

Audit Quality Disclosure Framework



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Foreword

In **the words** of US Securities and Exchange Commission (SEC) Chairman Jay Clayton, “The bedrock of our financial system is the audit.” Further, as **observed** by SEC Chief Accountant Wesley Bricker, “Trust in the audit is nurtured as the profession consistently delivers audit quality and value to audit committees and the investing public. Trust can be nurtured or broken—it is neither static nor assumed.”

The Center for Audit Quality (CAQ) and its member firms believe that increased transparency about how public company accounting firms promote and monitor audit quality strengthens trust. Public company accounting firms invest significant resources to enhance audit quality continuously. This sustained dedication to audit quality is one of many reasons **surveys consistently show** that US investors have high degrees of confidence in the US capital markets, public companies, auditors, and audited financial information.¹

Many public company accounting firms tell the public about how they promote audit quality through annual transparency or audit quality reports. Not all firms do so, however, and some variation exists between the reports. Therefore, we are pleased to present this *Audit Quality Disclosure Framework* (Framework), which can facilitate consistency and comparability over time across firms. This Framework was developed collaboratively with input from smaller and larger firms. We encourage readers to consider using this Framework as they develop or consider developing their 2019 transparency or audit quality reports.

The Framework provides yet another example of the public company auditing profession’s commitment to fostering transparency and to building the bedrock of investor confidence on which our capital markets depend.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

¹ See the CAQ’s 2018 *Main Street Investor Survey* at <https://www.thecaq.org/2018-main-street-investor-survey>.

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Introduction

To provide a window into how they promote and monitor audit quality, many accounting firms² publish transparency reports, audit quality reports, and other communications. The objective of this publication is to provide a disclosure framework to assist firms in their ongoing efforts to determine, assess, and communicate information that may be useful to stakeholders in understanding how audit quality is supported and monitored at the firm level.

Enhanced disclosures about how a firm monitors audit quality, including related metrics, can promote important dialogue and deepen the understanding of the investment a firm makes in its people and other resources, processes, policies, and technology. This Framework also may assist stakeholders in better understanding how a firm seeks to manage risks to audit quality.

This Framework builds on past efforts of the CAQ, its member firms, and others to develop

and seek perspectives on audit quality indicators (AQIs). The CAQ previously published *The CAQ Approach to Audit Quality Indicators* (April 2014) and *Audit Quality Indicators: The Journey and Path Ahead* (January 2016). Regulators are also focused on AQIs.³

Audit quality is not defined in professional standards, and stakeholders may have different views on how to measure and communicate information about audit quality. Accordingly, no single reportable metric or set of metrics should be viewed as a sole determinant of audit quality.

However, the CAQ believes that a combination of metrics—taken as a whole and supplemented with robust discussion—may provide those overseeing the audit and other stakeholders with information and additional transparency into the firm’s systems and processes that underlie the performance of an audit.

² Throughout this publication accounting firms providing audit services are referred to as “firms.”

³ The Public Company Accounting Oversight Board (PCAOB) describes [audit quality indicators](#) as “a potential portfolio of quantitative measures that may provide new insights about how high-quality audits are achieved. Taken together with qualitative context, the indicators may inform discussions among those concerned with the financial reporting and auditing process, for example among audit committees and audit firms. Enhanced discussions, in turn, may strengthen audit planning, execution, and communication.” In addition, “Determine, develop, and communicate indicators of audit quality” is an objective of the PCAOB’s [Strategic Plan 2018–2022](#).

Key Principles of the *Audit Quality Disclosure Framework* Design

The Framework was designed with the following key principles:

PRINCIPLE 1—THE FRAMEWORK IS VOLUNTARY AND ILLUSTRATIVE

This Framework is voluntary and provides examples of quantitative and qualitative information that individual firms may find useful as they determine and design disclosures that may provide stakeholders with insight about key matters that could contribute to audit quality. Suggested disclosures included in this Framework are illustrative and should not be viewed as all-inclusive. This Framework does not intend to suggest that all quantitative or qualitative information presented herein is expected to be disclosed.

PRINCIPLE 2—THE FRAMEWORK IS FLEXIBLE

This Framework gives a firm flexibility to identify and tailor the information that it believes may be most relevant and meaningful to audit quality. Firms manage their audit

practices, track and collect data, and define terms in different ways; therefore, a prescriptive approach to disclosure is challenging and likely would inhibit a firm’s ability to communicate effectively about its approach to promoting and monitoring audit quality. The methodology for calculating a quantitative metric also may vary among firms; accordingly, we encourage firms to disclose information about how metrics are calculated. This flexible approach allows for scalability of this Framework to firms of all sizes.

