# Audit inspection report

## 1 July 2021 to 30 June 2022

**Report 743 | October 2022**

**About this report**

This report summarises findings from our review of audit files for the period 1 July 2021 to 30 June 2022.

This report will be of interest to audit firms, directors, audit committees, investors and other stakeholders interested in financial reporting and audits.

# Contents



**About ASIC regulatory documents**

In administering legislation ASIC issues the following types of regulatory documents: consultation papers, regulatory guides, information sheets and reports.

**Disclaimer**

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.
Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

# Executive summary

## Overview

This report sets out findings from our review of audit files for the period 1 July 2021 to 30 June 2022.

Audit inspections are one of our activities directed at promoting audit quality and high-quality financial reports.

ASIC regulates over 2,100 ASX listed entities and 3,200 registered company auditors. Around 56 audit firms (firms) audit one or more listed entities.

In addition to the 39 ASX listed entities inspected, we also reviewed one large unlisted entity at each of the largest six firms for the first time this year. We set out our negative findings from reviewing audit files below and in 'Overview of audit file reviews and other indicators'.

## Our key findings

Our audit file review shows an overall increase in the level of negative findings from 32% last year to 36% this year. The equivalent level of findings for the largest six firms was 32% compared to 23% last year. The largest number of negative key audit area findings continued to relate to the audit of revenue and the audit of asset values and impairment of non-financial assets.

As the audit of revenue and receivables, and the audit of asset values and impairment of non-financial assets have historically had large numbers of negative findings, this year our report includes case studies of good practice in these key audit areas.

Our detailed findings and case studies are in 'Detailed audit file review findings'.

This year we also reviewed the largest six firms' approaches to root cause analysis of negative findings. Our observations and better practice considerations for all firms are included in Report 739 *Root cause analysis: Audit firm thematic review* (REP 739).

## Conclusion

All firms should continue to focus on improving audit quality which in turn should reduce the overall level of findings. We also expect audit firms to focus on identifying and addressing root causes of negative findings, developing and implementing action plans to address the identified root causes, and monitoring and revising action plans to ensure they are effective and sustainable.

The increase in negative findings is potentially due to our focus on a small number of high-risk audits and higher risk key audit areas within these audits, inclusion of audits of large unlisted entities and the impact of COVID-19 conditions.

We will continue to review financial reports as part of our risk-based financial reporting surveillance program. The outcomes from these financial report reviews and other intelligence will determine the audit files we review. To further improve the transparency of our inspection findings, ASIC will routinely report negative findings from audit file reviews to the directors of entities from 1 July 2022: see Regulatory Guide 260 *Communicating findings from audit files to directors, audit committees or senior managers* (RG 260).

## Background

The objective of an independent audit is to provide confidence in the quality of financial reports which is key to confident and informed markets and investors.

Our inspections intentionally focus on a limited number of higher risk key audit areas of audit files selected on a risk basis. Using this approach, we target our resources to the higher risk and more challenging files. Readers should therefore be cautious in extrapolating results across the entire market and comparing findings between periods. Purely random selections of audit files could produce higher or lower levels of negative findings.

A negative finding is where, in our view, auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement (negative findings). Negative findings from our reviews of audits do not necessarily mean that the financial reports audited were in fact materially misstated. Rather, in our view, the auditor did not have a sufficient basis to support their opinion on the financial report.

Information Sheet 224 *ASIC audit inspections* (INFO 224) outlines further information about our audit inspection program and how we measure and report findings.

Directors are primarily responsible for the quality of the financial report. Audit quality supports financial reporting quality, and it is in the interest of directors and audit committees to support the audit process. This includes ensuring that management produces quality financial information, that adequate resources, skills and expertise are applied in the reporting process, and that the audit is appropriately resourced: see Information Sheet 196 *Audit quality: The role of directors and audit committees* (INFO 196).

The report does not include details of enforcement actions underway or finalised in the 12-month period. These matters are included in ASIC's Enforcement update reports which are available on our website.

# Overview of audit file reviews and other indicators

## Key statistics at a glance

**2,175**
Number of ASX listed entities

**3,224**
Total number of registered company auditors

**14**
Audit firms inspected

**18**
Number of industry groups covered by files inspected

**45**
Audit files reviewed

**18**
Files with no negative findings

**146**
Key audit areas reviewed

**94**
Key audit areas with no negative findings

**4%**
All audit firms' percentage of negative findings increased

**9%**
Largest six audit firms' percentage of negative findings increased

## Our findings

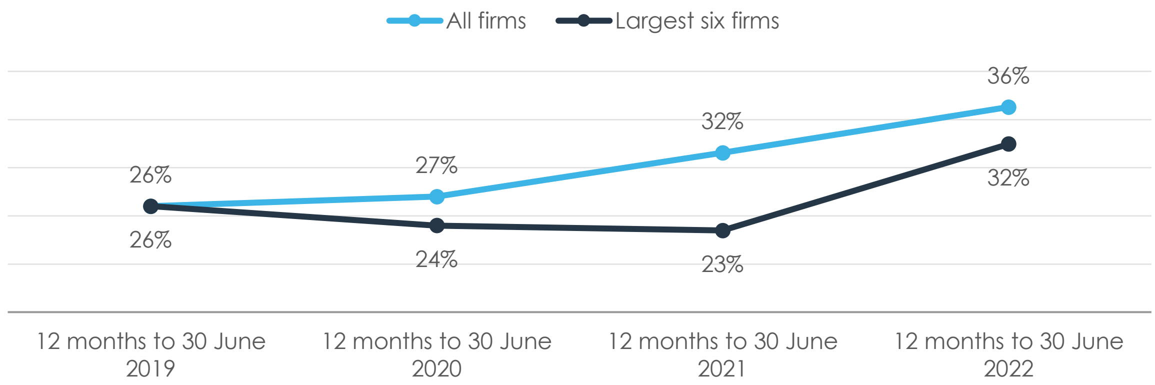
This year we identified negative findings in 36% of the 146 key audit areas reviewed across 45 audit files at 14 firms for the 12 months to 30 June 2022 (this year), compared to 32% of the 45 files covering 149 key audit areas at 16 firms for the 12 months to 30 June 2021 (last year). The equivalent level of findings across the largest six firms was 32% of the 114 key audit areas reviewed this year compared to 23% of the 115 key audit areas reviewed last year.

The level of negative findings based on the key audit areas reviewed this year for firms outside the largest six firms was 50% compared to 59% for those reviewed last year. However, the findings percentages for firms outside the largest six firms are not directly comparable between periods as two of the eight firms inspected this year were not inspected last year.

This year our reviews related to audits covering financial reports of listed entities for years ended from 31 December 2019 to 31 December 2021 and for the first time included one large unlisted entity across each of the largest six firms. These financial reports and audits occurred under COVID-19 conditions. This heightened the importance of audit quality as more difficult judgements were required on asset values, liabilities, solvency, going concern and disclosures with conditions and circumstances changing significantly between reporting dates, requiring thorough reassessment of past judgements and assumptions. These matters are discussed on the COVID-19 FAQs page on our website.

Figure 1 shows our overall negative findings for the last four inspection periods for all firms and the largest six firms. The findings in Figure 1 do not include matters arising from our separate surveillances of audits outside the audit inspection program—for example, those arising from reports of misconduct or other intelligence.

