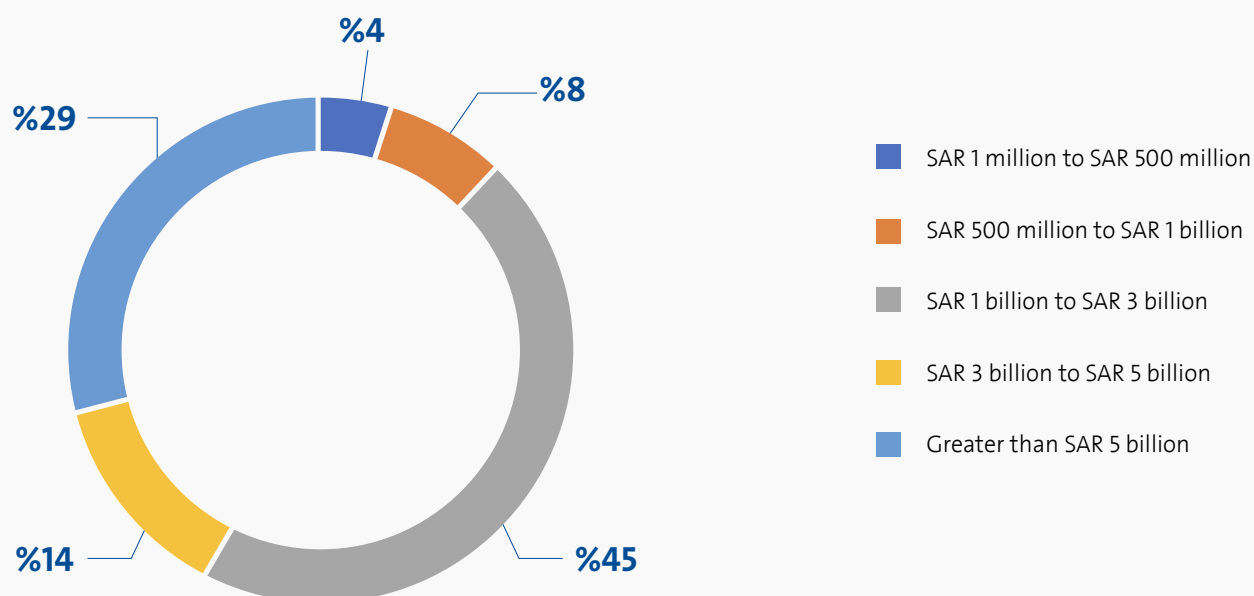
### ESAS Selections by Revenue as for Inspection Programs until 2021



### Listed Company Selections by Market Capitalizations as for Inspection Programs until 2021



## ESAS Selections by Total Assets for Inspection Programs until 2021



### 2.2 Focus Areas with Audit Deficiencies Observed

The CMA inspection focus areas generally cover the more complex, demanding, and challenging areas of an audit, or other areas that presented greater risk based on our evaluation. We identified certain deficiencies in number of those reviewed files.

#### 2.2.1 Testing Internal Controls

The testing of internal controls is critical to an audit as it is used to support a firm's audit strategy and to modify the nature, timing, and extent of its substantive testing in financial statement audits.

The CMA staff identified that number of the inspected firms used audit strategies that relied on obtaining assurance from testing internal controls for many of the focus areas that were selected for inspection. The CMA staff observed that engagement teams did not consistently obtain an understanding of the controls or the activities performed at the ESAS including: identifying the control; the control owners; evaluating the controls activities performed by control owners; how the controls were applied at relevant times during the period under audit; the consistency with which the controls were applied; and by whom and what means the controls were applied.

In addition, the CMA staff identified that engagement teams were addressed the risks of material misstatement identified for certain significant accounts without identifying internal controls which were relevant to that risks.

### **2.2.2 Completeness & Accuracy of IPE**

In order for an auditor to obtain reliable audit evidence, information produced by the entity (IPE) that is used in performing audit procedures over internal controls or substantive procedures needs to be complete and accurate. Obtaining audit evidence about the completeness and accuracy of such information may be performed concurrently with the actual audit procedure applied to the information when obtaining such audit evidence or by testing controls over the preparation and maintenance of such information. The appropriateness of the audit evidence obtained is affected by whether the information is sufficiently precise or detailed for the auditor's purpose.

The CMA staff observed on a number of audits that the engagement team failed to test the completeness and accuracy of IPE used in its audit procedures. The CMA recommends that auditors perform procedures to test whether the schedule, report, or information is complete and accurate prior to performing an audit procedure over internal controls or substantive procedures.

