ASIC

Australian Securities & Investments Commission

REPORT 534

Audit inspection program report for 2015–16

June 2017

About this report

This report summarises the observations and findings identified by ASIC’s audit inspection program in the 18 months to 31 December 2016.

We expect this report to be of significant interest both to the inspected firms and those firms we have not inspected, as well as companies, audit committees, investors and other stakeholders interested in financial reporting.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Scope

Sections of this report describe deficiencies or potential deficiencies in the systems, policies, procedures, practices or conduct of some of the 23 audit firms inspected. The absence of a reference in this report to any other aspect of a firm's systems, policies, procedures, practices or conduct is not an approval by ASIC of those aspects.

In the course of reviewing specific areas in a limited sample of a risk-based selection of audit engagements, an inspection may identify ways in which the audit work in a particular key audit area is, in our view, deficient. It is not the purpose of an inspection, however, to review all of the firm's audit engagements or to identify every aspect in which a reviewed audit may exhibit deficiencies.

We adopt a risk-based approach to selecting audit files and areas for review, and a random approach could result in a different level of findings.

This report covers findings from audit firm inspections only and does not include matters arising from other ASIC regulatory activities, such as our financial reporting surveillance program, and separate investigations or surveillances of the firms or the entities that they audit. However, these other activities may inform the general areas of focus in inspections.

Unless stated otherwise, not all matters in this report apply to every firm and, where they do apply to more than one firm, there will often be differences in the degree of application. Our observations and findings relate only to the individual firms inspected. Our observations and findings can differ significantly, even between firms of similar size, and for that reason we caution against drawing conclusions about any individual firms.

Contents

Executive summary

Overall findings

1 This report outlines the findings from our inspections of 23 Australian audit firms undertaken in the 18 months to 31 December 2016, covering financial reports for years ended 31 December 2014 to 30 June 2016. Our inspections focus on audits of financial reports of public interest entities prepared under the *Corporations Act 2001* (Corporations Act).

2 The objective of our audit firm inspection program is to promote the improvement and maintenance of audit quality. We work cooperatively with firms to achieve this objective.

3 In our view, in 25% of the total 390 key audit areas that we reviewed across 93 audit files at firms of different sizes, auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement. This compares to 19% of 463 key audit areas in the previous 18-month period ended 30 June 2015: see Section A.

4 Given the efforts by firms to improve audit quality and the consistency of execution of audits, this is a disappointing result. The findings suggest that further work and, in some cases, new or revised strategies are needed to improve quality.

5 We consider that good auditors deliver professional, high quality audits by matters such as applying appropriate experience and expertise, effective internal supervision and review, and having robust accountability mechanisms. We encourage all auditors to work to this standard.

6 Our audit inspection work complements our separate risk-based surveillance of the financial reports of public interest entities. This financial reporting surveillance continues to lead to material changes to 4% of the financial reports of public interest entities reviewed by ASIC.

7 In 15 cases where we reviewed audit files in our inspections in the 18 months to 31 December 2016, ASIC also raised financial reporting concerns with the company concerned or the auditor followed up financial reporting matters identified by ASIC with the company. In 12 of these cases, the companies made material changes to the amounts of both the net assets and profits in the subsequent period, or restated amounts for the year reviewed by us, which we believe related to our concerns. Generally, these cases are included in the 4% mentioned above. Two further companies made additional disclosures.

Initiatives to improve and maintain audit quality

8 Our findings suggest that audit firms should continue to work on improving audit quality and the consistency of audit execution. While firms continue to make good efforts to improve in this area, they should consider enhancing existing initiatives and focus on new and sustainable initiatives to improve audit quality, and maintain a culture focused on this.

9 Firms should undertake, or continue to undertake, comprehensive analysis to identify the underlying root causes of findings from their own quality reviews of audit files and our audit inspections. They should identify effective solutions to address these root causes, and consider past initiatives of the firm that have been effective in improving audit quality, as well as the initiatives and approaches outlined in Section B and Information Sheet 222 *Improving and maintaining audit quality* (INFO 222).

10 While the largest six audit firms maintained efforts to improve audit quality, they need to continue to focus on their action plans and other initiatives. Some action plan initiatives, including focuses on impairment of non-financial assets, have led to improvements in our findings in particular areas at some firms. Firms should consider the need for enhanced, new and changed initiatives to build on these areas of improvement.

11 We outline the areas of focus for our future inspections in Section C.

12 Directors are primarily responsible for the quality of the financial report. Audit quality supports financial reporting quality, and it is in the interests 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. We strongly caution against selecting auditors on the basis of cost rather than to ensure a quality audit. Refer Information Sheet 196 *Audit quality: The role of directors and audit committees* (INFO 196).

13 We have issued Regulatory Guide 260 *Communicating findings from audit files to directors, audit committees or senior managers* (RG 260) to explain when we will communicate findings to audit committees on an exception basis.

Areas for improvement

14 Our findings suggest that audit firms should continue to pay particular attention to:

(a) *the audit of asset values, particularly impairment of non-financial assets*—including challenging the reasonableness of any forecasts and key assumptions, and the basis of valuation;

(b) *the audit of revenue*—including accounting policy choices, substantive analytical procedures, and tests of detail; and

(c) *maintaining a strong culture of audit quality*—including strong messages from firm leadership, setting expectations, leading by example, coaching, robust review processes, and effective accountability mechanisms.

15 For further information on findings related to asset values, revenue recognition and other areas, see Section D

16 It also remains important for auditors to focus on:

(a) the sufficiency and appropriateness of audit evidence obtained by the auditor;

(b) the level of professional scepticism exercised by auditors; and

(c) appropriate use of the work of experts and other auditors.

17 Some audit firms inspected also need to further improve their quality control systems or adherence to existing quality control processes: see Section E.

Understanding our findings

18 The nature of our findings is consistent with the findings of audit regulators in other jurisdictions, as reflected in the inspection findings survey results published by the International Forum of Independent Audit Regulators (IFIAR) earlier this year. The level of findings may vary between jurisdictions.