**Figure 1: Negative inspection findings**

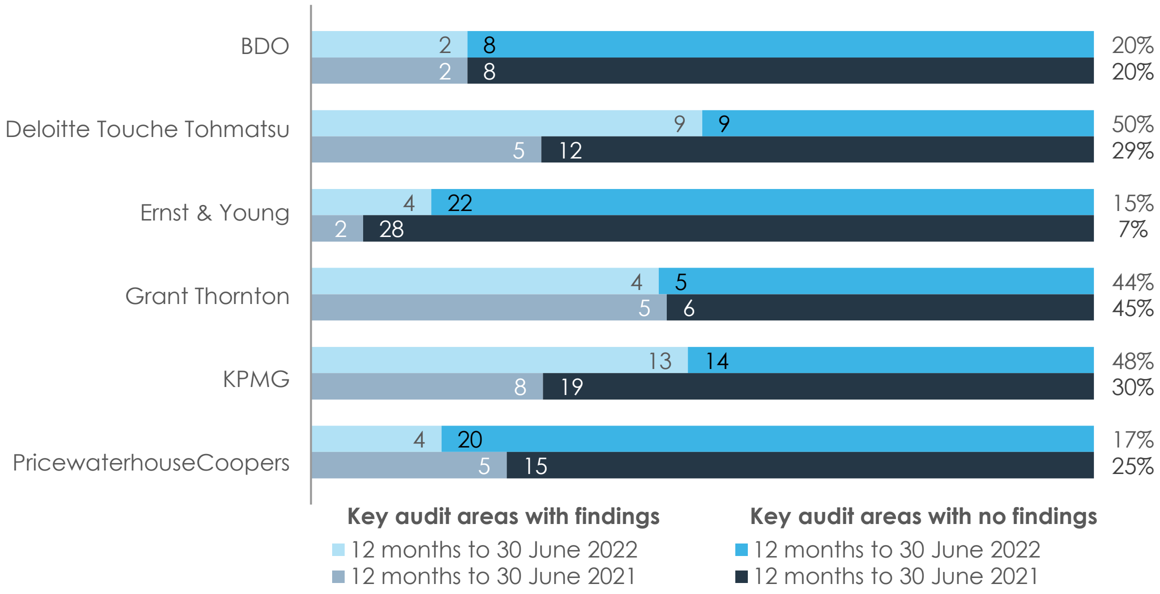



**Note:** See Table 4 for the data shown in this figure (accessible version).

The largest number of negative findings continued to be in revenue and receivables and asset values and impairment of non-financial assets. Other areas of our findings included the audit of inventories, taxation, investments and financial instruments, expenses and payables and provisions.

Figure 2 compares findings levels at each of the largest six audit firms this year and last year. These firms collectively audit 95% of ASX listed entities based on market capitalisation.

**Figure 2: Negative findings from reviews of key audit areas in audit files at each of the largest six audit firms**



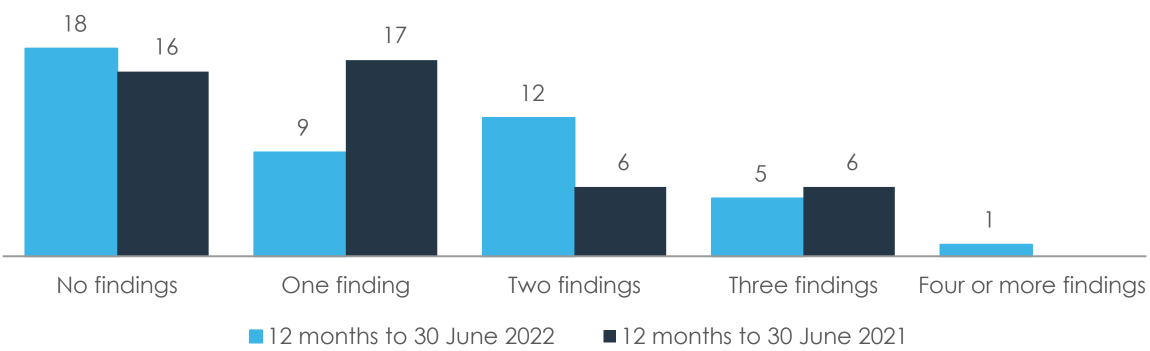

**Note:** See Table 5 for the data shown in this figure (accessible version).

The individual [ASIC inspection reports on each of the largest six firms] covering the results of our audit inspections and financial reporting surveillance are available on our website.

Although audit firms may take remedial actions based on our audit file review findings, firms do not necessarily agree with all of our findings. Firms often assert that our findings relate to documentation deficiencies in their audit file. An audit file should contain sufficient detail for an experienced auditor to understand the work performed and relied on in forming conclusions. Where this detail has not been documented, our presumption is that the work has not been performed. We have used this approach for several years and it is consistent with the approach applied globally by other audit regulators and in most firm internal quality review programs.

On average we reviewed three to four key audit areas on each audit file. Figure 3 shows the number of audit files reviewed with the number which had negative findings this year and last year. For example, 18 of the 45 files reviewed had no negative findings this year while the remaining 27 files had one or more negative findings.

**Figure 3: Number of audit files reviewed with the number of negative findings**




**Note:** See Table 6 for the data shown in this figure (accessible version).

## Our coverage and comparability of findings

Our risk-based targeting of financial reports and audits this year used the same criteria as last year. This year we reviewed 220 entity financial reports under our separate financial reporting surveillance program and in this report inspected the audit files of 36 of those entities. In addition, we inspected six large unlisted entities and three other listed entities identified as high risk.

We would expect audit quality to be consistent for all audit clients at all audit firms. Therefore, this year we selected a sample of entities outside the ASX as part of our inspection program.

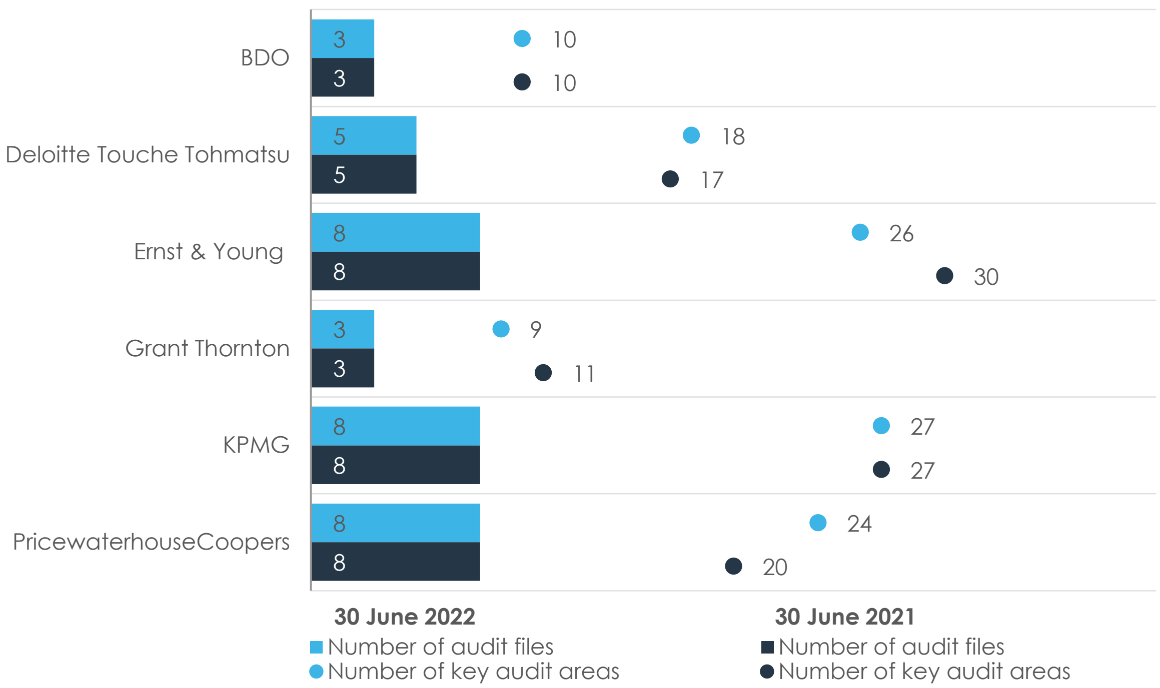
If we exclude the results of the six large unlisted entities file reviews, there would be a 2% and 3% decrease in overall and largest six firms' negative findings respectively. Our negative findings for the six large unlisted entities reviewed was 45% of 20 key audit areas.

We inspected a total of 45 audits of financial reports, for financial years ending from 31 December 2019 to 31 December 2021 at 14 audit firms in this year's report, compared to 45 audit files for financial years ending from 31 December 2019 to 31 December 2020 at 16 audit firms in last year's report.