### **2.2.3 Substantive Analytical Procedures**

The CMA staff observed deficiencies in the performance of substantive analytical procedures. These deficiencies included not developing expectations that were based on plausible relationships, not considering the accuracy with which results of such procedures could be predicted, and not testing the accuracy of data used in such procedures.

### **2.2.4 Auditing Accounting Estimates**

The CMA staff observed multiple deficiencies in the performance of substantive procedures over accounting estimates. The deficiencies resulted from the firms' failure to perform or sufficiently perform audit procedures, including procedures related to the following:

- Understanding how the estimates were developed, including the data, methods, and assumptions used.
- Evaluating the reasonableness of certain significant assumptions or testing certain inputs used in the determination of significant estimates.
- Evaluating the competence, capabilities, and objectivity of management's expert and the relevance and reasonableness of the methods and assumptions used by the expert.

In some cases, the firms failed to perform sufficient testing of the controls over the accounting estimates of ESAS and as a result, firms failed to determine a sufficient sample size for tests of details and analytical procedures, as it sample items selected did not Provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

Most of these deficiencies may stem, at least in part, from a lack of professional skepticism when auditing areas involving significant judgement. In some instances, it appeared that the engagement teams merely looked for evidence that supported management's assumptions, as opposed to challenging those assumptions.

Some of the deficiencies may also stem, at least in part, from the failure to develop procedures that are sufficiently responsive to identified significant risks of material misstatement, including fraud risks; the inadequate supervision of firm specialists involved in testing estimates; and/or the ineffective application of the firm's guidance.

Firms should emphasize the importance of the need for its professionals to comply with professional standards when auditing accounting estimates, including standards related to exercising professional skepticism, responding to risks of material misstatement, and supervising firm experts.

### **2.2.5 Review of Joint Auditor's Work**

The CMA staff reviewed documentation supporting joint auditors work on certain audit engagements. For these audits, the RAFs executed an agreement outlining the joint auditor arrangement, which included a division of roles and responsibilities for each auditor and both auditors in the joint auditor arrangement represented that they had taken full responsibility for all areas of the audit through their cross-review of the audit work papers. The CMA staff identified deficiencies at certain audit engagements for areas in which they had primary responsibility, which resulted in the issuance of comment forms to both firms in the joint auditor arrangement. The deficiencies identified during the joint inspections suggest that firms engaged in joint auditor arrangements did not perform their cross-reviews as thoroughly as necessary or devote sufficient time to their reviews of the joint auditor work papers.

### **2.2.6 Compliance with Laws and Regulations**

The CMA staff identified deficiencies related to the firm's failure to perform sufficient audit procedures to test compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. This included instances where the engagement team did not, for audits of funds inspected as the following:

- Obtain a sufficient understanding of how the ESAS, such as the funds was complying with the applicable legal and regulatory framework.
- Obtain sufficient appropriate evidence regarding compliance with the provisions of the applicable laws and regulations.

### **2.2.7 Modifications to the Opinion in the Auditor's Report Independent**

The CMA staff noted instances where firms issued modified opinions, including disclaimers of opinion or qualified opinions, in the auditor's report. In certain audits, the firms' systems of quality control appeared not to provide reasonable assurance that sufficient appropriate audit evidence was obtained to support the firm's modifications to the opinion in the auditor's report. For example, in one audit, the firm's procedures to support the modified opinion were limited to inquiries of the auditor of the subsidiary that had issued a qualified opinion on the subsidiary's audited financial statements and the inspected firm's procedures did not include any evidence of analysis or testing at the consolidated listed company level. In another audit, the firm failed to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty existed related to events or conditions that may cast a significant doubt on the entity's ability to continue as a going concern. And in another audit, the inspected firm failed to provide its technical consultation committee with the relevant facts to enable them to conduct a sufficient review of the audit evidence to ensure the ESAS's auditor's opinion was appropriate in the circumstances.

### **2.2.8 Risk Assessment Procedures**

The auditor performs risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. This process typically includes inquiries of management and others within the ESAS who may have information that is likely to assist in identifying risks of material misstatement due to error or fraud, analytical procedures, and observation and inspection. Many times, this can be best accomplished in part by performing a walkthrough of the significant processes, including relevant internal controls at ESAS.

Throughout the inspections, the inspection staff noted multiple instances where the firms lacked sufficient documentation for their rationale to support the inherent risk, control risk, and significant risk assessments, including fraud risks, for the focus areas inspected. A firm's guidance, as well as the supervision and review of the audit, should emphasize the importance of audit documentation that supports the firm's risk assessment especially where significant risks, including fraud risks, are identified.

