



AUDIT &
ASSURANCE
FACULTY

Assurance over key performance indicators

THE JOURNEY: MILESTONE 1

ICAEW AND ASSURANCE SERVICES

All types of business, public and voluntary bodies, investors, governments, tax authorities, market regulators and their stakeholders need to be able to rely on credible information flows to make decisions. Confidence suffers when there is uncertainty about the integrity of information or its fitness for purpose.

ICAEW's Audit and Assurance Faculty is a leading authority on external audit and other assurance services. It is recognised internationally by members, professional bodies and others as a source of expertise on issues related to audit and assurance.

The *re:Assurance* thought leadership programme aims to:

- Find out where assurance services could strengthen markets and support economic confidence by making information flows more credible.
- Ask how the International Framework for Assurance Engagements can be applied and developed.
- Answer demands for practical guidance to meet emerging market needs.
- Share best practice examples and promote the high-quality assurance engagements already carried out by many ICAEW members.

WHAT ARE ASSURANCE SERVICES?

Assurance services are engagements in which an independent chartered accountant takes a close look at some specified business information, comparing it to agreed criteria. The accountant is then able to gather evidence to support a conclusion, which is provided in a written report.

The purpose of any assurance engagement is to build trust. When a chartered accountant signs an assurance report, they attach their reputation for expert knowledge and integrity. This makes the business information covered by the report more credible, and gives confidence to the people using that information.

To learn more about what assurance can do, take a look at the articles, guidance and reports on icaew.com/assurance or telephone Ruth Ward on +44 (0)20 7920 8639.



Assurance over key performance indicators

When a business talks about its performance, **key performance indicators** (KPIs) hit the headlines. These figures, their nature varying not just from one industry to the next but also between one business and another, are seized upon and discussed by analysts and investors.

Whether it's a miner discussing extraction rates, a retailer talking about footfall, or a food producer quoting yield per hectare, a well-chosen KPI sheds light on the inner workings of a business.

Background: the journey

This paper follows *The journey: assuring all of the annual report?*¹, ICAEW's response to increasing demands for a higher degree of confidence over disclosures made in companies' annual reports outside the annual accounts. Much of the information disclosed by companies, whether in the annual report, in analyst presentations or in other reports (eg, sustainability reports) is not subject to statutory audit. Many companies have already chosen to supplement the statutory audit with additional assurance reports and increasingly companies are obtaining private assurance for published, but unaudited, information.

¹ICAEW, Audit & Assurance Faculty, Narrative Assurance Working Party, *The journey: assuring all of the annual report?*, 2013.

The journey

Existing assurance standards and practices provide an appropriate starting point for assurance on narrative reporting. We encourage a market-driven approach that sees each company consider the particular needs of people who want to rely on published information that is not subject to audit.

This approach follows from the idea that trust is built incrementally. Given the different needs and narrative reporting styles of different businesses, we think that efforts to develop assurance over elements of corporate communication are most likely to bear fruit if the endeavour is treated as a journey.

Assurance can also be provided over information entirely outside the annual reporting cycle. It is probable, as corporate communication takes place throughout the year, that businesses and investors will benefit from assurance provided at various times as well as over various kinds of information.

Moving immediately to a single opinion over the whole of the annual report, rather than waiting for the market, is likely to expand the existing gap between what shareholders expect and what audit delivers.

Why start with KPIs?

Despite the headline significance of KPIs, their use by investors externally, and their significance for management decision-making, they are in the main not covered by any form of independent assurance. Most corporate communications, including quarterly analyst briefings, include ranges of KPIs relating to different aspects of the business, but only a few of these are derived from numbers that are, or will be, included in the financial statements. This means that most KPIs are not covered by the statutory audit opinion. This is particularly true of non-financial indicators, which are likely to come from systems that are less mature than those used for financial reporting, and which have not previously been subject to internal or external audit scrutiny.

What might assurance over KPIs look like?

The process of giving assurance over KPIs is straightforward. Directors have already chosen the indicators and have developed a rationale for the use of each one, and a method for calculating it. An independent practitioner can gather evidence to support an opinion on whether the KPIs have been prepared in accordance with the disclosed method of calculation. This opinion can then be published, with reference to the publicly-available rationale and method of calculation, in an assurance report.

There are three elements for the assurance provider to consider: the design of the methodology, its implementation, and the quality of the raw data. Each element gives rise to a question.