Note: See IFIAR, *2016 Survey of inspection findings*, March 2017.

19 Findings from our audit inspection program do not necessarily mean that the financial reports audited were materially misstated. Rather, in our view the auditor did not have a sufficient basis to support their opinion on the financial report. Our inspections focus on higher risk audit areas and so caution is needed in generalising the results across the entire market.

20 We generally select some of the more complex, demanding and challenging audits, and some more significant or higher risk areas of the financial reports. We do not generally select audit files for review in our inspections

where known reporting or audit issues have already been identified in our financial reporting surveillance program, in our investigations, or by other means. Hence, purely random reviews could result in a different level of findings than indicated in paragraph 3.

21 Although audit firms may agree to take remedial actions based on our findings, firms do not necessarily agree with all of our findings. Audits necessarily involve the application of professional judgement, and there are some instances where different individuals will reach different judgements on whether the audit work performed is sufficient. The percentages in paragraph 3 do not include instances where we considered that individuals could reasonably reach different judgements.

22 Our inspections do not attempt to measure cases where auditors have performed their role and challenged an entity's draft financial report, resulting in material changes to those reports. We recognise that very often auditors will cause material changes to draft financial reports in performing their role.

23 Matters relevant to understanding the percentage measure in paragraph 3 are discussed in Information Sheet 224 *ASIC audit inspections* (INFO 224). ASIC was assisted by feedback from an external consultative panel on our method of measuring findings: see paragraphs 44–45.

A Overall findings

Key points

In our view, in 25% of the total 390 key audit areas reviewed across 93 audit files, at 23 firms of different sizes, auditors did not obtain reasonable assurance that the overall financial report was free of material misstatement.

While financial reports may not have been materially misstated, in our view the auditor did not have a sufficient basis to form an opinion on the financial report.

This section includes information on our approach to audit quality.

Audit quality

The importance of audit quality

24 The quality of financial reports is key to confident and informed markets and investors. The objective of the independent audit is to provide confidence in the quality of financial reports. Improving audit quality and the consistency of audit execution is essential to continued confidence in the independent assurance provided by auditors.

Our approach to audit quality

25 For our regulatory purposes, audit quality refers to matters that contribute to the likelihood that the auditor will:

(a) achieve the fundamental objective of obtaining reasonable assurance that the financial report as a whole is free of material misstatement; and

(b) ensure material deficiencies detected are addressed or communicated through the audit report.

26 This includes appropriately challenging key accounting estimates and treatments that can materially affect the reported financial position and results.

Our findings

27 In our view, in 25% of the 390 key audit areas that we have reviewed on a risk basis across 93 audit files in the 18 months to 31 December 2016, auditors did not obtain reasonable assurance that the financial report as a

whole was free of material misstatement. The corresponding figure for the 18 months to 30 June 2015 was 19% across 463 key audit areas.

28 The occurrence of the above findings at the firms of different sizes is shown in Table 1.

Table 1: Findings by number and size of firms inspected

Type of firm	18 months to 31 December 2016	18 months to 30 June 2015
Largest four national firms	23%	18%
Other national and network firms	28%	15%
Smaller firms	26%	42%

Note: The percentages for the 'other national and network firms' and 'smaller firms' are not directly comparable between periods, as we inspected different firms in the 18 months to 31 December 2016 and in the 18 months to 30 June 2015. For the smaller firms, we only reviewed one file at each of the 9 firms inspected.

29 Many of our findings related to accounting estimates (such as impairment of assets) and accounting policy choices (such as revenue recognition). Further information appears in Table 3, Table 4, and Section D of this report.

30 Our findings suggest that audit firms should continue to pay particular attention to:

(a) *the audit of asset values, particularly impairment of non-financial assets*—including challenging the reasonableness of any forecasts, key assumptions, and the basis of valuation;

(b) *the audit of revenue*—including accounting policy choices, substantive analytical procedures, and tests of detail; and

(c) *maintaining a strong culture of audit quality*—including strong messages from firm leadership, setting expectations, leading by example, coaching, robust review processes, and effective accountability mechanisms.

31 It also remains important for auditors to focus on:

(a) the sufficiency and appropriateness of audit evidence obtained by the auditor;

(b) the level of professional scepticism exercised by auditors; and

(c) appropriate use of the work of experts and other auditors.

32 Our findings do not necessarily mean that the financial reports audited were materially misstated. Rather, in our view, the auditor did not have a sufficient basis to support their opinion on the financial report.

33 An audit does not provide absolute assurance. Our findings are based on the requirement for the auditor to obtain reasonable assurance.

34 Our audit inspection work complements our separate risk-based surveillance of the financial reports of public interest entities. This financial reporting surveillance work continues to lead to material changes to 4% of the financial reports of public interest entities reviewed by ASIC.

35 In 15 cases (15 cases in the previous 18 months) where we reviewed audit files in our inspections in the 18 months to 31 December 2016, ASIC also raised financial reporting concerns with the company concerned, or the auditor followed up financial reporting matters identified by ASIC with the company. In 12 of these cases (12 cases in the previous 18 months), the companies made material changes to the amounts of both the net assets and profits in the subsequent period or restated amounts for the year reviewed by us, which we believe related to our concerns. Generally, these cases are included in the 4% mentioned above. Two further companies made additional disclosures.

36 We consider that there is still a need for audit firms to improve audit quality and the consistency of audit execution.

Our coverage

37 We inspected 23 audit firms of different sizes in the 18 months to 31 December 2016, covering financial reports for years ended 31 December 2014 to 30 June 2016. These firms, in aggregate, audit 97% of listed entities by market capitalisation.