#### **2.2.8.1 Adoption of New Accounting Standards**

The inspection staff identified a number of ESAS that adopted IFRS 16 | "Leases" during the periods subject to inspection by the CMA. The CMA staff identified multiple audit deficiencies where the firms failed to sufficiently test the listed company's adoption of the new accounting standards. The deficiencies identified during the inspections suggest that certain engagement team members, including engagement partners, did not possess the requisite skills to assess the ESAS's adoption of the new accounting standards or devote sufficient time to their reviews.

The firms should ensure that its guidance and tools are updated to reflect any changes in new accounting standards, as required, in advance of the rollout of new accounting standards, and that its engagement personnel are appropriately trained.

#### **2.2.9 Reporting of Key Audit Matters**

Key audit matters are those matters that the auditor determines are of most significance in the audit of ESAS's financial statements. The key audit matters are an important component of the auditor's opinion and provide greater transparency about the audit that was performed. The CMA staff observed on a number of audits that firms included specific procedures in the key audit matters section of the audit opinion, which they did not perform as part of the audits.

Firms need to ensure that the specific audit procedures they have included in the key audit matters component of the audit opinion are complete and accurate. The deficiencies identified during the inspections suggest that certain engagement partners, engagement quality control reviewers, or audit directors, did not perform their reviews as thoroughly as necessary or devote sufficient time to their reviews of the auditor's opinion.

#### **2.2.10 Evaluation of Experts**

The CMA staff identified deficiencies in multiple engagements, where neither the experts nor the other members of the engagement team performed sufficient procedures to test certain important data and/or assumptions underlying management estimates that the experts had been involved in reviewing.

It appears that certain engagement team members supervising the engagement may incorrectly assume that their responsibilities with respect to an estimate have been fulfilled once they have involved a firm expert in evaluating that estimate. As a consequence, these professionals may fail to specifically communicate with the individuals assigned to the engagement, including the expert, regarding their responsibilities, including the testing of the data and assumptions underlying management's estimate and/or may fail to identify that the experts have not undertaken to perform certain testing. In addition, this apparent incorrect assumption that the expert alone has assumed responsibility for the estimate may cause some engagement partners or other engagement team members to fail to appropriately follow up on significant issues identified as a result of the expert's work.



The firms should ensure engagement teams are evaluating the methods and assumptions used by the expert, reviewing the expert's conclusions, and challenging the expert's conclusions. Ultimately, the auditor is responsible for the work of the expert.

#### **2.2.11 Evaluation of Information Used in the Audit from External Sources**

During the inspections, the CMA staff identified a number of instances where the engagement team used external sources of information as an audit evidence, including industry data of ESAS. The deficiencies identified during the inspections suggest that certain engagement teams did not understand the requirements for the use of external data in an audit, including testing whether the information obtained from an external source was relevant to ESAS.

The firms should ensure engagement teams are appropriately evaluating the relevance of external sources of information used in the audit of ESAS.

#### **2.2.12 Revenue Recognition in Accordance with IFRS 15**

The CMA staff identified deficiencies related to the firms' failure to perform sufficient procedures to test whether revenue was accounted for in accordance with International Financial Reporting Standard 15 (IFRS 15). The deficiencies resulted from the firms' failure to perform or sufficiently perform audit procedures, including procedures related to the following:

- Understanding management's process to record revenues.
- Testing the design and implementation and operating effectiveness of controls over revenue including controls over information produced by the ESAS that was used in the operation of the control.
- Evaluating whether management appropriately followed the five-step process for revenue recognition, as required by IFRS 15.
- Determining appropriate sample sizes for performing tests of controls and substantive testing procedures.
- Performing substantive analytical procedures including developing expectations that were based on plausible relationships among both financial and non-financial data and considering the accuracy with which the expected results could be predicted.
- Evaluating the principal agent relationship determined by the entity. As a principal, the entity will record the entire amount billed to customers but as an agent, the entity will record only the net amount earned as a revenue.
- Testing the adequacy of the ESAS's financial statement disclosures related to revenue recognition.

#### **2.2.13 Inventories**

The CMA staff identified deficiencies related to the firms' failure to perform sufficient audit procedures to test inventory, including instances where the auditors did not perform sufficient procedures to the following:

- Test the design and implementation and operating effectiveness of controls related to the valuation of inventory.
- Understand management's process to develop the inventory provision and related control activities performed by the control owners.