PRINCIPLE 3—THE FRAMEWORK PROVIDES FOR FIRM-LEVEL DISCLOSURES

This Framework relates to disclosure of a system of quality control at the firm level rather than at the engagement level. While engagement-level disclosure also may be useful to discuss with those charged with governance, it is not within the scope of this Framework. The CAQ intends to develop additional resources related to engagement-level disclosures and AQIs.

As the CAQ has advocated in other publications, such as our *Tool for Audit Committees: Questions on Non-GAAP Measures*, we generally believe transparency, consistency, and comparability are important characteristics when considering disclosure.

TRANSPARENCY

A firm should consider disclosing the purpose of the AQI and how it is calculated.

CONSISTENCY

The AQI should be calculated consistently. A firm should consider disclosing why a certain AQI is no longer presented or if there is a change in the method of calculation since the AQI was previously reported.

COMPARABILITY

A firm should consider disclosing AQIs comparable with peers and in the same manner, if possible.

How to Use this Framework

The Framework is organized in three levels of detail as follows:

Level 1 – Elements of Audit Quality

Level 2 – Points of Focus

Level 3 – Example Firm-Level AQIs and Other Qualitative Information (See Exhibit)

LEVEL 1—ELEMENTS OF AUDIT QUALITY

This Framework includes Elements that are important to audit quality and describes why firms may want to include information about that particular Element. These Elements are drawn from professional standards, including the PCAOB’s [Quality Control Standards](#) and the International Federation of Accountants’ [International Standard on Quality Control 1 \(ISQC 1\)](#). These Elements are not all-inclusive, and additional disclosure may be warranted.

LEVEL 2—POINTS OF FOCUS

For each Element, this Framework identifies Points of Focus that describe potential processes, policies, and procedures that a firm may use to address or support each Element. Points of Focus are qualitative in nature and may lend themselves to a narrative disclosure. The Points of Focus are meant to be illustrative disclosures, and it is not intended that they be required or all-inclusive. Firms may want to consider other disclosures that may be relevant and meaningful. Along with appropriate context, qualitative disclosures and quantitative measures may be helpful and enable stakeholders to better understand the specific Point of Focus. Of course, all disclosures should be supported by internal documentation.

LEVEL 3—EXAMPLE FIRM-LEVEL AQIS AND OTHER QUALITATIVE INFORMATION

To enhance the understanding of how a firm believes a Point of Focus contributes to audit quality, a firm may consider supplementing a narrative description of the Point of Focus with certain Firm-Level AQIs or other qualitative information that is demonstrative through measures and graphics. Not all Points of Focus lend themselves to disclosure of quantitative measures, but for those that do, such measures may enhance transparency.

In the Exhibit, we include example Firm-Level AQIs and other qualitative information for certain Points of Focus to illustrate information that may be useful to provide additional detail related to the specific Points of Focus. Providing appropriate context related to the Firm-Level AQI—why and how it is used and calculated—may enable stakeholders to better understand the Firm-Level AQI and the related Point of Focus. Similar to Points of Focus, quantitative measures should be supported by internal data and firm quality controls to derive the measures.

The following is an example of a Firm-Level AQI versus an Engagement-Level AQI:

Element	Point of Focus	Firm-Level AQI	Engagement-Level AQI
Engagement Team Management	Firm-level policies and procedures designed to assign work to individuals with the appropriate knowledge, skills, and abilities to audit a particular company, including industry expertise.	<i>Average number of years in the profession by staff level (across the firm)</i>	<i>Number of years in the profession and on the engagement for key engagement team members</i>

CRITERIA TO CONSIDER WHEN IDENTIFYING POINTS OF FOCUS AND/OR FIRM-LEVEL AQIS

The following criteria may prove helpful to firms when evaluating whether a Point of Focus is relevant and meaningful for disclosure. The Point of Focus

- ▶ is a priority of firm leadership and is considered important to monitoring audit quality,
- ▶ conveys value to stakeholders in understanding how a firm champions and monitors audit quality,
- ▶ is used internally by the firm in management reporting or decision making,
- ▶ is objective and not misleading, and
- ▶ is supported by information that can be captured without unreasonable efforts.

The following criteria may prove helpful to firms when evaluating whether a Firm-Level AQI is relevant and meaningful for disclosure. The Firm-Level AQI

- ▶ promotes an understanding of the linkage of the Point of Focus to audit quality,
- ▶ is used internally by the firm in management reporting or decision making and is considered important to monitoring audit quality,
- ▶ can be consistently reported on a comparative basis over time,
- ▶ is objective and not misleading, and
- ▶ is supported by information that can be captured without unreasonable efforts.

