



Financial Reporting Council

AUDIT QUALITY INDICATORS

AQR THEMATIC REVIEW

MAY 2020

WHAT are Audit Quality Indicators (“AQIs”)?

AQIs are quantitative and qualitative measures of external audit quality, including both inputs and outputs. They indicate the firm’s historical, present or future ability to perform quality audits, as well as providing insights into audit quality when read with other AQIs and relevant context.

What is the DIFFERENCE between AQIs and Key Performance Indicators (“KPIs”)?

In many respects AQIs and KPIs are similar, and in some cases, the same. The distinguishing characteristic of AQIs is that they are viewed through a quality lens to either: assess audit quality; or determine actions that will improve audit quality.

What is the PURPOSE of monitoring AQIs?

Audit firms monitor AQIs so that they can identify where there may have been past failings in audit quality and where ongoing factors that are detrimental to current or future audit quality may still exist. This allows the firms to identify remedial actions that can be taken, on a timely basis.

WHO should be using AQIs?

Audit Committees should make use of AQIs when appointing their auditor, and to assess quality on an ongoing basis, by benchmarking against other firms. Management and leadership within audit firms should use AQIs to encourage a culture focused on quality.

What is the VALUE of monitoring AQIs over time?

By monitoring AQIs, firms can understand whether they have the correct conditions - including policies, procedures and resources - in place to encourage high-quality audits. Firms can also monitor trends in quality. This provides insight into the functioning of the audit practice so that firms can identify where changes are needed.

What is the difference between PUBLISHED AQIs and those used within the firm?

AQIs that are reported publicly provide stakeholders with information to inform their views on a firm’s audit quality. These are typically historical metrics at a firm-wide level. AQIs that are used privately within the firms tend to be more capable of analysis at a more granular level. The AQIs used within firms tend to be broader than those reported publicly.

There are several definitions of AQIs. Having completed this thematic review, we continue to support the FRC’s definition as set out above. We also include an alternative definition provided by the Canadian Public Accountability Board below.



CANADIAN PUBLIC ACCOUNTABILITY BOARD DEFINITION OF AQIs

AQIs are quantitative measures about the external audit process. When assessed alongside relevant qualitative information, they provide insights about factors that may influence audit quality.

AQR Thematic Review

Audit Quality Indicators

Contents

1 Executive Summary 1.1 Key findings <i>page 1</i> 1.2 Next steps <i>page 3</i> 1.3 The audit process and AQIs <i>page 5</i>	2 Background to this Report 2.1 Objectives of this report <i>page 7</i> 2.2 Scope and evidence base <i>page 8</i> 2.3 Audit quality <i>page 9</i>	3 Thematic Review Findings 3.1 Benchmarking of AQIs used by the UK's six largest firms <i>page 11</i> 3.2 The effectiveness of AQIs monitoring by firms <i>page 30</i> 3.3 How other firms are using AQIs <i>page 33</i> 3.4 Public reporting of AQIs in Transparency Reports in the UK <i>page 33</i> 3.5 How AQIs are used in other countries <i>page 37</i>	A Appendix A Case studies Examples of how AQIs have been used to good effect <i>page 45</i>
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Executive Summary

1.1 Key findings

Monitoring of AQIs by the UK's six largest firms

KEY MESSAGE 1

Continue to develop and embed the monitoring of AQIs with the aim of improving the correlation to audit quality (section 3.1.1)

Monitoring of AQIs has the potential to improve audit quality. The firms are at different stages of developing the monitoring of their AQIs. Some are at an early stage, while others have been developing and embedding them for several years, focusing on a manageable set of AQIs, with a potentially higher correlation to audit quality.

KEY MESSAGE 2

Improve the reporting and governance of AQIs (section 3.1.2)

Firms are at different stages regarding the reporting and governance of AQIs. Good practices in this area include:

- Regular reporting of AQIs, for example monthly reporting with supporting commentary
- Monitoring of the AQIs by the firm's Independent Non-Executives (INEs) and the Board
- Inclusion of visual summaries of AQIs in the reporting packs
- Digitisation of AQIs to allow them to be monitored more frequently and analysed at a granular level

In order to have effective monitoring, it is important that reported AQIs are investigated and acted on, to reduce risks to audit quality. Regular reporting plays an important part in the effective monitoring of AQIs. Also, the ability of the firm's systems to obtain information on a "real-time" basis is important to allow AQIs to be monitored and acted on in a timely way.

KEY MESSAGE 3

Increase the extent of AQIs monitored at an audit engagement level (section 3.1.2)

Monitoring of AQIs is currently mainly at a firm-wide level. With the right systems, it is possible to focus more at an audit engagement level, to identify audit-specific issues that need addressing. An example is monitoring the completion of key milestones throughout the audit process, which is done by some firms. Firms should increase monitoring at an audit engagement level.

KEY MESSAGE 4

Consider the types of AQIs used (section 3.1.3)

We benchmarked the AQIs monitored by the largest six firms and found that those most commonly used related to:

- People (13 AQIs)
- Other inputs (6)
- Project management (5)
- Other processes (11)
- Management initiatives (6)
- Outcomes (11)

Some types of AQIs are monitored by all or most firms, in particular people-related AQIs and outcomes (such as inspection results). However, a number of AQIs are monitored by one or two firms only, especially those relating to processes. Other firms should consider whether these AQIs would be useful to monitor.

KEY MESSAGE 5

Increase the extent of leading and in-flight AQIs (section 3.1.5)

We categorised the different AQIs used by firms into 'leading' (before the audit commences), 'in-flight' (during the audit) and 'historical' (after the audits have happened). This showed that the majority of the AQIs monitored by the firms are historical, with a limited number of leading AQIs. The benefit of leading or in-flight AQIs is that firms can take action to improve the quality of individual audits before those audits are completed. Firms should increase the number of leading and in-flight AQIs to ensure they are identifying those areas of the audit where early action could prevent deficiencies in audits.

KEY MESSAGE 6

Consider the development of AQIs in the context of ISQM 1 (section 3.1.2)

International Standard of Quality Management 1 (ISQM 1) is expected to be implemented by firms by 2022. This will require firms to identify quality objectives, the risks to achieving them, and appropriate responses to mitigating those risks. Firms should consider what AQIs they will need to monitor achievement of their quality objectives and include them in their AQI development plans.

Monitoring of AQIs by the UK's other firms

KEY MESSAGE 7

Develop the monitoring of AQIs (other firms) (section 3.3)

Of the nine firms we reviewed outside the largest six audit firms, only two had commenced the monitoring of AQIs. The other firms should develop and start monitoring AQIs, and also consider the practices adopted by the largest firms.

Public reporting of AQIs by firms

KEY MESSAGE 8

Improve the reporting of AQIs in firms' Transparency Reports; FRC will consult publicly on a core set of AQIs (section 3.4 and 3.5)¹

The Policy and Reputation Group ("PRG") of the largest UK audit firms has agreed a common set of AQIs to be included in firms' annual Transparency Reports. We found that not all these AQIs are reported consistently.

We held roundtables with groups of investors and Audit Committee Chairs and found that they were not fully aware of the AQIs being published in Transparency Reports. They expressed an interest in a consistent and concise set of AQIs.

We have compared the AQIs reported publicly in the UK to other countries. The AQIs reported in the UK focus on outcomes, such as inspection results, whereas some of the other countries have a broader range of AQIs: for example, including people-related indicators. The FRC will consult publicly on a proposed set of AQIs that firms should include in their Transparency Reports.

Communication of AQIs on audits to Audit Committees

KEY MESSAGE 9

Improve the communication of AQIs on individual audits to Audit Committees (section 3.5)

Firms do not report AQIs on individual audits to Audit Committees. Some other countries have initiatives where audit teams report AQIs directly to Audit Committees. Firms should consider what types of AQIs and contextual information would help Audit Committees assess individual audit quality and begin reporting them to the Audit Committees of their audited entities.

¹ The timing of this consultation is to be decided and will be cognisant of the impact of COVID-19.

1.2 Next steps

Firms

The six largest audit firms should endeavour to:

- A1** Refine the AQIs that management within the firms monitor and review to ensure they bring about positive actions to improve audit quality. This should include a move to more leading and granular indicators.
- A2** Develop and automate their systems for reporting AQIs. Firms should consider areas of good practice highlighted in this thematic report and, where possible, adopt those initiatives.
- A3** Engage with stakeholders to understand which publicly reported AQIs are important to them and would enable them to make informed decisions based on appropriate and balanced information.
- A4** Develop AQIs on individual audit engagements to share with, and help, Audit Committees of audited entities assess audit quality.
- A5** The PRG should continue to refresh and improve the AQIs reported publicly in Transparency Reports to ensure they are consistent and relevant.

Other audit firms should:

- A6** Consider, where appropriate, developing a system of AQI monitoring.

FRC

The FRC intends to:

- B1** Consult publicly on a core set of AQIs that should be published in firm's Transparency Reports.² This consultation will also address:
 - How these reports can be more accessible to stakeholders, and/or whether a separate, condensed statement of AQIs would be more suitable; and
 - Ensuring consistent reporting across the firms.
- B2** Monitor internal development and use of AQIs as part of our routine supervision of the large audit firms. We will expect to see evidence of firms enhancing their AQIs and acting on information from AQIs to improve audit quality.

Audit committees, investors and other stakeholders

Investors and Audit Committees should continue with the actions we set out in our Thematic Review on Transparency Reporting in September 2019. Stakeholders should:

- C1** Read Transparency Reports and provide audit firms with constructive feedback.
- C2** Consider the types of AQIs and contextual information that would help them gauge audit quality, request these from audit firms, and respond to the FRC's consultation.

² The timing of this consultation is to be decided and will be cognisant of the impact of COVID-19.

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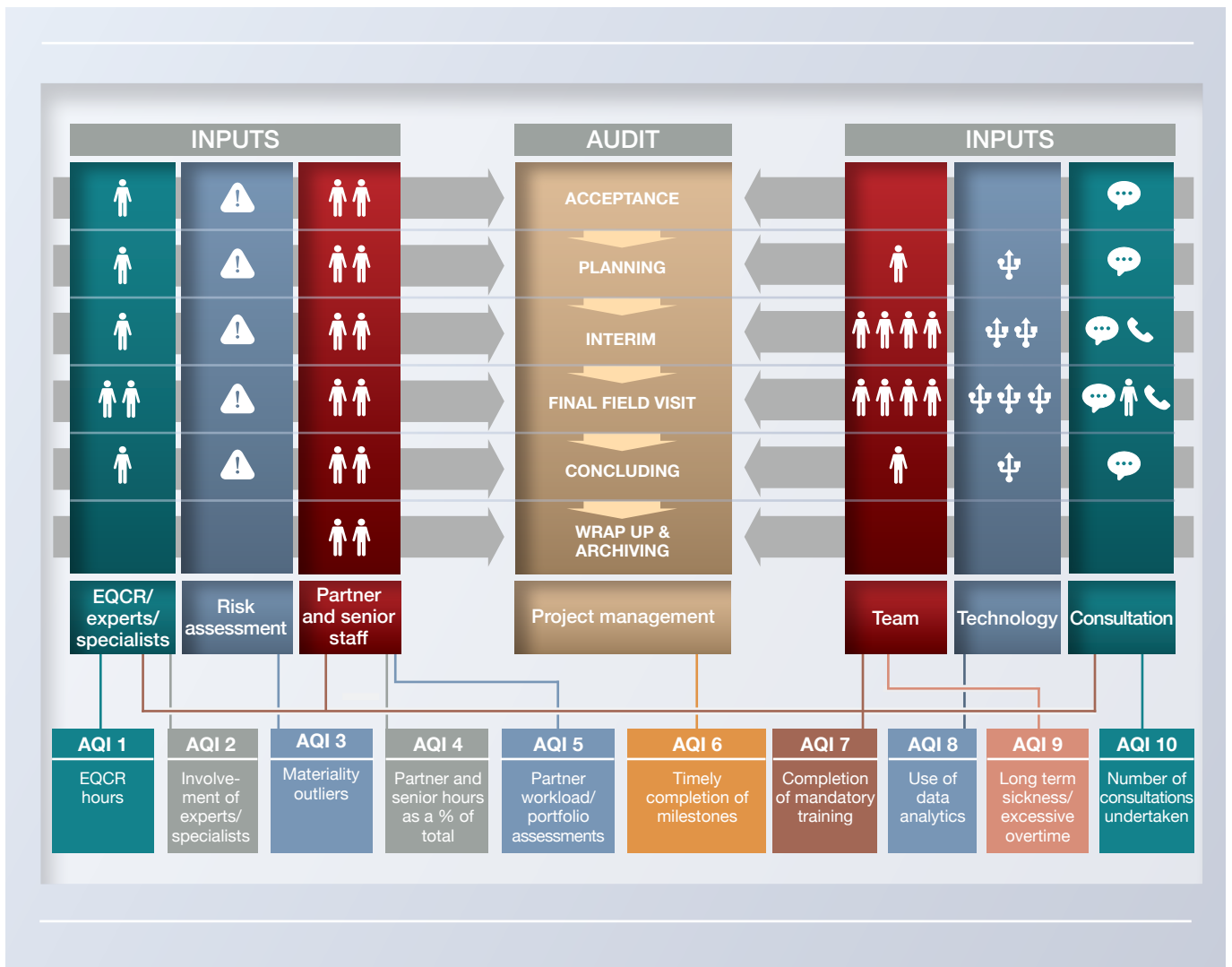
The FRC encourages the use of both publicly reported AQIs, and those reported privately within the firms.”

