

Audit Committee Guide to Audit Quality Indicators



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Preface

Audit quality indicators (AQIs) have been gaining traction among audit committees and management as a way to measure various aspects of the external audit quantitatively. However, there has been limited information available to help these groups identify and evaluate appropriate AQIs.

The Chartered Professional Accountants of Canada (CPA Canada), the Canadian Public Accountability Board (CPAB), the Institute of Corporate Directors (ICD) and a specially formed advisory committee jointly developed the non-authoritative guidance presented in this document to provide much needed direction in this matter.

This *Guide* provides a useful step-by-step process to help audit committees and management identify relevant AQIs and establishes a general understanding of how they can be used to spark a discussion both internally and with the external auditor (auditor) about improving audit quality.

For a more practical application of AQIs, we recommend using this *Guide* in conjunction with our updated Enhancing Audit Quality (EAQ) publications:

1. [*Oversight of the External Auditor – Guidance for Audit Committees*](#)
2. [*Annual Assessment of the External Auditor – Tool for Audit Committees*](#)
3. [*Periodic Comprehensive Review of the External Auditor – Tool for Audit Committees*](#)

Additionally, to help new audit committee members feel confident in understanding the various aspects of the external audit, we have also developed a series of short training videos as follows:

- [*What External Auditors Do: A Primer*](#)
- [*What External Auditors Do: The Process*](#)
- [*What External Auditors Do: Process Continued*](#)

By better understanding the auditor's role, audit committee members may find it easier to select and evaluate AQIs.

CPA Canada, CPAB and the ICD acknowledge and thank each member of our Audit Quality Indicators Advisory Group for their invaluable advice and support throughout this project.

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Introduction

Audit quality is challenging for audit committees to measure and evaluate. Where the auditor spends time and effort and the extent of co-ordination among the auditor, management and others often cannot be easily observed by the audit committee. Audit Quality Indicators (AQIs) are a response to this problem because they provide quantitative measures of particular aspects of the external audit (the audit). **AQIs are a useful tool that, with proper context and discussion among all stakeholders, can provide insights and facilitate collaboration among auditors, management and the audit committee and provide more in-depth information to assist in evaluating and achieving sustained audit quality.**

This *Guide* provides information on how to implement AQIs at your organization. While the primary audience of this *Guide* is audit committees, the effective implementation of AQIs requires significant collaboration with management and the auditor. This *Guide* can assist all stakeholders in this process.

Potential Benefits of Using AQIs

- improves efficiency and effectiveness of interactions between management, the audit committee and the auditor
- provides an opportunity to clarify expectations and responsibilities related to audit quality
- helps improve the knowledge of, and engagement in the audit process by all members of the audit committee
- improves coordination and collaboration in the execution of the audit
- provides the audit committee with quantitative and qualitative information for the purposes of auditor evaluation

How to Use This Guide

This *Guide* is intended to provide a high-level, five-step process that can be adapted by interested organizations to help implement AQIs while also providing practical tips and considerations at each step.

For a more detailed and pragmatic approach specific to assessing the external auditor by using AQIs, we encourage readers to review our

three updated companion documents on Enhancing Audit Quality (EAQ):

1. [*Oversight of the External Auditor – Guidance for Audit Committees*](#)
2. [*Annual Assessment of the External Auditor – Tool for Audit Committees*](#)
3. [*Periodic Comprehensive Review of the External Auditor – Tool for Audit Committees*](#)

Background: How does an audit work?

New audit committee members or those who want a refresher can [click to watch a series of three videos](#) which describe the basic roles and responsibilities of an external auditor. By better understanding the auditor's role, audit committee members may find it easier to select and evaluate AQIs.

Step	Details
STEP 1: Get to know AQIs.	See <u>Section 1: Background on AQIs</u> , which also introduces elements of a quality audit.
STEP 2: Define your objectives and select AQIs.*	See <u>Section 2: Determining objectives and selecting AQIs</u> .
STEP 3: Determine how and when the AQIs should be reported.*	See <u>Section 3: Reporting of AQIs</u> for guidance on effective reporting mechanisms and frequency.
STEP 4: Monitor and evaluate AQI results.	See <u>Section 4: Evaluating AQIs</u> .
STEP 5: Debrief the AQI process and consider changes for the next audit cycle.*	Tailor and adjust AQIs as needed, including changes to selected AQIs where necessary.

*These activities should be done as a stakeholder group with representatives from the audit committee, management and the audit firm.

