Audit Quality Indicators
Final Report

INTRODUCTION

Interested in getting started with AQIs?

Click here to access the *Audit Committee Guide to Audit Quality Indicators* developed by CPAB, CPA Canada and the Institute of Corporate Directors – a useful step-by-step process to help audit committees and management implement AQIs for the first time.

Audit quality is a challenge for audit committees to measure and evaluate. Audit Quality Indicators (AQIs) are a response to this and provide quantitative measures about the external audit process. They facilitate collaboration among key stakeholders (auditors, management and the audit committee), and provide more in-depth information to assist in evaluating and achieving sustained audit quality.

Jurisdictions around the world, including Canada, are experimenting with AQIs to drive audit quality. CPAB has recently concluded a two year exploratory AQI pilot project. This document summarizes our key observations.

CPAB believes that **AQIs have significant potential to positively impact audit quality.**

CPAB'S AQI PILOT

In 2016, CPAB launched an exploratory AQI Pilot project (Pilot) with six Canadian audit committees, their management and external auditors to get feedback about the usefulness of AQIs and to support broader national and international discussions. We expanded the Pilot in 2017 to 18 reporting issuers.

The following chart shows some of the reporting issuers who have participated in our Pilot over the last two years:

Reporting Issuer	Audit Committee Chair	Reporting Issuer	Audit Committee Chair
Air Canada	Chris Clark	Intact Financial	Eileen Mercier
ARC Resources Ltd.	Kathleen O'Neill	Magna International Inc.	Lawrence Worrall
Ballard Power	Douglas Hayhurst	NAV Canada	Linda Hohol
Bank of Montreal	Philip Orsino	Rogers Communications Inc.	John Clappison
Cogeco Communications Inc.	Joanne Ferstman	Royal Bank of Canada	David Denison
Cogeco Inc.	James Cherry	SMART REIT	Garry Foster
Hydro One Inc.	Philip Orsino	Sun Life Financial Inc.	Bill Anderson
iA Financial Group	Michael Hanley	Telus Corporation	Bill Mackinnon

CPAB's Pilot was exploratory and encouraged innovation in how audit committees approach the use of AQIs. While CPAB provided participants with guidance, no specific requirements were given regarding the number or type of AQIs to use. Participants were encouraged to determine how to work with AQIs in a way that best suited their objectives and areas of interest.

A set of initial AQIs were presented to the audit committee and then analyzed by the audit firm and management. CPAB had various touchpoints with participants, including a number of Roundtables, to collect feedback.

> **I really learned a lot through this process. I have been the chair of the audit committee for six years now, and I'm surprised at how much more I have learned about audit quality.**
>
> *- Audit committee chair*

BENEFITS AND CHALLENGES

Pilot participants identified the following benefits and challenges from using AQIs.

BENEFITS:

- A better understanding among management, the audit committee and the external auditor of roles and responsibilities related to audit quality, and their expectations of others.
- More efficient and effective interactions between the audit committee and the auditor – as discussions are focused on the most important areas of the audit.
- Improved knowledge of and engagement in the audit process and audit quality by audit committee members.
- Improved project management over the audit, including coordination and collaboration in audit execution.
- Better information for the purposes of auditor evaluation.

> **It was extremely useful for our organization to come up with common language for what audit quality is.**
>
> *- Audit committee chair*

> **We originally thought the AQI process would be difficult to scale to a small entity with our limited resources however we were pleasantly surprised at how easy it was to scale and tailor the AQIs to an entity of our size.**
>
> *- Audit committee chair*

These benefits enhance audit quality through an enriched understanding of expectations among stakeholders, improved coordination and cooperation in audit execution, and a more informed and engaged audit committees, resulting in improved oversight over the external audit process.

CHALLENGES:

- Determining relevant AQI measures.
- Evaluating AQIs, including the development of evaluation criteria and understanding causes for their variability.
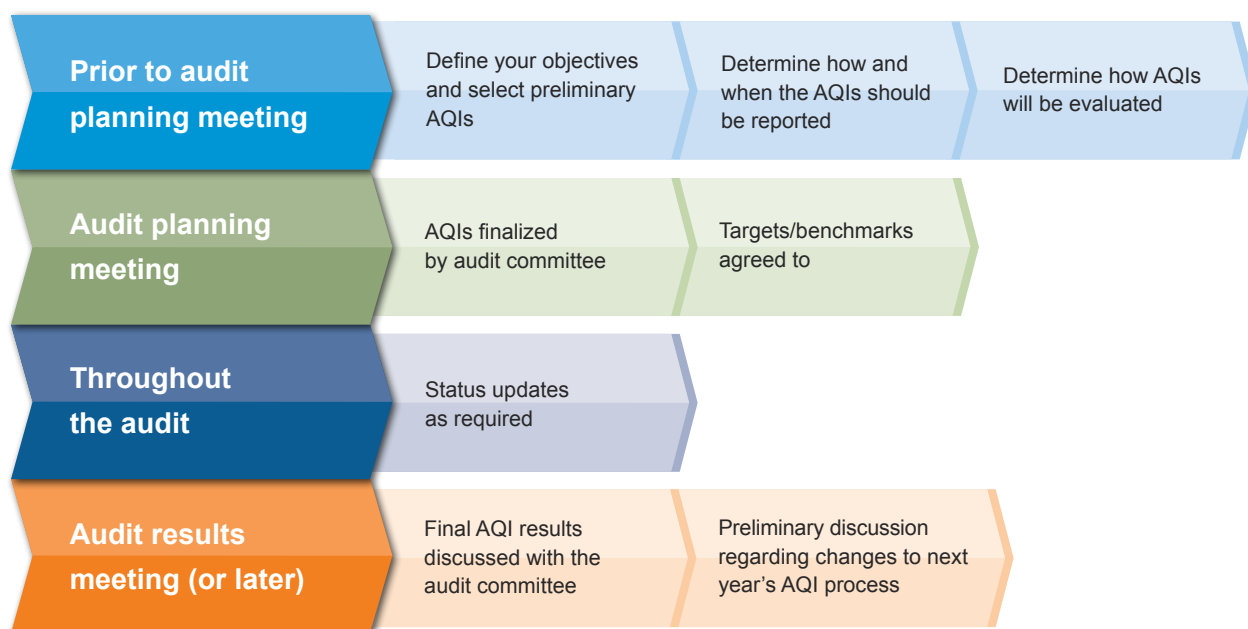- Changes required in audit firm systems and processes to facilitate reporting.

> **The first year you implement AQIs is the hardest, because you lack a historical baseline to help you evaluate your results.**
>
> *- Audit committee chair*

When using AQIs, it is important to remember that they 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 that will be built over time by audit committees, management and the audit firms.

IMPLEMENTING AQIs: THE PROCESS

Key to the effective use of AQIs is engagement in a collaborative process among management, the audit committee and the auditor.

Prior to audit planning meeting	Define your objectives and select preliminary AQIs	Determine how and when the AQIs should be reported	Determine how AQIs will be evaluated
Audit planning meeting	AQIs finalized by audit committee	Targets/benchmarks agreed to	
Throughout the audit	Status updates as required		
Audit results meeting (or later)	Final AQI results discussed with the audit committee	Preliminary discussion regarding changes to next year's AQI process	

MULTI-STAKEHOLDER DISCUSSION

Developing AQIs begins with an open conversation between management, the audit firm and the audit committee chair. While the main goals of the conversation are to determine the objectives in using AQIs, select AQIs and determine how they will be reported and evaluated, many participants noted that the most valuable part of the discussion was not about such practical matters. They said they gained the most value from understanding how each party defines audit quality, expectations around audit quality, and how to manage the coordination needed to achieve everyone's goals. Many participants stressed the importance of taking the time to ensure these conversations are sufficiently robust and agreed that they provided the greatest value in the process.

> **Much of the value of AQIs is created up front – during the initial discussions.**
>
> *- Audit committee chair*

DETERMINING OBJECTIVES

The objectives of Pilot participants varied and significantly influenced the selection of AQIs. Participants noted that AQIs were not the only tool available to the audit committees to meet their stated objective(s), and that their chosen AQIs would be considered in conjunction with other sources of information. Examples of objectives identified include:

- General audit oversight, including project management and monitoring of key audit risks.
- External auditor evaluation in terms of audit quality and client service.
- Monitoring and managing the added value provided by the auditor.

Real life examples:

One audit committee chair wanted to use AQIs to monitor "sensitive areas of interest to the audit committee", including the adoption of new IFRS standards and financial reporting systems conversion.

At the suggestion of management, another audit committee chair used AQIs to improve oversight of the audit of areas of particular interest to investors/analysts, such as significant estimates.

SELECTING AQIs

The average number of AQIs selected was eight. Participants stressed the need to be thoughtful and focused when selecting indicators, and that a smaller number (10 or fewer) is ideal. Experienced participants noted they became better able to evaluate the cost-benefit provided by each of their selected AQIs by the end of the first year and, in some cases, reduced the number of AQIs by consolidating similar metrics.

In determining which AQIs to select, participants were encouraged to consider:

- The unique nature of their business.

- Their specific areas of significant audit risk.

- Areas of the audit they would like more transparency/ information on.

- Factors most meaningful to them when evaluating their external auditor.

- Themes noted in the reports of external audit inspections including those from CPAB or the PCAOB.

- AQIs their external auditor and/or management are already tracking or considering for internal management purposes.

- The ability of their external auditor and/or management to provide information and have a meaningful discussion on the context surrounding the information.