Leading Practices—Firms embarking on developing an audit quality report may want to consider the following leading practices:

- ▶ Establish a timeline—The initial process may take longer than anticipated.
- ▶ Set clear objectives for the audit quality report—Who are the intended users? What Elements, Points of Focus, and Firm-Level AQIs are relevant and meaningful to those users?
- ▶ Form a cross-functional team—It may be beneficial to include multiple perspectives such as those from field auditors, audit policy professionals, operations personnel, and firm leadership.
- ▶ Build a sustainable process—Develop a process to obtain and review data that is replicable.
- ▶ Be consistent and balanced—When disclosing comparable data over time, discuss metrics consistently, even when they tell a different story from one year to the next. Be balanced when considering disclosures.
- ▶ Take a fresh look—Points of Focus and AQIs may evolve over time. Be transparent about changes. Consider feedback from internal and external stakeholders and re-evaluate the relevance of disclosures.
- ▶ Consider the use of an executive summary or summary of key measures in the audit quality report.

Elements of Audit Quality

ELEMENT 1

Leadership, Culture, and Firm Governance

Why Leadership, Culture, and Firm Governance Are Important to Audit Quality

LEADERSHIP

The firm's leadership sets the tone for the effectiveness of the firm's system of quality control and emphasizes the importance of audit quality and the auditor's role in providing trust in the capital markets. The firm's leadership also communicates the importance of adherence to professional standards, including those related to ethics and independence. The level of commitment by the firm's leadership to invest in its audit practice, including personnel, technology, and innovation, is significant to audit quality.

It is important to recognize that there are various leadership roles within a firm. The process of establishing the tone at the top starts with the firm's senior leaders and cascades down to all staff levels. In addition, at an office and engagement level, the tone is heavily influenced and reinforced by partners, directors, and managers through messaging and actions. Each level of leadership contributes to audit quality and is foundational to a firm's system of quality control.

CULTURE

Together with firm leadership, the foundation of audit quality is the establishment of policies and procedures designed to promote an internal culture that recognizes that quality is essential in performing audit engagements.⁴ Culture and core values influence many behaviors that are hard to measure, such as professional skepticism and professional judgment. Further, culture influences attitudes and behaviors such as coaching, consultation, compliance, remediation, innovation, and continuous improvement, which are critical to audit quality. Also, a firm's commitment to diversity and inclusiveness initiatives is important to audit quality. Such initiatives promote well-balanced, collaborative audit teams that identify new ways to solve problems and provide a more meaningful overall experience for professionals, management at the companies audited, and audit committee members.

FIRM GOVERNANCE

Firm governance gives stakeholders perspective regarding how audit quality is promoted and monitored internally. The structure and composition of a firm's governing body, leadership team, internal committees, professional practice group (e.g., national office or similar body), audit quality networks, and partnerships/alliances give insight into who is responsible for oversight of audit quality initiatives.

⁴ Required by ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagement*, paragraph .18.

Communicating about Leadership, Culture, and Firm Governance

The following Points of Focus may assist firms in describing how **Leadership, Culture, and Firm Governance** contribute to audit quality in their firms. These Points of Focus are meant to be illustrative disclosures, and it is not intended that they be required or all-inclusive. Firms may want to consider other disclosures that may be relevant and meaningful. Providing appropriate context, qualitative disclosures, and quantitative measures may be helpful and enable stakeholders to better understand the specific Point of Focus. See the Exhibit for example Firm-Level AQIs and other qualitative information.

Consider describing the following Points of Focus:

LEADERSHIP

- a. What audit quality means to the firm's leadership, how those views are shared throughout the organization, and how the firm evaluates the effectiveness of its messaging
- b. How the firm's leadership, operational goals, and strategy are aligned with a focus on audit quality
- c. How firm leaders and engagement team members at each staff level, including engagement partners, are evaluated and held accountable for demonstrating behaviors that emphasize the importance of audit quality

CULTURE

- a. How the firm's core values, principles, and code of conduct emphasize audit quality
- b. How the firm assesses the promotion of an appropriate culture related to audit quality, including the alignment of the actions of the firm's partners and professionals with the firm's core values and how this alignment is evaluated

- c. Matters that provide insights into the firm's culture, such as its general approach for dealing with difficult or challenging matters, how it emphasizes exercise of professional skepticism, and initiatives to promote innovation and ideas for continuous improvement
- d. Actions taken to promote diversity and inclusiveness

FIRM GOVERNANCE

- a. The firm's legal and ownership structure, and, if applicable, its network structure and how the importance of audit quality is communicated to member or affiliated entities
- b. The firm's governance and reporting structure, including how the structure contributes to an emphasis on audit quality and is responsive to the auditor's important role in the capital markets
- c. Whether firm leadership obtains independent views (e.g., from inclusion of independent non-executives on a firm's board or other independent advisors) and, if so, the roles and responsibilities of independent advisors related to audit quality

COMPENSATION, INCENTIVES, AND REWARDS

Culture evolves and develops based on behavior, and incentives often drive behavior. As a firm considers its policies and procedures related to promoting audit quality, key underlying factors influencing audit quality are compensation, incentives, and rewards, including, but not exclusively, monetary. It is important for compensation, incentives, and rewards to align with audit quality objectives. A firm may want to consider disclosing how compensation, incentives, and rewards reinforce the importance of audit quality.