For a list of additional resources, please see the [Appendix](#).

SECTION 1

Background on AQIs

Audit quality can be challenging to define, measure, and quantify. This has made it difficult for audit committees, investors and others to evaluate how well the audit was performed and where areas of improvement might be found. In response, there has been increased international discussion of AQIs to help alleviate this issue.

Although there have always been some quantitative metrics and communications about audit quality (e.g., audit plans frequently include the engagement team's amount of industry experience), there is still a need for greater insight and a more structured approach to audit quality. This *Guide* encourages the use of AQIs to augment communication about audit quality among the key stakeholders: audit committee, management, and external auditors.

A project run by the Canadian Public Accountability Board (CPAB) with the input of key stakeholders identified the following benefits and challenges of using AQIs.

Potential benefits of using AQIs:

- provides management, the external auditor and the audit committee with a clear understanding of their responsibility in facilitating a quality audit by being open about expectations
- facilitates more efficient and effective interactions between the audit committee and the auditor because discussions focus on the most important areas of the audit

What Are AQIs?

Audit quality indicators are quantitative measures of particular aspects of the audit. The objective is to provide more in-depth information about factors that influence audit quality.

- creates an improvement in the knowledge of, and engagement in, the audit process and audit quality by all members of the audit committee as a result of increased information on the most important areas of the audit
- improves project management over the audit, including co-ordination and collaboration in the execution of the audit
- provides better information for the purposes of auditor evaluation

These points highlight the fact that AQIs and the resulting discussions help inform audit committee members, management and the auditor about expectations and allow for greater co-ordination and co-operation in the execution of an audit. This can lead to better oversight and higher audit quality.

Challenges:

- determining relevant AQI measures and understanding the relationship between multiple AQIs
- evaluating AQIs, such as identifying evaluation criteria and understanding any discrepancies
- identifying changes required in audit firm systems and processes needed to facilitate reporting

In using AQIs, it is important to remember that AQIs are not the only means through which audit quality is managed or evaluated. The effective use of AQIs (including selecting, evaluating and interpreting AQIs) is a skill the key stakeholders will build over time.

AQIs have the potential to influence audit quality positively. However, since there is no “one size fits all” approach, organizations must develop their own rationale for selecting and evaluating AQIs. They can then be used to facilitate a more informed and meaningful conversations about audit quality among the audit committee, management and audit firm.

What Is Audit Quality?

In 2014 the International Auditing and Assurance Standards Board (IAASB) published A Framework for Audit Quality. This framework indicates that a quality audit is likely to have been achieved by an engagement team 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 law, regulation and applicable standards
- provided useful and timely reports
- interacted appropriately with relevant stakeholders

See [Table 3](#) for a consideration of AQIs that may assist in consideration of these characteristics.

SECTION 2

Determining Objectives and Selecting AQIs

“Take the time to do it right. Carve out time to discuss what audit quality is; the quality of conversation is important.”

— Audit partner

The AQI process begins with an open conversation among management, the audit firm and the audit committee about their respective roles and expectations. The group can then determine the objectives that will drive the selection of specific AQIs. In determining objectives, it is important to remember that AQIs are only one tool in helping the audit committee meet their chosen objective. Other sources of information will provide additional context and information.

Examples of common objectives of AQIs are shown in [Table 1](#) below. This list is not exhaustive; it is anticipated that objectives and the AQI population will evolve as the use of AQIs becomes common practice. Audit committees are encouraged to consider all objectives since in some cases the use of a particular AQI could support more than one objective.

TABLE 1: EXAMPLES OF COMMON OBJECTIVES FOR THE USE OF AQIS

Objective	Comment
General oversight of the audit, including project management	AQIs can improve co-ordination and collaboration throughout the audit process. In addition to assisting with setting expectations, AQIs provide a mechanism through which aspects of project management (e.g., tasks outstanding and amount of work completed) are monitored.
Transparency of the audit approach, including the monitoring of risks	AQIs can ensure that discussions among management, the audit committee and auditor are more focused on areas where more time is spent in the audit, and that the audit committee has a stronger understanding of the audit approach. In this way, audit committees can see whether the areas they expected to have a greater emphasis in the audit are consistent with the auditor's planned approach. This can be done, for example, by integrating AQIs into the audit plan.
External auditor evaluation in terms of both audit quality and client service	AQIs can be a valuable tool in the evaluation of the external auditor. CPA Canada in conjunction with the ICD and CPAB has updated the Annual Assessment and Periodic Comprehensive Review Tools to provide audit committees with additional examples on how this can be done.