38 The number and size of firms we inspected is provided in Table 2.

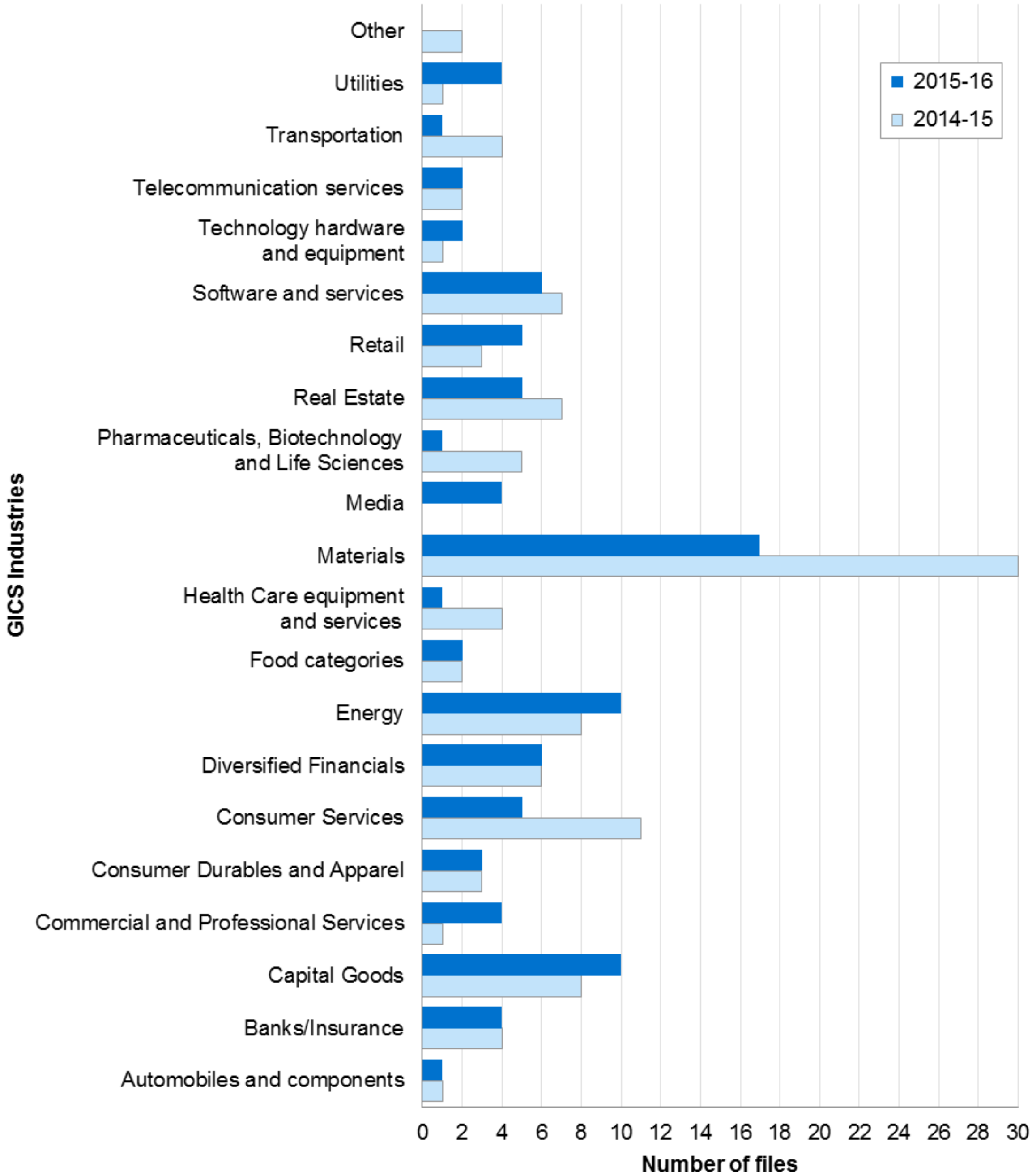
Table 2: Number and size of firms inspected

Type of firm	18 months to 31 December 2016	18 months to 30 June 2015
Largest four national firms	4	4
Other national and network firms	10	7
Smaller firms	9	10
Total	**23**	**21**

39 Other than a reduction in audits of entities in the materials industry group, there has been no significant change to the industry groups covered by our reviews of audit files in inspections in the 18 months to 31 December 2016 compared to the 18 months to 30 June 2015: see Figure 1. As many of our

findings relate to impairment in the materials industry group, reducing coverage in this group should not have resulted in an increase in our percentage of findings.

Figure 1: Industry groups for the audit files reviewed in the current and previous 18-month periods using Global Industry Classification Standard (GICS)



Note: See Table 8 in Appendix 1 for the data shown in this graph (accessible version).

40 Our findings were not affected by any significant change in our areas of focus. The audit areas covered in our reviews in the 18 months to 31 December 2016 and the 18 months to 30 June 2015 were similar, as

shown in Table 3. The percentages of total key audit areas reviewed are shown in parentheses.

Table 3: Key audit areas selected for review in current and previous 18-month periods

Key audit area	18 months to 31 December 2016	18 months to 30 June 2015
Revenue/receivables	90 (23%)	102 (22%)
Impairment/asset valuation	78 (20%)	121 (26%)
Tax	70 (18%)	46 (10%)
Loans/borrowings	39 (10%)	32 (7%)
Inventory/cost of sales	18 (5%)	32 (7%)
Investments	18 (5%)	23 (5%)
Expenses/payables	16 (4%)	28 (6%)
Mining exploration and evaluation (excluding impairment)	16 (4%)	19 (4%)
Cash	8 (2%)	19 (4%)
Provisions	13 (3%)	9 (2%)
Financial instruments	8 (2%)	9 (2%)
Acquisition accounting	4 (1%)	9 (2%)
Share-based payments	4 (1%)	5 (1%)
Other (including ‘Going concern’, ‘Segment reporting’ and ‘Equity’)	8 (2%)	9 (2%)
Total	**390 (100%)**	**463 (100%)**

41 Table 4 shows that most of our findings in the 18 months to 31 December 2016 concerned the audit of asset values and revenue. The level of findings in these areas has increased compared to the 18 months to 30 June 2015, indicating that these areas require further focus by auditors. The figures in parentheses represent the percentage of findings out of the number of times we reviewed the key audit area.