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1.3 The audit process and AQIs

The following diagram shows an example of a large Public Interest Entity (“PIE”) audit and the various resources required at each stage. At the foot of the diagram, some potential AQIs are identified to demonstrate the types of indicators that could be used, and how they can help assist in achieving a quality audit.



The next page expands upon the example AQIs shown above.

A blend of AQIs can help address the common causes of poor-quality audits. There is no one silver bullet, but a combination of interventions can work together to improve audit quality.

	WHAT IS BEING MEASURED?	HOW CAN THIS HELP WITH AUDIT QUALITY?
AQI 1 EQCR hours	The Engagement Quality Control Reviewer ("EQCR") hours are either compared to a minimum expected total hours, or as a percentage of total hours.	Ensure that there is sufficient and appropriate EQCR involvement and review time.
AQI 2 Involvement of experts/specialists	Number of experts or specialists involved on larger, more complex audits.	Ensure the right specialist skills are deployed to support partners in forming opinions on areas requiring a high degree of judgement or estimation.
AQI 3 Materiality outliers	Materiality levels set for all audits are compared to the benchmarks prescribed by the firm's methodology and outliers are highlighted.	Identify where materiality has been set too high or too low, which will impact on the level of audit work.
AQI 4 Partner and senior hours as a % of total	Tracks the percentage of total time spent by Partners and senior staff.	To ensure sufficient and appropriate partner involvement.
AQI 5 Partner workload/portfolio	Measures aspects of workload that may impact quality, including total overall workload in hours and number of clients compared to the average audit partner portfolio.	Audit partners working higher hours, managing larger numbers of clients, and/or higher risk engagements may be at risk for quality lapses.
AQI 6 Timely completion of milestones	Tracks that each key phase of the audit is completed and signed off on a timely basis. This includes that client acceptance is completed prior to planning commencement and that the planning is completed prior to performing any field work.	Engagements that have not completed milestones on a timely basis could have a higher likelihood of quality lapses.
AQI 7 Completion of mandatory training	Reports compliance with mandatory learning for all auditors from staff to partner, including EQCRs and consultation teams who need to refresh their technical expertise.	Compliance with mandatory learning is key to delivering quality audits. Monitoring and chasing non compliance ensures that audit staff are fully trained.
AQI 8 Use of data analytics	Identifies all larger audits where data analytics are not being used.	Questions the appropriateness of not using data analytics in the audit of large businesses that include high volume/low value transaction cycles.
AQI 9 Long term sickness/ excessive overtime	Reports the number of people by level who are absent from work above a certain number of hours because of sickness.	May indicate excessive pressure on an audit team that could lead to poor audit quality. Enables the firm to respond: for example, by increasing support to the team.
AQI 10 Number of consultations undertaken	Counts and reports the number of consultations.	Consultations may indicate good audit quality where audit teams seek technical advice on complex audit and accounting issues.

Background to this Report

Introduced in 2013, thematic reviews supplement our annual programme of reviews of individual audits. The reviews are deliberately more focused in scope, considering a selected area in greater depth.

In this section, we describe the objectives of this thematic review, how AQIs fit into the audit process, and how we obtained evidence relevant to this review. We also consider what is a high-quality audit.

2.1 Objectives of this report

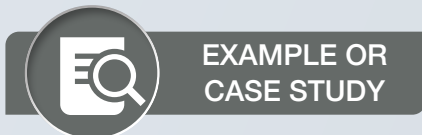
AQIs are used by audit firms as a basis to identify and take positive actions and interventions to improve audit quality. They may also be used as part of a monitoring process over the firms' system of quality control.

Auditors of PIEs³ are required to publish annual Transparency Reports. Audit firms that are within the scope of/or voluntarily adopt the Audit Firm Governance Code ("AFGC"), and are members of the PRG, voluntarily report 11 AQIs agreed upon and set out by the PRG. This public reporting of AQIs is helpful to enable stakeholders, including Audit Committee Chairs, to understand audit quality within the firms.

This thematic review seeks to provide an understanding of the AQIs being used by the large audit firms for internal audit quality management purposes, along with their systems of monitoring and reporting. This includes observing areas of good practice with the objective of promoting continuous improvement in audit quality. We also explore which publicly reported AQIs are important to stakeholders. Furthermore, we highlight areas of good practice we see in other countries that promote public reporting of AQIs and stakeholder engagement on this topic.

Auditors of PIEs are required to publish annual Transparency Reports

Key used throughout this document



³ At the time of reporting, PIEs are still defined by EU legislation.

2.2 Scope and evidence base

The scope of this thematic includes the following areas:

Benchmarking of AQIs used by the UK's six largest firms

We benchmarked the AQIs that are monitored privately within the six largest UK audit firms: BDO LLP ("BDO"); Deloitte LLP ("Deloitte"); Ernst & Young LLP ("EY"); Grant Thornton UK LLP ("Grant Thornton"); KPMG LLP ("KPMG"); and PricewaterhouseCoopers LLP ("PwC"). These are distinctly different to the AQIs publicly reported in the UK. We gathered information for this work stream of the thematic review as follows:



We requested that each firm provide a summary of their AQI monitoring and reporting system and analysis of the metrics that they use.



We held a workshop to analyse, benchmark and compare the information obtained.



We held meetings with each firm to discuss our benchmarking and comparisons, to discuss our findings, and to develop further analysis and case studies.



The information from the firms was provided between July and November 2019. Our review was performed from November 2019 to February 2020.

How other firms are using AQIs



We met with nine firms that were not within the scope of the benchmarking exercise (firms outside the largest six). We conducted interviews with these firms to understand their current and planned use of AQIs.

Public reporting of AQIs in Transparency Reports in the UK



We held two round tables, one with investors and one with Audit Committee Chairs and spoke with over one hundred Audit Committee Chairs. We have also met with the PRG.

How AQIs are used in other countries



We interviewed 15 regulators in other countries to understand how AQIs are being publicly reported and used by the regulator in those countries. We also obtained and examined available guidance material from each country.

2.3 Audit quality

What is considered high audit quality? The FRC has issued the following definition of a high quality audit.



DEFINITION OF HIGH QUALITY AUDIT

The FRC defines high quality audits as those that:

- Provide investors and other stakeholders with a high level of assurance that financial statements give a true and fair view;
- Comply with both the spirit and the letter of auditing regulations and standards;
- Are driven by a robust risk assessment, informed by a thorough understanding of the entity and its environment;
- Are supported by rigorous due process, avoid conflicts of interest, have strong quality management, and involve the robust exercise of professional judgement and professional scepticism;
- Challenge management effectively and obtain sufficient audit evidence for the conclusions reached; and
- Report unambiguously the auditor's conclusion on the financial statements.

Recent source:

FRC letter to the heads of audit of the larger audit firms in November 2019

<https://www.frc.org.uk/auditors/audit-quality-review/aqr-audit-reviews/high-quality-audits-letter>

The Brydon report highlights that this is one of several definitions of audit quality and suggests a unified definition for a broader concept of audit quality is needed. It is not within the scope of this thematic review to seek to reproduce the work performed in the Brydon report.



OBSERVATION: HOW AQIs USED WITHIN THE FIRMS CAN HELP

The AQIs the firms use privately can help to achieve this. The calibration of AQIs can help audit firms demonstrate their commitment to audit quality by setting the threshold at a level above and beyond a “compliant audit” to ensure that there are no major shortcomings. We consider this later in this report.



OBSERVATION: HOW PUBLICLY REPORTED AQIs CAN HELP

AQIs that are publicly reported can allow firms to make it clearer to stakeholders, and the general public, how they are striving to ensure consistent, high quality audits and what issues they are facing as a firm. This can help reduce the expectation gap and strengthen confidence in the audit firms.



“

AQIs help reduce the expectation gap and strengthen confidence in the audit firms.”

3

Thematic Review Findings

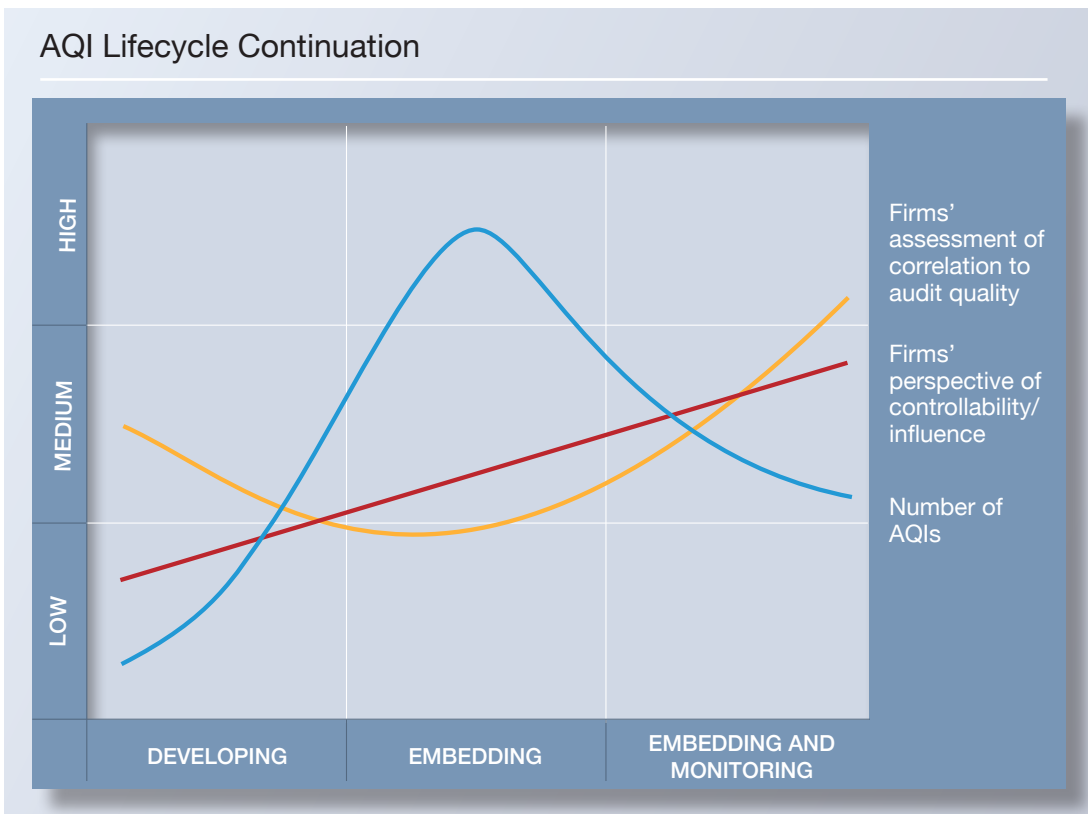
3.1 Benchmarking of AQIs used by the UK’s six largest firms

Our findings are set out within this section of the thematic review. We have structured our observations as follows:

- Orientation – analysis of the maturity of the firms’ systems of monitoring AQIs
- Reporting and governance – how the firms select, monitor and report AQIs
- The challenges in comparing and charting common AQIs
- The list of AQIs used by the firms
- The gameboard

3.1.1 Orientation – analysis of the maturity of the firms’ systems of monitoring AQIs

We asked the firms their perspective on the extent to which the AQIs they monitor have a direct correlation to audit quality, and can be used as a basis for actions to improve audit quality, including those AQIs that they are able to control or influence. We observed a relationship between these characteristics, the number of AQIs being used, and the relative maturity of each firms’ system of AQI monitoring, as shown in the following chart.