We reviewed 146 key audit areas this year and 149 last year. The key audit areas inspected this year were similar to those inspected last year. Expected credit losses have been categorised into the key audit area of the related asset this year, for example, revenue and receivables or investments and financial instruments. For consistency, comparative information has been restated in each graph and table where required.

The number of audit files and key audit areas reviewed at the largest six audit firms this year and last year is set out in Figure 4.

**Figure 4: Number of files and key audit areas reviewed at the largest six audit firms**




**Note:** See Table 7 for the data shown in this figure (accessible version).

There was some movement in the industry groups of the audit files reviewed this year compared to last year. For example, there was a significant shift from companies in the materials sector last year (from eight to two) to the software and services sector this year (from three to nine), and a slight increase in both the energy and health care equipment and services sectors from two to four companies each. Companies in the consumer services and financials sectors stayed consistent with last year at six and seven respectively.

There were no other material changes to the way in which we conducted our reviews that would affect the level of findings shown in Figure 1.

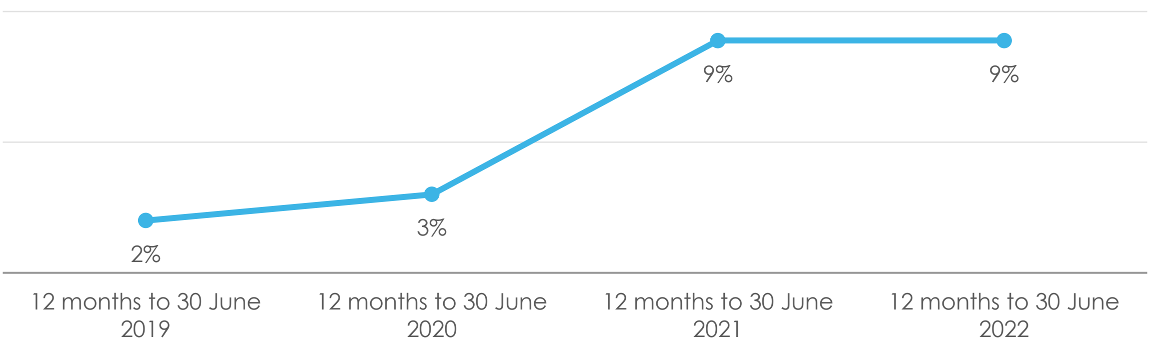
The nature and significance of our findings are consistent with those of audit regulators in other jurisdictions, as reflected in the results of the International Forum of Independent Audit Regulators' (IFIAR) Survey of inspection findings 2021 (PDF 846 KB), published in March 2022.

## Financial report misstatements

Our separate risk-based reviews covering 220 financial reports of entities from 30 June 2021 to 31 December 2021 conducted this year led to material changes to net assets and profits for 4% of financial reports reviewed. This compares to 3% for previous years. A further 2% of companies made significant enhancements to their operating and financial review business risk disclosures following our inquiries this year.

Figure 5 shows the percentage of audit files reviewed where audited entities made material changes to net assets, profits or financial information previously provided to the market in the relevant or in a subsequent financial report, and we identified negative findings (either before or after the material changes) which we believe related to concerns raised by ASIC. An example of this includes a company recording an impairment charge after we contacted them regarding aggressive or optimistic impairment assumptions identified through a negative finding on the audit file.

**Figure 5: Audits reviewed where there was a material change to the financial report**

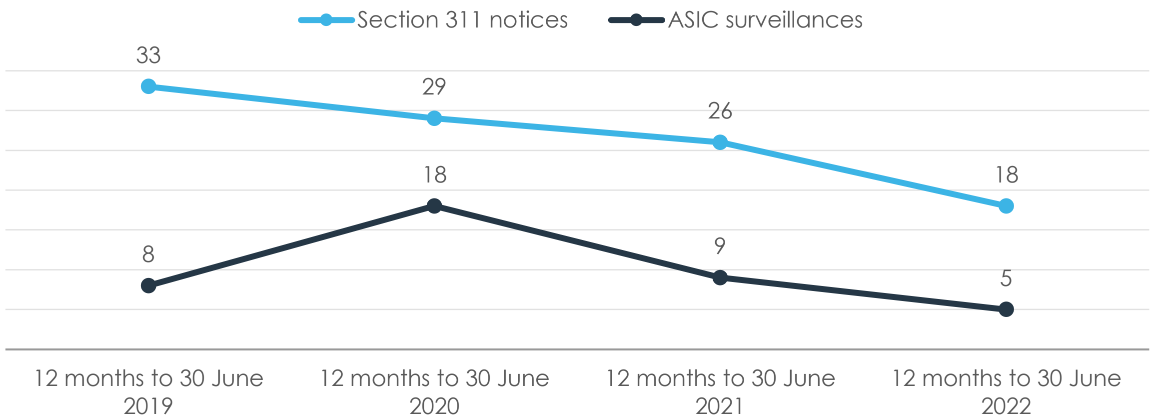



**Note:** See Table 8 for the data shown in this figure (accessible version).

From 1 July 2020, we included areas in our audit file reviews where an entity had made material changes to net assets, profits or financial information previously provided to the market following our inquiries of the audited entity on its financial report. This could be a reason for the higher percentages in Figure 5 subsequent to that period.

The number of material adjustments to previously reported net assets and profits for listed entities from ASIC surveillances is outlined in Figure 6. Figure 6 also shows the number of notices lodged by auditors reporting material adjustments to previously reported net assets and profits for listed entities.

**Figure 6: Adjustments to financial reports**




**Note:** See Table 9 for the data shown in this figure (accessible version).

These adjustments concern matters not identified or addressed during a previous audit. The matters may have been subsequently identified by the company or ASIC rather than the auditor.

## External panel

We consulted an independent external panel on the method of measuring and reporting aggregate findings from our audit file reviews and the panel agreed with our overall methodology and approach.

As part of its own review process, the panel discussed and tested the conclusions reached on a small number of our file review findings and agreed with ASIC's findings and conclusions. For each of these findings, we provided the panel with an anonymised comment form which included the firm's response to our findings.

This year the panel consisted of Mr Peter Day, Mr Des Pearson AO and Ms Robin Low. All panel members have extensive qualifications and experience in business, accounting and audit, and are considered independent of the audit firms and professional accounting bodies.