Table 4: Findings in each key audit area in current and previous 18-month periods

Key audit area	18 months to 31 December 2016	18 months to 30 June 2015
Revenue/receivables	30 (34%)	15 (16%)
Impairment/asset valuation	29 (37%)	31 (28%)
Tax	5 (7%)	5 (11%)
Loans/borrowings	1 (2%)	4 (13%)
Inventory/cost of sales	6 (29%)	5 (21%)
Investments	12 (67%)	4 (21%)
Expenses/payables	2 (14%)	4 (16%)
Mining exploration and evaluation (excluding impairment)	3 (18%)	9 (47%)
Cash	0 (0%)	2 (11%)
Provisions	4 (30%)	3 (38%)
Financial instruments	2 (33%)	4 (57%)
Acquisition accounting	1 (20%)	1 (22%)
Share-based payments	1 (33%)	0 (0%)
Other (including 'Going concern', 'Segment reporting' and 'Equity')	1 (40%)	1 (14%)
Total	**97**	**88**

42 The nature of our findings are consistent with those of audit regulators in other jurisdictions, as reflected in the inspection findings survey results published by IFIAR earlier this year. The level of findings may vary between jurisdictions.

Note: See IFIAR, *2016 Survey of inspection findings*, March 2017.

43 Other matters relevant to understanding our findings and the percentages reported above are outlined in INFO 224, particularly findings excluded from these percentages. The percentages reflect findings in the areas and industries discussed in Section D.

Consultative panel

44 We used a panel to consult on the method of measuring and reporting aggregate findings from our inspections. The panel discussed the conclusions reached on a sample of inspection findings when considering our measurement and reporting methodology.

45 The panel consisted of Messrs Peter Day, Brian Long and Des Pearson AO, who have extensive qualifications and experience in business, accounting and audit, and are considered independent of the audit firms and professional bodies. Overall, the panel concurred with our approach and the reporting of our findings.

B Improving and maintaining audit quality

Key points

Audit firms should undertake or enhance root cause analysis on quality review and inspection findings, and develop or revise action plans to improve audit quality.

In this section we discuss:

- what good looks like for audit firms;
- action plans to improve audit quality;
- initiatives that appear to have improved audit quality in specific areas;
- the role of directors, audit committees and others in supporting audit quality; and
- our work with international regulators.

What good looks like for audit firms

46 Auditors should deliver professional, high quality audits through:

(a) a strong internal culture focused on quality audits and professional scepticism;

(b) applying appropriate resources, experience and expertise to audits;

(c) effective internal supervision and review;

(d) robust accountability mechanisms;

(e) identifying and addressing audit risks and issues on a timely basis; and

(f) accepting and addressing key findings from audit inspections, including findings on asset values and revenue recognition.

Key initiatives to improve audit quality

47 Given the findings from our audit inspections, to improve audit quality, audit firms should improve their focus on:

(a) conducting effective quality reviews of audits;

(b) remediating findings from firm quality reviews and our inspections by obtaining the audit evidence necessary to form an opinion on the financial report;

(c) identifying root causes of findings from their own quality reviews and our audit inspections;

(d) developing and implementing action plans to address findings; and

(e) monitoring and revising action plans to ensure that they are effective.

Action plans

48 We consider that developing, maintaining and updating action plans to address the underlying causes of audit deficiencies is a key part of improving audit quality and consistent execution of audits. This involves ongoing analysis of the underlying root causes of findings from quality reviews and audit inspections.

49 Auditors should refer to INFO 222, which outlines considerations for auditors to improve and maintain audit quality. In their action plans, firms should consider opportunities to improve their focus on:

(a) the culture of the firm, including messages from the firm’s leadership on the importance of audit quality, setting expectations and leading by example;

(b) the experience and expertise of partners and staff, including increased and better use of experts;

(c) supervision and review, including greater partner involvement with audit teams when planning and executing audits, robust review processes during the engagement, robust post-completion reviews, and real-time quality reviews of engagements; and

(d) accountability, including impact on remuneration for engagement partners and review partners for poor audit quality, often extending to firm leadership.

50 For example, there may be opportunities to improve the overall direction and supervision of complex audits of entities such as large financial institutions, and to review audit approaches.

51 Firms that have not yet done so should consider developing action plans to improve the quality of the audits they conduct.

52 During 2013, the largest six audit firms responded to our requests to prepare action plans to improve audit quality and the consistency of audit execution. These plans continue to be updated and revised. We continue to discuss with these firms their progress in implementing these action plans, and assess the impact of these plans on audit quality. Plans continue to develop and evolve. Firms should continue to explore the need for new and changed initiatives.

53 Plans that are too high level and general, without specific documented actions, responsibilities and timelines, are less likely to be effective.

54 Refer to INFO 222 for some examples of initiatives to improve and maintain audit quality that might appear in action plans.

Some initiatives that appear to have improved audit quality

55 Initiatives undertaken by some firms that appear to have a positive impact on aspects of audit quality at those firms include:

(a) forming specialist focus groups and risk panels on impairment of non-financial assets, substantive analytical procedures and other areas to develop the necessary expertise, support and coaching for audit teams;

(b) increasing partner time spent on engagements;

(c) developing a strong culture focused on audit quality with accountability at all levels of partners and staff;

(d) proper project management of audits, including monitoring—at audit team and firm level—of progress against key engagement-specific milestones, and addressing issues early to minimise deadline pressures at the conclusion of the audit; and

(e) greater education of directors and management of audited entities to improve financial reporting quality and support the audit process.

The role of others in supporting audit quality

56 While auditors have the primary responsibility for audit quality, there are actions that others can take to promote and support audit quality, including:

(a) directors and audit committees—by supporting quality financial reporting and the external audit process;

(b) standard setters—by developing and maintaining quality auditing and ethical standards;

(c) international regulators—by cooperating to influence audit firms, directors and audit committees, and standard setters internationally; and

(d) professional accounting bodies—by educating members and ensuring the supply of qualified accountants.