Selecting AQIs

“Keep it light—it’s the only way to avoid it being a compliance exercise. Be thoughtful, meaningful and focused.”

—Chief Financial Officer

“There are no ‘silver bullet’ AQIs”

—Audit committee chair

There is no short list of the best AQIs. Instead, audit committees need to select AQIs that meet their needs and objectives as determined above.

In selecting AQIs, there is a number of global resources that can be consulted. These resources are listed in the [Appendix](#) of this *Guide*. To simplify the process, [Table 2](#) below lists some common AQIs which can serve as a starting point for consideration. [Table 3](#) considers AQIs that can be linked to the characteristics of a quality audit as outlined in the IAASB’s *Framework for Audit Quality*.

While these AQIs are most common, they are not the only AQIs available. Experience in Canada has shown that audit committees are best served when they customize AQIs to their specific circumstances and information needs.

In determining which AQIs to select, elements to consider include:

- unique nature of your business
- your specific areas of significant audit risk
- areas of the audit over which you would like more transparency/information
- factors most meaningful to you when evaluating your external auditor
- themes noted in the reports of provincial CPA practice reviews and/or external audit regulators including CPAB and the PCAOB
- AQIs your external auditor and/or management are already tracking or considering for their own internal management purposes
- ability of your external auditor and/or management to provide you with the information and have a meaningful discussion on the context surrounding the information
- information already provided by your audit firm in other reports (e.g., as contractually required or requested for other purposes)
- output arising from an [annual](#) or [comprehensive](#) auditor evaluation

It is important to note that AQIs initially selected will evolve over time as stakeholders refine their processes and identify which AQIs provide the most meaningful insights to them on audit quality.

Tips for First Time AQI Users:

- Keep the process manageable for all parties by being pragmatic and not overly ambitious.
- Start small; select between five and 10 indicators.
- Leverage information that has already been provided in the past, or that you know the auditor or management can readily provide.

Spotlight On: Management Indicators

Management plays an important role in audit quality and is a key participant in the audit process. In addition to being responsible for the preparation of the financial statements, management's relationship, co-operation and openness with the external auditor can be a significant driver of audit quality.

In Canada, a number of audit committees have developed AQIs to measure aspects of management's role in audit quality. The inclusion of these indicators provides a broader perspective to the audit committee on the contribution of management to the successful execution of a high-quality audit.

Audit committees are encouraged to continue to explore the use of measures that help improve the dialogue between management and the auditor, and enhance management's contribution to audit quality.

The chart below lists some common AQIs that have been put into practical use by audit committees in Canada. For additional resources and lists of AQIs, please see the [Appendix](#).

TABLE 2: COMMON AQIs

Type	Indicator	Example Definitions
Engagement Team Indicators	experience of engagement team	delivery of agreed upon team skills (industry/specialty/client knowledge) years of audit experience of key members of the engagement team
	training and professional development	number of hours and type of professional development and technical training attended by key engagement team members
	turnover of engagement team	turnover rates of key engagement team members and/or level
	partner/manager involvement	percentage of audit hours carried out by senior engagement team members compared to the entire engagement team
	partner workload	information about the level of work for which key engagement partners are responsible and the number of claims (including clients and internal responsibilities) receiving their attention

Type	Indicator	Example Definitions
Audit Execution Indicators	audit hours by risk	time spent by the engagement team on significant risk areas
	timing of audit execution	audit hours by phase (e.g., planning, interim, year end)
	audit progress milestones	timeline for the completion of the audit as mapped to key milestones within the process.
	technology in the audit	use of technology initiatives in the audit, including information about areas of use, types of tool, number of hours, etc.
	specialist engagement	where and how many (measured in hours) persons with “specialized skill and knowledge” are used in the audit
	service delivery centres	amount of audit work centralized at service centres
Management Indicators	management deliverables	achievement of timing of agreed-upon deliverables from management to the auditor
	remediation of control deficiencies	efficiency of remediation of control deficiencies
	reliance on controls	planned/unplanned reliance on internal controls
Firm Level Indicators	results of inspections	results of internal and/or external inspections specific to the engagement and/or to the audit firm generally
	independence	results of independence findings specific to the engagement and/or to the audit firm generally
	reputation	reputation based on news reports
	tone at the top	tone at the top determined by audit firm survey results
Client Service Indicators	communication with audit committee	effective and timely communications between the auditor and the audit committee and/or management related specifically to the audit and/or wider issues of importance (e.g., regulatory and accounting changes)
	sharing of Insights	number and quality of insights gained and shared with management and the audit committee

The chart below considers AQIs that could be used in evaluating the characteristics of a quality audit as outlined in the IAASB's *Framework for Audit Quality*.