As the firms' systems for monitoring AQIs develop, the number of metrics being monitored initially increases. The number then reduces as firms gain more experience over time. The correlation of the AQIs to audit quality dilutes initially as the number of AQIs expands, but becomes stronger as firms gain more experience of using AQIs. The degree to which firms can take actions on the basis of AQIs progressively strengthens as firms become more experienced in designing and using AQIs. They are also more able to control how they use AQIs in order to improve their effectiveness. We explore each of these themes in more detail below.

We identified three distinct stages of maturity of the firms' systems of AQI monitoring, and the relative number of AQIs that they would monitor at each level.



DEFINITION – DEVELOPING AQIs

At the developing stage, a firm identifies and monitors a relatively small number of AQIs. We found that these were predominately lagging or historical AQIs and were mainly at the firm-wide level.



DEFINITION – EMBEDDING AQIs

At the embedding stage, a firm expands its monitoring program to include a larger suite of AQIs. We found that firms at this stage considered a wider range of metrics and were keen to explore whether these provided a more useful insight into good or poor-quality audits.

The further AQIs introduced tends to include those that are capable of being analysed at a more granular level to enable the firm to make more direct and focused interventions.

The mix of AQIs at this stage would also begin to include a blend of leading, in-flight and historical indicators.



DEFINITION – EMBEDDING AND MONITORING AQIs

At the embedding and monitoring stage, a firm capitalises on the learning experience from the embedding stage and refines its population of AQIs.

A firm rationalises its AQIs to focus on those that have a strong correlation to audit quality.

The resultant AQIs are distilled to an enriched set of metrics, including:

- More AQIs that are capable of drilling down to a granular level;
- A much stronger mix of leading or inflight indicators; and
- The performance of AQIs is kept under review and the set of AQIs periodically reviewed, for example every three to four years.



INSIGHT INTO FIRMS' ASSESSMENT OF THE CORRELATION OF AQIs TO AUDIT QUALITY

We found that the link between AQIs and audit quality, from the firms' perspectives, was relatively strong at the developing stage. The firms' initial selection of AQIs focused on those that measure audit quality more closely. For example, internal quality monitoring of completed audits, and the results of external quality reviews have the strongest correlation to audit quality and normally feature in the mix of AQIs at the developing stage.

The correlation at the embedding stage is diluted by the increased number of AQIs, some of which have a less direct relationship with audit quality.

At the embedding and monitoring stage, firms focus on a set of AQIs that they find have a good correlation to audit quality. However, this is a different set to the initial selection at the developing stage, including more granular and leading or inflight indicators.



INSIGHT INTO FIRMS' PERSPECTIVES ON HOW THEY MAY USE AQIs TO CONTROL OR INFLUENCE AUDIT QUALITY

We found that firms are increasingly able to act to improve audit quality in response to AQIs as their systems of AQI monitoring mature.

The firms tended to select the AQIs that they could influence or use to make positive interventions as they progress through the embedding and embedding/monitoring phases.

For example, the results of internal and external quality monitoring have a strong correlation to audit quality, but external quality monitoring is not subject to control. In contrast, internal quality monitoring through hot reviews may be used to influence audit quality by increasing the number and timeliness of reviews performed.

Most firms have been monitoring AQIs for less than five years. Once a firm is in the embedding and monitoring stage, a reappraisal of the suite of AQIs should take place periodically. Initiatives that have been judged to be successful can be deselected, and a firm can begin to focus on newer and emerging quality issues. Factors to consider when determining the frequency of overhauling AQIs include:

- The rate of turnover in audit staff. Generally, a high proportion of audit staff will turn over on a three to four-year cycle; and
- Some AQIs are focused on behavioural changes, which may take two to three years to embed.



EXAMPLE

One firm is reviving the AQL of monitoring hours spent by EQCR at an engagement level. This AQL was previously deselected. However, the firm wished to refocus on this area as part of an initiative to monitor more engagement level AQLs on a real-time basis, so that more effective interventions can be made.

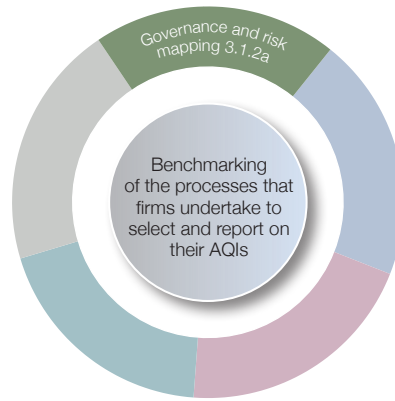
We have seen that the firms with more mature systems have already refreshed their suite of AQLs. A factor to consider when determining the frequency of overhauling AQLs is the rate of turnover in audit staff. Generally, a high proportion of audit staff will turnover on a three to four-year cycle, with some staff making the decision to exit the profession upon qualification.

This cycle appears sensible, as some AQLs are focused on behavioural changes which may take two to three years to embed. Initiatives that have been judged to be successful can be periodically deselected, and the firm can begin to focus on newer and emerging quality issues.

3.1.2 Reporting and governance – how firms select, monitor and report AQLs



3.1.2a Governance and risk mapping



GOOD PRACTICE IN GOVERNANCE AND RISK MAPPING

Firms have involved their Boards and the Independent Non-Executives (“INEs”) in the setting and review of AQIs. Two firms have mapped their AQIs to their risks.

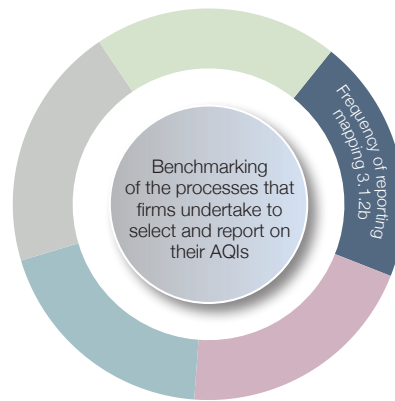
	Firm					
	A	B	C	D	E	F
Do the INEs review the setting of the AQIs?	✓		✓		✓	
Are the AQIs reported to the Board and the INEs on a regular basis?	✓		✓		✓	
Are AQIs mapped to the firm’s risks?			✓		✓	

Some firms involve their INEs in the process of setting AQIs and regularly report their AQIs to the Board and the INEs. Of the firms that do not, one reports AQIs to their audit executives on an exception basis.

The firms that map risks to AQIs do so only for the most significant AQIs currently. They intend to extend this to all metrics in the future. Another firm is currently in the process of mapping its AQIs to its firm-wide risk register.

We have considered governance related aspects of AQIs in respect of the impact of the forthcoming proposed International Standard of Quality Management 1 (“ISQM1”), and how AQIs are linked to partner and staff reward and pay structures. We have included separate thought pieces on both subjects at the end of this section.

3.1.2a Frequency of reporting



THOUGHT PIECE: WHY IS FREQUENCY OF REPORTING IMPORTANT?

The frequency with which AQIs are monitored and reported helps determine whether corrective action can be taken on a real-time basis. Frequent reporting allows quality issues to be addressed proactively.



GOOD PRACTICE IN FREQUENCY OF REPORTING

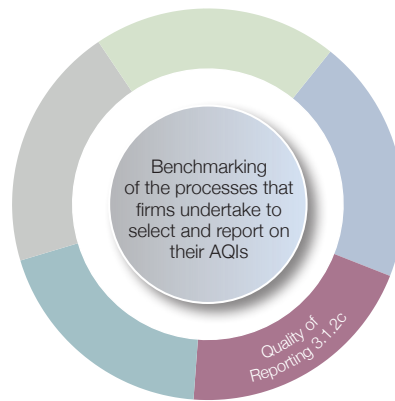
One of the firms that monitor AQIs on a monthly basis prepares a particularly good quality reporting pack. Some firms are moving to monitoring more AQIs on a monthly, or even real-time basis, and are developing automated data flows to support this.

	Firm					
	A	B	C	D	E	F
AQIs monitored on a monthly basis	✓		✓		✓	✓

Some AQIs relate to annual processes such as the staff survey or partner portfolio reviews and cannot be monitored more frequently. However, four of the firms have chosen to monitor at least some AQIs on a monthly basis. Of the two remaining firms, both have delegated the monitoring of AQIs to process owners or members of their central team so that there is monitoring of these measures in the intervening period.

We have considered the extent to which the information flows and reporting are automated, and have included a thought piece and case study on this subject at the end of this section.

3.1.2c Quality of reporting



THOUGHT PIECE: WHY IS QUALITY OF REPORTING IMPORTANT?

A clear, comprehensible and digestible AQI reporting pack allows management and those charged with governance to identify trends at a firm-wide, business unit, office and engagement level and highlight where follow-up action is needed.



GOOD PRACTICE IN QUALITY OF REPORTING

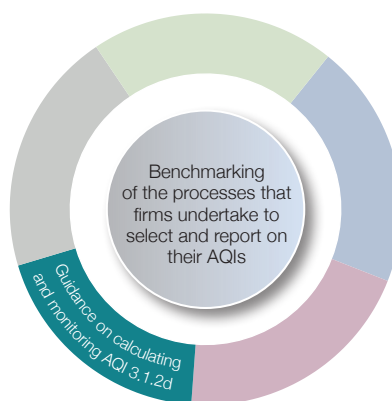
Most firms are preparing a consolidated reporting pack with detailed analysis of trends and their underlying drivers. Some firms are reporting on actions taken to address issues arising in the previous reporting pack.

	Firm					
	A	B	C	D	E	F
Reporting pack produced on AQIs with narrative analysis	✓	✓	✓		✓	
Analysis explains the drivers of trends and the follow-up actions taken			✓		✓	

Of the four firms that produced AQI reporting packs, two included extensive narrative analysis. One firm included, for key AQIs, the trend noted in the previous periods and the actions being taken, with a risk rating for each AQI based on this trend and the success of follow-up actions. This draws attention clearly to how AQIs are being utilised and where the firm needs to focus attention.

The reporting packs for two of the firms were large in comparison to the other firms. Both firms explained that further contextual management information was necessary to assist in understanding the AQIs presented.

3.1.2d Guidance on calculating and monitoring AQIs



THOUGHT PIECE: WHY IS GUIDANCE ON CALCULATING AND MONITORING AQIs IMPORTANT?

Clear guidance over how AQIs should be calculated and reported ensures consistency and thus comparability, which allows trends and anomalies to be identified.



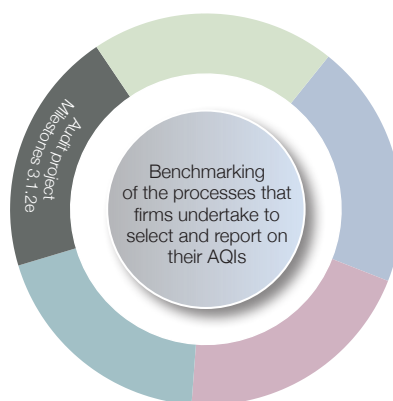
GOOD PRACTICE IN GUIDANCE ON CALCULATING AND MONITORING AQIs

Most firms' global networks have issued explicit guidance on how to calculate and report AQIs.

	Firm					
	A	B	C	D	E	F
Global reporting of AQIs	✓	✓	✓		✓	✓
Global written guidance on how AQIs should be calculated and monitored		✓	✓		✓	

UK firms have not issued written guidance on how AQIs should be calculated, monitored and reported. Whilst formal guidance is desirable, it is not essential as the majority of AQIs are calculated by central teams within the firms. Firms should consider this further to ensure consistency over time. Five of the firms monitor AQIs set by the global network. However, only three of the networks have explicit guidance for the calculation of AQIs set at a global level.

3.1.2e Audit Project Milestones



THOUGHT PIECE: WHY ARE AUDIT PROJECT MILESTONES IMPORTANT?

Root Cause Analysis (“RCA”) performed by the firms consistently identifies poor project management and late performance of work as an underlying factor for audit quality issues.

Setting and monitoring AQLs over audit project milestones allows the firms to identify audit teams that may be struggling or failing to plan their audits in an appropriate and timely manner.



GOOD PRACTICE IN AUDIT PROJECT MILESTONES

Four firms monitor project management, including two firms which have detailed milestones for all types of audit engagements.