ELEMENT 2

Ethics and Independence

Why Ethics and Independence Are Important to Audit Quality

Ethics and independence are foundational qualities underlying the auditing profession. In recognition of this, professional standards require firms to establish policies and procedures to provide reasonable assurance that firm personnel maintain independence (in fact and in appearance) in all required circumstances, perform professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.⁵

ETHICS

Ethics are a set of principles or values that guide a person's behavior, including his or her compliance with laws, rules, and regulations. Professionals are expected to act responsibly and ethically at all times, as required under professional standards.⁶ Because professional reputations are built on adherence to ethical behavior, some firms adopt a set of core values that provide a common understanding of their most significant operating principles and serve as the basis for the firm's code of ethics that governs actions and working relationships. Ethical behavior and adherence to core values contribute to the nature and extent of the numerous thoughtful assessments performed and conclusions reached by auditors throughout the conduct of an audit.

INDEPENDENCE

To be independent, the auditor must be intellectually honest; to be recognized as independent, the auditor must be free from any obligation to or interest in the client,⁷ its management, or its owners⁸ – at a firm and individual level. Furthermore, there are two important concepts underlying independence: (1) independence in fact and (2) independence in appearance. Independence in fact occurs when an auditor is without bias and acts with judicial impartiality.⁹ Independence in appearance is achieved when third parties would recognize a professional as independent based on relevant information and safeguards presented in the situation. Achievement of both of these concepts throughout the course of an audit is required by professional standards as they are essential to quality audit outcomes.

5 PCAOB QC Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, (QC 20) paragraph .09.

6 See for example, PCAOB Rule 3520, *Auditor Independence* regarding independence.

7 In the context of this Framework, "client" refers to audit client as defined by PCAOB Rule 3501(a)(iv), "the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client." In accordance with Sarbanes Oxley Section 301, only the audit committee has the authority to engage the auditor.

8 PCAOB AS 1005, *Independence* (AS 1005), paragraph .03.

9 PCAOB AS 1005, paragraph .02.

Communicating about Ethics and Independence

The following Points of Focus may assist firms in describing how **Ethics and Independence** contribute to audit quality in their firms.

These Points of Focus are meant to be illustrative disclosures, and it is not intended that they be required or all-inclusive. Firms may want to consider other disclosures that may be relevant and meaningful. Providing appropriate context, qualitative disclosures, and quantitative measures may be helpful and enable stakeholders to better understand the specific Point of Focus. See the Exhibit for example Firm-Level AQIs and other qualitative information.

Consider describing the following Points of Focus:

ETHICS

- a. The firm's policies, procedures, and methods for promoting and monitoring an ethical workplace (including, for example, a compliance program for the firm's code of ethics and confidentiality policies)
- b. The relevant certification and licensing requirements, as well as the firm's processes to monitor compliance with these requirements

INDEPENDENCE

- a. The firm's processes for monitoring compliance with independence requirements at the individual, engagement, and firm levels
- b. How the firm monitors partner rotation requirements

WHAT IS THE DIFFERENCE BETWEEN A TRANSPARENCY REPORT AND AN AUDIT QUALITY REPORT?

Generally speaking, **transparency reports** refer to reporting *mandated* or prepared in response to *statutory* requirements in non-US jurisdictions for firms that perform audits of publicly traded companies within those jurisdictions. These reports are required to include certain audit quality information and metrics, including, but not limited to, legal structure, ownership, governance structure, internal quality control systems, quality assurance, education and independence practices, partner remuneration, certain firm financial information, and listings of public companies audited. Firms often complement such required disclosures with additional information, including narratives and visualizations about various self-selected AQIs, policies, procedures, and investments that stakeholders may find of interest and that could help reflect the firm's focus on delivery of audit quality.

In contrast, **audit quality reports** generally refer to *voluntary* reports issued by firms to convey how each individual firm approaches its delivery of audit quality. Such reports may contain certain similar information and metrics as prescribed by transparency reports, but frequently contain additional content selected by the individual firm that may best describe the firm's unique approach to internal resourcing, methodology, structure, quality control, and other factors that it believes may have an impact on audit quality.

