



AUDIT QUALITY INDICATORS

THE JOURNEY  
AND PATH AHEAD



CENTER  
FOR AUDIT  
QUALITY

*Serving Investors, Public Company Auditors & the Markets*

## FOREWORD

January 2016

The CAQ is pleased to share recent insights learned from a series of roundtable discussions with audit committee members and other interested stakeholders around the globe to gather their feedback on a potential set of audit quality indicators. This outreach, together with the results from pilot testing of the CAQ's approach, has led to an understanding that audit committee members may benefit from a multidimensional resource that can assist them in gauging the performance of the audit using qualitative and quantitative factors.

As this report documents, we found that determining audit quality is more art than science. It is the conversation that is important; having a dialogue to explore the context and relevance of certain indicators is critical to obtaining a deeper understanding of the quality of a particular audit. We heard that audit committee members desire assistance with their efforts to grasp the more qualitative aspects of the audit, such as the engagement team having the right mindset to bring forth professional skepticism, which is difficult to measure, and is best achieved through dialogue.

We also learned that audit committee members believe this conversation is most impactful in driving actions that improve or maintain audit quality when audit committees have the flexibility to tailor the discussion around the facts and circumstances of their particular audit. The potential components, or indicators, of audit quality, detailed in the CAQ's April 2014 publication, can support or be used to initiate these conversations about auditor performance, but by themselves cannot lead to a holistic understanding of audit quality.

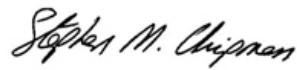
We have learned a great deal on this journey, but much more remains to be done to strengthen our ability to assess audit quality. We invite you to join us as we continue down the path towards this vital goal.



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## EXECUTIVE SUMMARY

Audit committees serve an essential role in corporate governance by protecting investors through their oversight of a company's financial reporting process and the audit. The Center for Audit Quality (CAQ) believes that reliable quantitative metrics regarding the audit, commonly referred to as "audit quality indicators" or "AQIs," could be used to better inform audit committees about key matters that may contribute to the quality of an audit. The CAQ developed an approach to communicate AQIs that recognizes the roles and responsibilities of audit committees and reinforces the importance of, and enhances the dialogue around, the auditor's communications with the audit committee. The approach is focused on the communication of engagement-level indicators that can be tailored based on the information needs and interests of a specific audit committee to support its oversight responsibility. Firm-level indicators, which focus on an audit firm's overall strategies and initiatives, can be used to complement these engagement-level indicators. The focus on communication of AQIs to audit committees is appropriate because AQIs:

- **Provide relevant information to audit committees** – AQIs provide greater value to those who have direct oversight responsibilities for the audit.
- **Increase the quality of the dialogue with audit committees** – Audit committees are uniquely positioned to engage in dialogue with the auditor to obtain the context necessary to give meaning to AQIs and potentially take actions that might help maintain or increase audit quality on an engagement.
- **Assist with selection/evaluation of the external auditor** – Given their governance authority and knowledge of the particular circumstances of the audit engagement, audit committees are in a position to act upon the information communicated to make decisions about reappointing the auditor, appointing a new auditor, and selecting a lead engagement partner.

To develop perspectives on the key elements of a quality audit and a sample set of quantitative indicators that provide information about the performance of those elements over time, the CAQ worked with a Stakeholder Advisory Panel composed of investors, audit committee members, former standards-setters, auditors and others. The CAQ and the Panel identified a set of potential AQIs they believed would provide the greatest opportunity to enhance discussions between auditors and audit committees, and the ability of audit committees to fulfill their responsibilities relative to oversight of the audit. In January of 2014, the CAQ assembled a roundtable of audit committee members to get their reactions to these indicators. The set of indicators were amended slightly based on their feedback to make them more

risk-based. The CAQ in April 2014 published the *CAQ Approach to Audit Quality Indicators (Approach)*.<sup>1</sup>

In coordination with its member firms, the CAQ subjected the set of potential AQIs to pilot testing. The objective of the pilot testing was to identify potential barriers to auditor preparation and communication of AQIs, and to assess the overall usefulness of the *Approach* to audit committees. Most of the participating audit committees and engagement teams generally expressed overall support for a discussion of AQIs between the audit committee and the engagement team, although feedback on individual AQIs varied.