	Firm					
	A	B	C	D	E	F
Monitor project management	✓	✓	✓		✓	
Use of milestones for non-PIE audits			✓		✓	
Use of milestones other than client acceptance and planning?			✓		✓	
Use of hot reviews for compliance	✓	✓	✓		✓	

Four of the firms monitor project management. Two of the firms have extensive defined milestones for PIE audits, with these firms also setting milestones for all audits. These firms have a more granular approach to setting detailed milestones to cover other phases of work, including interim work.

One facet of a successful milestone program is the availability of reliable data from both the audit software and timesheet systems. Of the four firms that have milestone programs, three were able to extract key completion date information directly from the audit software. The two firms that have not yet implemented milestone programs intend to do so once they have upgraded their audit software.

Four of the firms use hot reviews or inflight thematic studies to check that the milestone information recorded is accurate, and that audit teams are completing milestones in a meaningful manner.



THOUGHT PIECE: DIGITISATION OF AQI REPORTING

Compiling and reporting AQI information on a timely basis is important, particularly when identifying actions to respond to in-flight and leading AQIs, where the information can turn stale rapidly.

One firm has explained to us that the source information supporting AQIs needs to be easy to obtain and must be capable of extraction, with minimal effort, in a form that can be analysed. Where these characteristics are not present, the resultant AQIs will be of little use and the firm will be unable to calculate and monitor the AQIs with sufficient frequency.

We examined the blend of system-derived AQIs that the firms are using. Approximately a third of the AQIs used by four of the firms were sourced from systems, whilst the remaining two firms had a higher percentage, at approximately 55%.

Where AQIs become digitised, firms should avoid situations where executives and their quality boards begin to fulfill the role of day to day management activity.



CASE STUDY

One firm had undertaken an exercise to digitise its AQI reporting and develop a dashboard style of reporting. For many of the AQIs reported, this firm has automated the extraction from the underlying source systems and developed an interactive dashboard using Power BI⁴.

This firm can then calculate and report AQIs as often as the information in the underlying systems is updated. The dashboards also allow AQIs to be reported at an aggregated level, with the capability of then drilling down to a region, office, grade or partner level as applicable. The dashboards use numerous data visualization tools to present AQIs in ways that allow them to be quickly understood and interpreted.

Whilst the dashboards have taken significant time to develop, they can now be quickly updated and interrogated. These dashboards are, therefore, a powerful tool to enable clear, regular monitoring and detailed analysis of AQIs, and to identify where follow-up actions are needed.

The other firms are working to digitise their AQI reporting.

⁴ Power BI is the Microsoft business intelligence, analysis and visualisation tool. It allows the exploration of complex data using visual means. It allows the automation of dashboards of analysis and sits on-top of the Microsoft cloud suite of products. It is similar to tools such as Tableau.



THOUGHT PIECE: HOW AQIs ARE USED IN THE APPRAISAL AND REWARD PROCESS

Five of the six largest firms make some use of AQIs for the appraisal and remuneration of audit partners and directors. AQIs typically used included external and internal quality review ratings, the occurrence of prior year adjustments, independence breaches, non-compliance with mandatory training and the incidence of any claims, litigation or investigations.

Some of the firms also referenced AQIs around internal and external review ratings and training compliance, in their appraisal of other senior staff.

Several of the firms are working towards making further use of AQIs in their appraisal processes. This is a way of making the appraisal process more structured, objective and focused on recognising and rewarding high audit quality.





THOUGHT PIECE: INTERNATIONAL STANDARDS OVER QUALITY MANAGEMENT

The existing framework of quality control procedures set out in ISQC1 is due to be replaced by two new International Standards of Quality Management:

International Standard of Quality Management 1 (“ISQM1”) Quality Management for Firms that Perform Audits or Reviews of Financial Statements

When approved by the IAASB, the revised ISQM1 is expected to be effective from December 2022. ISQM1 requires firms to focus on how they set quality objectives and identify/manage risks to these objectives across the entity. It requires a more holistic and risk-based approach than ISQC1.

How is this relevant to AQIs?

AQIs can support firms in monitoring risks when they implement the standard. Key areas where AQIs will prove useful include:

ISQM1 area	Potential areas of impact on AQIs
Monitoring and remediation processes over the design, implementation and operation of the system of quality management	Firms are required to identify deficiencies and understand their root causes. AQIs can support the RCA process by providing further diagnostics to identify deficiencies and provide further insight.
Governance and leadership, including responsibility and accountability for quality	We have made good practice observations on the governance process over AQIs, particularly the linkage of risks and audit quality plans to AQIs. We have seen relatively few AQIs directed at culture: one key exception being the results of staff surveys. Firms should explore this area further as they plan to implement ISQM1.
Resources, including appropriately obtaining, developing, using, maintaining and allocating resources	This is an area where the six largest firms have already developed AQIs that can be adapted to assist in the monitoring process.

International Standard of Quality Management 2 (“ISQM2”), Engagement Quality Reviews

The proposed draft of ISQM2 updates the requirements around the selection of engagement quality reviewers and how such reviews should be performed and documented.

How is this relevant to AQIs?

The use and involvement of engagement quality reviewers is often included within AQIs, used privately by the firms, on staff mix and seniority and on the number of review hours spent per audit. Engagement quality reviews also feature within some of the publicly reported AQIs used by other countries (see section 3.5).

Another related area where firms have developed relevant AQIs, concerns the number of mandatory or non-mandatory consultations undertaken. We anticipate that the firms may bring this area more into scope when ISQM2 is finalised.

Progress on implementation plans for ISQM1 and 2

The six largest firms in the UK expect to review and refresh their AQIs as part of the transition to ISQM1 and ISQM2, with the objective that their AQIs map to their audit quality objectives and risks, as identified under ISQM1. None of the firms have yet determined precisely how this transition will affect their AQIs.

3.1.3 The list of AQIs used by the firms

The following table provides a list of the AQIs that are used by the six largest audit firms. We have also charted the AQIs later in this section.

		Firm					
		A	B	C	D	E	F
Inputs - people							
1	Time spent by staff and partner level	●	●	●	●	●	●
2	Staff headcount	●	●	●		●	●
3	Staff turnover	●	●	●		●	●
4	Wellbeing measures	●		●		●	●
5	Unstaffed hours	●	●	●			
6	Utilisation	●		●		●	●
7	Partner portfolio reviews			●		●	
8	Audits exited and entered			●			
9	Use of specialists			●		●	
10	Ratios of staff and partner headcount			●			●
11	Staff and partner seniority		●			●	
12	Diversity			●			
13	Percentage of continuity at grades		●				
Inputs - other							
14	Training	●		●	●	●	●
15	Technical queries			●		●	●
16	Central team resources			●		●	
17	Coaching					●	
18	Compliance confirmations	●					
19	Ethics training and communication						●
Processes - project management							
20	Milestones	●	●	●		●	
21	Percentage of time by stage of audit		●				
22	Completion of all mandatory file steps by the Responsible Individual ("RI")		●				
23	Timeliness of deliverables		●				
24	Monitoring audit progress (review notes and sign off)			●			

	Firm					
	A	B	C	D	E	F
Processes - other						
25 Archiving	●		●	●	●	
26 Prior year adjustments	●	●	●			●
27 Use of data analytics and other tools					●	●
28 Ethics queries						●
29 Staff quality objectives					●	
30 Audit software issues						●
31 Follow up of methodology findings					●	
32 Suspicious activity report follow-up					●	
33 Materiality outliers					●	
34 Acceptance and Continuance milestone		●				
35 Risk panels completed			●			
Management initiatives and other						
36 Monitoring of higher risk clients	●	●	●		●	
37 Audit fees per hour		●	●		●	
38 Root cause analysis			●		●	
39 Whistleblowing and grievances	●		●			●
40 No of clients with history of larger adjustments		●				
41 Financial investment in audit quality			●			
Outcomes						
42 Internal inspection results	●	●	●	●	●	●
43 External inspection results	●	●	●	●	●	●
44 Ethics breaches	●		●		●	●
45 Internal hot reviews	●	●	●		●	●
46 Partner quality ratings	●	●	●	●	●	
47 Investigations, legal claims and disciplinary sanctions	●		●		●	●
48 Staff attitudes to audit quality and the firm's approach to quality	●	●	●		●	
49 Internal firm-wide programs		●	●		●	
50 Hot review of financial statements						●
51 Time remediating files					●	
52 Comparison of internal and external results					●	

3.1.4 The challenges in comparing and charting AQIs

AQIs vary by firm and few indicators are used by all firms, with the exception of grades from external quality monitoring. This reflects in part the different business models, internal structures and cultures of the firms. It might also be because some firms have developed AQIs incrementally whereas others have used a top-down selection process. Comparison is therefore inherently difficult and subjective. The meetings we held with the firms and stakeholders identified many different perceptions of the most important AQIs and their respective characteristics.



OBSERVATION: THE CHARACTERISTICS FOR ANALYSIS

In developing a method of analysing AQIs we selected the following dimensions:

- The pipeline of resource inputs, processes, initiatives and outcomes
- The degree to which an AQI may be leading or historical

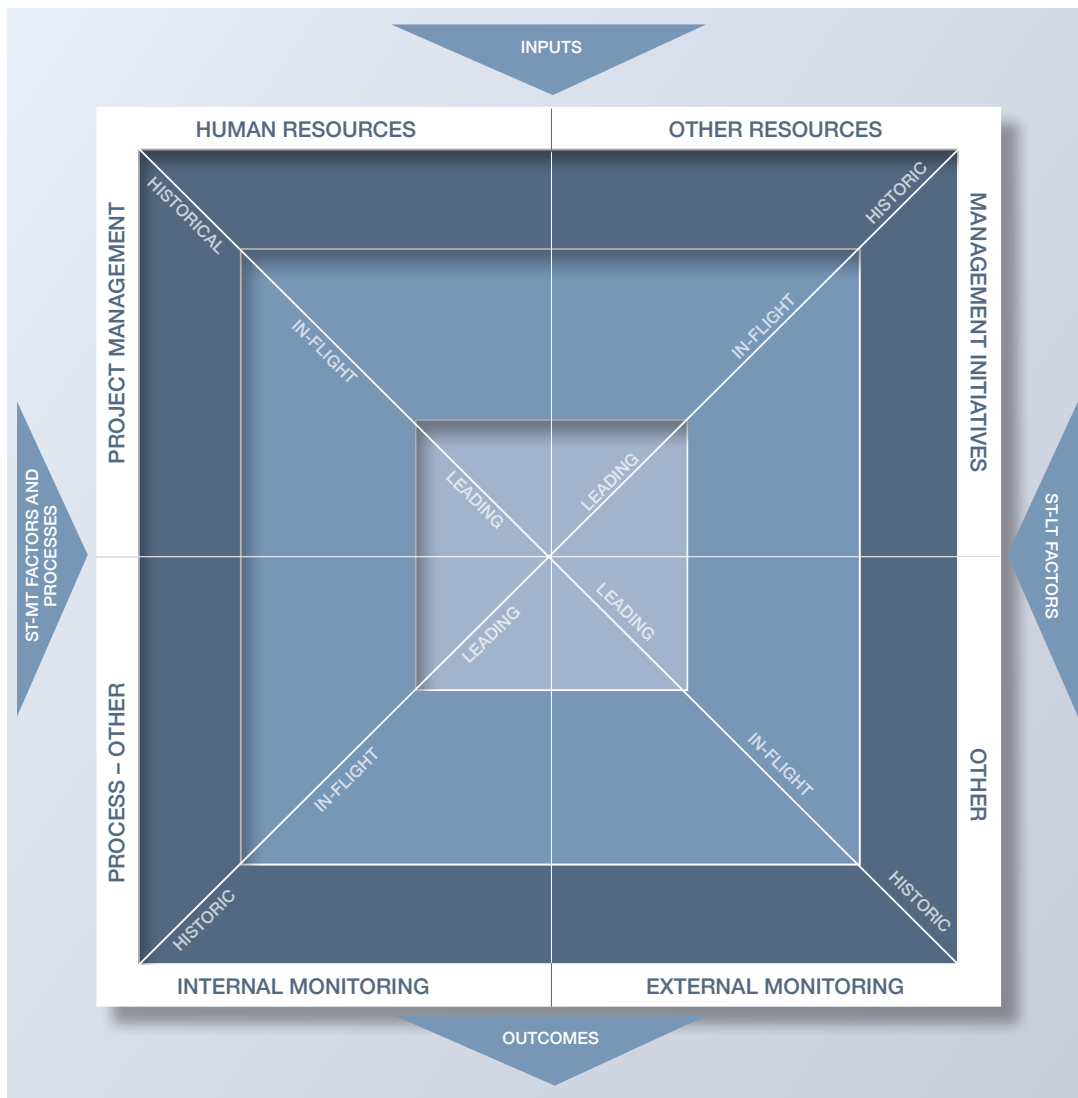
3.1.4a Development of the AQI chart

We envisaged an hourglass shape, with inputs, being human, technological and intellectual resources, feeding into the top chamber. The lower chamber of the hourglass represents the outcomes, being the results from internal and external quality monitoring. The factors that narrow the middle portion of the hourglass include:

- Audit initiatives and processes, such as policies and procedures, milestone projects or project management; and
- Management and strategic initiatives.