Both transparency and audit quality reports are generally publicly available. Some firms publish a combined transparency and audit quality report. It is important to note that both types of reporting continue to evolve in terms of content, design, and scope.

ELEMENT 3

Acceptance and Continuance of Clients and Engagements

Why Acceptance and Continuance of Clients and Engagements Are Important to Audit Quality

Firms establish policies and practices to determine whether to accept or continue a client relationship and whether to perform a specific engagement for that client. These policies and procedures are designed to provide reasonable assurance that the firm

- ▶ is competent to perform the engagement and has the capabilities, including time and resources, to do so;¹⁰
- ▶ can comply with relevant ethical requirements;¹¹
- ▶ appropriately considers the risks associated with providing professional services in the particular circumstances;¹² and
- ▶ has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity.¹³

Such policies and procedures are important to audit quality because they mitigate the risk the firm will engage with a client that lacks integrity or take on work that it does not have the appropriate capabilities to perform.

Communicating about Acceptance and Continuance of Clients and Engagements

The following Points of Focus may assist firms in describing how **Acceptance and Continuance of Clients and Engagements** contribute to audit quality in their firms. These Points of Focus are meant to be illustrative disclosures, and it is not intended that they be required or all-inclusive. Firms may want to consider other disclosures that may be relevant and meaningful. Providing appropriate context, qualitative disclosures, and quantitative measures may be helpful and enable stakeholders to better understand the specific Point of Focus.

Consider describing the following Points of Focus:

- a. Firm policies and procedures for considering the acceptance of a potential client or continuance of an existing audit client relationship, such as how the firm determines that it has the relevant competencies and capabilities, including time and resources
- b. Firm processes for evaluating management's integrity and whether the firm is independent prior to acceptance and continuance of clients and engagements
- c. How the firm identifies and assesses risk on an engagement basis and how these risk assessments are updated for changes in circumstances over time

¹⁰ ISQC 1, paragraphs A18 and A23, and PCAOB QC 20.15(a).

¹¹ ISQC 1, paragraphs A19–A20 and A23.

¹² PCAOB QC 20.15(b).

¹³ ISQC 1, paragraphs A19–A20 and A23, and PCAOB QC 20.14.

ELEMENT 4

Engagement Team Management

Why Engagement Team Management Is Important to Audit Quality

Engagement team management encompasses policies and procedures associated with recruitment, retention, and promotion; professional development; and assignment of engagement teams. These policies and procedures are designed to mobilize an engagement team that has the appropriate mix of knowledge, relevant experience by staff level and industry, and sufficient time to design and execute a quality audit under professional standards. Certain aspects of these processes are executed at the firm (as opposed to engagement) level and thus are appropriate for Firm-Level AQIs.

RECRUITMENT, RETENTION, AND PROMOTION

The quality of a firm's audit work depends on recruiting and hiring professionals with integrity, objectivity, intelligence, competence, education, and experience. Effectively mobilizing an audit engagement team (including firm specialists and shared service center employees) also involves retaining and promoting the firm's most important resource—its people. Therefore, a firm's policies and procedures to incentivize and motivate professionals to stay with the firm and promoting those with qualifications necessary for fulfillment of their responsibilities factor into maintaining audit quality.

PROFESSIONAL DEVELOPMENT

Given the complexity of accounting and auditing standards, auditing requires technical training and maintenance of professional credentials. Auditing also may require specialization in certain industries or technical areas. Professionals must also understand and comply with ethics and independence standards. Auditing is highly contingent upon human behavior and the ability to work as a

team, exercise professional skepticism, apply judgment, manage projects, and conclude in a timely manner on technical accounting and auditing matters. A firm's commitment to appropriately developing individuals who can consistently make objective, informed, and supported auditing decisions is critical to audit quality.

ASSIGNMENT OF ENGAGEMENT TEAMS

It is important to evaluate the knowledge, relevant experience, and workload of the engagement partner and members of the engagement team (including firm specialists and shared service center employees) when determining how to plan and execute an audit. Therefore, assigning resources with the relevant knowledge and experience to engagement teams based on company risk profiles while managing resource capacity and workload is important to audit quality.

INNOVATION AND TECHNOLOGY

Innovative technologies and auditing techniques are transforming and improving financial reporting and audit quality. Innovative technologies and auditing techniques include advancements in the areas of robotic process automation, artificial intelligence, and blockchain, among other developments. Auditors who appropriately utilize technologies and techniques can perform more effective audit procedures, including risk assessments. Investing in the audit of the future starts with support from firm leadership. A firm may want to consider describing how its innovation and technology affect the firm's approach to audit quality.