To continue to evaluate the set of potential AQIs and suggested communication approach, the CAQ convened a series of roundtable discussions with audit committee members around the globe throughout the summer of 2015. The roundtables were designed to spur discussion of whether and how AQIs might assist audit committee members in performing their important audit and financial reporting oversight responsibilities on behalf of investors. Roundtable participants thoughtfully considered the findings from pilot testing and shared their views on the potential benefits and challenges of identifying and

developing a set of AQIs. Key findings from the roundtables included the following:

- Desire for information that can assist audit committees in their assessment of the more qualitative aspects of the audit, such as the engagement team having the right mindset to bring forth professional skepticism and auditor judgment, which cannot be adequately captured in a quantitative AQI, and is best achieved through dialogue.
- Recognition that although AQIs can help audit committees oversee the quality of their external audit, the external audit is just one aspect of quality financial reporting.
- Endorsement of a flexible approach that allows an audit committee, working with the external auditor, to tailor or customize the selection and portfolio of AQIs that best suit its specific information needs.
- General support for the concept of AQIs and recognition of their potential value to audit committees' auditor oversight responsibilities, although some participants felt they already have the tools necessary for them to gauge the quality of their audit.
- Agreement that AQIs alone, without context, cannot adequately communicate factors relevant to any particular audit engagement or audit firm.

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<sup>1</sup> *CAQ Approach to Audit Quality Indicators*, is available at <http://www.thecaq.org/reports-and-publications/caq-approach-to-audit-quality-indicators>.

- Agreement that the process of identifying and evaluating AQIs needs to be audit committee-driven and iterative, and will require continuous assessment and refinement in order to meet the changing information needs of audit committees.
- Belief that mandated public disclosure of engagement-level AQIs could lead to unintended consequences and that any disclosures of engagement-level AQI information should be voluntary.

This report is intended to advance consideration of the issues uncovered during these roundtable discussions, pilot testing, and through additional outreach and efforts in recent years on this important topic. While the CAQ has learned a great deal since the launch of its AQI initiative, more remains to be done. For example, because audit committee members are interested in more qualitative information to evaluate audit quality at the engagement level, a potential path forward is to create a tool for audit committees that guides their assessment of both quantitative and qualitative information. Further dialogue and continued collaboration among all stakeholders is needed so that we all can participate in the development of a path forward on AQIs and, potentially, best practices for their use.

In 2012, the CAQ began work to attempt to define and measure audit quality with the goal of determining a set of measures, or framework, from which key stakeholders could communicate and discuss the quality of an audit. Like others around the world, the U.S. public company auditing profession recognized the importance of a common vision and understanding of factors that may contribute to the performance of a quality audit. To inform its efforts, the CAQ convened a Stakeholder Advisory Panel comprising audit committee members, investors, academics, profession representatives and others.<sup>2</sup> An initial roundtable held in January of 2014 with audit committee members helped provide insights on the development of the CAQ's *Approach*.

In developing the *Approach*, the progress of others working on AQIs was considered. The United Kingdom's Financial Reporting Council and the International Auditing and Assurance Standards Board have both sponsored initiatives to help understand and describe AQIs. In identifying potential indicators of quality, the CAQ also evaluated the indicators employed to review quality in other professions and industries, such as the airline, manufacturing, and service industries, and the medical profession. In parallel to the efforts of the CAQ and its member firms, the Public Company Accounting Oversight Board (PCAOB) identified AQIs as a priority in 2013.<sup>3</sup> The CAQ has shared and continues to share with the PCAOB its perspectives regarding the components of audit quality, including potential AQIs to measure those components, as well as the feedback received through pilot testing.<sup>4</sup> While there have been a number of research projects and global initiatives centered on the topic of audit quality in recent years, there remains little consensus on a definition of audit quality, an audit quality framework, and the most relevant indicators of audit quality and how and to whom they should be communicated.

Recognizing the challenges associated with putting words around a specific definition of audit quality, the CAQ instead worked with its Stakeholder Advisory Panel to agree on a framework that describes the elements of audit quality. The elements of audit quality that were included as part of this framework were largely drawn from the PCAOB's quality control standards and other professional standards. The indicators in the *Approach* fall into four principle areas:

1. Firm leadership and tone at the top
2. Engagement team knowledge, experience, and workload
3. Monitoring
4. Auditor reporting

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<sup>2</sup> See the Appendix for a list of Stakeholder Advisory Panel members.

<sup>3</sup> PCAOB Briefing Paper, *Discussion – Audit Quality Indicators*, SAG Meeting, May 15–16, 2013. See also, PCAOB's *AQI Update*, SAG Meeting, November 14, 2013.

<sup>4</sup> See, for example, the CAQ's letter to Greg Jonas, Director of the PCAOB's Office of Research and Analysis, on May 13, 2013, which is available at <http://www.thecaq.org/newsroom/2013/05/13/caq-provides-perspectives-on-understanding-audit-quality-to-pcaob-ahead-of-sag-meeting>. See also, the CAQ's comment letter in response to the PCAOB's July 2015 *Concept Release on Audit Quality Indicators*, which was submitted on September 28, 2015, and is available at <http://thecaq.org/resources/comment-letters/caq-comment-letter-pcaob-s-concept-release-on-audit-quality-indicators>. The PCAOB's Concept Release sought public comment on 28 potential quantitative AQIs, with over 70 illustrative calculations.

