

Audit Quality Indicators: How to put them to work

Audit quality indicators (AQIs) help evaluate audit quality, enhance dialogue among auditors, audit committees and management, and can improve the quality of audit oversight by audit committees. The Canadian Public Accountability Board (CPAB) has seen a number of good practices that have contributed to better audit quality outcomes.

The benefits of AQIs

- **They drive audit process accountability** – selecting meaningful measures, setting measurable targets and establishing regular reporting and discussion improves everyone’s focus during the audit.
- **They improve the discussion about audit quality** – AQIs give audit committees more targeted information which improves the insights and quality of questions asked to the auditor and management.
- **They provide more tangible information that can support auditor evaluation** – AQIs provide more tangible information to help the audit committee understand how the auditor has responded to targets and requests for improvement.

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The selected AQIs have created a common language amongst stakeholders that help foster early dialogue and reduce surprises in the audit.

Audit Committee chair

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Putting AQIs to work

AQIs are most effective when they are tailored to each organization. CPAB has seen companies combining a core set of common AQIs with a number of more innovative and customized ones.

Practical tip: Most audit committees find five to 10 AQIs the most manageable and practical to apply.

Common AQIs

AQI	What it means	What else to think about
Hours by phase of the audit	Hours spent at different stages of the audit, generally split between hours before and after the fiscal year-end.	This AQI helps auditors and management focus on moving audit work out of the busy year-end period to allow for more time to discuss and address challenging issues, reducing deadline pressure that can be more susceptible to error.
Audit effort (# of hours) by risk area	Useful in comparing the auditor and audit committee's expectations on where more or less time is spent during the audit.	The amount of time spent on different risk areas may vary from year to year. Variations from prior years or expected amounts can be an important area of discussion.
Management deliverables	The most common AQI in this category is tracking the timing of when management provides information to the auditor (e.g. per cent on time, per cent one to three days late, etc.)	Significant delays in providing information to the auditor can put pressure on the auditor and make it more challenging to meet reporting deadlines.
Hours by level within the audit team	Can include hours spent by partners, managers and audit staff.	Expectations of hours spent by different levels may differ based on the company and complexity of business activity during the year.
# of hours by specialists	Hours spent by specialists including valuation, IT, tax, etc.	Companies with more challenging auditing issues (including fair value estimates) and/or unusual transactions (e.g. business combinations) may expect increased involvement of specialists.
Amount of training	Number of hours of training to upgrade skills and competencies.	Can include a combination of more general training as well as focused industry training.

Non-traditional AQIs

AQI	What else to think about
<p>AQIs that track time spent on specific areas of focus or concern for the audit committee.</p> <p>Specific information tracked may include achievement of milestones and number of hours by the auditor and management.</p>	<p>Can be added or removed depending on progress of the project and relative risk to the company in a given year.</p> <p>Examples include:</p> <ul style="list-style-type: none"> • Adoption of a new IFRS standard (e.g. IFRS 15, 16) • Major information technology project (i.e. general ledger replacement; implementation of a new IT system)
<p>Use of technology</p>	<p>An emerging area where auditors are providing information about the extent of use of new and emerging technology in the audit.</p>
<p>Reliance on internal controls</p>	<p>Helps improve the discussion around the quality of internal controls and the auditor’s approach to testing these controls.</p> <p>Examples include:</p> <ul style="list-style-type: none"> • Planned vs. actual reliance on internal controls (number or percentage). • Time required by management to remediate internal control weaknesses.
<p>Time spent on accounting issues</p>	<p>Helps audit committees understand the time spent on new accounting standards and special transactions to ensure appropriate attention on more challenging parts of the audit.</p>
<p>Income taxes</p>	<p>Includes time spent on tax developments such as number of hours incurred by tax specialists.</p>
<p>Alternative performance measures (including non-GAAP measures)</p>	<p>One audit committee receives regular reporting of time spent by the auditor in reviewing and commenting on their non-GAAP measures.</p>

Best practices

Presenting AQIs in periodic audit committee reports

AQI information is shared in a variety of ways. Sometimes they are reported within the audit firm's planning and completion documents. Others find it more useful to report AQIs as a separate deliverable to the audit committee.

Reporting frequency

Usually audit committees begin by discussing and agreeing to a set of AQIs during the planning phase of the audit; we see many audit firms and management providing a target or budgeted amount for these measures at this time.

Reporting frequency ranges from quarterly to annual depending on the nature of the output; regular discussion for certain AQIs is essential to facilitate early identification of issues and keep things on track.

Audit committee members agree that timely reporting of AQIs is key to successful implementation and execution.

Public disclosure

More audit committees are providing increased disclosure of ongoing activities including how they oversee audit quality and their auditor.

In our review of public filings CPAB found an initial list of 15 Canadian reporting issuers that disclose the use of audit quality indicators in the audit committee report included in the management information circular or annual information form.

Management Information Circular Excerpts

Sample AQI disclosures

➤ **Example 1:** If deemed appropriate, establish annual Audit Quality Indicators in a consultation with the External Auditors and senior Management and review at least annually a report from the External Auditors addressing Audit Quality Indicators.

➤ **Example 2:** The external auditors report directly to the Audit Committee. The Audit Committee is responsible for evaluating the effectiveness of the external audit and the external auditors and annually conducts a formal audit effectiveness assessment to drive continuous improvement in the external audit. The Audit Committee, in coordination with Management and XXX audit firm, continues to participate in the Canadian Public Accountability Board’s audit quality indicators project. The project is aimed at improving audit quality through the use of quantitative measures to evaluate audit quality. Using the year-end audit quality indicators report, the Audit Committee will evaluate how to best integrate the indicators into its regular processes and into the external audit.

External audit (responsibilities):

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- Adopted audit quality indicators to create improved monitoring of the external auditor
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➤ **Example 3:** External audit quality – Monitoring the integration of audit quality improvements that resulted from the introduction in 2016 of measureable audit quality indicators in xxx’s external audit globally. The audit committee continues to monitor audit quality initiatives and developments. In order to gain further insights into the factors that promote audit quality and provide a useful ongoing benchmark regarding best practices in the use for audit quality indicators.

Use of AQIs around the world

Several audit regulatory bodies either mandate the use of AQIs by audit firms and companies or request adoption through a voluntary protocol. A few examples include:

- In 2016 the Accounting and Corporate Regulatory Authority (Singapore) implemented a voluntary framework with eight measures defined as Engagement Level and Firm Level indicators.
- In 2018 the Independent Regulatory Board for Auditors (IRBA) in South Africa required 18 audit firms of listed companies to provide specific data across eight selected AQIs.

Reporting of certain audit quality measures also exists in other jurisdictions where transparency reporting is already mandatory such as the European Union, the United Kingdom, Japan, Australia and New Zealand.

Want to know more?

Find out more about AQIs on our [website](#).

Learn More

Visit us at www.cpab-ccrc.ca and join our mailing list. Follow us on Twitter — @CPAB-CCRC

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