# Detailed audit file review findings

## Overview

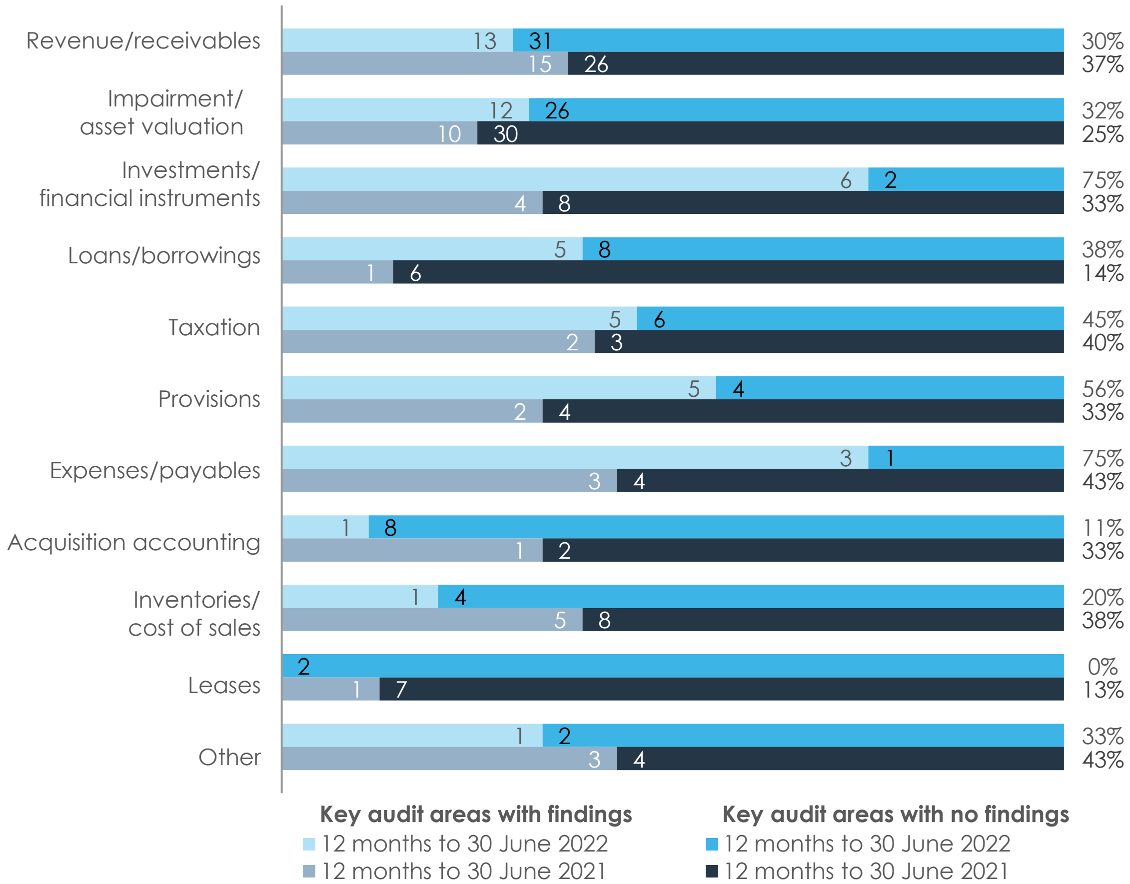
Audits of revenue and receivables and impairment of non-financial assets continue to be areas of more common negative findings from our audit file reviews.

This section contains further details of the factors contributing to our negative findings across all key audit areas reviewed. In many cases we identified a combination of contributing factors that led to negative findings for a key audit area. However, not all contributing factors noted in this section applied in all cases where we had a finding in that area.

This year we have included two case studies in this section relating to the audit of revenue and receivables and impairment of non-financial assets which summarises good practices from the review of two files where there were no negative findings. These may be useful to auditors of all firms when considering areas to improve audit quality.

Figure 7 details the number of key audit areas in which we had negative findings and the number of key audit areas that we reviewed for this year and last year. All negative findings are important and should be addressed by the firms because we consider the auditors had not performed or evidenced all the work necessary to support their opinion on the financial report.

**Figure 7: Key audit areas with negative findings and key audit areas reviewed in the 12 months to 30 June 2022 and the 12 months to 30 June 2021**

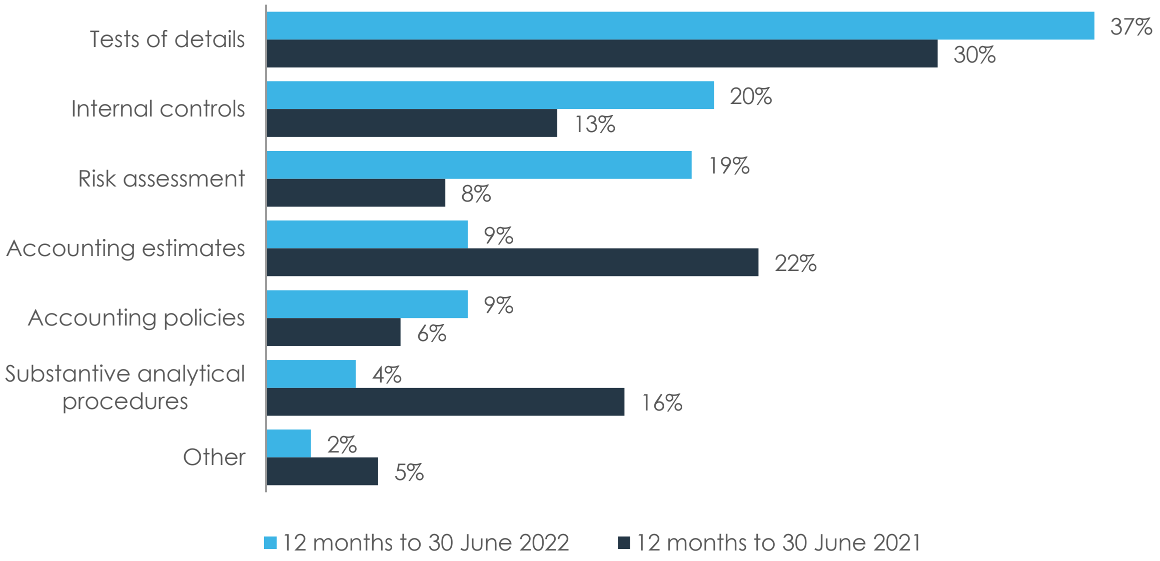



**Note 1:** See Table 10 for the data shown in this figure (accessible version).
**Note 2:** Other key audit areas include prepayments and cash (last year: deconsolidation, assets held for sale, discontinued operations and cash).
**Note 3:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

## Revenue and receivables

We reviewed revenue and receivables in 44 key audit areas this year and in 41 key audit areas last year. Figure 8 shows the matters contributing to negative findings in relation to revenue and receivables this year and last year.

**Figure 8: Matters contributing to revenue and receivables negative findings in the 12 months to 30 June 2022 and the 12 months to 30 June 2021**




**Note 1:** See Table 11 for the data shown in this figure (accessible version).
**Note 2:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

Tests of details, internal controls work and risk assessment procedures contribute to about 75% of our findings for revenue and receivables.

Case study 1 below provides examples of good practice and the nature and extent of work performed on the revenue and receivables key audit area.

### Case study 1: Revenue and receivables

*Background: The company provides information technology services and bills customers monthly. Customers are not required to sign up to long-term contracts but can receive increased savings if they choose to. Customers are located globally. Annual revenue increased 30%.*

- Based on understanding of the entity and preliminary analytical review, risks were assessed at the assertion level, including mandatory fraud risk considerations, and the audit approach responded to the identified risks.
- The process documentation and flowcharts outlined the understanding and walkthrough of the design and implementation of key controls.
- IT specialists were engaged to understand and test IT general controls and application controls. The scope of IT audit work, work papers, minutes of meetings and the auditor's evaluation of the work done by the IT auditors was well documented.

- Key controls were tested for operating effectiveness according to the firm's sampling methodology. The auditor concluded they could not rely on revenue controls.
- Information produced by the entity was tested for completeness and accuracy.
- Substantive analytical procedures were performed. The data came from an independent source, reliability of the data was tested, the population was adequately disaggregated, expectations were based on a plausible relationship, thresholds were set at an appropriately low level, and additional work done where differences between the auditor's expectations and recorded amounts exceeded thresholds.
- The tests of details included a sample of sales transactions that were agreed to sales invoices, cash received at bank and evidence of services being delivered. The sample size was increased due to the conclusion that controls were not effective.
- Transactions were tested substantively either side of balance date for cut-off and subsequent credit notes were reviewed to ensure services were provided in the correct financial year.
- Audit procedures included whether the receivables at balance date were subsequently received and the auditor evaluated the expected credit loss models, including historical loss rates, in accordance with AASB 9 *Financial instruments*.
- Accounting policies and contracts were reviewed against the requirements of AASB 15 *Revenue from contracts with customers*, applying the five-step process to recognise revenue.
- The financial statements were reconciled to the final consolidated trial balance and lead sheets, with a disclosure checklist also completed. The auditor considered the most significant areas of audit attention and concluded and documented that revenue was not a key audit matter.
- Deficiencies in internal controls were communicated to those charged with governance.

The contributing factors to the negative findings in the revenue and receivables key audit area are ranked by frequency in Table 1.