As a guiding principle in developing a set of potential AQIs, the CAQ established that each of the indicators should measure an input or output related to an element of this audit quality framework. Other guiding principles used by the CAQ required that the AQIs collectively avoid or minimize unintended negative consequences, and be scalable to audit firms and audit engagements of different types and sizes.

The feedback received during stakeholder outreach efforts led the CAQ to focus primarily on the communication of engagement-level metrics to audit committees – an approach that recognizes the critical role that audit committees play in the oversight of audits on behalf of investors. Consequently, the *Approach* includes a set of potential AQIs that could aid audit committees in their oversight of the audit and potentially enhance discussions between auditors and audit committees.

The CAQ engaged in two separate efforts to assess the usefulness and feasibility of the *Approach* for audit committees. First, the CAQ coordinated with 10 audit firms of various sizes to pilot test these indicators during the 2014 audit cycle. A total of 30 audit engagements participated encompassing a broad range of operations and industries. None of the selected audit engagements were identified to the CAQ and participating audit firms shared the pilot testing results on a confidential basis. During the pilot testing, audit committees were asked for feedback on the usefulness of a number of proposed AQIs in fulfilling their auditor oversight responsibilities.<sup>5</sup> Although the AQIs, on average, were seen as useful by audit committees, some were more relevant to certain audit committees than others. The audit committee members ranked certain AQIs related to engagement team experience and workload as the most useful indicators, including years of industry experience relevant to the audit engagement, years on the engagement, changes in audit hours between years, and audit hours spent on the audit engagement by engagement team members grouped by their seniority in the audit firm. Many audit committee members expressed a preference for flexibility in the approach to discussing AQIs and a desire to be able to tailor the discussion to include those AQIs most relevant to their company and its audit.

Secondly, in the summer of 2015, the CAQ convened four roundtables with audit committee members in London, Chicago, New York, and Singapore to further explore the issues around AQIs. Through these activities, the CAQ gathered the perspectives of audit committee members and information on current practices around the globe on the identification and communication of AQIs.

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<sup>5</sup> Some of the AQIs in the *Approach* that were communicated to audit committees overlapped with existing audit committee communications required by professional standards. For example, Auditing Standard (AS) No. 16, *Communications with Audit Committees*, requires that the nature and extent of specialized skills or knowledge needed related to significant risks be communicated to the audit committee (AC). The *Approach* includes metrics to quantify factors related to “specialists and national office personnel involvement by significant risk area.”

## MAJOR THEMES FROM THE ROUNDTABLE DISCUSSIONS



Most participants supported the concept of AQIs and recognized their potential value to audit committees in execution of their auditor oversight responsibilities. However, some of the audit committee members who participated in the roundtables believed they had sufficiently robust audit evaluation and oversight processes without the need for additional AQI information. Participants agreed that deriving value from AQIs would be dependent upon their ability to tailor or customize the selection and portfolio of AQIs that best suit their specific information needs. Participants also agreed that AQIs alone, without context, cannot adequately communicate factors relevant to the audit of any particular engagement or firm. The PCAOB also notes the importance of context in its *Concept Release on Audit Quality Indicators* and emphasizes that for this reason, AQIs cannot be used as benchmarks.<sup>6</sup> Participants stressed that context is integral to the proper understanding of any AQI, which can lead to an enhanced dialogue between the audit engagement team and the audit committee regarding matters that affect audit quality. Using PCAOB inspections reports as an example, participants said they would find them more useful as an indicator of audit quality if it were clear how identified deficiencies relate to the facts and circumstances of their own audits. Such an understanding requires dialogue with the engagement team to understand the nature of the deficiencies identified, how they may or may not relate to the particular audit, and how the engagement team has addressed them as part of their audit plan.

Another example of the importance of context heard during earlier outreach efforts is a scenario in which an engagement team is experiencing higher than expected overtime. This could be caused by many different factors, including, for example, that the engagement team encountered an unforeseen issue that required extra time, or that the team is overburdened. A timely dialogue with the auditor regarding such matters would allow the audit committee to better understand the specific factors driving the measure and to address potential issues with the engagement team and evaluate the reasonableness of any response.

Another common theme that emerged in the roundtable discussions was that, in many cases, the drivers of the quality of an audit are not inherently quantifiable and, as a result, require evaluation of qualitative factors, such as the engagement team having the appropriate mindset to bring forth professional skepticism and requisite auditor judgment. While quantitative AQIs may inform qualitative aspects of the audit, they cannot be a substitute for an audit committee member's judgment of these qualitative aspects. Moreover, many participants pointed out that evaluating audit quality should be a multidimensional process that focuses on more than the external auditor. While recognizing that responsibility for performing an audit rests with external auditors, these participants noted that without a high-quality internal organization – management and internal audit – achieving high-quality financial reporting and the related audit is challenging.

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<sup>6</sup> PCAOB Release No. 2015-005, July 1, 2015, p. 7.



