Audit Quality Indicators- A tool to measure Audit Quality

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Introduction

SAICA published an article entitled “The global quest for the best indicators” in the July 2016 edition of the Accountancy SA magazine.¹ This article highlighted that Audit Quality Indicators (AQIs) are emerging as a means of evaluating audit quality and providing more transparency about audits and audit firms – to the benefit of the firms themselves and to support boards and audit committees in discharging their oversight responsibilities. This article continued to describe the groundwork and research undertaken by the Center for Audit Quality (CAQ) in the years 2014 and 2015, the Public Company Accounting Oversight Board (PCAOB) in the year 2015 and the Federation of European Accountants in the year 2015 on AQIs, including a list of potential AQIs proposed by each of these three oversight bodies. Since then, developments around AQIs have continued to grow.

What are AQIs

Since AQIs have emerged as a measure of evaluating audit quality, it is important to note that audit quality is a complex subject that is difficult to describe in a single definition. From the International Auditing and Assurance Standards Board (IAASB) 2014 At a Glance: A Framework for Audit Quality², audit quality encompasses the key elements that create an environment which maximises the likelihood that quality audits are performed on a consistent basis.

In principle, AQIs refer to a portfolio of quantitative measures of particular aspects of audit firms and provide a basis to evaluate audit quality. AQIs are beneficial to external interested parties, such as audit committees, where these parties are better informed about key matters that may contribute to the quality of an audit, both at audit firm level and at audit engagement level. This additional information may be useful in assisting the audit committee in discharging its oversight responsibilities regarding the external audit process, including the appointment of the external auditor.

The Canadian Public Accountability Board (CPAB) recently concluded a two-year exploratory AQI pilot project³ 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.

In terms of this project, the CPAB identified the following potential benefits and challenges of using AQIs:

Potential benefits of using AQIs:

¹ This article is available on: https://www.saica.co.za/Portals/0/Technical/Assurance/3_SASAJuly2016.pdf


³ The CPAB Audit Quality Indicators Final Report is available on http://www.cpab-crc.ca/Documents/Topics/Audit%20Quality%20Indicators/AQI%20Final%20Report%20EN.pdf
• 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
• 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

Potential challenges of using AQIs:

• Determining relevant AQI measures and understanding the relationship between multiple AQIs
• Evaluating AQIs, including identifying evaluation criteria and understanding any discrepancies
• Identifying changes required in audit firm systems and processes needed to facilitate reporting

Determining Objectives and Selecting AQIs

From the learnings of the CPAB pilot participants, it was noted that developing AQIs begins with an open conversation between management, the audit firm and the audit committee chair. It was recognised that the main goals of such conversations is to determine objectives in using AQIs, selecting AQIs and determining how they will be reported and evaluated.

Examples of objectives in using AQIs identified in the study 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.

Interestingly, there was significant variety in the types of AQIs selected by pilot participants and the average number selected was eight. In determining which AQIs to select, pilot 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
• AQIs their external auditors and/or management were already tracking/considering
• The ability of their external auditor and/or management to provide the required information

The AQI indicators identified were categorised into five main categories as follows:

• Engagement team indicators
  o Experience of engagement team
  o Training and professional development
• Turnover of engagement team
• Partner/management involvement
• Partner workload
  • Audit execution indicators
    • Audit hours by risk
    • Timing of audit execution
    • Audit progress milestones
    • Technology in the audit
    • Specialist engagement
    • Service delivery centers
  • Management indicators
    • Management deliverables
    • Remediation of control deficiencies
    • Reliance on controls
  • Firm level indicators
    • Results of inspections
    • Independence
    • Reputation
    • Tone at the top
  • Client service indicators
    • Communication with audit committee
    • Sharing of insights

It is interesting to note the scope of AQI identified in that management indicators were identified as a separate category of AQIs.

**Reporting of AQIs**

The study found that AQI reporting mechanisms and the frequency of reporting will vary based on the specific needs of an audit committee. From the learnings of the CPAB pilot participants, regular communication on AQIs during the audit cycle as preferred to annual reporting. An example of such a reporting cycle is as follows:

• Appointment or reappointment of the auditors.
• Audit planning phase.
• Audit execution/fieldwork phase.
• Audit finalisation phase.

Further to the CPAB pilot project on AQIs, CPA Canada and the Institute of Corporate Directors, developed the Audit Committee Guide to Audit Quality Indicators⁴ which is intended to assist audit committees to implement AQIs for the first time.

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South African developments around AQIs

The Independent Regulatory Board for Auditors (IRBA) – the statutory regulator of Registered Auditors in South Africa – has identified a number of initiatives to be rolled out to restore confidence in the profession. Strengthening the work of audit committees through measures such as AQIs has been identified as one such initiative. The IRBA’s project to develop AQIs is envisioned to help improve audit quality in South Africa.

In terms of the IRBA Public Inspections Report 2018, the objectives of this project were for AQIs to:

- Be used by auditors to manage audit quality within their firms;
- Be used as a tool by those charged with governance, such as audit committees, when overseeing and assessing the quality of external auditors; and
- Be a further source of information for business intelligence gathering and risk-based selections, as part of the IRBA inspections process.

Conclusion

Based on the CPAB pilot project 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 skill set which enables the team to exhibit appropriate professional scepticism and judgment.

While the primary responsibility for performing quality audits rests with auditors, audit quality is best achieved in an environment where there is support from other participants in the financial reporting supply chain.

SAICA will continue to monitor developments around AQIs, particularly the IRBA’s project to develop AQIs and will incorporate these developments on its member outreach activities including seminars in due course.

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