3.1.4b Adding a further dimension

We found that firms were most interested in those AQIs that were leading. The centre of the chart shows those AQIs that were leading. The margins of the chart show the historical or lagging indicators.



Historical
 Decisions/actions are made on historical data only and cannot affect audits that are in process or are commencing in the short term. The decisions/actions taken will only affect future audit performance as part of a wider management initiative.

In-flight
 Decisions or actions could lead to quality issues on engagements being identified and resolved before the date of the audit report.
 The information used is based on current information on audits.

Leading
 Decisions or actions can improve the quality of future audits and are designed to predict factors that impair audit quality so remedial action can be taken in advance.

3.1.5 The gameboard

We have charted the AQIs used by the six largest firms on the game board, set out on this page. The number shown for each AQI correspond to the list included at 3.1.3.

We identified the following clusters and deserts.

THE COMMON AQIs

These common AQIs are a mix of historical and in-flight and are spread across the areas of human resources, other resources, internal and external outputs and project management. This demonstrates that most of the firms are already achieving a strong mix of AQIs.

Staff headcount, turnover and utilisation (2,3 and 6)

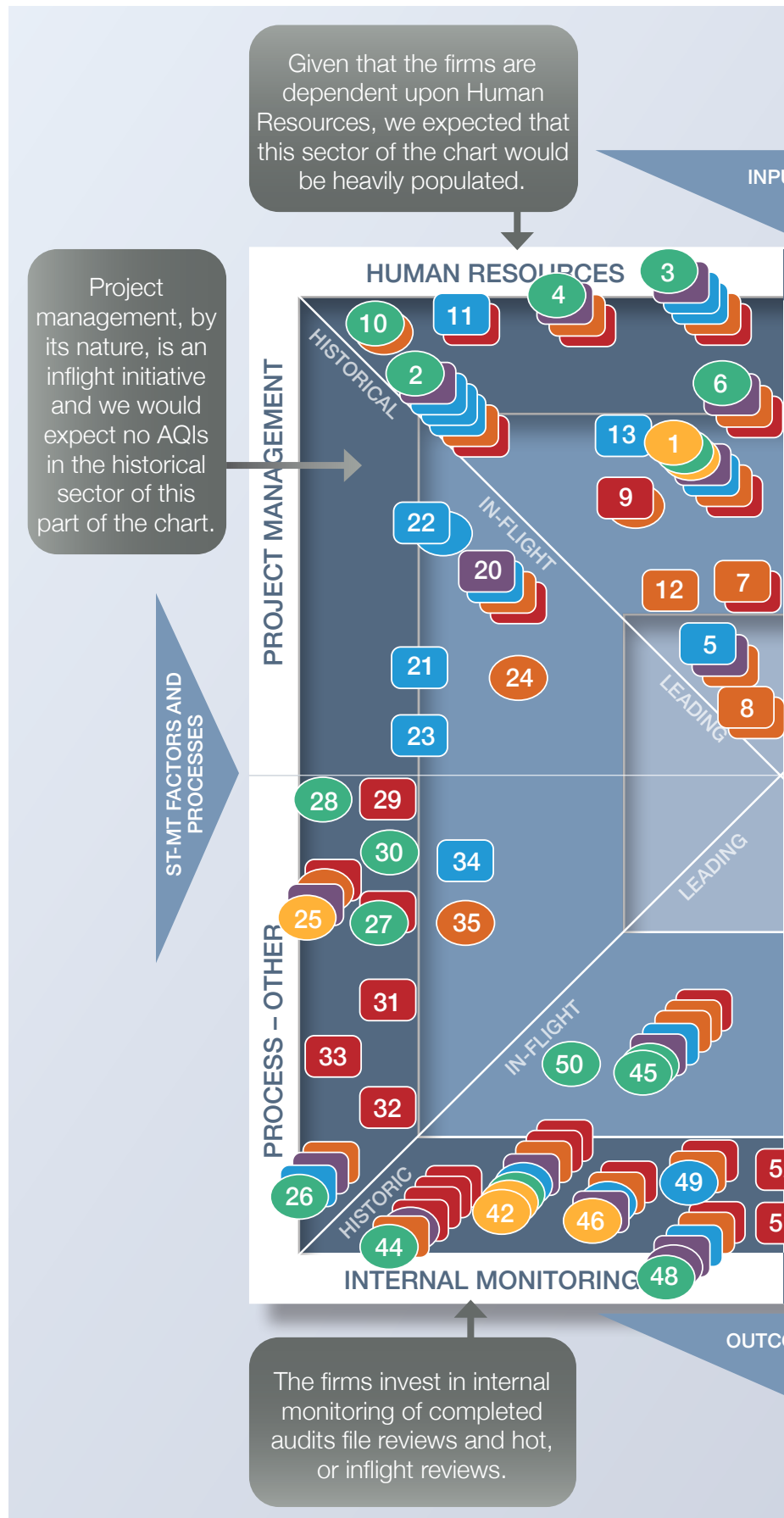
These are intended to measure: whether the firm has sufficient resources to perform quality audits; if staff are overworked, which could impact quality; and, if there are high levels of staff turnover, which could indicate wellbeing concerns, as well as a lack of continuity on audit engagements.

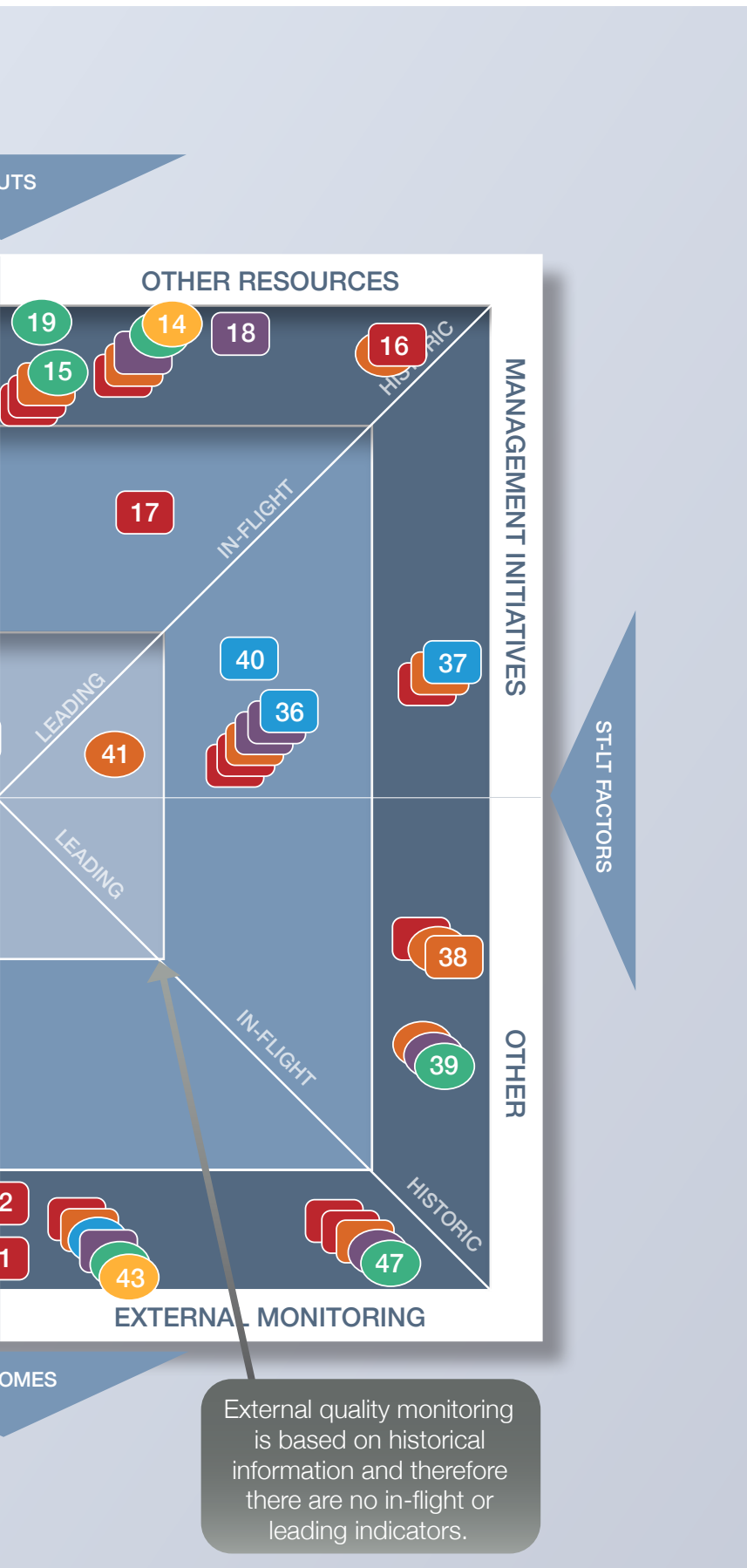
Internal and external inspection results (42 and 43)

These track the output of quality reviews in order to flag areas with recurring issues and any trends in audit quality.

Claims, litigation and sanctions (47)

These identify external investigations and claims against the firm and allow firms to identify trends/themes so that they can ensure necessary actions have been taken to prevent recurrence.





Investment in training (14)

These measure time invested in training and staff who have not complied with training requirements, in order to highlight where staff may not have the appropriate skills and knowledge to perform high quality audit work. Some firms are developing this AQI to identify how well training has been adsorbed as well as whether it has been attended.

Audit hours by staff and partner level (10 and 11)

These track time recorded to audit engagements by quality control reviewers, partners and senior staff in order to check that adequate senior time has been spent, as this is usually a driver of improved audit quality.

Audit milestones and archiving (20)

These monitor audit teams' compliance with audit milestones, including archiving, in order to ensure prescribed timelines are met, and that audit work is completed on a timely basis.

The AQIs that are formally reported within the firms reporting packs were described as primary AQIs, whilst those reported through different means were described as secondary.

FIRM	Primary	Secondary
A	■	●
B	■	●
C	■	●
D	■	●
E	■	●
F	■	●

In performing this mapping, we have focused on identifying common areas/themes for AQIs as opposed to identical AQIs. Multiple firms have, for example, an AQI relating to utilisation. However that does not mean that they are all measuring AQIs in exactly the same way.

We have only mapped metrics specifically defined by the firms as AQIs. Firms might monitor metrics for operational or business reasons but we have included them only if they are also identified as indicators of audit quality.

For example, the AQI on diversity is monitored by one firm, whilst the other firms have chosen to focus on this subject through other governance processes.

The firms should consider which of these AQIs would be useful to monitor. We do not advocate a number of AQIs that firms review, and recommend that each firm focuses on a manageable set of AQIs that they find most useful.

Firms have only identified a few leading AQIs, with the majority of AQIs being historical. This is not surprising as most available information is historical. The firms should seek to increase their use of leading and in-flight AQIs. It is however important to have a mix of leading and lagging AQIs in order to measure what is likely to impact audit quality going forward and to measure the success of actions taken so far.

We did not select the following characteristics to map on the game board and instead provide comment below.



INSIGHT: AQIs THAT ARE CAPABLE OF BEING MONITORED AT A GRANULAR LEVEL

We asked the firms to identify which AQIs were monitored at a firm-level and which were monitored at a more granular level; such as region, office or engagement level. For most firms, granular AQIs were significantly less than half of the total metrics being monitored, ranging from 15% to 38%.

Choosing the appropriate level of granularity at which to monitor AQIs is important to ensure that trends and issues can be promptly identified, and any interventions appropriately directed.