Participants agreed that the process of identifying and evaluating AQIs needs to be driven by the audit committee and iterative. It also will require continuous assessment and refinement in order to meet an audit committee’s changing information needs.

Generally, participants also believed that any disclosures of engagement-level AQI information should be voluntary, and expressed concern that mandated public disclosure of engagement-level AQIs could lead to unintended consequences in the marketplace. For example, some participants said that publication of engagement-level AQIs could lead to the production of boilerplate, or one-size-fits-all, approaches that would likely change the nature and usefulness of the information in their discussion with the external auditor. These and other key themes are discussed below.

## AUDIT COMMITTEES SUPPORT THE CONCEPT OF AQIS

As noted above, there was widespread agreement that audit quality is a function of the competency and effectiveness of the external audit team, and recognition that the same attributes in company management, internal audit, and audit committees also play critical roles in contributing to the quality of financial reporting and the related audit.<sup>7</sup> While a few participants felt they had what they needed, and that the development of AQIs was “a solution in search of a problem,” most participants generally agreed that AQIs could enhance audit committee discussions with the auditor about the engagement team’s experience and skills and lead to greater understanding of how those attributes contribute to the audit process. Participants also believed that AQIs could help focus discussions on how the engagement team allocates key resources to address and manage potentially serious audit risks, such as using a specialist to audit a significant estimate. High value

“I particularly liked the range of AQIs that were being suggested for engagement team knowledge experience and workload because those give insights into the capability of the firm to take on the task and some check about whether what was put into the original plan – the assessment of risk and the allocation of resources – has worked out.”

– Chicago Roundtable Participant

<sup>7</sup> While the roundtable discussions focused on indicators that could help audit committees assess the quality of their external audit, some noted that the external auditor’s performance is but one aspect of quality financial reporting, albeit a critical one.

was attributed to AQIs that could help clarify how the audit firm’s tone at the top and system of quality control support the engagement team in delivering quality audit outcomes. One audit committee member said that if AQI information was distributed to the audit committee in advance of the meeting, it likely would help the committee ask more insightful questions of the auditor and increase the efficiency and impact of their limited time together.

Several participants offered that AQIs could be another tool for audit committees to use when selecting the external auditor, as some feared the primary consideration too often used by some may be the audit fee. Some audit committee members favored AQIs as a way to provide a framework supporting a deliberate process in reviewing competing audit firm proposals and ultimately choosing a new audit firm or reappointing the incumbent firm, as the case may be, during an audit tender.<sup>8</sup> For example, AQIs on the extent, distribution, and timing of planned audit hours could be gathered from prospective audit firms at the tendering stage. Audit committees could use the information to gain perspective on strategy and timing of work, which would help audit committees evaluate competing auditors’ proposals.

“As with anything of quality, it starts with people. For audit committees, audit quality starts with the lead audit partner – the quality, experience, background, perspective, and philosophy of how they approach client service and working with an audit committee. That’s tough to quantify.”

– *New York Roundtable Participant*

Some participants viewed AQIs as a potentially useful tool in initiating dialogue with prospective lead engagement partners in anticipation of the current lead engagement partner rotating off the engagement. Many participants said they evaluate a prospective lead engagement partner to determine whether he or she has the right mix of skills and experience to manage audit risk and can set the right tone with the rest of the engagement team in promoting independence, objectivity, and skepticism. While many accepted that AQIs can support this process, they did not believe that analyzing quantitative AQIs alone could replace the audit committee’s assessment of the independence, objectivity, and skepticism of partner candidates.

<sup>8</sup> Participants thought this would be of growing importance when mandatory audit firm rotation becomes effective in the United Kingdom and other European Union member states in 2016.

## QUALITATIVE ASPECTS OF THE AUDIT NECESSARY TO INFORM QUALITY

Many participants noted that quantitative AQIs can provide a good starting point for a discussion, but by themselves cannot lead to an understanding of those factors that are the actual drivers of audit quality. Participants emphasized the importance of the external auditor’s mindset in terms of the engagement team’s capacity and propensity to exercise professional skepticism and question and critically assess audit evidence. To participants, the importance of this mindset went hand in hand with those skills associated with a person’s emotional intelligence quotient or EQ.<sup>9</sup>

According to participants, engagement teams with high EQ display intellectual rigor, and strong communication and

influencing skills, and are highly valued for their ability to quickly and effectively resolve matters with management, the audit committee, and their firm’s national office, as appropriate.

Participants acknowledged that there are AQIs that might contribute to a conversation about the competence and capacity of the engagement team to apply independent judgment and professional skepticism, but they did not believe that relying on these types of AQI data alone would be helpful in assessing such skills, as they are not easily quantified. The participants noted that they can better assess mindset and EQ through conversational discourse with the engagement team, and explained that they would value additional tools to help them consider these important qualities.