TABLE 3: APPLICATION OF IAASB *FRAMEWORK FOR AUDIT QUALITY*

Characteristic	AQIs to Consider
Exhibited appropriate values, ethics and attitudes	<ul style="list-style-type: none"> • results of audit firm people surveys related to the ethical culture of the audit firm • reputation of the audit firm based on news reports
Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work	<ul style="list-style-type: none"> • years of experience of key members of the engagement team • percentage of hours worked by senior engagement team members compared to the entire engagement team • partner workload
Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards	<ul style="list-style-type: none"> • information about involvement in the audit of quality control reviewers and/or professional practice members • results of internal and/or external inspections specific to the engagement and/or to the audit firm generally • frequency of violations to independence requirements, engagement-specific and firm-wide measures
Provided useful and timely reports	<ul style="list-style-type: none"> • evaluation of timeliness of meeting audit progress milestones • evaluation by audit committee and management of the quality and timeliness of audit planning and summary reports and other communications by the auditor • effective and timely communications between the auditor and the audit committee and/or management related specifically to the audit and/or wider issues of importance (e.g., regulatory and accounting changes)
Interacted appropriately with relevant stakeholders	<ul style="list-style-type: none"> • results of survey of audit committee members and key members of management evaluating the quality and timeliness of their interactions with the auditor

Illustrative Examples of Selecting AQIs

Two illustrative examples of practical approaches to selecting AQIs are noted below.

Illustrative Example 1: Selecting AQIs based on desired areas of improvement

Some audit committees may find it helpful to consider how the use of AQIs can improve the efficiency and effectiveness of the audit process as that use relates to the objectives listed in [Table 1](#). Using this approach, audit committees would first develop a list of areas where they would like to see improvement and then select the relevant AQIs from [Table 2](#) (or develop/identify others).

Company ABC is working to implement AQIs. Utilizing [Table 1](#), the audit committee, management and the auditor have determined together that they are interested in using AQIs to improve the audit committee's oversight of the audit. As a group, the following areas of improvement were identified:

1. Engagement team knowledge of the business
2. Management's contribution to audit quality
3. Partner availability

Utilizing the list of AQIs provided in [Table 2](#), the audit committee, management and the auditor have determined that the following AQIs can provide greater insight and drive better accountability in each of the identified areas:

Area of Improvement	Type of AQI	Possible AQIs
1. Engagement team knowledge of the business	<ul style="list-style-type: none"> • engagement team indicators • audit execution indicators 	<ul style="list-style-type: none"> • experience of engagement team • turnover of engagement team • training and professional development • specialist engagement
2. Management's contribution to audit quality	<ul style="list-style-type: none"> • management indicators • audit execution indicators 	<ul style="list-style-type: none"> • management deliverables • timing of audit execution
3. Partner availability	<ul style="list-style-type: none"> • engagement team indicators 	<ul style="list-style-type: none"> • partner workload • partner/manager involvement

Illustrative Example 2: Customizing AQIs to specific circumstances

Company DEF frequently makes acquisitions and has a significant balance of goodwill and intangible assets on its balance sheet. In using AQIs, the audit committee of Company DEF would like to have more oversight of the audit of the accounting for its acquisitions and the evaluation of goodwill and intangible assets for impairment. The audit committee would also like management and the auditor to complete this work on a more timely basis to avoid last minute discussion of important issues.