For example, if a firm only monitored staff utilisation at a firm-wide level, high levels of utilisation in one office could be offset by very low levels in another office. This could mean that the firm did not promptly identify that one office was struggling and needed additional resources to support them in maintaining quality standards.



INSIGHT: HOW CAN HISTORICAL AQIs BE CHANGED TO BECOME IN-FLIGHT

Whilst the balance of AQIs that we have charted are historical, some have the potential to become in-flight or leading metrics. For example, a firm has a policy of completing client acceptance procedures within three months of the client's year end. In this situation, the AQI will only report non-compliance as a historical indicator, but an alert 16 weeks before the year-end will prompt audit teams to take appropriate action and ensure that the acceptance procedures are performed on a timely basis. This would be more characteristic of an in-flight indicator.



INSIGHT: INDEPENDENCE OF AQIs

We considered whether the source information for AQIs was independent and objective. Independent AQIs include external quality monitoring results, which are not subject to bias or prejudice. A more subjective AQI concerns the results of staff surveys, particularly around whether senior leadership are seen to place sufficient emphasis on quality. A balanced suite of AQIs should include some that are from independent sources, which are more objective measures of audit quality.

3.2 The effectiveness of AQIs monitoring by firms

The aim of monitoring AQIs is to identify concerns so that effective and timely actions can be taken in order to ensure that good quality audit work is consistently performed.

During our benchmarking, we have considered whether AQIs are focused only on compliance, or also on achieving a higher level of audit quality. Whilst some AQIs, by their nature are focused on compliance, the majority were positive initiatives that the firms had adopted to improve audit quality beyond the level of compliance.

All the firms felt that their AQIs were effective in helping identify appropriate actions to drive positive improvements in audit quality. This was achieved by taking actions or interventions to address behaviours, resources and tools either at a firm-wide level or, to a lesser extent, at more granular levels such as at a regional, office, audit partner or specific engagement/individual audit level.

We have included case studies in Appendix A that demonstrate positive effects of the actions taken. The actions may fall into three broad categories:

1

Direct interventions

Usually taken at a more granular level.



EXAMPLE

A firm has arranged additional resources to support an engagement team that were under pressure or taken action to address headcount shortages in a specific office.

2

Recalibration of a firm's policy

Where monitoring of AQIs had identified that existing policies are not set at an appropriate level.



EXAMPLE

A firm noted that an AQI measuring the completion of client acceptance procedures three months before year-end created a resource strain for clients with upcoming December year-end audits. For these clients, the need to complete client acceptance procedures by the end of September competed with the need to complete subsidiary audits, from the previous December, which were also due to be filed at the end of September. This led the firm to consider if they needed to move this milestone, change the workload of certain staff, or even change the client portfolio to avoid unnecessary pressure on audit teams.

3

Development of new policies

When monitoring AQIs, firms have identified that certain behaviours or processes need to be encouraged and so have developed new policies for this purpose.



EXAMPLE

Some firms have chosen to require EQCR sign offs in specific sections of the audit file to ensure that a particular audit area receives additional focus and review.



INSIGHT: POTENTIAL LIMITATIONS IN USING AQIs

It is difficult to establish a direct correlation between the extent to which AQIs are used by firms, and the results of external quality monitoring. This is also true of other recent innovations such as RCA by larger audit firms. There are many variable factors, including external challenges and internal initiatives, contributing to audit quality. Measuring the degree to which an individual initiative affected external quality monitoring scores in these circumstances is difficult.

AQIs create the right environment to enable audit teams to perform a quality audit. AQIs help firms to ensure that audit teams have appropriate resources and timelines and prompt teams to do the right things at the right times. However, AQIs cannot be used to manage the entire audit engagement, or to oversee how auditors apply their own professional judgement in the field.

A combination of leading or in-flight AQIs, capable of being analysed at a granular level, can provide a basis to identify more effective, direct and focused actions. Leading and in-flight AQIs enable firms to direct interventions that can prevent poor quality outcomes from occurring. This can be more effective when the AQI is capable of drilling down to a granular level to identify exactly where the intervention is needed.

Historical AQIs also have a place. They allow firms to identify where issues have arisen, which can provide a basis for root cause analysis and other investigative processes, for example focused thematic studies, so that remedial actions can be identified.

The holistic process of monitoring, reporting and reviewing AQIs also has a positive impact on the culture and the working environment within the firms.



INSIGHT: DATA COLLECTION

The process of collating and analysing relevant data for AQI reporting encourages inquiry and questions. Individuals preparing the information will seek explanations for anomalies or outliers and those who are questioned will begin to reflect and think differently about the data set that they own. This process creates a more inquiring mindset and promotes audit quality.



INSIGHT: REPORTING

The reporting and discussion of AQIs within the firms' leadership helps to ensure that emerging quality issues are given appropriate scrutiny. Remedial actions or interventions that are developed can be considered alongside other strategic aims/decisions for consistency.

We have reflected on the most useful or powerful AQIs and considered which ones help to create and encourage the conditions that are characteristic of good audits. These conditions include appropriate monitoring of resources, technical support, and strong project management.

One factor that the firms agreed to be a powerful AQI is monitoring of audit clients delivering information on time, in full and of good quality. This is an example of a metric that the firms monitor at an engagement level from an operational perspective. One firm has begun to monitor late client deliverables as part of its AQI reporting.

One audit partner explained that they do not currently report a metric that gauges whether audit staff are content to work on certain audits. This information may provide useful insights into the relative quality of certain clients.



OBSERVATION: THE USE OF AQIs TO INCREASE STAKEHOLDER ENGAGEMENT

We have not seen examples where UK firms set AQIs at an engagement level and share them with Audit Committees. Our discussions with other countries (see section 3.5) have identified that monitoring the delivery of client information has been successful in engaging Audit Committees and executive management of audited entities.

Suitable metrics may include:

- The number of Audit Committee meetings and frequency of attendance by the members;
- The number of interactions between the audit partner and the Audit Committee Chair;
- The number of audit adjustments;
- The number of restatements or prior year adjustments.

Firms should consider whether the AQIs include an appropriate balance of quantitative and qualitative measures.

Finance teams at audited entities may also wish to share quality indicators, including where appropriate similar metrics to those listed in section 3.1.3. These may include tenure, staff turnover and training hours.

3.3 How other firms are using AQIs

We met with nine firms that were not within the scope of the benchmarking exercise (firms outside of the largest six). We conducted interviews with these firms to understand their current and planned use of AQIs. Of these firms, two had commenced using AQIs:



GOOD PRACTICE

One firm had already developed a reporting pack of four AQIs, which were predominately lagging.



GOOD PRACTICE

Another firm is at the pilot stage of developing a suite of approximately 48 lagging Audit Quality Measurables to be monitored on a quarterly basis. The initiative is led by the firm's internal quality monitoring team. The purpose of the monitoring and reporting is to provide further insight into the internal quality monitoring findings, to direct further thematic work and root cause analysis.

All the firms expressed an interest in making further use of AQIs and developing internal systems of monitoring and reporting, as part of their firm-wide system of quality control, in the short to medium term.

We encourage other firms to commence their AQI programs and hope that the observations in this thematic review will help maximise the impact of the AQIs selected and the control actions/interventions taken.

3.4 Public reporting of AQIs in Transparency Reports in the UK

Within this section, we examine how the public reporting of AQIs included in Transparency Reports were developed, and how useful these have been to stakeholders.

3.4.1 What is a Transparency Report?

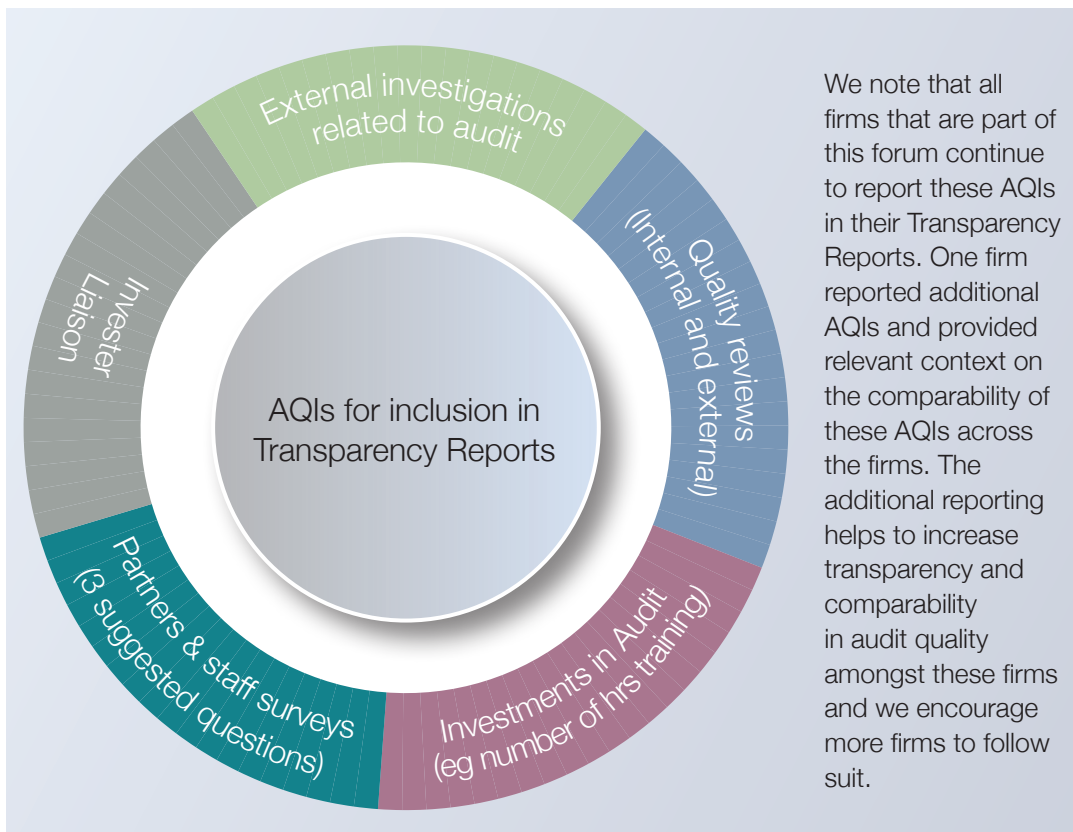
Auditors of PIEs are required to publish annual Transparency Reports, which include information relating to the firm's legal structure, ownership, governance and independence practices. If an audit firm audits more than twenty listed companies, they are required to comply with the AFGC.

The AFGC requires audit firms to disclose information additional to that required by law such as governance KPIs, appointment processes, INEs details and activities, and a business risk assessment. All firms that are required to comply with the AFGC, or choose to do so on a voluntary basis, combine the requirements of the law and AFGC into one published Transparency Report.

		Firms	
Firms within the expressed scope of the AFGC	Firms with more than 20 listed entities	6	BDO, Deloitte, EY, Grant Thornton, KPMG, and PwC
Firms that voluntarily adopt the AFGC	Firms with fewer than 20 listed entities	3	Mazars LLP (“Mazars”), National Audit Office (“NAO”) ⁵ and RSM UK Audit LLP (“RSM”)

3.4.2 Policy and Reputation Group (“PRG”) and AQLs in Transparency Reports

The PRG is a forum for the largest audit firms to debate topical public interest issues that might have an impact on the reputation of the firms collectively and on the profession. In 2015, the PRG developed a set of AQLs comprising eleven metrics in five specified areas, for inclusion in Transparency Reports. The five areas are:



GOOD PRACTICE: DELOITTE

Deloitte disclosed two additional AQLs in their Transparency Reports around partner tenure and overall partner and staff turnover, along with an explanation that there may be inconsistencies in how each of the firms report these AQLs. We consider this additional reporting to be good practice.