- Test the existence of inventories. For example, in some cases, locations with material levels of inventory were excluded from the auditor's testing and in other cases auditors performed inadequate procedures for the locations selected for testing.
- Perform sufficient substantive procedures to test whether inventories were carried at the lower of cost or net realizable value.
- Perform sufficient substantive procedures to evaluate the reasonableness of the obsolescence reserve percentages that were applied to certain inventory categories.
- Test the data and evaluate the reasonableness of assumptions used in the preparation of inventory provision estimates for obsolete and slow-moving inventory.

#### **2.2.14 Receivables**

The CMA staff identified deficiencies related to the firms' failure to perform sufficient audit procedures to test receivables, including instances where the auditors did not perform sufficient procedures to the following:

- Test the design and implementation and operating effectiveness of controls related to the existence and valuation of receivables.
- Test the reasonableness of the methods and assumptions used in the determination of the allowance for expected credit losses for the receivables.
- Test the completeness and accuracy of information produced by the entity, used in the determination of the allowance for expected credit losses.
- Extend the results of the interim testing procedures to the year end.
- Ensure that all receivables were considered in the assessment of expected credit losses.

#### **2.2.15 Property, Plant, and Equipment**

The CMA staff identified deficiencies related to the firms' failure to perform sufficient substantive audit procedures to test the valuation of property, plant, and equipment, including instances where the auditors did not sufficiently as the following:

- Test the reasonableness of the estimated useful lives of buildings and resulting depreciation factors.
- Evaluate and challenge the discounted cash flow projections used to estimate the recoverable amount of assets as they did not sufficiently test the accuracy and completeness of the data and reasonableness of the assumptions used in the cash flow projections.
- Evaluate the competence and objectivity of management's expert and the relevance and reasonableness of the methods and assumptions used by the expert in estimating the fair value of the asset.
- Evaluate and challenge the ESAS's determination that an impairment analysis was not warranted for certain assets.

#### **2.2.16 Cash and Cash Equivalents**

The CMA staff identified deficiencies related to the firm's failure to perform sufficient substantive audit procedures to test the existence and completeness of cash and cash equivalents, including instances where the auditors did not sufficiently evaluate the confirmations received from the bank.

## IV. Remediation

Remediation is a critical element of the CMA auditor inspection program and ensures that RAFs analyze inspection deficiencies and apply corrective measures to prevent recurrence of these deficiencies.

With respect to inspection deficiencies identified by the CMA inspections staff, firms should undertake a comprehensive analysis to identify the underlying root causes of the findings. A remediation plan or action plan should be developed in response to each deficiency to address the root causes identified and firms should continuously monitor the remedial actions taken to assess their effectiveness.

Firms should develop a formal root cause analysis process that is part of their system of quality control. The CMA reviews the firms' root cause analyses and remediation plans as part of its annual inspection program, including inspecting a sample of the remedial actions from prior inspection deficiencies and the firm's monitoring of the remedial actions.

As part of the firms' remediation process, firms should take appropriate actions and to the extent that these actions identify facts that would have affected a firm's previously expressed opinion, the CMA reminds the firms to take the appropriate actions to prevent unwarranted reliance on those opinions. In addition, the CMA suggests that firms consider the results of its inspection findings on other firm audits that were not subject to the CMA inspection. Firms should develop similar processes to address inspection deficiencies from their internal quality reviews of audit files.

The CMA has established a process for evaluating the sufficiency of responses from RAFs with respect to remediation of inspection deficiencies identified as part of inspections of audits of ESAS and deficiencies in firms' systems of quality control.

As a firm's remediation is an iterative process, the CMA conducts ongoing communications with a registered accounting firm until an assessment of the firm's remedial actions can be completed. And the remediation process may require periodic updates from firms to communicate their progress regarding the proposed remediation plans as firms should be continuously monitoring the remedial actions taken to assess their effectiveness. A firm's monitoring program is a key component of a firm's system of quality control and its monitoring of its remedial actions will be part of the CMA's assessment of that component.

## V. Lessons Learned

The ESAS's financial information and statements are the key for promoting confidence in the capital market, as it is the method used by these ESAS to communicate the financial information to the users, so their decisions can be taken in a timely manner. The auditors conduct an audit of ESAS's financial statements to enhance the degree of confidence of intended users in those financial statements. Therefore, it is important to activate the role related to the preparation of financial statements and to conduct high-quality audits by all parties participating in this role, as follows:

### **1. Role of The Management of the ESAS**

The responsibility for the preparation and fair presentation of the financial statements and related disclosures as required by IFRS endorsed in the Kingdom of Saudi Arabia to be included therein by the laws and regulations to which the ESAS is subject, rests with management. This responsibility includes designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free of material misstatement, whether due to error or fraud. It is critical for the management of an ESAS to have sufficient, competent staff with the right skills to ensure that the financial statements are in compliance with current accounting standards and financial reporting requirements.