57 Directors are primarily responsible for the quality of the financial report. Audit quality supports financial reporting quality, and it is in the interests of directors and audit committees to support the audit process. This includes ensuring that management produces quality financial information and that the audit is appropriately resourced. We strongly caution against selecting auditors on the basis of cost rather than to ensure a quality audit.

58 Audit committees should take an interest in our findings and discuss with their auditors whether the findings are relevant to the auditors and their firm, and how those findings are being addressed.

59 We have issued RG 260 to explain when we will communicate findings to audit committees on an exception basis.

60 Directors and audit committees should consider the following ASIC information sheets:

(a) Information Sheet 196 *Audit quality: The role of directors and audit committees* (INFO 196);

(b) Information Sheet 183 *Directors and financial reporting* (INFO 183); and

(c) Information Sheet 203 *Impairment of non-financial assets: Materials for directors* (INFO 203).

61 The role of standard setters, accounting bodies and others is discussed in Information Sheet 223 *Audit quality: The role of others* (INFO 223).

International regulators

62 ASIC works with securities and audit regulators in other countries to promote audit quality. This is important because many corporations operate across borders, the larger audit firms are part of global networks, our auditing and ethical standards are based on international standards, and our markets are affected by international economic, regulatory and other developments.

63 Through the International Organization of Securities Commissions, we have worked with other securities regulators on such matters as:

(a) seeking to enhance the standard setting governance for the international auditing and ethical standards setting boards;

(b) seeking improvements to the international auditing and ethical standards; and

(c) surveying securities regulators on the role of audit committees in connection with audit quality.

64 Through IFIAR, we have worked with other major regulators in discussing actions to improve audit quality with the largest six firms internationally. We also led work to develop and finalise a multilateral memorandum of understanding (MMOU) on information sharing between audit regulators. The MMOU was signed by 22 regulators in April 2017.

Note: IFIAR, ‘IFIAR documents’, webpage, www.ifiar.org.

C Areas of future focus

Key points

We will continue to inspect firms that audit significant public interest entities, using a risk-based approach.

The top areas of focus for our upcoming inspections are:

- asset impairment;
- revenue; and
- firm cultures focused on audit quality.

Other areas of focus for our upcoming inspections include:

- the other focus areas identified in our six-monthly financial reporting media releases, including asset values and revenue;
- firms having robust quality reviews and undertaking root cause analysis;
- firms developing, implementing and revising action plans to improve audit quality;
- partner involvement, project management, supervision and review and accountability frameworks;
- audits of client monies held;
- audit evidence, professional scepticism, and the use of experts and other auditors;
- balancing audit efficiency and effectiveness;
- understanding of business models and risks;
- internal control reviews and taxation;
- enhanced audit reports; and
- major new accounting standards.

Our continuing general approach to inspections

65 Our reviews will continue to focus on:

(a) firms that audit entities that are likely to be of significant public interest;

(b) files for audits of financial reports of listed entities and other public interest entities, such as financial institutions;

(c) files for audits of entities and industries that may be more vulnerable to risks arising from existing and emerging market conditions; and

(d) assessing the quality of judgements and decisions made by the auditor and not on matters of mere process.

66 We will continue to conduct follow-up inspections of audit firms. Where significant issues have been identified in previous inspections, we will perform follow-up reviews to ensure that the firms are taking prompt and appropriate action to address our observations and findings.

Our areas of focus in upcoming inspections

67 Tables 5 and 6 outline areas of focus for our upcoming inspections of audit firms.

Table 5: Top three areas of focus for firms and our inspections

Focus area	Details
Asset impairment	Whether root causes of findings about the audit of impairment of non-financial assets have been identified and addressed. Auditors should also focus on asset values that may be affected by economic and other developments in the extractive industries and mining services, as well as entities that may be affected by digital disruption.
Revenue	Whether root causes of findings about the audit of revenue have been identified and addressed, including the adequacy of substantive analytical procedures and other audit techniques, appropriateness of accounting policy choices, consistency with the substance of commercial arrangements and cut-off.
Culture	Whether the firm's culture promotes audit quality, including strong, consistent and genuine messages from leaders and partners. There should be acceptance of the need to change, improve, and accept and address quality review findings.

Table 6: Other areas of focus for firms and our inspections

Focus area	Details
Financial reporting focuses	Whether audits adequately address other focus areas identified in our six-monthly financial reporting surveillance program media releases.
Quality reviews	Effective quality reviews are key to maintaining and improving audit quality. Internal monitoring processes should be robust and effective. Firms should consider: • the quality, experience and independence of reviewers; • the scope and coverage of reviews; • how audit files and audit areas are selected for review; • the depth of reviews of individual audit files and audit areas; • whether reviews deal with difficult judgement areas; and • how findings are identified and addressed.

Focus area	Details
Root cause analysis	Whether firms have undertaken effective root cause analysis on findings from inspections, internal quality reviews, restatements and other sources. This includes using suitably qualified and experienced independent reviewers with sufficient authority to conduct the analysis, interviewing engagement team members, identifying themes, identifying underlying causes, and developing actions to address those underlying causes.
Action plans	Whether firms that have developed action plans to improve audit quality and the consistency of execution, and whether they have continued to review and update those plans to ensure they are effective in improving and maintaining audit quality. Firms should consider which initiatives have been most effective in improving audit quality in their own firms, and at other firms in their local and international networks. Firms that do not have action plans should consider developing and implementing such plans.
Partner involvement	Whether partners are devoting sufficient time to audits, including the planning and execution of the audit and the concluding procedures and key judgements.
Project management	Whether there is proper project management of audits to address issues sufficiently early and to minimise deadline pressures at the conclusion of the audit, including: • at audit team and firm level, monitoring progress against sufficiently granular and specific key engagement specific milestones; • monitoring of component audits by the group auditor; and • monitoring client deliverables.
Supervision and review	Whether: • there is strong and effective supervision and review at all stages of the audit, including planning, performance and concluding procedures; • reviews by senior team members, the partner and the engagement quality control reviewer (EQCR) are timely and comments raised are properly addressed and cleared by the reviewer; • firm quality reviews are frequent, timely, have depth and are undertaken by independent reviewers; and • firms have considered real-time quality reviews and coaching for key areas during execution of the audit.
Accountability	Whether partners, managers and staff are adequately held accountable—through performance reviews and remuneration—for findings from firm quality reviews and external inspections. Credit should be given for accepting findings and acting to address those findings.
Audit evidence	Whether auditors have obtained sufficient appropriate audit evidence to conclude whether the financial report is free of material misstatement and to support their audit opinions.
Professional scepticism	Whether an appropriate level of professional scepticism is exercised by auditors, focusing on significant judgements about audit evidence, accounting estimates, going concern assumptions and accounting treatments.