Participants agreed that an audit firm’s tone at the top serves as an important indicator of the incentives that drive auditors to deliver quality outcomes. Through an audit firm’s tone at the top, the leadership emphasizes audit quality and holds itself accountable for the audit firm’s system of quality control. Having the proper tone at the top is essential for creating a firm culture that supports professional skepticism and the expression of EQ at the engagement level. It is also something that is difficult to capture in an AQI or set of AQIs. Some participants indicated that they do review audit firms’ messaging around their tone at the top and the

“An independent professional’s skepticism is most important and is also the most immeasurable of any criteria.”

– New York Roundtable Participant

<sup>9</sup> Emotional Intelligence Quotient (EQ) is a term created by two researchers – Peter Salavoy and John Mayer – and popularized by Dan Goleman in his 1996 book of the same name. In a workplace, this term refers to the individual’s ability to sense, understand and effectively apply the power and acumen of emotions to facilitate high levels of collaboration and productivity.

“What I depend on first and foremost is the tone at the top — the integrity of the organization.” — *New York Roundtable Participant*

measures meant to capture the effectiveness of such messaging, like employee surveys provided to the audit committee by the engagement team. In their minds, however, these measures fall short of being sufficient indicators of how audit firms incentivize their audit partners and personnel to deliver high quality audits.

Participants offered suggestions on qualitative factors that could serve to more adequately validate a firm’s tone at the top and commitment to audit quality. A recurring suggestion related to how firms structure compensation of audit partners and personnel to reward quality. Having an

“You can’t have audit quality without a quality audit committee, quality management, and quality internal audit. To me, the evaluation of audit quality is more multidimensional than just focusing on those items that relate back to the audit firm and the team.”

— *New York Roundtable Participant*

“...the quality comes from the entire audit which includes the input, the audit process, as well as the output.”

— *Singapore Roundtable Participant*

appropriate “compensation philosophy,” some reasoned, would be one indication that a firm has the right tone at the top. Another suggestion was to include information about the systems in place at the audit firm to strengthen quality control and detect and deter wrongdoing within its own organization.

Several participants noted that the audit committee also plays a role in setting the right tone that supports and encourages auditors, both internal and external, to maintain a questioning mindset and work effectively with the audit committee and management to address and resolve issues. In pursuit of

setting the appropriate tone, some audit committees conduct a system-wide review that includes an assessment of how well the work of internal audit was integrated into the external audit process. Some participants pointed to the fact that the audit committees on which they serve routinely undertake some form of performance self-assessment, which often included a conversation about whether the audit committee’s process for evaluating the previous year’s audit and planning for the current year audit was adequate and complete. This evaluation might be another type of indicator of audit quality. Some participants advocated for the development of additional tools that could guide audit committee self-assessments of not only their oversight of the external audit, but also that of the company’s controllership, internal audit functions, and tone at the top.

## AUDIT COMMITTEES SHOULD DRIVE PROCESS OF USING AND REPORTING ON AQIS

Because audit committees represent investors, most roundtable participants view themselves as the primary audience for AQI information as it relates to a particular company's financial reporting and audit oversight. Participants felt that as audit committee members they are best informed of the circumstances surrounding the audit engagement, and are, therefore, ideally placed to determine which AQIs are relevant to a given audit engagement. Participants also felt that audit committees are best situated to discuss AQI information with the audit engagement team and management to obtain the necessary context that gives significance to AQIs or fluctuations in AQIs over time.

There was agreement among those audit committee members who participated in the pilot testing and those who participated in the roundtables that there is no "right" set of AQIs that could, for every audit engagement, consistently add value and insight to audit committee discussions with the engagement team. This is due in part, they explained, to variations among companies' geographic locations, industries, and scope of operations. An overwhelming majority of roundtable participants agreed that the use and reporting of AQIs should remain voluntary to allow for audit committees to experiment with AQIs and tailor the information to address the unique facts and circumstances of their particular audit. For example, audit committee members who serve on boards of global companies said they would focus on AQIs that helped them evaluate how well the global aspects of the audit are being managed by the audit firm. Participants also believed that mandating the communication or reporting of specific AQIs could overburden audit committees with required or expected communications on matters that may not be relevant to the quality of their particular audit. Some participants expressed that they viewed AQIs as generators of questions for the audit committee to ask of the external auditor, as opposed to serving as sources of useful information about audit quality on their own.

Some participants thought a list of common AQIs that could be widely accepted and understood might elevate the use of AQIs among a greater population of audit committees. Over time, experimentation by audit committees may result in the fine tuning or identification of AQIs or a set of AQIs that are widely accepted as useful in the audit committee's dialogue with the auditor.

“ I think indicators precipitate important conversations, but those conversations need to be tailored to the individual engagements, voluntary, and very qualitative. ”

– Chicago Roundtable Participant

“ I think we will continue to fine tune these measures or indicators and this will allow us to have a useful dialogue with the auditor.”