> **❝ Don't pick too many AQIs – it's the only way to avoid it being a compliance exercise. Be thoughtful, meaningful and focused. ❞**
>
> *- Management representative*

Participants also considered these additional factors:

- Audit quality metrics their audit firm tracks for partner compensation purposes.

- Information provided by the audit firm in other reports (for example, as contractually required or requested for other purposes).

- Output from the annual or comprehensive auditor evaluation if performed in the same year.

There was significant variety in the types of AQIs selected. This relates partially to differing objectives, and also to the innovative mindset of the participants, some of whom attempted to develop novel measures.

Table 1: Examples of 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	Per cent of audit hours carried out by senior engagement team members compared to the entire engagement team
1	**Partner workload**	Information about the level of work for which key engagement partners are responsible for and the number of claims on his or her 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 (planning, interim, year-end)
	Audit progress milestones	A timeline for the completion of the audit which is 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 tools, number of hours, etc.
	Specialist engagement	Where and how much (measured in hours) persons with "specialized skill and knowledge" are used in the audit
2	**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
3	**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 upon news reports
4	**Tone at the top**	Tone at the top determined by audit firm people 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 (i.e. regulatory and accounting changes)
5	**Sharing of insights**	Number and quality of insights gained and shared with management and the audit committee

REPORTING AQIs

Frequency

With the exception of the initial AQI conversation, reporting mechanisms and frequency varied. All participants agreed the best time for the audit firm to present the initial list of AQIs to the audit committee was during the audit planning meeting, as part of the audit plan. Frequency of reporting varied between quarterly, semi-annually, annually, or a combination of the three. Year-end reporting typically took place either at or after the year-end audit results meeting. Many participants noted that some form of regular communication on AQIs during the audit cycle was preferable to year-end only reporting.

Format

Most participants tracked AQI information in a standalone AQI report, typically produced by the auditor for the audit committee (see Figure 1).

Some participants noted that they may also consider integrating AQIs directly into their audit plan or other reports (such as auditor evaluation templates) in the future.

Figure 1

Audit Quality Indicators – Company X (Name of AQI)

(Definition of AQI)
(Important contextual information or assumptions)

Name of AQI	Actual	Target	Difference
XXX	# / %	# / %	# / %
XXX	# / %	# / %	# / %
XXX	# / %	# / %	# / %

(Qualitative explanation of results)

EVALUATING AQIs

Many AQIs listed in Table 1 above were selected by more than one participant, particularly the AQIs listed in the Engagement Team and Audit Execution categories. However, the way each measure was defined, reported and evaluated often differed, depending on the information capability of the audit firm and the needs of the audit committee.

Participants identified the development of evaluative criteria as the most significant challenge to using AQIs. This is especially true for first time AQI users. In the absence of historical data, the lack of an objective benchmark was considered particularly difficult. Participants raised both industry groups and audit firms as possible sources for objective benchmarks; they also suggested setting an acceptable range or directional trend as an alternative to setting a specific point value.

It was noted that it is essential to provide qualitative information to allow audit committee evaluation of each AQI. This is because there is typically no "right" answer for AQIs and the primary benefit is the discussion of the context surrounding the result of 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 (lower level staff were not competent requiring increased partner time to deal with numerous issues). Qualitative information provides important contextual facts to the audit committee enabling them to determine if the results are positive or negative indicators of audit quality or if additional attention is needed in a certain area.

❝ **Context is vital to understanding AQIs.** ❞

- Audit firm representative

WHAT WE LEARNED

DIVERSE OPINIONS ON THE USEFULNESS OF SPECIFIC AQIs

There are no silver bullet AQIs. Instead there is a range of perspectives depending on the unique needs and circumstances of individual audit committees. Table 2 to the right outlines AQIs selected by greater than 75 per cent of Pilot participants and are consistently identified as very useful by audit committees, management and audit firms. Reactions to all other indicators were mixed, from not useful to extremely useful. This illustrates the diverse perspectives of participants and their differing needs and goals.

Table 2: AQIs selected by more than 75 per cent of Pilot participants

Name of AQI
Timing of audit execution
Use of specialists
Partner/manager leverage
Experience of engagement team
Management deliverables
Audit hours by areas of significant risk

Ilustrative Example: Workload AQI

This look at the Workload Indicator shows varying perspectives on specific indicators.