Communicating about Engagement Team Management

The following Points of Focus may assist firms in describing how **Engagement Team Management** contributes to audit quality in their firms. These Points of Focus are meant to be illustrative disclosures, and it is not intended that they be required or all-inclusive. Firms may want to consider other disclosures that may be relevant and meaningful. Providing appropriate context, qualitative disclosures, and quantitative measures may be helpful and enable stakeholders to better understand the specific Point of Focus. See the Exhibit for example Firm-Level AQIs and other qualitative information.

Consider describing the following Points of Focus:

RECRUITMENT, RETENTION, AND PROMOTION

- a. The firm's approach to recruiting, hiring, retaining, and promoting qualified personnel, including personnel at shared service center(s), if applicable, and how that approach is related to audit quality and the firm's system of quality control
- b. How the firm's incentive structure (compensation, incentives, and rewards) reinforce the importance of audit quality
- c. How the firm conducts its performance evaluation process and how it promotes audit quality

PROFESSIONAL DEVELOPMENT

- a. How the firm's training is designed to develop the appropriate proficiency in new and existing professional standards (including ethics and independence), the firm's audit methodology, and such other appropriate competencies as project management skills

- b. The firm's investment in training related to new technologies and skills (including technologies used by companies or developed for internal use, as well as new auditing techniques)
- c. The firm's approach to coaching and mentoring programs, including leadership development initiatives
- d. The firm's approach to enhancing an auditor's skills and experience, such as offering rotational job opportunities and/or programs to help professionals achieve certain certifications or expertise (e.g., information technology, valuation, data analytics)
- e. How the firm monitors compliance with firm training and continuing professional education requirements

ASSIGNMENT OF ENGAGEMENT TEAMS

- a. Firm-level policies and procedures designed to assign work to individuals with the appropriate knowledge, skills, and abilities to audit a particular company, including industry expertise.
- b. Procedures to monitor appropriate workload of partners and staff
- c. If applicable, how the firm uses internal and external specialists, shared service center(s), and technical resources (e.g., national office or similar body) to promote audit quality, including how the firm provides sufficient resources to enable appropriate consultation on accounting, auditing, ethics, independence, and risk management matters

ELEMENT 5

Audit Engagement Performance

Why Audit Engagement Performance Is Important to Audit Quality

Audit engagement performance encompasses processes such as planning and performing the audit; supervision and review, including engagement quality review (EQR); and communicating audit results. Policies and guidance related to these processes are often developed at the firm level. These processes help professionals perform audit procedures in accordance with the applicable professional standards.

PLANNING AND PERFORMING THE AUDIT

Professional standards require, among other things, the auditor to understand the audited entity's business, the industry and macroeconomic environment in which the entity operates, and the risks of material misstatement associated with the entity's accounts and disclosures. Establishing an appropriate audit strategy and audit plan is an important component of a quality audit. Certain firms have developed and monitor formal milestones to promote completion of phases of the audit by established dates.

Integral to performing a quality audit are a firm's audit methodology, promotion of professional skepticism and objectivity, and consultation processes. A responsive audit strategy requires the application of professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of audit evidence.¹⁴ Applying professional judgment and exercising professional skepticism often requires audit professionals to consult with other skilled professionals and specialists to

reach audit conclusions. Auditors within a firm can bring different skillsets and experiences as well as diverse viewpoints to bear in reaching technically supportable and reasonable conclusions.

Throughout the audit process, contemporaneous audit documentation, which facilitates an effective review and supports the audit opinion, is important to audit quality. The nature and extent of audit evidence necessary depends on the types of risks present and judgments made in the design and execution of the audit.

SUPERVISION AND REVIEW, INCLUDING EQR

The nature and extent of timely supervision and review at varying levels of the audit engagement team are critical to determining that audit evidence obtained and documented supports final audit conclusions. Supervisory procedures vary based on certain factors, including the nature and risks of the company, risks of material misstatement, and the competencies of the individual auditor performing the work. One of the objectives of the auditor's supervision is to evaluate whether (1) the work was performed and documented, (2) the objectives of the procedures were achieved, and (3) the results of the work support the conclusions reached.¹⁵

Further, an important part of supervision and review is the role of the EQR. PCAOB AS 1220, *Engagement Quality Review*, paragraph .02 states, "The objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the

¹⁴ PCAOB AS 1015, *Due Professional Care in the Performance of Work*, paragraph .07.

¹⁵ PCAOB AS 1201, *Supervision of the Audit Engagement*, paragraph .05(c).

engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.” The EQR is objective and does not make decisions on behalf of the engagement team or assume any of the responsibilities of the engagement team.¹⁶

COMMUNICATING AUDIT RESULTS

Professional standards require certain communications, including audit reports and independence letters among others, with management, those charged with governance, and various other stakeholders. The effective and timely delivery of accurate and complete required communications is one component of effective engagement performance. These communications promote important dialogue that enhances audit quality.