⁵The NAO is an independent Parliamentary body in the United Kingdom

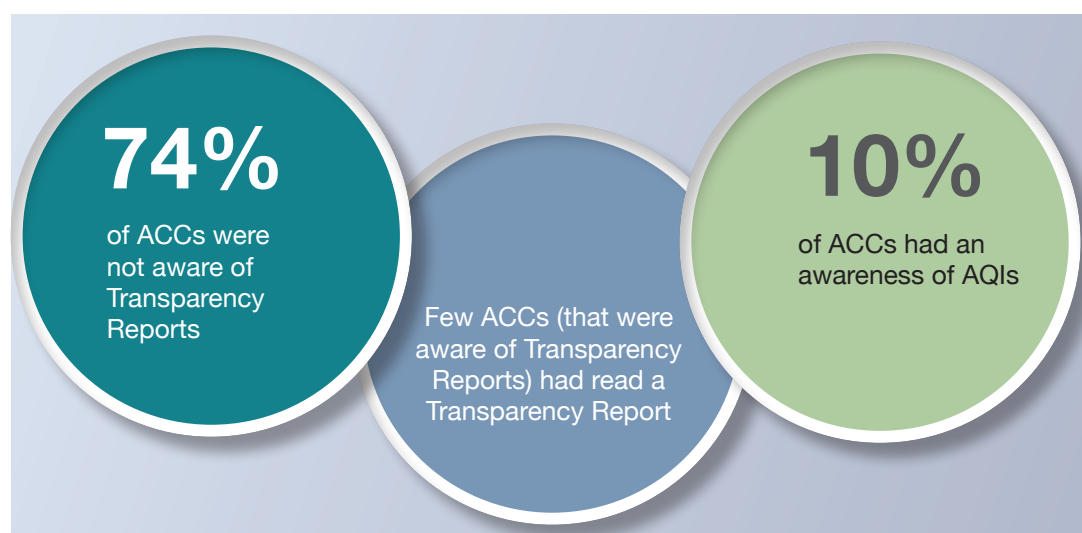
3.4.3 Views from Audit Committee Chairs (“ACCs”) and investors

The role of Audit Committees of audited entities is fundamental in ensuring that investors and other stakeholders can have confidence in the quality and independence of the audit work being carried out.

3.4.3a Survey of Audit Committee Chairs

As part of our routine inspections of individual audit engagements, we speak with Audit Committee Chairs prior to starting a review. During our 2018/19 and 2019/20 review cycles, we incorporated specific questions to understand their awareness of Transparency Reports and the AQIs reported within them, and to evaluate how useful the reports and AQIs are in carrying out their duties.

We spoke with over a hundred Audit Committee Chairs: 74% were unaware of Transparency Reports or the content within them; and only 10% were aware of publicly reported AQIs. Of the Audit Committee Chairs who had an awareness of Transparency Reports, few had read the report relevant to the audit firm that they engaged with. Whilst feedback and views on Transparency Reports focused on the length and “boiler-plate” content, some Audit Committee Chairs commented that they found information on AQIs and the FRC’s audit quality inspection results particularly useful.



3.4.3b Audit Committee Chair roundtable discussion

We held a roundtable on AQIs with Audit Committee Chairs. The Chairs described the due diligence that they perform on the firms before selecting an auditor, and as part of their ongoing evaluation of audit quality, once appointed. The Audit Committee Chairs preferred face to face meetings to gauge the quality of the auditor and ask insightful questions. They found this particularly useful when trying to understand whether recent press articles on some firms were representative of a systematic weakness in the firms, or an isolated incident.

Other information on the firms was deemed to be useful. However, the Chairs felt that Transparency Reports were lengthy and difficult to read. AQIs had a part to play in helping gauge audit quality. However, they felt that a consistent, digestible summary of the AQIs by firm would be useful.

We shared the table of AQIs that are used in other countries (please see section 3.5.5). There was no consensus on the most important types of AQIs. Most Chairs did consider the results of staff surveys (used within the UK) and also the blend of senior time (partner and manager hours as a percentage of total audit time) to be useful AQIs.

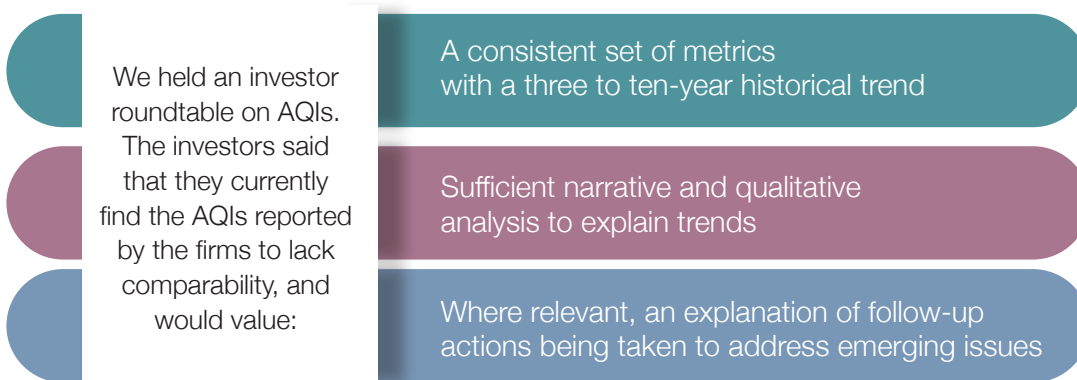
The Chairs acknowledged that all audits are different, and that AQIs had limitations when comparing audits with contrasting complexity or size. They also explained that they felt that the dynamism of the UK market required the AQIs to be refreshed on a frequent basis.



INSIGHT

Audit Committee Chairs value public reporting of some AQIs (for example: staff survey results and partner and manager hours as a percentage of total audit time), and would find a consistent, digestible summary particularly helpful.

3.4.3c Investor roundtable discussion



Our roundtable found that annual reporting of AQIs would probably be sufficient. However, the investors questioned the appropriateness of the Transparency Report for reporting AQIs given the narrow readership and that not all reports are issued at the same time due to each firm's differing year-end date. The round table explained that they would find a separate, condensed report on AQIs useful.

When discussing the list of AQIs reported by the firms, investors noted that requiring firms to report a more extensive list of AQIs could risk creating a tick-box exercise.



There was also interest in the firms reporting on how they incorporate AQIs into the process of determining partner remuneration. They also commented that it would be easier to understand the significance of AQIs reported if the firms also reported internal, or industry, targets for each AQI.



INSIGHT

Investors are interested in AQIs and value consistency, context (including a track record) and a wider range of AQIs, to assist in understanding audit quality.

3.5 How AQIs are used in other countries

We interviewed the audit regulators in 15 countries to understand: how the regulator uses AQIs; whether AQIs are reported publicly; and, if so, the nature of this reporting.

3.5.1 How AQIs are used by other audit regulators

We found that AQIs are used by some overseas audit regulators for a variety of purposes. The uses of AQIs included:

- Risk assessment, with some regulators using AQIs as part of their risk-based assessment when selecting audit files for inspection, or when selecting areas of focus as part of their firm-wide work;
- Developing a deeper understanding of the firms; and
- Using the AQIs, in some instances, to facilitate a more focused discussion with the firms' leadership when discussing the tone at the top of the firm.

3.5.2 How other countries commenced public reporting of AQIs

Six countries have AQI initiatives.



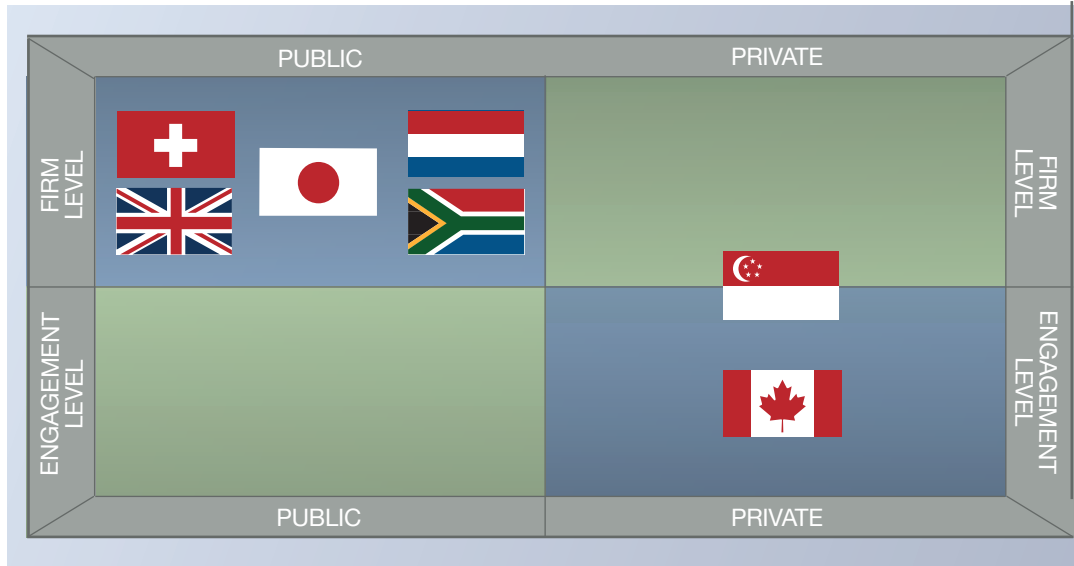
INSIGHT ON HOW OVERSEAS REGULATORS HAVE CULTIVATED CHANGE

From our discussions with each country, we identified a similar pattern that the regulators adopted to enable change. The regulators held a series of roundtables with the audit firms, and where relevant, separate roundtables for Audit Committee members.

This approach secured the agreement of the firms and created an open dialogue for all parties to express their concerns and what they felt was most important. This ultimately led to a pilot phase of using/sharing AQIs which was later embedded.

3.5.3 The types of AQI models used in other countries

There is no global standard on AQIs. The following chart provides information on the public reporting of AQIs and/or the private reporting of AQIs to Audit Committees of audited entities for each country. This chart maps whether each country requires public or private reporting of AQIs and whether the AQIs required are predominantly at a firm-wide level, an engagement level, or a blend of both.



GOOD PRACTICE

We have identified good practice in respect of six countries that have adopted either public reporting of AQIs and/ or developed a framework where AQIs were shared between the firms and Audit Committees of audited entities. These countries were: Singapore; Switzerland; Netherlands; Canada; South Africa; and Japan.



OBSERVATION ON WHO SETS THE AQIs

In the Netherlands, Switzerland, Singapore, and South Africa the AQIs are set by the audit regulator, whilst in Canada, AQIs are set by Audit Committees at engagement level.

In Japan and the UK, the AQIs were set by the firms (via the PRG or the relevant professional body).



OBSERVATION ON THE CHARACTERISTICS OF PUBLICLY REPORTED AQIs

In most cases the AQIs reported and used were at a firm-wide level and were largely historical. Singapore uses a blend of firm-wide and engagement level AQIs. In Canada, the AQIs are set at an individual audit engagement level, with allowance for firmwide measures.



CASE STUDY ON SINGAPORE



Since 2011, the Accounting and Corporate Regulatory Authority in Singapore (“ACRA”) has collected AQI data from 14 firms that audit listed companies. ACRA performed RCA on the data gathered and the findings from inspection activity, to identify areas of focus and causes of poor-quality audits.

Eight AQIs were identified from this process. Firms are encouraged to share these, including comparatives, with Audit Committees annually and during tender processes. These AQIs include a mixture of firm-wide and engagement level metrics.

ACRA issued guidance on how these AQIs should be calculated and presented. The guidance explained how ACRA sees these AQIs affecting audit quality.

Since 2016, ACRA set targets for the AQIs to provide Audit Committees with a benchmark. Whilst there is no equivalent of Transparency Reporting in Singapore, the firms do report these AQIs to the regulator on a bi-annual basis for monitoring.

In January 2020, ACRA further refreshed the AQIs, retiring one (compliance with independence requirements), whilst requiring more detail for two other metrics. ACRA will also publish, on its website, bi-annual industry averages and industry range information for three of the metrics. The information distinguishes between the four largest firms and the non-big four firms.



CASE STUDY ON SWITZERLAND



In 2009 the Federal Audit Oversight Authority (“FAOA”), with the cooperation of the five largest audit firms, developed an AQI gathering and monitoring model. The FAOA determined twelve AQIs, which the five largest audit firms report to the regulator.

Since 2009, the FAOA started to report on up to four of these AQIs. Since 2017, the FAOA has reported on up to nine of these AQIs as part of its annual public report on regulated audits within Switzerland.

The list of AQIs has been updated once, in 2014, and the FAOA plans a further refresh in 2020.



CASE STUDY ON NETHERLANDS



In September 2014, the Dutch Authority for the Financial Markets (“AFM”) published a report on the audit market, which identified failings within the Big Four firms. In response, a working group of young partners and directors from the Big Four firms and smaller firms was convened to develop a response.