**Table 1: Key factors contributing to revenue and receivables negative findings in the 12 months to 30 June 2022 and the 12 months to 30 June 2021**

| Contributing factors | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| Tests of details: | | |
| › procedures performed did not address the level of risk assessed or specific audit assertions | 9 | 13 |
| › sample sizes and sampling techniques were inadequate | 6 | 2 |
| › source data used was not tested for completeness or accuracy | 6 | 1 |
| › obtaining insufficient independent evidence for items selected | 3 | 2 |
| › errors were not investigated or evaluated, or taken to summary of unadjusted differences | 3 | 1 |

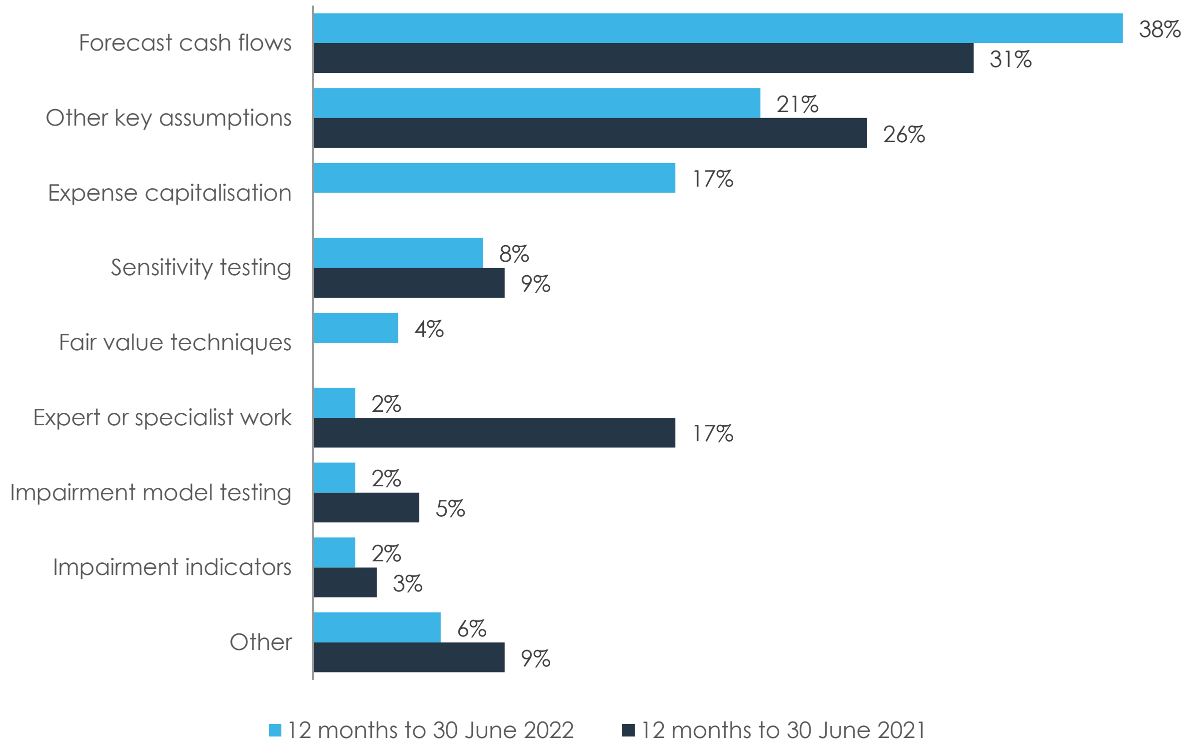
| Contributing factors | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| Internal controls: | | |
| › inappropriate reliance on internal controls | 12 | 7 |
| › not obtaining an understanding of systems and controls | 3 | 1 |
| Risk assessment not performed appropriately or no procedures performed for risks/assertions | 14 | 5 |
| Accounting estimates: | | |
| › not testing and/or challenging the relevance and reliability of data and assumptions, for example, in expected credit loss models or effective interest calculations | 5 | 2 |
| › insufficient testing of trade receivables | 1 | 4 |
| › insufficient testing of significant assumptions to estimate unearned/deferred income | 1 | 2 |
| Accounting policies: | | |
| › inappropriate accounting policy for revenue recognition, or not checking for consistency with key contract or regulatory terms | 5 | 2 |
| › not obtaining a detailed understanding of revenue recognition policy and process | 2 | 1 |
| Substantive analytical procedures: | | |
| › data used to develop the auditor's expectation was not reliable or tested | 3 | 2 |
| › thresholds for investigating differences were too high and/or population not disaggregated | 0 | 3 |
| › the relationship used was not plausible or did not consider key factors affecting the expectation | 0 | 3 |
| › differences between recorded amounts and the auditor's expectation of those amounts that exceed the tolerable threshold were not identified or adequately investigated | 0 | 2 |
| Other: | | |
| › not assessing the competence, capability and objectivity of management's expert and inadequate evaluation of work performed, including ensuring source data used was complete and accurate | 1 | 0 |
| › deficiencies in instructions to or communication with component auditors, insufficient involvement in the work of component auditors or evaluation and review of work performed | 0 | 2 |
| › insufficient consideration of whether service providers met the definition of service organisations | 0 | 1 |

**Note:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

## Asset values and impairment of non-financial assets

We reviewed work on impairment and asset values in 38 key audit areas this year and in 40 key audit areas last year. Figure 9 shows matters contributing to negative findings in relation to audit of asset values and impairment of assets.

**Figure 9: Matters contributing to asset values and impairment of non-financial assets negative findings in the 12 months to 30 June 2022 and the 12 months to 30 June 2021**




**Note:** See Table 12 for the data shown in this figure (accessible version).

Audit procedures over forecast cash flows, other key assumptions and expense capitalisation contribute to about 75% of our findings for asset values and impairment of non-financial assets.

Case study 2 below provides examples of good practice and the nature and extent of work performed on the asset impairment key audit area.

### Case study 2: Impairment of intangibles

*Background: A company with numerous generic and proprietary products in development and production. Operations are in multiple countries with impairment testing performed at a CGU level by the group auditor. Impairment was identified as a key audit matter (KAM) in the Independent Auditor's Report. The auditor:*

- Obtained and demonstrated an in-depth understanding of the company's industry, products and markets as well as microeconomic factors that might impact product development and sales.
- Assessed the key judgements and assumptions used in the cash flow forecasts prepared by the Group with reference to external data (where available), performed their own independent analysis and determined their own conclusions.

- Assessed management's judgements surrounding potential future impact arising from the COVID-19 pandemic.
- Compared the discount rates for each CGU to external market data of comparable companies.
- Challenged management's assumptions and associated updates to value-in-use models.
- In respect of pipeline products not yet released to market, assessed a sample of projects and their status against plan (including milestone achievement for the period), obtained and considered any regulator correspondence for the sample of projects selected, and assessed any updates made by the Group to the initial project feasibility assessments.
- Tested the identification of any products or pipeline products which have been discontinued and require specific impairment.
- Considered the earnings multiples implied by the value-in-use models of each CGU against the earnings multiples of other comparable companies for each respective CGU.
- Performed sensitivity analysis in respect of key assumptions to determine the sensitivity of the valuation to changes in those assumptions individually or collectively.
- Procedures outlined in the KAM were clearly cross-referenced to the work performed on the audit engagement file.

The contributing factors to the negative findings in the impairment key audit area are ranked by frequency in Table 2.