Communicating about Audit Engagement Performance

The following Points of Focus may assist firms in describing how **Audit Engagement Performance** contributes to audit quality in their firms. These Points of Focus are meant to be illustrative disclosures, and it is not intended that they be required or all-inclusive. Firms may want to consider other disclosures that may be relevant and meaningful. Providing appropriate context, qualitative disclosures, and quantitative measures may be helpful and enable stakeholders to better understand the specific Point of Focus. See the Exhibit for example Firm-Level AQLs and other qualitative information.

Consider describing the following Points of Focus:

PLANNING AND PERFORMING THE AUDIT

- a. How the firm establishes, maintains, communicates, and updates its audit

methodology, including providing audit professionals with tools, templates, and guidance

- b. How the firm is designing and/or deploying tools and technologies to improve audit quality
- c. How the firm monitors timely identification of potential issues, the execution of timely audit procedures, and meeting formal milestones, if applicable
- d. How the firm’s processes promote consistent and effective application of its methodology, including the exercise of professional skepticism and development and retention of sufficient audit documentation
- e. The firm’s consultation policy and whether the firm requires consultations in certain situations

SUPERVISION AND REVIEW, INCLUDING EQR

- a. The firm’s policies with respect to supervision of professionals and review of audit work papers, including on-the-job training and coaching, use and oversight of specialists, shared service center(s), and other auditors in a group audit, as applicable, and how the firm monitors compliance with such policies
- b. Internal quality review procedures performed before report issuance that may supplement the engagement team’s review and how these reviews contribute to audit quality
- c. The firm’s EQR policies and how the firm monitors compliance with such policies

COMMUNICATING AUDIT RESULTS

- a. Applicable processes within the firm that contribute to high-quality audit deliverables

¹⁶ PCAOB AS 1220.07.

ELEMENT 6

Monitoring

Why Monitoring Is Important to Audit Quality

A firm is required to have a system of quality control and continually monitor the effectiveness of this system.¹⁷ Monitoring activities are important to audit quality because they provide a firm with reasonable assurance that the policies and procedures relating to the system of quality control are suitably designed and are being effectively applied.¹⁸ Monitoring procedures may include such procedures as inspections and root cause analysis. These processes are performed by qualified individuals who are not directly associated with the performance of the engagement. The nature and extent of monitoring procedures may vary given the nature and complexity of a firm's operations.

Communicating about Monitoring

The following Points of Focus may assist firms in describing how **Monitoring** contributes to audit quality in their firms. These Points of Focus are meant to be illustrative disclosures, and it is not intended that they be required or all-inclusive. Firms may want to consider other disclosures that may be relevant and meaningful. Providing appropriate context, qualitative disclosures, and quantitative measures may be helpful and enable stakeholders to better understand the specific Point of Focus. See the Exhibit for example Firm-Level AQIs and other qualitative information.

Consider describing the following Points of Focus:

- a. The nature and/or extent of internal and external inspections and findings
- b. The processes used for evaluating the severity of inspection findings
- c. The processes used for determining causal effect of inspection findings (root cause analyses)
- d. The firm's process for identifying instances of higher audit quality and determining/analyzing relevant contributing factors
- e. The firm's process for summarizing and evaluating engagement and other deficiencies to determine and evaluate systemic concerns and other quality control weaknesses
- f. The procedures the firm performs to assess the timeliness and effectiveness of remediation

¹⁷ See generally PCAOB QC 20.20 and PCAOB QC Section 30, *Monitoring a CPA Firm's Accounting and Auditing Practice* (QC 30), paragraph .02.

¹⁸ PCAOB QC 20.20.

Exhibit: Example Firm-Level AQIs and Other Qualitative Information

The following Exhibit includes certain Points of Focus described within the Framework with example Firm-Level AQIs and other qualitative information.¹⁹ The listing includes illustrative disclosures and is not all-inclusive. It is important to provide context regarding how a Firm-Level AQI is used and disclose how a Firm-Level AQI is calculated.

Element	Points of Focus	Example Firm-Level AQIs and Other Qualitative Information
Leadership, Culture, and Firm Governance	What audit quality means to the firm’s leadership, how those views are shared throughout the organization, and how the firm evaluates the effectiveness of its messaging	<i>Survey or focus group results related to audit quality</i>
	The firm’s governance and reporting structure, including how the structure contributes to an emphasis on audit quality and is responsive to the auditor’s important role in the capital markets	<i>Governing board (or equivalent) composition, including diversity mix</i>
		<i>Biographies of key partners and leaders responsible for overseeing audit quality</i>
		<i>The firm’s reporting structure, including to whom the leader of the professional practice group (or similar body) reports</i>
Ethics and Independence	The firm’s processes for monitoring compliance with independence requirements at the individual, engagement, and firm levels	<i>Percentage of professionals and/or audit engagements chosen for firm internal independence reviews annually</i>

¹⁹ Not all Elements are represented in this table.