– Singapore Roundtable Participant

“ We ought to be careful not to be too prescriptive because every company is different and every audit is going to be unique.”

– New York Roundtable Participant

This also could serve to promote consistency among audit firms in terms of how certain AQIs are calculated and to generate expectations for audit firms to assist in providing the data associated with these AQIs. Firm-level transparency reports or audit quality reports that are made publicly available by some of the audit firms provide an example of some level of consistency of AQI reporting across firms.<sup>10</sup> The CAQ has observed that among those publicly available reports issued by the largest audit

firms in the United Kingdom, the United States, the Netherlands, and Australia, examples of similar types of AQIs include measuring revenue splits between audit and non-audit services, the results of externally published inspections, and a qualitative description of investor engagement. Such voluntary reporting allows for comparison of firm-wide AQI data, to the extent that two firms report the same AQIs.<sup>11</sup>

Audit committee members who serve on the boards of multiple companies pointed out that standardization of AQIs at the engagement level would be challenging given the variation among companies' business models, scope of operations, and risk profiles. They observed that choosing which AQIs best fit the facts and circumstances of each audit engagement requires the audit committee to apply judgment. In applying that judgment, participants said they would likely choose different AQIs on which to focus depending on the company, and that AQIs of importance to a company could change from one year's audit to the next. Even in those cases where they would look at the same AQIs across the different companies, the contextual information they would solicit from the external audit team to explain the significance of an AQI or change in that AQI over time likely would be very different. On the other hand, some participants wondered whether a core set of AQIs could be identified as particularly useful to certain types of companies, such as those in certain complex or high risk industries, or for companies with significant operations in many different countries. Others cautioned that standardization of AQIs runs the risk of turning reports of AQI information into boilerplate documents, which in turn could diminish their usefulness to audit committees.

<sup>10</sup> In general, these reports are intended to provide greater transparency into the public company audit process by assisting financial statement users, audit committee members, and other stakeholders in understanding how an audit firm's management and operations support the performance of high quality audits.

<sup>11</sup> Since 2007, the International Organization of Securities Commissions (IOSCO) has been evaluating the role of audit firm transparency reporting in protecting investors and ensuring that markets are fair, efficient and transparent. In November 2015, IOSCO issued a final report on this work which posits that high quality transparency reports issued by audit firms could reinforce audit firm internal policies and practices aimed towards improving audit quality and assist those responsible for selecting a public company auditor by providing information that would enable them to compare firms on the basis of information on a firm's audit quality. See, *Transparency of Firms that Audit Public Companies* (Final Report), available at [www.IOSCO.org](http://www.IOSCO.org). See also the CAQ's *Resource on Audit Quality Reporting* (August 2013), which highlights elements of audit quality that audit firms could consider in refining or developing their own reporting regarding their public company audit practice, and which is available at <http://www.thecaq.org/docs/audit-committees/caqresourceonauditqualityreporting.pdf>sfvrsn=0.

## POTENTIAL UNINTENDED CONSEQUENCES OF PUBLIC REPORTING OF AQI INFORMATION

Participants acknowledged growing interest from investors for more information about how the work of the audit committee fulfills its responsibilities. In the case of AQI information, participants observed that it is not possible for investors to be privy to the dialogue necessary to bring focus on the significance of AQIs to audit quality at the engagement level. On this basis, many participants believed it would do more harm than good to publicize engagement-level AQI information.

Participants expressed concern that public AQIs could turn into a set of inconsistent and misleading benchmarks or tests. Such metrics, without an accompanying dialogue to provide the appropriate context, could lead the recipient to draw incomplete or uninformed conclusions regarding the presence or lack of audit quality. Also, there could be a tendency to choose a particular set of metrics because they are easily and reliably measured rather than being relevant to audit quality. This could lead to a check-the-box compliance exercise or, worse, a misallocation of resources and overemphasis on managing select metrics to the detriment of a focus on other factors that might be more pertinent to quality performance.

“This is ultimately a judgment. It’s not a math test to see whether or not you got a 90% to have quality.”

– New York Roundtable Participant

“It’s an evolution, not a revolution.”

– London Roundtable Participant

Some participants observed that the audit model is also changing in response to technical improvements to audit methodologies and as new, macro and microeconomic risks emerge. For example, audit firms are developing capabilities to incorporate data analytics testing procedures on audit evidence into their audit methodologies, which should increase the efficiency and effectiveness of auditors. Accounting and auditing standards also are evolving to address emerging risks. In light of these factors, some participants posited that the development and required use of a static set of AQIs could serve to reinforce outdated audit methodologies and impede innovation in audits, which over time could risk reducing the overall relevance of the audit, the role of the auditor, and, ultimately, audit quality. To continue to be helpful and not a hindrance, AQIs, they asserted, should be allowed to evolve as well.