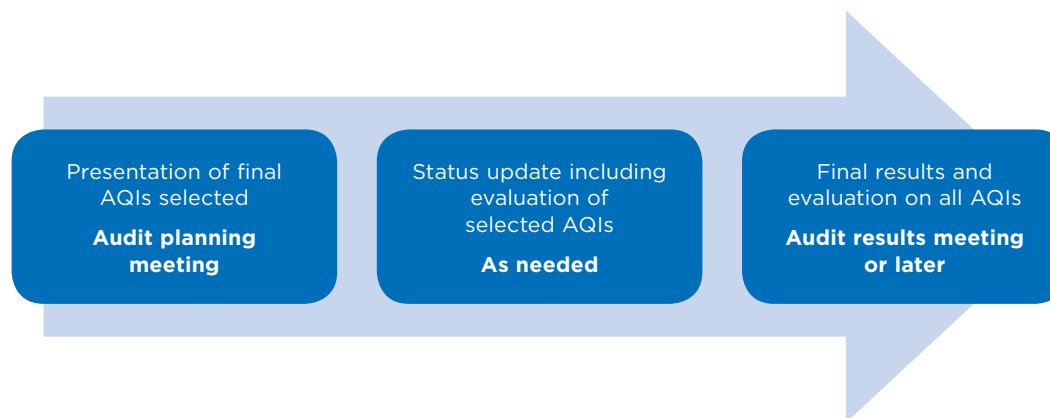
In considering these areas of focus the audit committee, management and the auditor of Company DEF select the following AQIs:

Area of Focus	Possible AQIs
Acquisitions	<ul style="list-style-type: none"> • achievement of management timelines for completing purchase price allocation • achievement of auditor timelines for auditing purchase price allocation (throughout the year) • targeted number of valuation specialist hours on the audit of acquisitions
Impairment analysis of intangible assets	<ul style="list-style-type: none"> • achievement of management timelines for preparing impairment analysis for review by auditors • achievement of milestones for audit of impairment analysis • targeted number of specialist hours in the audit of the impairment analysis • targeted # of hours in audit of this area

SECTION 3

Reporting of AQIs

AQI reporting mechanisms and frequency will vary based on the specific needs and rhythms of an audit committee. Experience from Canadian audit committees suggests that regular communication on AQIs during the audit cycle is more effective than annual reporting. An example of such a reporting cycle is as follows:



After the initial presentation, reporting on AQIs will vary based on the needs of the audit committee and on the specific AQI. Certain AQIs are detective in nature and lend themselves to more frequent reporting (e.g., timing of audit execution) while others only need to be reported annually (e.g., inspection results). Frequency of reporting can vary among quarterly, semi-annually, annually, or a combination of all three. Audit committees should determine reporting expectations after the selection of specific AQIs.

Some audit committees are provided AQI information through a separate report while other audit committees have been integrating AQIs directly into their audit plan or other reports (e.g., auditor evaluation templates). Audit committees are encouraged to consider which reporting format works best for them.

SECTION 4

Evaluating AQIs

“If I could give one tip to help others select their AQIs, I would say ‘Think about how you will measure each AQI at the outset.’”

—Chief Financial Officer

The evaluation of AQIs is one of the most significant challenges in using AQIs. This is especially true for first-time AQI users. Determining how AQIs will be evaluated is a critical component of early conversations because it helps to determine expectations. Once the AQI data has been collected, it is vital that they be discussed with the audit committee to provide sufficient background and context for the results.

[Table 4](#) below outlines common methods of evaluation. In each instance, information is provided by management and/or the audit firm to the audit committee for review. In some circumstances, the audit committee may be responsible for collecting the information required for evaluation (e.g., if the audit committee is conducting a survey of other audit committee members' views). Different methods of evaluation should be selected for each AQI, depending on the nature of the AQI.

Context Is Vital to Understanding AQIs

Regardless of the evaluation method, it is essential that qualitative information be provided to the audit committee for context. Because there is typically no “right” answer for AQIs, the primary benefit arises from the discussion of the circumstances which resulted in the AQI. For example, an increase in the number of hours a partner spends on an audit engagement could mean improved audit quality (due to the increased involvement of an experienced auditor) or decreased audit quality (incompetence of lower level staff required increased partner time to deal with numerous issues). Qualitative information provides important contextual facts to the audit committee and enables them to determine whether the results are positive or negative indicators of audit quality or whether additional attention is needed in a certain area.

TABLE 4: POSSIBLE METHODS OF EVALUATION OF AQIs

Possible Methods of Evaluation	Description
Comparison to budget or target	This requires audit firms and management to share their expected outcomes or to develop aspirational or objective targets. The audit committee evaluates the AQI by comparing actual results to the budget/target and obtaining an explanation for significant differences.
Trending analysis	This method involves collecting AQI data over several years and reviewing data points for trends (typically upward or downward trends). This method may be useful if the audit committee knows in which direction they would like a certain indicator to move but are unable to determine a specific target. It is important to consider the use of this method carefully as it requires the underlying audit to stay fairly stable year over year.