- Is the methodology used to prepare the KPI appropriate for providing an indicator that will give a robust measure of an aspect of performance?
- Have the calculations been carried out correctly?
- Have the underlying inputs into the calculation been correctly derived from an appropriate source?

A mismatch between the methodology used and the definition of the KPI can distort the impression given by a KPI. For example, if a railway company were to exclude cancelled trains from its definition of 'delays', making the change without changing the definition of the indicator, its apparent 'train delays' score would be reduced despite passengers being left waiting on platforms for long periods.

Even when a methodology is appropriate to the purpose, a KPI can still be misstated as a result of poorly designed systems or ineffective controls over the data used to calculate it. Testing the design and operation of systems and controls intended to ensure the integrity of underlying data and the calculation itself can be a critical part of the process of gaining assurance over the fair presentation of KPIs at a specific date. This testing can also provide a degree of ongoing comfort over presentation of the same KPIs over a period of time.

Further considerations

As well as checking that information is accurate, assurance providers should also consider the choice of KPIs disclosed, together with the context in which they are presented. This can be complicated because the assurance provider will need to consider what other KPIs could have been included and judge whether the combination of reported KPIs will distort a reader's impression of the business. The following two questions might therefore be added.

- Is each KPI described in a way which is not misleading and allows an informed user to make worthwhile comparisons, year-on-year and with other businesses?
- Are KPIs linked in the narrative reporting to underlying strategic imperatives, as well as associated targets and trends, giving the reader sufficient context to understand how they relate to value creation?

Assurance over KPIs can be simple, practical and easy. Accountants can provide it under existing technical standards, and the opportunity to do this can emerge naturally from discussions that auditors already have with people preparing the annual report. Most importantly, given how critical KPIs are to understanding a business, it can add value that investors will appreciate, not only to the information presented in the annual report but also to other corporate communications.

Two real life-examples

Many years of statutory financial statements prepared in accordance with common frameworks and audited in accordance with auditing standards have given users experience of interpreting financial statements and an understanding of the confidence an audit gives. Assurance over KPIs presents new challenges.

KPIs are intended to be specific to the entity in question, meaning that even entities in the same industry may

measure indicators that are nominally the same on a different basis, or indeed use different indicators. Assurance practitioners will also vary their work to suit the indicators and measurement criteria that are chosen. This means it is important for users that measurement criteria are clear and that the scope of work performed may need to be disclosed in more detail than for an audit. The real-life examples below illustrate these points.

KPMG provides assurance for Statoil²

This report gives assurance over two different aspects of Statoil's 2012 annual report and accounts: the sustainability report and a selection of KPIs (both the data and the explanatory notes).

Subject	Assurance report	Implication
Sustainability	'Based on our procedures for limited assurance, nothing has come to our attention to indicate that the report is not fairly presented, in all material respects, in accordance with the reporting criteria.'	This conclusion indicates that KPMG provided limited assurance. Less evidence is gathered than would be needed for the reasonable assurance provided by an audit, but it is still designed to give a meaningful level of assurance.
KPIs	'In our opinion the data and related explanatory notes for the indicators as outlined under Scope above are presented, in all material respects, in accordance with the reporting criteria.'	This opinion indicates that KPMG has given the highest level of assurance that is practical, namely the reasonable assurance provided by an audit. The reader can conclude that the work performed was sufficient to create a high degree of confidence in the opinion.

Deloitte provides assurance for Centrica³

This assurance report covers selected corporate responsibility (CR) performance indicators disclosed in Centrica's annual report and accounts 2012.

Subject	Assurance report	Implication
A selection of KPIs: <ul style="list-style-type: none"> British Gas Net Promoter Score Direct Energy Net Promoter Score Vulnerable households impacted by British Gas initiatives (number) Lost time injury frequency rate (per 100,000 hours worked) Smart Meters installed (number) Significant process safety events (number) Employee Engagement Score 	'Based on the scope of our work and the assurance procedures we performed, nothing has come to our attention that causes us to believe that the selected CR performance indicators are materially misstated.'	This conclusion indicates that Deloitte provided limited assurance. Less evidence is gathered than would be needed for the reasonable assurance provided by an audit, but is still designed to give a meaningful level of assurance.

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As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

Because of us, people can do business with confidence.




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