## CONCLUSION

By sharing input, feedback, and findings from its multi-year effort to explore AQIs, the CAQ aims to further the dialogue and study of AQIs. This publication is intended to advance that effort. The CAQ anticipates that greater awareness, discussion, and collaboration will lead to the development of a common path forward on AQIs and, potentially, best practices for their use.

“I am a supporter of audit quality indicators. I believe the project has great merit, and I’m glad to see people out in front of it.”

– *New York Roundtable Participant*

The feedback received on the *Approach* through these efforts has reinforced the view that although there is no “right” set of AQIs for every audit engagement, the *Approach* provides a good foundation for further development of tools that could advance the oversight capability of the audit committee with respect to both the quantitative

and qualitative aspects of the audit process. Audit committee members expressed an appetite for more qualitative information, as well as guidance on how to use firm-level AQI information already publicly available to enhance the dialogue about their audits. Allowing audit committees to continue to explore AQIs in an audit committee-driven, voluntary environment could facilitate the development of a common principles-based framework that could promote consistency in application of AQI use and reporting while maintaining the flexibility audit committees need to tailor approaches to their specific information needs.

All stakeholders in the financial reporting and audit process can benefit from an understanding of how certain AQIs may correlate with audit quality. For its part, the CAQ will continue to monitor and engage in this exciting and important global dialogue. The CAQ looks forward to the outcome of the PCAOB’s project on root cause analysis, which seeks to analyze certain measures of audit quality.<sup>12</sup> The CAQ also will monitor the work of other organizations around the world that have an AQI project on their agenda. The involvement of these organizations and their efforts will continue to be invaluable for driving continued stakeholder interest in identifying AQIs that are both relevant to audit quality and which can be consistently and reliably measured.

<sup>12</sup> PCAOB staff briefing memo, *Initiatives to Improve Audit Quality – Root Cause Analysis, Audit Quality Indicators, and Quality Control Standards*, June 24–25, 2014 SAG meeting.



The CAQ expresses its sincere thanks and gratitude to the roundtable participants, as well as the investors, academics, audit committee members, and audit firm representatives who served on the Stakeholder Advisory Panel, and the participants in the pilot testing. Their generosity with their time – and their valuable insights and perspectives – have helped to advance the discussion on this critical issue. Additionally, the CAQ extends its gratitude and appreciation to the Singapore Institute of Directors and the Singapore Accounting and Corporate Regulatory Authority for their support in organizing the Singapore roundtable. The CAQ will continue its rewarding interaction with these stakeholders as it further explores and studies AQIs.

## APPENDIX: STAKEHOLDER ADVISORY PANEL AND ROUNDTABLE PARTICIPANTS

### STAKEHOLDER ADVISORY PANEL

Stephen Chipman, Retired Chief Executive Officer, Grant Thornton LLP; Former CAQ Governing Board AQI Lead (2012–2015)

Peggy Foran, Senior Vice President, Chief Governance Officer, and Corporate Secretary, Prudential Financial, Inc.

Arnold Hanish, Audit Committee (AC) Chairman, Omeros Corp.

Michele Hooper, President and CEO, The Directors' Council; AC Chairman, PPG Industries, Inc.; CAQ Governing Board Lead AQI (2015–Present)

Robert H. Herz, Executive in Residence, Columbia Business School

William Kinney, Charles and Elizabeth Prothro Regents Chair in Business, University of Texas at Austin

Charles Noski, AC Chairman, Microsoft Corp. and Avon Products, Inc.

Lynn Paine, Senior Associate Dean, Harvard Business School

Zoe-Vonna Palmrose, Professor of Accounting, University of Washington

Anne Sheehan, Director of Corporate Governance, California State Teachers' Retirement System

### ROUNDTABLE PARTICIPANTS

#### LONDON: JUNE 2, 2015

##### DISCUSSION MODERATOR:

Mark Jeffries, Economist and Keynote Speaker

##### PARTICIPANTS:

Mike Ashley, AC Chairman, Barclays

Steve Bailey, Managing Director, Aim Proactive Ltd

Hywel Ball, Managing Partner, EY LLP

Lisanne Barrell, Senior Manager, Deloitte LLP

Wanda Eriksen, AC Member, AXA Winterthur and Meyer Burger

Thorsten Grenz, AC Chairman, Draeger

David Isherwood, Partner, BDO LLP

Shonaid Jemmett-Page, AC Chairman, GKN plc

Nick Land, AC Chairman, Vodafone Group plc

David Lindsell, AC Chairman, Drax Group plc and Premier Oil plc

Gillian Lord, Partner, PwC LLP

Steve Maslin, Partner, Grant Thornton UK LLP

John Ormerod, AC Chairman, ITV plc

Kevin Parry, AC Chairman, Standard Life plc

Richard Pinckard, Partner, KPMG LLP

Eric Tracey, AC Chairman, Findel Plc.