**Table 2: Key factors contributing to asset values and impairment of non-financial assets negative findings in the 12 months to 30 June 2022 and the 12 months to 30 June 2021**

| Contributing factors | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| Forecast cash flows: | | |
| › cash flows, including capital expenditure, growth rates and/or terminal value not reasonable or were not adequately tested | 13 | 10 |
| › not challenging forecasts where the entity has not met forecasts historically | 5 | 1 |
| › impact of not meeting forecasts subsequent to balance date | 2 | 0 |
| Other key assumptions: | | |
| › discount rate, exchange rate, commodity price or other key assumptions not appropriate or reasonable or were not adequately tested | 10 | 6 |
| › insufficient testing of recoverability of resources or mining approvals | 1 | 3 |
| Procedures over expense capitalisation: | | |
| › inadequate understanding of the nature and complexity of projects | 4 | 0 |
| › inappropriate accounting policy for recognition of non-financial assets | 2 | 0 |
| › insufficient testing of key internal controls | 1 | 0 |
| › insufficient procedures over existence of non-current assets | 1 | 0 |
| › not challenging management explanations on variances | 1 | 0 |

| Contributing factors | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| Issues with sensitivity testing or no sensitivity testing performed | 4 | 3 |
| Adequately test fair values: | | |
| › cross-checks not reliable or not performed | 1 | 0 |
| › using a valuation technique for which sufficient data and/or observable inputs were not available | 1 | 0 |
| Issues with work performed by audit firm's expert or specialist | 1 | 6 |
| Impairment model not adequately tested, including: | | |
| › mathematical accuracy | 1 | 1 |
| › impact of the new lease standard | 0 | 1 |
| The auditor did not ask management to perform impairment testing where there were indicators of impairment or goodwill | 1 | 1 |
| Other: | | |
| › deficiencies in instructions to or communication with component auditors, insufficient involvement in the work of component auditors or evaluation and review of work performed | 1 | 2 |
| › deficiencies in disclosures not identified or corrected | 1 | 1 |
| › appropriateness of journal entries | 1 | 0 |

## Using the work of experts and other auditors

Where financial reports involve complex or subjective matters requiring specialist skills and knowledge (e.g. valuation of assets), entities may obtain advice from external and internal experts. Where the auditor does not have sufficient knowledge or expertise, they may use their own internal or external experts to help the auditor obtain sufficient appropriate audit evidence for significant account balances.

By focusing our inspection activities on the more risky and complex audits and key audit areas that often have estimation uncertainty and significant judgements, we frequently encounter instances where auditors use the work of experts. We continue to have negative findings where auditors do not use experts where necessary or where the auditor's evaluation of the work performed by experts is insufficient.

In Tables 1, 2 and 3, we outline factors contributing to negative findings in relation to revenue and receivables, asset values and impairment of non-financial assets, values of investment properties, provisions and tax balances. When using experts in these areas we found cases where the auditor did not:

› appropriately review and evaluate the work and reports of the auditor's expert, including resolving issues raised by the expert

› assess the competence, capability and objectivity of experts—in one instance the auditor did not evaluate the independence of the expert providing advice on the valuation methodology when the same expert was used in the valuation exercise which initially recognised the asset

- adequately evaluate the work of management's expert, including ensuring source data used was complete and accurate, or
- use an auditor's expert where the audit team did not have sufficient knowledge and experience.

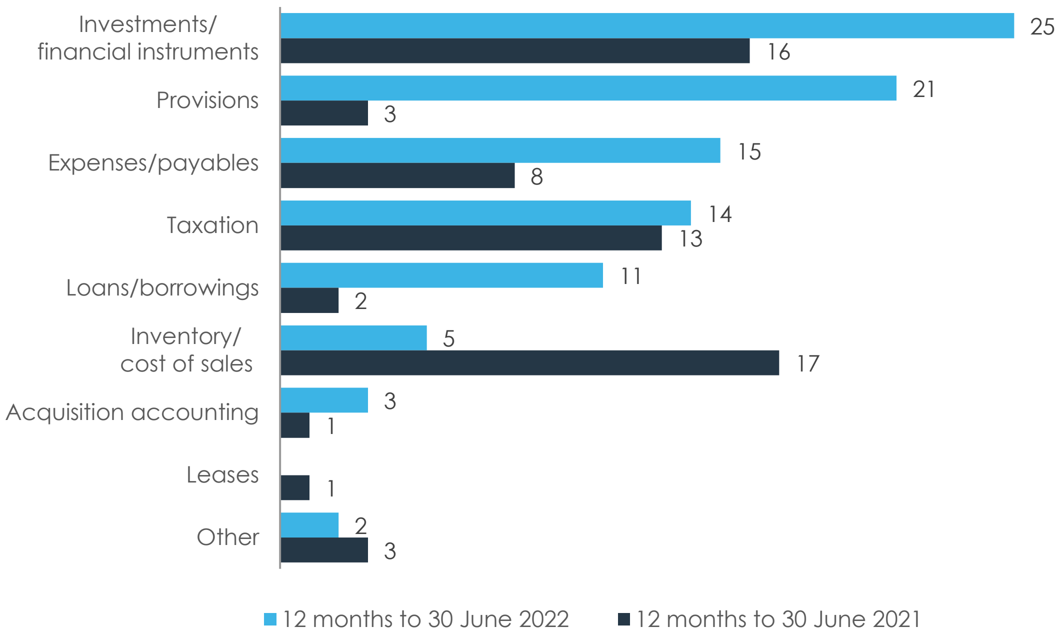
In the audit of a financial report consolidating many business components, the group auditor often relies on the audit work performed by component auditors that may be affiliated, or separate firms, and are often located in a foreign jurisdiction.

We reviewed 12 audit files where the work of component auditors was used by the group auditor. We found instances where the auditor did not sufficiently review and evaluate the work of component auditors to ensure appropriate substantive procedures were performed to respond to the assessed risk.

## Other negative findings

We reviewed 64 other key audit areas this year and 68 other key audit areas last year. Figure 10 and Table 3 show the factors contributing to the negative findings from all other key audit areas.

**Figure 10: Number of key factors contributing to negative findings by key audit area in the 12 months to 30 June 2022 and the 12 months to 30 June 2021**




**Note 1:** See Table 13 for the data shown in this figure (accessible version).
**Note 2:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

**Table 3: All other key factors contributing to negative findings in the 12 months to 30 June 2022 and the 12 months to 30 June 2021**

| Contributing factors | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| For financial instruments and investments, we found instances where auditors did not: | | |
| › test the methodology or relevance and reliability of data and reasonableness of assumptions used for valuations and models | 20 | 11 |
| › appropriately evaluate the work and reports of the management or auditor's expert, including resolving issues raised by the expert | 2 | 0 |
| › sufficiently test assets for impairment or write-off | 2 | 0 |
| › consider whether the accounting treatment of an investment was appropriate by analysing the terms and conditions of the agreement | 1 | 1 |
| › perform sufficient or appropriate tests of details over underlying assets, or use an adequate sample size for the assessed risk | 0 | 3 |
| › appropriately rely on internal controls | 0 | 1 |
| For provisions, we found instances where auditors did not: | | |
| › test the relevance and reliability of the methodology, data and assumptions used, including contradictory evidence | 8 | 0 |
| › ensure the basis for calculation of the provision was adequately disclosed in the financial report | 4 | 0 |
| › adequately test the completeness and accuracy of provisions, or identify and investigate variances | 3 | 2 |
| › understand or challenge the accounting policy for recognising provisions, including applicable legislative requirements impacting on the provision | 3 | 0 |
| › use their own expert where the audit team did not have sufficient knowledge, experience or expertise | 1 | 0 |
| › sufficiently test key internal controls | 1 | 0 |
| › appropriately evaluate the work and reports of the auditor's expert, including resolving issues raised by the expert | 1 | 0 |
| › assess the relevance, completeness and accuracy of the methods and source data used by experts | 0 | 1 |
| For expenses and payables, we found instances where auditors did not: | | |
| › adequately test and evidence the completeness and accuracy of expenses | 7 | 2 |
| › test the relevance and reliability of data and assumptions used | 4 | 5 |
| › perform procedures to address the level of risk assessed or specific audit assertions | 4 | 0 |
| › test key controls or perform tests of detail using a representative sample | 0 | 1 |