Example definitions	Example evaluative criteria
Absolute and percentage of hours dedicated to Company X, other client commitments and internal activities by Lead Audit Partner and Engagement Quality Control Reviewer	"The Lead Audit Partner and Engagement Quality Control Reviewer will devote X and X hours respectively to the client. Partners are normally expected to work X number of client service hours annually".
Absolute and percentage of hours dedicated to Company X, other client commitments and internal activities by Lead Audit Partner and Engagement Quality Control Reviewer	"Our audit firm will meet the budgeted figures as listed below, per staffing level and specialist group:" Chart provided lists the following figures per staffing level and specialist group: (1) Planned average hours to be spent on the client in the current year (2) Planned average total client service hours in the current year (3) Actual average total client service hours in the previous year

When discussing the usefulness of the Workload indicator, participant perspectives varied. Some audit committee chairs felt that the workload of key partners was not important as long as the partners continued to deliver a quality audit. Others said it is important to understand the amount of pressure on key partners and their ability to make critical judgments. It was also noted that certain unique situations may result in increased interest in this indicator in a given year, such as: if it is a first year audit, if a significant transaction occurred during the year, or if a new audit partner is being rolled onto the engagement.

THE ENGAGEMENT TEAM IS CRITICAL TO AUDIT QUALITY

There was widespread acknowledgement that the composition of the engagement team is foundational to audit quality. Strong engagement teams are appropriately staffed, have the right mix of industry and specialist expertise, and include a diverse skillset which enables the team to exhibit appropriate professional skepticism and judgment. Half of the AQIs most frequently selected by Pilot participants were engagement team-related, as outlined in Table 2 above.

SUPPORT FOR MANAGEMENT-RELATED AQIS

During the first year of the Pilot, some participants developed AQIs to measure management's role in audit quality. The inclusion of these indicators provides a broader perspective to the audit committee highlighting the contribution of management to the successful completion of a high quality audit.

Insights obtained by audit committees from management indicators resulted in the majority of 2017 Pilot participants including an AQI to measure management's role in audit quality. While the most common indicator was project management-based (the achievement of timing of agreed upon deliverables from management to the auditor, for example), we saw innovation including indicators measuring the quality of management's control systems and the timeliness of management's remediation of control deficiencies.

> **Real life example**
>
> As a result of including a management AQI in their AQI profile, one audit committee discovered that over 40 per cent of management's deliverables were provided an average of five days late to the auditor. This insight resulted in actions from management that positively impacted audit quality.

PROJECT MANAGEMENT AND AUDIT QUALITY

The use of AQIs highlighted the importance of project management to audit quality. A number of participants used indicators related to tracking milestones or phases of the audit. These indicators typically held the audit firm accountable for meeting certain milestones by a specific date. For example, one audit firm provided the audit committee with a list of significant tasks (e.g. lead engagement partner sign-off on audit planning) and completion date. Another audit firm provided dates when a certain amount of the audit work was to be completed (e.g. 55 per cent of the audit to be completed before year end).

Benefits of using such AQIs included increased focus by the audit firm on project management, and improved coordination among management, the audit firm and the audit committee throughout the audit process. The discussion of such milestones highlighted the importance of management providing working papers to the audit firm on time.

EVOLUTION IS KEY

To keep AQIs out of the compliance trap, participants highlighted the need to reflect on them every year. Some experienced AQI participants modified their AQIs to reflect changes at the audit firm, business environment, audit risks, or needs of the audit committee. Others maintained their AQIs from the previous year as a baseline for future trending analysis.

Regardless, substantially all experienced Pilot participants felt that AQIs continued to provide them with positive value in the second year.

> **You need to re-evaluate your AQIs – both the specific indicators and associated targets – on an annual basis to reflect progress and changing circumstances.**
>
> *- Audit committee chair*

DISCLOSURE AND AUDIT COMMITTEE REPORTING

There was discussion about whether audit committees should disclose the use of AQIs in their annual filings, which some see as evidence of robust audit committee oversight of the external auditor. Several of our Pilot participants, such as Telus Corporation and Sun Life Financial, chose to publicly disclose their use of AQIs.

> **I wonder if we should be publicly disclosing our use of AQIs to demonstrate our oversight of the external auditor.**
>
> *- Audit committee chair*

INTERESTED IN USING AQIs?

AQIs can positively impact audit quality. We encourage you to use the following resources:

(1) **Audit Committee Guide to Audit Quality Indicators:** Together with CPA Canada and the Institute of Corporate Directors, we developed a short guide to assist audit committees to implement AQIs for the first time. The 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 about improving audit quality. The Guide can be used in conjunction with the updated Enhancing Audit Quality (EAQ) publications:

    a. Oversight of the External Auditor – Guidance for Audit Committees,
    b. Annual Assessment of the External Auditor – Tool for Audit Committees,
    c. Periodic Comprehensive Review of the External Auditor – Tool for Audit Committees.

(2) **AQI Network:** In 2018, CPAB launched an AQI network to enable information sharing and support for current and future AQI users. The network allows CPAB to collect and share information about AQIs with the wider audit community. To join our AQI Network, or to learn more, contact AQINetwork@cpab-ccrc.ca.

We encourage audit committees, management and audit firms to use AQIs and share their experiences with the audit community. To receive advance notification of the launch of our new AQI publications and initiatives, please click here.