Guy Wilson, AC Chairman, Fresnillo plc

#### CHICAGO: JUNE 23, 2015

##### DISCUSSION MODERATOR:

Leslie Seidman, Executive Director, Center for Excellence in Financial Reporting, Pace University, Lubin School of Business; Director, Moody's Corp. and FINRA

##### PARTICIPANTS:

Michelle Applebaum, AC Member, Northwest Pipe

Jeffrey Brown, AC Chairman, Teachers Insurance and Annuity Association

Jennifer Burns, Partner, Deloitte LLP

Howard Carver, AC Member, Assurant Inc., Pinnacol Assurance, and StoneMor Partners

Rodney Chase, AC Chairman, Tesoro

Ruth Ann Gillis, Board Committee Member, Snap-On, Inc. (Audit), KeyCorp (Risk), and Voya Financial (Finance)

David Landsittel, Former Chairman and Former AC Chairman, COSO

Janet Malzone, Midwest Audit Practice Leader, Grant Thornton LLP

Mark Zorko, AC Chairman, MFRI, Inc.

## NEW YORK: JUNE 29, 2015

### DISCUSSION MODERATOR:

Leslie Seidman, Executive Director, Center for Excellence in Financial Reporting, Pace University, Lubin School of Business; Director, Moody's Corp. and FINRA

### PARTICIPANTS:

Joan Amble, AC Member, Brown-Forman Corp. (Chair), Sirius XM Radio (Chair), Booz Allen Hamilton, and Zurich Insurance Group

Raymond J. Bromark, AC Chairman, YRC Worldwide, Inc., CA, Inc. and Tesoro Logistics GP, LLC

J. Frank Brown, Managing Director and COO, General Atlantic

Stephen Chipman, Retired Chief Executive Officer, Grant Thornton LLP; Former CAQ Governing Board AQI Lead (2012-2015)

John Cody, AC Chairman, Gannett

J. Michael Cook, AC Chairman, Comcast

William Ehrhardt, AC Chairman, Oppenheimer Holdings, Inc.

Timothy Flynn, AC Chairman, Walmart

Robert Hagemann, AC Chairman, Zimmer Biomet Holdings and Ryder Systems

Robert Herdman, AC Chairman, Cummins, Inc. and WPX Energy, Inc.

Robert H. Herz, Executive in Residence, Columbia Business School

Michele Hooper, President and CEO, The Directors' Council; AC Chairman, PPG Industries, Inc.; CAQ Governing Board Lead AQI (2015-Present)

Peter Kind, AC Member, Enable Midstream Partners (Chair) and NextEra Energy Partners

Lewis Kramer, AC Chairman, L-3 Communications

Catherine Lego, Board Member, SanDisk Corp. (AC Chair), Lam Research and Fairchild Semiconductor

Douglas L. Maine, Limited Partner and Sr. Advisor, Brown Brothers Harriman & Co.

Charles Noski, AC Chairman, Microsoft Corp. and Avon Products, Inc.

Joseph Perry, AC Member, Dime Community Bancshares

Thomas Presby, AC Chairman, ExamWorks Group, Inc.

Richard Randall, AC Chairman, Steve Madden, Ltd.

## SINGAPORE: JULY 27, 2015

### DISCUSSION MODERATOR:

Willie Cheng, Chairman, Singapore Institute of Directors, and AC Chairman, United Overseas Bank

### Special Guest:

Julia Tay, Deputy Chief Executive, Singapore Accounting and Corporate Regulatory Authority

### PARTICIPANTS:

Fong Heng Boo, AC Chairman, CapitaRetail China Trust Management Ltd

Euleen Goh, AC Chairman, Capitaland Ltd

Chua Phuay Hee, AC Chairman, Perennial Real Estate Holdings Ltd

Tan Boon Hoo, AC Chairman, Bumitama Agri Ltd

Lee Chiang Huat, AC Chairman, Keppel Reit

Tan Ngiap Joo, AC Chairman, Oversea-Chinese Banking Corp.

Goh Boon Kok, AC Chairman, Pan Asian Holdings Ltd

Soon Tit Koon, AC Chairman, SPH Reit

Kevin Kwok, AC Chairman, Singapore Exchange Ltd

Fang Ai Lian, AC Chairman, Banyan Tree Holdings Ltd

Jenny Lim, AC Chairman, CDL Hospitality Real Estate Investment Trust

Paul Ma, AC Chairman, Keppel Infrastructure Trust

Yap Chee Meng, AC Chairman, Keppel Land Ltd

Bahren Shaari, AC Chairman, Singapore Press Holdings Ltd

Alan Ow Soon Sian, AC Chairman, M1 Ltd

Neo Boon Siong, AC Chairman, Keppel Telecommunications & Transportation Ltd

Bernard Tay, AC Chairman, SIIC Environment Holdings Ltd

Timothy Teo, AC Chairman, Guocoland Ltd

Danny Teoh, AC Chairman, Keppel Corp. Ltd



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