| Contributing factors | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| For taxation balances, we found instances where auditors did not: | | |
| › include all tax workpapers on file, adequately test the accuracy of tax workings and assess the tax treatment of material items | 5 | 6 |
| › appropriately evaluate the work of management's expert, including assessing their competency and objectivity, or using their own expert | 4 | 3 |
| › adequately test the recoverability of deferred tax assets based on carried forward tax losses, including assessing the availability of future taxable profits | 3 | 0 |
| › sufficiently test the entity's compliance with relevant tax legislation, including transfer pricing and uncertain tax positions | 2 | 3 |
| › evaluate the design and implementation of systems, processes and controls or test key controls | 0 | 1 |
| For loans and borrowings, we found instances where auditors did not: | | |
| › obtain sufficient evidence over completeness and accuracy of borrowings, including compliance with covenants | 6 | 1 |
| › perform sufficient procedures over presentation and disclosure of borrowings, including maturity analysis and current/non-current classification | 3 | 0 |
| › consider and test whether an embedded derivative was accounted for appropriately | 2 | 0 |
| › perform adequate procedures over management's assessment of going concern and consider whether a material uncertainty existed | 0 | 1 |
| For inventory and cost of sales, we found instances where auditors did not: | | |
| › adequately test the accuracy and value of inventories, including provisions for stock obsolescence and sales discount programs | 3 | 8 |
| › evaluate the design and implementation of systems, processes and controls or test key controls | 1 | 5 |
| › test whether inventories were recognised and measured in line with the entity's accounting policy | 1 | 0 |
| › adequately test the existence and cut-off of inventories, including stocktake attendance by component auditors | 0 | 3 |
| › appropriately scope and evaluate the work of the component auditor or evaluate the work of a management expert | 0 | 1 |
| For an acquisition, we found instances where auditors did not: | | |
| › perform sufficient procedures or obtain sufficient evidence over the accuracy of contingent consideration | 3 | 0 |
| › identify whether the acquisition treatment was incorrect | 0 | 1 |

| Contributing factors | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| For leases, we found an auditor did not sufficiently assess whether make good provisions should have been recognised for leased premises | 0 | 1 |
| For cash, we found an auditor did not perform adequate procedures to confirm cash held, including evaluation of the work of component auditors | 2 | 2 |
| For a disposal of operations, we found an auditor did not obtain sufficient evidence that the disposal was highly probable at balance date | 0 | 1 |

**Note:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

## Journal entries

We identified deficiencies in journal entry testing in 2% of audit files reviewed this year, compared to 7% of files reviewed last year. Findings included instances where the auditor did not test journal entries and adjustments made at year end or did not evaluate whether journal entries and adjustments needed to be tested throughout the year.

These findings do not relate to a specific key audit area and are not included in the percentage measures in Figure 1.

# Auditor independence, audit firm action plans and the role of directors, audit committees and management

## Auditor independence

Audit firms have policies and processes to facilitate compliance with the auditor independence requirements of the *Corporations Act 2001* (Corporations Act) and professional standards. Our inspections identified instances that could undermine independence (or the appearance of independence) and objectivity of auditors.

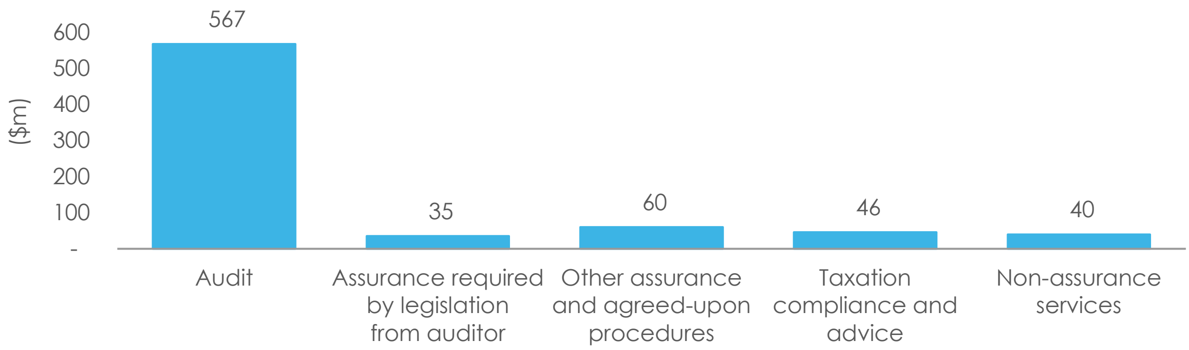
This year we found:

- one instance where the auditor did not document their evaluation of independence threats and safeguards in accordance with the independence requirements and firm policy for a vendor business relationship in an overseas jurisdiction, and
- three instances where there were auditor rotation contraventions of the Corporations Act reported to ASIC. In all three instances the firms identified that six consecutive audit reports were signed by the auditor in breach of the auditor rotation requirements. Neither the firm's quality control system nor the auditor accurately monitored the rotation requirements in these instances.

The level or nature of non-assurance services may be seen to affect the independence and objectivity of the auditor. Auditors should carefully evaluate the appropriateness of providing non-audit services to audit clients. They should also consider the appropriateness of any proposed safeguards intended to address threats to independence.

Figure 11 provides a breakdown of the fees payable to auditors of the top 300 ASX listed entities as at 31 March 2022. The average proportion of fees for non-assurance and taxation services to audit fees was 15% (last year: 17%). The proportion of non-assurance and taxation service fees was 50% or more for 27 of the 300 entities and 100% or more for 14 of the entities (last year: 23 and 18 entities respectively).

**Figure 11: Fees payable to auditors of the 300 largest ASX listed Australian entities**




**Note:** See Table 14 for the data shown in this figure (accessible version).

## Audit firm action plans

To improve audit quality, we expect audit firms (if not already doing so) to:

- identify root causes of negative findings from effective internal quality reviews of audits, our audit inspections and material changes to audited financial reports
- develop and implement action plans to address the identified root causes, and
- monitor and revise action plans to ensure they are effective.

This year we separately reported on the effectiveness of root cause analysis at the largest six firms in REP 739. We encourage all firms to review this report as ASQM 1 *Quality management for firms that perform audits or reviews of financial reports and other financial information, or other assurance or related services engagements*, effective from December 2022, will require all firms to perform root cause analysis.

Information Sheet 222 *Improving and maintaining audit quality* (INFO 222) outlines considerations and examples of initiatives for audit firms to improve and maintain audit quality. We will continue to discuss with the largest six audit firms their action plans, how firms measure their progress against those plans and how they assess the impact of these plans on audit quality.

## The role of directors, audit committees and management

From 1 July 2022, we commenced routine communication of negative findings to directors of the companies of the audit files reviewed. This will provide transparency of the findings from our audit file reviews and assist companies to drive audit quality actions. Further details about the process and timing of these communications can be found in Media Release (22-172MR) *ASIC to communicate negative audit review findings to directors* (1 July 2022) and revised RG 260.

Directors and audit committees should ensure the company's internal governance and risk frameworks are robust and support the preparation of financial statements free of material misstatements.

Directors and audit committees should also ensure that audit fees are set at a level that supports the audit work required. Audit fees are usually a very small proportion of costs and reducing them does not generally have a significant impact on a company's profit. As noted in our previous report (Report 709 *Audit inspection report: 1 July 2020 to 30 June 2021* (REP 709)) audit fees are well under 1% of net profit after tax, net assets and market capitalisation for the 300 largest ASX listed Australian entities by market capitalisation.

Company directors, audit committees and management have a critical and ongoing role in supporting quality audits. For further information see INFO 196 and Information Sheet 223 *Audit quality—The role of others* (INFO 223) for more information.

# Appendix: Accessible versions of figures

This appendix is for people with visual or other impairments. It provides the underlying data for the figures in this report.