Focus area	Details
Use of experts and other auditors	Whether auditors have appropriately used and evaluated the work of: • their own experts; and • other auditors, including—in the context of group audits—interests in joint ventures and the use of service organisations. This includes focusing on the processes of a firm's internal specialist groups (e.g. technical accounting, business valuation, treasury, actuarial and taxation) in supporting audit engagement teams and the quality of their advice and judgements as audit evidence.
Client monies held	Whether auditors have tested client monies held and related assets for Australian financial services (AFS) licensees and other entities that hold client monies. Auditors should also ensure that client monies are dealt with appropriately and that any breaches for AFS licensees are reported to ASIC in accordance with the Corporations Act and Regulatory Guide 34 *Auditors' obligations: Reporting to ASIC* (RG 34).
Audit efficiency and effectiveness	Whether changes in approaches to audits have led to audit quality being compromised in individual engagements: see paragraphs 68–71.
Business models and risk assessment	Whether auditors have adequately understood the business model of the entity audited. We will also consider whether the auditor has identified and appropriately responded to key areas of risk. Auditors need to: • understand the impact of technology on the businesses of their clients, such as any threats from competitors using new electronic product distribution channels; • understand the impact of certain systems and processes occurring outside the entity and the need to use other auditors to gain assurance over the adequacy of these systems and processes, and perform substantive testing on relevant transactions and balances.
Internal controls	Whether: • consideration is given to assessing controls, which can give rise to a more effective audit and add value; • internal control reviews are conducted and the impact of deficiencies are identified for institutions with large numbers of systematically processed transactions, where an effective audit may be difficult without relying on controls; and • auditors appropriately identify, understand and test the controls that they rely on.
Tax	Whether the auditor has independently reviewed the tax calculations of the audited entity and used their own tax expert. This includes whether auditors and their tax experts have communicated effectively in reviewing and testing tax calculations, including ensuring that: • tax experts understand the business and general ledger items; • the auditor understands the potential implications of tax treatments affecting the entity and their impact on the financial report; and • differences between tax and accounting treatments are properly identified and appropriately accounted for.

Focus area	Details
Enhanced audit reports	New enhanced audit reports are mandatory for audits of listed entities for financial reporting periods ending on or after 15 December 2016. In particular, auditors should focus on the clear and meaningful communication of key audit matters that are specific to the entity audited. Including key audit matters in the auditor's report is not a substitute for disclosures in the financial report, the auditor expressing a modified opinion, or reporting material uncertainty about going concern.
Major new accounting standards	Auditors should ensure that partners and staff are appropriately skilled to undertake audits under new accounting standards on: • revenue; • financial instruments, including loan loss provisioning under an expected loss model; and • leases. There is also a new international standard on insurance activities. Auditors should also encourage their clients to be adequately prepared for these new standards.

Audit efficiency and effectiveness

68 Seeking greater efficiency in the audit process is a positive feature of market forces and private sector audit firms. Changes in the audit process aimed at increasing efficiency should not compromise audit quality and, ideally, should also be accompanied by a more effective audit.

69 Firms should have processes in place—such as quality reviews of audit files—to ensure that any efficiency measures introduced have not led to audit quality being compromised on individual audit engagements.

70 In our upcoming inspections, we will continue to focus on the impact of audit efficiency measures, and changes in audit approaches or techniques, on the quality of audits.

71 Table 7 outlines some areas that firms might consider concerning audit efficiency measures and the effect of any audit fee reductions.

Table 7: Matters to consider for audit efficiency and effectiveness

Focus area	Considerations
Tone at the top	Whether firm leadership gives strong and consistent messages that improvements in efficiency do not mean compromising on audit quality.
Fee reductions	Whether audit quality is being maintained for engagements where there have been large fee reductions for new or existing audits without underlying changes to business operations. Attempts to sell additional services to these clients can also raise auditor independence issues. We may review audit files where there have been fee reductions that do not reflect changes in the business of the audited entity. We will review whether there is evidence that firm leaders have communicated strong, consistent and genuine messages that, where fees are reduced, audit teams must still perform quality audits.
Methodology changes	Whether audit methodologies—and any changes to these— are consistent with auditing standards, result in more effective audits and do not compromise audit quality. Also, whether individual audit teams have adopted methodologies in a manner that does not compromise audit quality. When interpreting auditing standards,a genuine and common sense approach should be taken that considers the overall objectives of the standards, rather than interpretations that may minimise audit work.
Standardisation	Whether standardising audit processes and procedures, to promote greater consistency in audit quality, has been appropriately balanced against the risk that auditors fail to address matters that are specific to individual audits, such as business models, risks and controls. Standardisation can assist in ensuring a minimum level of work but can have limitations, given the need to apply judgement to the specific circumstances of any audit.
Risk ratings, materiality, and sampling	Whether audit partners and teams sufficiently consider the risks, materiality and sample sizes for individual audits.
Internal control reviews	Whether a more effective audit that adds greater value can be achieved by evaluating and determining whether reliance can be placed on internal controls, rather than performing increased tests of detail.
Reliance on internal audit and management's experts	Whether reliance has been placed on internal audit or management experts. The type of work performed by internal auditors as employees of an audited entity may be inconsistent with the fundamental requirement for an independent audit. Internal audit work may help inform audit risks and form part of the system of internal control, but should not be used as a substitute for work that should be undertaken by the external auditor. Similarly, reliance on management experts—rather than engaging the auditor's own expert—can result in the work of the expert forming the basis for both the financial report and the audit. This can undermine the ability of investors and other users of financial reports to rely on, and have confidence in, an independent audit.