Developing Targets

Developing targets can be challenging, especially for first-time AQI users who may lack historical data on which to make an informed decision. In the absence of widely accepted objective data points, audit committees, management and the auditor must work together to determine reasonable targets. The following tip box provides some possible sources of information. [Table 5](#) below provides some illustrative examples of targets.

Tips on Developing Targets for Audit Committee Members

- Talk to other audit committee members.
- Ask your audit firm for comparable audit engagements of your size and complexity.
- Consider developing current-year targets based on prior-year actuals.
- Review literature to determine whether objective benchmarks exist.
- Review your audit firm's audit quality report or transparency report to be informed of firm-wide benchmarks.

TABLE 5: ILLUSTRATIVE EXAMPLES OF AQI TARGETS

Indicator	Definition	Example Target
Experience of team	years of audit experience of key members of the engagement team	at staff level, targeted number of years of relevant experience (e.g., lead partner: 20+ years; managers: average five years)
Turnover of engagement team	turnover rates of key engagement team members and/or level	at staff level, maximum turnover ranges (e.g., managers: 5-10% turnover)
Partner workload	information about the level of work for which key engagement partners are responsible and the number of claims on their attention	compared to average number of audit hours partners are expected to have (e.g., audit partners are, on average, expected to incur 800-1,300 audit hours per year. Partner A is budgeted to spend 1,000 hours on Company X in 201X)
Audit hours by risk	time spent by the engagement team on significant risk areas	according to risk area, specific targets for number of hours to be spent, based on prior-year actuals
Timing of audit execution	audit hours by phase (i.e., planning, interim, year end)	target for amount of work to be completed prior to year end (e.g., 60% of work to be done before year end)
Audit progress milestones	a timeline for completion of the audit, which is mapped to key milestones within the process	table with key milestones and specific due dates (e.g., EQCR sign off on planning: by November 1, 201X)
Management deliverables	achievement of timing and quality of agreed-upon deliverables from management to the auditor	targeted dates and percentage achievement of submissions from management at the appropriate quality level (e.g., 90% completion of walkthrough meetings by June 30, 201X, including agreement on design deficiencies and management action plan or 95% of management submissions to auditor delivered on time, at the appropriate level of quality, based on agreed-upon schedule)

APPENDIX

Additional Resources

Listed below are additional resources about AQIs.

Document	Publication Date	Description
<u><i>Audit Quality Indicators: Final Report on CPAB's AQI Pilot Project</i></u>	June 2018	This report outlines CPAB's findings regarding AQIs based on observations of participants in CPAB's AQI Pilot Project.
<u><i>Center for Audit Quality (CAQ) Audit Quality Indicators: The Journey and Path Ahead</i></u>	January 2016	This publication outlines the results of the CAQ's AQI pilot testing (30 audit committees and 10 audit firms) and provides a summary of feedback obtained through roundtable discussions with audit committee chairs.
<u><i>Guidance to Audit Committees on The Accounting and Corporate Regulatory Authority of Singapore's (ACRA) Audit Quality Indicators Disclosure Framework</i></u>	October 2015	ACRA's publication outlines the eight AQIs identified in their <i>Framework</i> and how they should be interpreted by audit committees. This <i>Framework</i> is available for voluntary adoption by audit committees of all listed entities in Singapore and was developed in consultation with stakeholders from the audit profession and audit committees.
<u><i>Public Company Accounting Oversight Board (PCAOB) Concept Release on Audit Quality Indicators</i></u>	July 2015	In this release, the U.S. PCAOB was seeking input for a set of 28 potential quantitative measures of audit quality. Issues raised by the release include: <ul style="list-style-type: none"> • the nature of the potential indicators • the usefulness of particular indicators described in the release • suggestions for other indicators • potential users of the indicators • an approach to implementation over time of an audit quality indicator project

Document	Publication Date	Description
<u><i>Center for Audit Quality (CAQ) Approach to Audit Quality Indicators</i></u>	April 2014	In this paper, the U.S. CAQ provides its perspectives regarding: <ul style="list-style-type: none">• background and context for the discussion of AQIs• suggested approach for communication of AQIs• identification of a set of potential AQIs• overview of CAQ's pilot-testing initiative
<u><i>The International Auditing and Assurance Standards Board (IAASB)'s Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality</i></u>	February 2014	In this paper, the International Auditing and Assurance Standards Board outlines key elements that create an environment for audit quality.



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