The working group proposed and adopted a set of 37 AQIs for firms to include within a single appendix in their Transparency Reports. Dutch firms are required to explain if they cannot calculate or monitor any of these indicators. To ensure consistency, a guidance document was published in 2016, explaining how these AQIs should be calculated.

A recent report from the Future of the Audit Profession Committee, in the Netherlands, recommended that a set of AQIs be developed, be reported by firms and made available on a public website. It also recommended that the AFM assess these indicators, which should address quality at an engagement level and a firm-wide level, as well as at the level of other relevant factors, such as culture, governance and remuneration systems. Further decision making on these proposals is expected to take place in the course of 2020.



CASE STUDY ON SOUTH AFRICA



In 2017, the Independent Regulatory Board for Auditors (“IRBA”) commenced an AQI project, as part of its efforts to restore market confidence. In 2018, IRBA held workshops with Audit Committee Chairs and the audit firms accredited for auditing PIEs. An initial shortlist of 20 AQIs was refined to a final list of 13, to be reported by the firms to the IRBA in respect of their PIE clients.

In December 2019, the regulator published its first report on AQIs. The report included a definition and explanation of each AQI as well as anonymised data, on a firm by firm basis, for each AQI. The report is intended to be used by Audit Committees. The next steps will include a focus on how to improve the quality/completeness of the AQI data, and how to interpret and analyse the AQIs reported.



CASE STUDY ON CANADA



In 2016, the Canadian Public Accountability Board (“CPAB”), launched an AQI Pilot Project with six audit committees and reporting issuers. In the pilot, audit teams, management and Audit Committees set tailored AQIs for each audit. These were primarily metrics at the engagement level, including AQIs for both the audit team and for management (such as audit deliverables). On average each pilot participant selected eight AQIs.

In 2017, this pilot was expanded to 18 reporting issuers and the regulator issued an AQI Guide in 2018. The pilot focused on Audit Committees’ objectives for using AQIs. Audit Committees selected the AQIs that they felt were most relevant.

The feedback, so far, from Audit Committees has been that setting AQIs for each audit helps clarify expectations and improve project management, although there can be challenges in defining and interpreting the AQIs. AQIs are not publicly reported in Canada.



CASE STUDY ON JAPAN



Since 2018/19, the four largest firms in Japan have published Transparency Reports on a voluntary basis. The Japanese Institute of Certified Public Accountants (“JICPA”) published a list of 16 AQIs in November 2018, which the four largest firms included in their 2019 Transparency Reports.

3.5.4 Key observations on AQI initiatives used by other countries

We have reflected on the approaches taken in each country described above. The following table sets out certain particular positive factors that we can see in each country.

	Singapore	Switzerland	Netherlands	South Africa	Japan	Canada
Guidance issued to ensure consistency in calculating AQIs	✓	✓	✓		✓	✓
AQIs are located in one single appendix			✓			
Further firm-specific context presented with the AQIs			✓			
AQIs are periodically refreshed/reappraised	✓	✓				
Quantum/span of themes	✓	✓		✓		
The regulator uses the trends as context to their annual findings		✓				
Stakeholder engagement	✓					✓

We are encouraged to see a wide variety of approaches to promote audit quality through the use of AQIs and raise awareness with stakeholders. As an action, the FRC is keen to engage with stakeholders, including the UK firms, Audit Committee Chairs, Investors and the PRG, to evaluate which of the above initiatives are of merit to the UK.

The FRC believes that public reporting of AQIs in the United Kingdom can be improved to make them more useful to audit committees and investors. The FRC will consult publicly on:

- Which AQIs should be included in a core set for public reporting;
- How to ensure consistent reporting across the firms, including relevant comparative data, and the extent of explanations for the reader;
- In what format these AQIs should be reported; and
- What process to put in place to ensure that AQIs are kept up-to-date and relevant for users.



INSIGHT

The types of AQIs used within other countries are shown on the next page. Whilst we can see some commonality between these and the AQIs used privately by the UK firms (see section 3.1), there are some which do not overlap. It is important to understand the purpose of the different sets of AQIs. The AQIs used by other countries have been developed, in most cases, in conjunction with Audit Committee roundtables. To some extent, this explains why there is diversity in the AQIs used.



INSIGHT

We intend that this thematic review, the case studies on how other countries use AQIs, and other guidance material will serve as a useful reference point for other countries that wish to commence their own AQI initiatives. A blend of the following initiatives may assist in encouraging a framework of AQIs:

- Understand and encourage the AQIs that the firms are monitoring in their jurisdiction;
- Hold roundtables with stakeholders to understand what they will find useful; and
- Encourage a framework where AQIs are:
 - Reported publicly; and
 - Shared between firms and Audit Committees at an engagement level.

3.5.5 Comparison of the AQIs that are used by other countries

We have tabulated the AQIs used in some countries. We have not included Canada, as the list of AQIs issued by CPAB are recommendations only. Whilst the UK has a similar number of metrics to some of those countries, they are condensed to relatively fewer themes.

AQIs used in different countries	UK	Singapore	Switzerland	Netherlands	South Africa	Japan
Inputs - people						
Partner/manager involvement		●		●	● ●	
Experience of the team		●				●
Annual revenue per audit partner			●			
Ratio of staff per partner		●	●	●	●	●
Ratio of partners to technical partners					●	
Number of professional staff				●		●
Staff turnover		●	●	●		●
Hours by staff and partners				●		●
Average partner and staff tenure				●	●	●
Average number of EQCR hours			● ●	●	●	●
Average number of in-charge hours			● ●			
Number of staff handling firm-wide quality control						●

AQIs used in different countries	UK	Singapore	Switzerland	Netherlands	South Africa	Japan
Inputs - other						
Training	●	●	●	●●	●	●
Quality control resources		●		●		
Average audit tenure					●	
Ratio of non-audit fees to audit fees			●●		●	
Number of foreign shared service centre hours as a percentage of overall hours			●			
Processes - other						
Compliance with independence requirements		□		●		●
Investments made in the audit practice	●			●		
Number of consultations per audit/total			●	●		
Management initiatives						
Fee recovery					●	
Outcomes						
Results of internal file reviews*	◆	❖		●	●	●
Results of external reviews*	◆	❖		●		●
Number and coverage of internal reviews*	◆			●	●●	
External investigations related to audit and other matters	●●			●		●
Number of reports on internal control deficiencies provided to Audit Committees						●
Staff surveys	●●●			●		●●
Qualitative description of investor liaison	●					

	5 areas	8 areas ***	9 areas	17 areas	11 areas	15 areas
	11 metrics**	9 metrics	12 metrics	37 metrics ****	13 metrics	16 metrics

*	UK quality metrics have been shown over three rows ("◆").
**	UK permits R&D on assurance and investor liaison to be qualitative descriptions.
***	Singapore has guidance on 8 AQIs, in which it combines the results of internal and external reviews as one AQI (shown here by "❖"). The metric on independence has recently been deselected (shown here by "□").
****	The Netherlands reports on 37 AQIs. We have shown only the AQIs which are common to the other countries shown in the above table. Other AQIs monitored by the Netherlands that were not monitored by one of the other countries included: average time invested in training, overtime hours, hours by specialists, prior year adjustments, audits terminated early and partners exited.

Appendix A

We include the following case studies from the firms. These show the positive impact of using AQIs and provide examples of where actions have either improved audit quality or prevented poor audit quality.

Intervention at a firm-wide level using historical AQIs

“One firm noted, from monitoring of AQIs around attrition, that attrition levels were increasing, particularly for qualified staff, and could pose a risk to audit quality. They addressed this by introducing career milestone payments to recognise progression to manager and senior manager from October 2018. This led to an improvement in staff retention.”

Intervention at a business unit level using leading AQIs

“Due to monitoring the level of budgeted audit hours for which no staff are allocated, one firm identified a lack of staff resources in their public sector business unit. As a result, the firm took the decision to delay the timetable on a number of specific audits so that all audits could be resourced appropriately.”

Intervention at an individual level using in-flight AQIs

“One firm has an AQI over excessive hours charged by staff and partners. From monitoring this AQI they have identified where individuals need additional support or an adjustment to their existing responsibilities, to ensure that they are able to manage their workload without compromising on audit quality.”

Intervention at an office level using leading AQIs

“Through reviewing office level portfolio management AQIs, a firm decided that, in one office, there was insufficient experience within the partner group to perform complex PIE audits. Due to this, they changed the engagement partner for the one listed client in this office to an audit partner with a strong quality record from another part of the country and changed the engagement quality review partner.

The audit team were also provided with support from the technical team in respect of financial reporting and audit technical skills, as they had been identified as not having significant PIE experience.”

Intervention at an engagement level using in-flight AQIs

“For a significant new PIE client, a firm noted that initial project milestones had been missed. This led the firm to review the situation and staffing in detail. As a result of this intervention, further resources were identified to support the audit, including an experienced partner who worked almost full time with the main component audit team. This audit then achieved a good rating in an AQR external quality review.”

Intervention at an engagement level using leading AQIs

“The firm monitors a number of external risk indicators relating to UK listed audited entities. These indicators include shorted stocks reported to the FCA, share price movements, and third-party information from credit agencies. Where certain thresholds are exceeded, this triggers the firm to consider whether appropriate quality controls are in place, and where appropriate, require additional procedures to be performed.

This may include use of an independent risk panel to challenge the risk assessment and planning, as well as the subsequent audit conclusions reached. The risk panels can also require further work in relation to specific audit areas, such as going concern. This can lead to specialists from the restructuring team being brought in to review and support the engagement team’s risk assessment procedures and audit work.”

Intervention at a firm-wide level using historical AQIs

“The Ethics team implemented AQIs around ethics and independence compliance, in respect to non-audit services, gifts and hospitality. This led to targeted interventions of training and monitoring of independence queries raised. This has brought about a cultural change in the firm, which is evidenced by a decline in the number of issues relating to non-audit services and gifts and hospitality, a more robust standard of documentation on audit files, and more consistent use of the independence workbook on all audit files.”

Milestone monitoring

“On a large group audit, audit quality milestones have effectively been used as an audit quality indicator and project management tool. This was the second year where audit quality milestones (AQMs) were used on the engagement and where AQMs were met in all instances. Overall the AQMs assisted the team in improving quality on the basis that they highlighted issues much earlier, with focus being placed on addressing these in a more timely fashion.

The greatest benefit to the quality of the audit being delivered was felt through the early review of key areas of planning by the EQCR reviewer. This was a multi-site audit spanning a number of geographies and utilising input from a number of member firms. Achieving early input on key areas such as engagement risk, independence and determination of materiality was key in helping plan and communicate these issues to component teams and avoiding late surprises from reviews.

In addition to enhancing audit quality and an improved client relationship, the AQMs have a positive impact on staff wellbeing - the more efficient the team are before year-end, the better the team well-being over busy season, with significant amounts of work being front-loaded, providing the team with breathing space and time to focus on finalising and delivering a high quality audit.”

On another, mid-sized engagement, the benefit of using AQMs was experienced in the planning of the audit, particularly when setting materiality and planning controls testing. The early identification and communication of control deficiencies also improved the client relationship. The use of AQMs also encourages the early involvement of specialists and the EQCR team which assists in avoiding any late surprises.”

Involvement of INEs in setting AQIs

“As part of their oversight role, the INEs asked whether the firm could evidence how quality was being measured across all areas of the audit practice. Certain AQIs were in place, predominantly those included in the Transparency Report. However, the full suite of AQIs currently in place were not monitored across the practice in significant detail or reported to leadership on a regular basis.

The INEs therefore requested that key AQIs were measured, monitored and reported to them on a regular basis. In determining the key AQIs to be looked at, we had to determine which processes and controls were in place to address audit quality and who reviews these processes and controls. As all of these are assessed at least annually by the System of Quality Control (SQC) review team, the main components of SQC were considered to be the basis of the AQI framework, these being Leadership (tone at the top), Ethics, Reputation Protection & Risk Management, Independence, Engagement Performance, Monitoring and Human Resources.

We then considered what an appropriate measure (AQI) would be for each of the processes underpinning the AQI framework and started measuring and monitoring these, and reporting the results on a quarterly basis to the leadership and the INEs, who have found these to be of great benefit in identifying matters requiring attention.

For all AQIs, owners are allocated actions which are discussed, and timelines agreed upon at quarterly quality meetings attended by all involved in owning the various AQIs. These actions ultimately flow through to the audit quality plan.”



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