Focus area	Considerations
Use of data analytics and new audit technologies	Whether using new technologies and techniques could increase audit effectiveness and result in a higher level of assurance. These new technologies and techniques may include data analytics, robotics and cognitive learning. For example, valuing a whole portfolio of financial instruments using independent models and pricing sources may enable the auditor to evaluate differences in values across the whole population and their materiality. When using data analytics, auditors should consider whether applications have been properly implemented and whether the results can be relied on. Data analytics can lead to a more effective audit, but there are risks and limitations to the circumstances in which it can be used. For example: • the auditor must have a good understanding of business, risks and controls; • data used must be complete, accurate and reconciled to the financial report or appropriate independent sources; • controls around the data should be reviewed and tested for effective operation; • exceptions should be investigated on an appropriate basis; • models and techniques should be reviewed each reporting period to ensure that they remain relevant and effective, including taking into account changes in the business and controls of the audited entity; • appropriately qualified and experienced staff should design and perform the procedures; • substantive analytical procedures rely on the ability to predict a population from independent data, and there may be limited cases where this technique can be used; • significant judgement and business knowledge can be required to identify exceptions or unusual patterns in populations for audit focus; • data analytics will not assist with the most difficult judgements on accounting policies and estimates. These judgements will continue to require experience, expertise and professional scepticism; and • there must be sufficient documentation for an experienced auditor, having no previous connections with the audit, to understand the work performed and the reasons for the conclusions reached. Proper use of data analytics may increase audit costs rather than increase efficiency, particularly in the first year. The use of robotics and learning systems will also create challenges in understanding the business, considering limitations and exceptions, and obtaining and reconciling source information.
Outsourcing	Whether centres of excellence and offshoring arrangements have been used appropriately. For example, some firms have outsourced basic audit work to offshore service centres or created centres of excellence to provide specialist skills and advice to audit teams. Where work is outsourced, the quality of the work needs to be properly controlled, monitored and reviewed. Staff need to be properly experienced and have appropriate expertise.

D Key findings: Audit file reviews

Key points

Our inspections suggest that, in addition to maintaining a strong culture of audit quality (see Section B), audit firms should continue to improve both the adequacy of their audits of asset values and revenue recognition.

In particular, auditors can improve in the areas of:

- impairment of non-financial assets;
- revenue and receivables;
- tax calculations;
- investment and financial assets, and contract liabilities;
- inventory and cost of sales;
- using the work of experts and other auditors; and
- journal entry testing.

72 This section contains examples of findings from file reviews in the 18 months to 31 December 2016 that may be useful to other auditors in considering areas to improve audit quality on individual engagements.

73 We reviewed 93 files in the 18 months to 31 December 2016. Table 3 (in Section A) shows the number and percentage of those files for which we reviewed particular key audit areas. Table 4 (also in Section A) shows the number and percentage of cases where we had findings in each key audit area.

74 This section includes some more common or important findings across key audit areas. In many cases where we had a finding in a particular area (e.g. impairment of non-financial assets), we identified a combination of the matters shown below for that area. However, it should not be inferred that all of the examples that relate to a particular audit area applied in all cases where we had a finding in that area.

75 For example, at a financial institution, we might have findings in each key audit area reviewed. In each area there could be a number of findings on risk assessment, controls, and substantive testing.

76 The largest numbers of findings in the 18 months to 31 December 2016 related to the audit of asset values and revenue/receivables.

77 This section also covers findings on journal entry testing. Because these findings are not associated with a specific key audit area, they are excluded from the findings percentage in paragraph 3.

Impairment of non-financial assets

78 Regarding impairment of non-financial assets, we continued to find instances where the auditor did not:

(a) adequately consider the appropriateness and reasonableness of forecast cash flows and key assumptions used in discounted cash flow models, taking into account matters such as historical cash flows, and economic and market conditions—for example:

  (i) the auditor did not challenge why revenue and earnings growth were not consistent with past actual outcomes, or why management's explanations for growth were realistic and supportable, particularly where management has a history of not meeting forecasts;

  (ii) perpetuity cash flows forecast did not reflect the cyclical nature of the business;

  (iii) the proportion of working capital as a percentage of revenue was inconsistent with more working capital being required as business and revenues increase; and

  (iv) the auditor did not evaluate key model assumptions, including discount rates, future capital expenditure and forecast resource pricing assumptions;

(b) ensure that the carrying amount and recoverable amount were calculated on a consistent basis, such as including projected cash flows in the recoverable amount calculation but not including all related assets in the carrying amount. Other examples were excluding capital expenditures, corporate costs and corporate assets from impairment calculations;

(c) assess the appropriateness of the cash-generating units used and whether they were identified at an appropriately low level of independent cash flows;

(d) perform a valuation cross-check to assess the reasonableness of the assumptions underpinning the recoverable amount calculation. Or, when they did perform a valuation cross-check:

  (i) comparable multiples did not support the asset's carrying amount;

  (ii) comparable companies relied on were not appropriate or identified in the audit work papers; or

  (iii) the auditor did not challenge the appropriateness of comparable entities used by internal experts;

(e) regarding sensitivity testing:

  (i) perform adequate sensitivity testing of significant assumptions such as prices, margins and volumes;

(ii) perform the test on year one budgeted cash flows; and

(iii) address inaccuracies in the model used to test sensitivities;

(f) when testing an asset's fair value:

(i) use a valuation technique for which sufficient data and/or observable inputs were available;

(ii) evidence a reliable exit price from the perspective of a market participant or consider whether management's assumptions would be those used by market participants;

(iii) consider the legal ability to use an asset in its purported highest and best use;

(iv) perform valuation cross-checks; and

(v) include analyst reports used to support key impairment assumptions on the engagement file or refer to where they could be obtained.