One of the drivers to improving audit quality is in management's hands and involves modernizing the internal controls within its organization through the implementation of leading practices, innovation, and technology to increase the level of precision of the performance of the internal controls. It is critical for management to have documentation of their financial reporting processes which includes evidence related to the process flows and related risks and internal controls. Ultimately, these actions may serve to reduce the cost of compliance and increase the reliability of financial reporting.

### **2. Role of The Board of Directors**

Companies Law, as well as the Corporate Governance Regulations, include provisions that expressly state that the Board of Directors shall be responsible for preparing the financial statements. Moreover, the Board shall hire the competent persons to manage the company and competent persons who have the necessary accounting and financial knowledge to run the finance affairs.

### **3. Role of The Audit Committees and Others Charged with Governance**

The responsibility for performing quality audits of financial statements rests with auditors. However, support from and appropriate interactions amongst participants in the financial reporting eco-system are critical to achieve the goal of enhanced audit quality. Audit Committees are essential in the governance of ESAS and also set the tone for the relationship of the ESAS with its external auditors.

Our inspection results can assist Audit Committees in carrying out their oversight role. Although this report is not for a specific firm, we encourage Audit Committees to gather information on how its auditors performed on specific audits and in high-risk areas across audits.

**Potential questions Audit Committees might consider inquiring of their auditors include:**

- Was the ESAS's auditor firm selected for inspection by the CMA?
- Was the ESAS's audit selected for inspection by the CMA?
- What focus areas did the CMA review in the ESAS's audit?
- Did the CMA identify any deficiencies in the audit of the ESAS?
- Did the CMA identify deficiencies in other audits that involved auditing or accounting issues similar to those in the ESAS's audit?
- Did the CMA identify issues in the firm's system of quality control?
- What were the firm's responses to the deficiencies identified by the CMA?
- What is the firm's process to evaluate the issues identified, develop action plans, take remedial measures, and monitor audit quality so that such issues do not recur in the future?
- Can the Audit Committees obtain a copy of the firm's transparency report?

#### **4. Role of The Auditors and Audit Firms**

Auditors and audit firms are a key element of the financial reporting eco-system, and the quality of their work is pertinent to the success of the capital market. The purpose of an audit is to enhance the degree of confidence of intended users of financial statements. This is achieved by auditors gathering sufficient appropriate audit evidence in order to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

The International Auditing and Assurance Standards Board (IAASB) has developed a Framework for Audit Quality. According to this framework, the term Audit Quality encompasses the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis. A quality audit is likely to have been achieved by a firm that:

- Exhibited appropriate values, ethics, and attitudes;
- Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work;
- Applied a rigorous audit process and quality control procedures that complied with the law, regulation, and applicable standards;
- Provided useful and timely reports; and
- Interacted appropriately with relevant stakeholders.

A firm's system of quality control enables engagement teams to consistently obtain sufficient and appropriate audit evidence for each and every audit engagement of the firm.

Strong quality control systems at both the firm and engagement level are critical to enhancing audit quality. A good quality control system facilitates risk management, emphasizes strong governance and accountability, and deploys highly trained professionals with skills relevant to the client's industry and areas of expertise.

# Appendix

## Acronyms

CMA/Authority	Capital Market Authority of Saudi Arabia
ESAS	Entities Subject to the Authority's Supervision, are: <ol style="list-style-type: none"><li>1. Saudi Stock Exchange</li><li>2. Depository center</li><li>3. Clearing center</li><li>4. Capital Market Institutions, except ones licensed with Arranging and/or Advisin</li><li>5. Investment Funds</li><li>6. Listed companies</li><li>7. Special Purposes Entities</li></ol>
RAFs	Registered Accounting Firms auditing ESAS
The Rules	Rules for Registering Auditors of Entities Subject to the Authority's Supervision
Program	CMA's program for inspecting RAFs
CPA	Certified Public Accountant
CPE	Continuing Professional Education
IPE	Information Produced by the Entity
IAASB	The International Auditing and Assurance Standards Board
ISA	International Standards on Auditing
KSA	Kingdom of Saudi Arabia