Exhibit (cont.)

Element	Points of Focus	Example Firm-Level AQIs and Other Qualitative Information
Engagement Team Management	The firm’s approach to recruiting, hiring, retaining, and promoting qualified personnel, including personnel at shared service center(s), if applicable, and how that approach is related to audit quality and the firm’s system of quality control	<i>Average annual voluntary turnover rate (expressed in percentages) by staff level with insight into how the firm monitors turnover</i>
	How the firm’s training is designed to develop the appropriate proficiency in new and existing professional standards (including ethics and independence), the firm’s audit methodology, and such other appropriate competencies as project management skills	<i>Average annual hours of continuing professional education by level compared with professional requirements, including accounting, auditing, industry-specific, and ethics and independence training</i>
	Firm-level policies and procedures designed to assign work to individuals with the appropriate knowledge, skills, and abilities to audit a particular company, including industry expertise	<i>Average number of years in the profession by staff level (across the firm)</i>
	Procedures to monitor appropriate workload of partners and staff	<i>Leverage ratios of audit-related hours for audit team members expressed in percentages (e.g., partner to staff, manager to staff), or percentage by staff level compared with total audit hours</i>
		<i>Average hours worked in excess of standard workweek by staff level</i>
	If applicable, how the firm uses internal and external specialists, shared service center(s), and technical resources (e.g., national office or similar body) to promote audit quality, including how the firm provides sufficient resources to enable appropriate consultation on accounting, auditing, ethics, independence, and risk management matters	<i>Percentage of total audit hours performed by specialists (such as information technology, tax, and valuation)</i>
		<i>Percentage of total audit hours performed by shared service center(s)</i>
<i>Ratio of partners serving in technical support roles (e.g., national office or similar body) to the number of audit partners</i>		

Exhibit (cont.)

Element	Points of Focus	Example Firm-Level AQIs and Other Qualitative Information
Audit Engagement Performance	How the firm is designing and/or deploying tools and technologies to improve audit quality	<i>Percentage of audits using technology tool (identify tool)</i>
	The firm's consultation policy and whether the firm requires consultations in certain situations	<i>For an aggregation of all audits, the average number of consultations per audit engagement, total number of consultations, and/or number of consultations by type</i>
	Internal quality review procedures performed before report issuance that may supplement the engagement team's review and how these reviews contribute to audit quality	<i>Total internal quality review hours (before report issuance), internal quality review hours (before report issuance) as a percentage of total audit hours, or number of engagements subject to internal quality review (before report issuance)</i>
Monitoring	The nature and/or extent of internal and external inspections and findings	<i>Number of engagements internally and externally inspected on an annual basis and number of audits with inspection findings</i>
		<i>Number and percentage of restatements of financial statements and trends by type of restatement and by industry</i>
		<i>Number and percentage of withdrawal of previously issued internal control over financial reporting reports and trends by type of material weakness</i>

Conclusion

The CAQ believes that increased transparency of firm-level processes and AQIs can promote trust in and understanding of the audit process. We hope this Framework is a helpful tool to promote such transparency, and we look forward to continuing the conversation with stakeholders on this important topic.

Resources

1. Canadian Public Accountability Board (CPAB): *Audit Committee Guide to Audit Quality Indicators* (June 2018)
2. CPAB: *Audit Quality Indicators: Final Report on CPAB's AQI Pilot Project* (June 2018)
3. Federation of European Accountants: *Overview of Audit Quality Indicators Initiatives* (July 2016)
4. CAQ: *Audit Quality Indicators: The Journey and Path Ahead* (January 2016)
5. The Accounting and Corporate Regulatory Authority of Singapore (ACRA): *Guidance to Audit Committees on ACRA's Audit Quality Indicators Disclosure Framework* (October 2015)
6. PCAOB: *Concept Release on Audit Quality Indicators* (July 2015)
7. CAQ: *CAQ Approach to Audit Quality Indicators* (April 2014)
8. The International Auditing and Assurance Standards Board: *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality* (February 2014)
9. CAQ: *Resource on Audit Quality Reporting* (August 2013)

**WE WANT
TO HEAR
FROM YOU**

So that we can provide resources that are informative and best address the needs of our stakeholders, we would appreciate your response to three, short questions.

SHARE FEEDBACK

Survey URL: https://thecaq.qualtrics.com/jfe/form/SV_7TVXT31IGPpozZ3

About the Center for Audit Quality

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high-quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues that require action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs.



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