**Table 4: Negative inspection findings**

| Period | Overall percentage | Largest six firms percentage |
|---|---|---|
| 12 months to 30 June 2019 | 26% | 26% |
| 12 months to 30 June 2020 | 27% | 24% |
| 12 months to 30 June 2021 | 32% | 23% |
| 12 months to 30 June 2022 | 36% | 32% |

**Note:** This is the data shown in Figure 1.

**Table 5: Negative findings from reviews of key audit areas in audit files at each of the largest six audit firms**

| Audit firm | FY 2021–22 Key audit areas with findings | FY 2021–22 Key audit areas reviewed | FY 2021–22 Percentage | FY 2020–21 Key audit areas with findings | FY 2020–21 Key audit areas reviewed | FY 2020–21 Percentage |
|---|---|---|---|---|---|---|
| BDO | 2 | 10 | 20% | 2 | 10 | 20% |
| Deloitte | 9 | 18 | 50% | 5 | 17 | 29% |
| Ernst & Young | 4 | 26 | 15% | 2 | 30 | 7% |
| Grant Thornton | 4 | 9 | 44% | 5 | 11 | 45% |
| KPMG | 13 | 27 | 48% | 8 | 27 | 30% |
| PwC | 4 | 24 | 17% | 5 | 20 | 25% |

**Note:** This is the data shown in Figure 2.

**Table 6: Number of audit files reviewed with the number of negative findings**

| Number of areas with findings | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| None | 18 | 16 |
| One | 9 | 17 |
| Two | 12 | 6 |
| Three | 5 | 6 |
| Four or more | 1 | 0 |

**Note:** This is the data shown in Figure 3.

### Table 7: Number of files and key audit areas reviewed at the largest six audit firms

| Audit firm | No. of audit files FY 2021–22 | No. of audit files FY 2020–21 | No. of KAAs FY 2021–22 | No. of KAAs FY 2020–2021 |
|---|---|---|---|---|
| BDO | 3 | 3 | 10 | 10 |
| Deloitte Touche Tohmatsu | 5 | 5 | 18 | 17 |
| Ernst & Young | 8 | 8 | 26 | 30 |
| Grant Thornton | 3 | 3 | 9 | 11 |
| KPMG | 8 | 8 | 27 | 27 |
| PricewaterhouseCoopers | 8 | 8 | 24 | 20 |

**Note:** This is the data shown in Figure 4.

### Table 8: Audits reviewed where there was a material change to the financial report

| Period | Percentage |
|---|---|
| 12 months to 30 June 2019 | 2% |
| 12 months to 30 June 2020 | 3% |
| 12 months to 30 June 2021 | 9% |
| 12 months to 30 June 2022 | 9% |

**Note:** This is the data shown in Figure 5.

### Table 9: Adjustments to financial reports

| Period | Section 311 notices | ASIC surveillances |
|---|---|---|
| 12 months to 30 June 2019 | 33 | 8 |
| 12 months to 30 June 2020 | 29 | 18 |
| 12 months to 30 June 2021 | 26 | 9 |
| 12 months to 30 June 2022 | 18 | 5 |

**Note:** This is the data shown in Figure 6.

### Table 10: Key audit areas with negative findings and key audit areas reviewed in the 12 months to 30 June 2022 and the 12 months to 30 June 2021

| Key audit areas | FY 2021–22 Key audit areas with findings | FY 2021–22 Key audit areas reviewed | FY 2021–22 Percentage | FY 2020–21 Key audit areas with findings | FY 2020–21 Key audit areas reviewed | FY 2020–21 Percentage |
|---|---|---|---|---|---|---|
| Revenue/ receivables | 13 | 44 | 30% | 15 | 41 | 37% |
| Impairment/ asset valuation | 12 | 38 | 32% | 10 | 40 | 25% |
| Investments/ financial instruments | 6 | 8 | 75% | 4 | 12 | 33% |
| Loans/ borrowings | 5 | 13 | 38% | 1 | 7 | 14% |
| Taxation | 5 | 11 | 45% | 2 | 5 | 40% |
| Provisions | 5 | 9 | 56% | 2 | 6 | 33% |
| Expenses/ payables | 3 | 4 | 75% | 3 | 7 | 43% |
| Acquisition accounting | 1 | 9 | 11% | 1 | 3 | 33% |
| Inventories/ cost of sales | 1 | 5 | 20% | 5 | 13 | 38% |
| Leases | 0 | 2 | 0% | 1 | 8 | 13% |
| Other | 1 | 3 | 33% | 3 | 7 | 43% |
| **Total** | **52** | **146** | **36%** | **47** | **149** | **32%** |

**Note 1:** This is the data shown in Figure 7.
**Note 2:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

### Table 11: Matters contributing to revenue and receivables negative findings in the 12 months to 30 June 2022 and the 12 months to 30 June 2021

| Matters | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| Tests of details | 37% | 30% |
| Internal controls | 20% | 13% |
| Risk assessment | 19% | 8% |
| Accounting estimates | 9% | 22% |
| Accounting policies | 9% | 6% |
| Substantive analytical procedures | 4% | 16% |
| Other | 2% | 5% |

**Note 1:** This is the data shown in Figure 8.
**Note 2:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

### Table 12: Matters contributing to asset values and impairment of non-financial assets negative findings in the 12 months to 30 June 2022 and the 12 months to 30 June 2021

| Matters | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| Forecast cash flows | 38% | 31% |
| Other key assumptions | 21% | 26% |
| Expense capitalisation | 17% | 0% |
| Sensitivity testing | 8% | 9% |
| Fair value techniques | 4% | 0% |
| Expert or specialist work | 2% | 17% |
| Impairment model testing | 2% | 5% |
| Impairment indicators | 2% | 3% |
| Other | 6% | 9% |

**Note:** This is the data shown in Figure 9.

### Table 13: Number of key factors contributing to negative findings by key audit area in the 12 months to 30 June 2022 and the 12 months to 30 June 2021

| Key audit areas | 12 months to 30 June 2022 | 12 months to 30 June 2021 |
|---|---|---|
| Investments/financial instruments | 25 | 16 |
| Provisions | 21 | 3 |
| Expenses/payables | 15 | 8 |
| Taxation | 14 | 13 |
| Loans/borrowings | 11 | 2 |
| Inventory/cost of sales | 5 | 17 |
| Acquisition accounting | 3 | 1 |
| Leases | 0 | 1 |
| Other | 2 | 3 |

**Note 1:** This is the data shown in Figure 10.
**Note 2:** Comparatives have been restated where required. Refer to 'Our coverage and comparability of findings'.

### Table 14: Fees payable to auditors of the 300 largest ASX listed Australian entities

| Fee category | $ million |
|---|---|
| Audit | 567 |
| Assurance required by legislation from auditor | 35 |
| Other assurance and agreed-upon procedures | 60 |
| Taxation compliance and advice | 46 |
| Non-assurance services | 40 |

**Note:** This is the data shown in Figure 11.

# Key terms

| | |
|---|---|
| **accounting standards** | Standards issued by the Australian Accounting Standards Board under section 334 of the Corporations Act |
| **ASIC** | Australian Securities and Investments Commission |
| **auditing standards** | Standards issued by the Auditing and Assurance Standards Board under section 336 of the Corporations Act |
| **CGU** | Cash generating unit |
| **Corporations Act** | *Corporations Act 2001*, including regulations made for the purposes of that Act |
| **INFO 196 (for example)** | An ASIC information sheet (in this example numbered 196) |
| **key audit area (KAA)** | An area of an audit selected for review by ASIC on a risk basis that generally relates to a financial statement line |
| **large unlisted entities** | Entities including unlisted financial institutions, larger unlisted public and proprietary companies (including subsidiaries of foreign companies), registered schemes and disclosing entities |
| **largest six firms** | Large firms that audit listed entities with the largest aggregate market capitalisation. These firms may operate through national partnerships, an authorised audit company or a national network of firms. They are the BDO firms in Australia, Deloitte Touche Tohmatsu Australia, Ernst & Young Australia, Grant Thornton Australia Limited, KPMG Australia and PricewaterhouseCoopers Australia |
| **last year** | Files reviewed in the 12 months to 30 June 2021 which covered audits of financial reports for financial years ending from 31 December 2019 to 31 December 2020 |
| **negative findings** | Where in our view auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement |
| **professional accounting bodies** | Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants |
| **REP 739 (for example)** | An ASIC report (in this example numbered 739) |
| **RG 260 (for example)** | An ASIC regulatory guide (in this example numbered 260) |
| **this year** | Files reviewed in the 12 months to 30 June 2022 which covered audits of financial reports for financial years ending from 31 December 2019 to 31 December 2021 |