(g) consider the adequacy of disclosures in the financial report.

79 We had concerns about some impairment assessments for mining assets where the auditor did not:

(a) adequately consider the appropriateness and reasonableness of forecast commodity prices;

(b) assess whether the forecast assumptions, including mine plans and management-prepared resource estimates underpinning the impairment models, were reasonable and supportable;

(c) assess impairment indicators in line with AASB 136 *Impairment of assets* and AASB 6 *Exploration for and evaluation of mineral resources*, including where market capitalisation was less than net assets or there was illiquidity in the company's shares;

(d) identify the appropriate provisions of AASB 6 and AASB 136 that apply to impairment assessments for exploration and evaluation assets versus development assets, and accepted the capitalisation of exploration expenditure after expiry of the relevant exploration licence;

(e) consider the application of AASB 136 and AASB 13 *Fair value measurement* to a fair value less cost of disposal methodology and using information that market participants would use; and

(f) confirm the rights to tenements and existence of exploration licences.

Revenue and receivables

80 Our findings increased in all areas of the audit of revenue and receivables, including revenue recognition, recovery of receivables, substantive

analytical procedures, and test of detail. About a third of our findings relate to substantive analytical procedures, which has been an area of concern highlighted in previous audit inspection reports.

81 Our main findings about the audit of revenue and receivables were:

(a) risks were not assessed;

(b) controls relied upon were not identified or tested, or the nature and extent of testing changed in response to identified control deficiencies;

(c) substantive analytical procedures were used without:

  (i) evaluating the reliability of data used to develop the auditor's expectation;

  (ii) determining acceptable thresholds or identifying differences from expectations for investigation, particularly where revenue was disaggregated; and

  (iii) investigating results of differences from expectations;

(d) substantive procedures that did not respond to the assessed risks;

(e) the appropriateness of a change in revenue accounting policy was not considered, and key contract terms were not understood;

(f) accounting estimates relevant to the recognition of revenue were not challenged by the auditor;

(g) use of inadequate sampling techniques and sample sizes; and

(h) errors from tests of detail were not investigated or evaluated.

82 Regarding the interest and fee revenue of financial institutions, we found instances where the auditor did not always:

(a) adequately assess risks or respond to identified risks;

(b) understand processes, identify or evaluate key controls when relying on controls, consider or review controls responding to risks, consider controls in relation to information from external adminstrators, or consider the adequacy of work by other auditors on controls of external administrators;

(c) include all significant revenue streams in the scope of testing or used inadequate sample sizes when testing some revenue streams;

(d) test information from internal systems, external administrators or other sources, and consider the work of another auditor where relevant;

(e) perform adequate substantive analytical procedures;

(f) when relying on cash receipts to test revenue, ascertain whether cash received represented pass through transactions, deferred or unearned income;

(g) adequately challenge estimates for an expected sale or assumptions for other estimates affecting fees, including not adequately justifying their range of estimated expected sales values for testing fees, and using outdated data; and

(h) perform adequate cut-off testing.

83 In testing insurance company premium revenue, we found instances where the auditor did not:

(a) adequately understand the business operations to design audit procedures, adequately identify and evaluate risks, cover key products, or identify and test key controls when relying on controls;

(b) test system-generated information they relied upon; and

(c) design and perform adequate substantive procedures, including substantive analytical procedures.

Tax calculations

84 Auditors should use their own tax experts when auditing tax calculations, where appropriate. The auditor should work closely with any tax specialist to ensure that the level and scope of the specialist's work is suitable for audit purposes, and that issues raised are resolved. The auditor should ensure that the tax expert has a good understanding of the business and nature of the financial reporting balances, and that the auditor understands differences between tax and accounting treatments that give rise to deferred tax balances.

85 We found that some auditors did not:

(a) sufficiently test tax benefits for unused tax losses, and assess the probability that taxable profits will be available to use the tax losses;

(b) assess recoverability of deferred tax assets for tax loses using taxable profit, instead using earnings before interest and tax;

(c) test information used in tax calculations;

(d) test completeness of deferred tax balances;

(e) identify and test controls relied on for tax assets and liabilities subject to significant estimation;

(f) for material provisions for tax uncertainties, adequately assess the appropriateness of the work of tax experts;

(g) adequately review the work performed by management's tax expert;

(h) evaluate their own tax expert's work and conclusions, including on provisions for tax uncertainties; and

(i) use their own tax expert for complex taxation issues, or use tax experts for relevant overseas jurisdictions.

Investment and financial assets, and contract liabilities

86 Regarding investments and financial assets, we found instances where the auditor did not:

(a) when testing the values of financial instruments at financial institutions:

(i) adequately evaluate the design and implementation or adequately test the operating effectiveness of key controls;

(ii) adequately evaluate the valuation expert’s assumptions;

(iii) develop sufficiently precise thresholds for identifying differences in values to investigate, adequately investigate the reasons of differences, or evaluate differences as possible errors;

(iv) adequately test the classification of financial instruments into the three levels of the fair value hierarchy; and

(v) obtain sufficient appropriate audit evidence when testing unconfirmed deals.

(b) obtain sufficient appropriate audit evidence or adequately question the accounting basis for investment assets to support the:

(i) reclassification of non-current assets to current assets where the assets were treated as held for sale under the ‘highly probable’ test in AASB 5 *Non-current assets held for sale and discontinued operations*;

(ii) de-consolidation of a subsidiary in a complex arrangement;

(iii) equity accounting where investee financial statements were not obtained;

(iv) value of investment properties, relying on management’s assessment without testing and of key valuation inputs such as capitalisation and vacancy rates; and

(v) evaluation of the reasonableness of significant assumptions for an investment in associate.

(c) for investment assets of financial institutions:

(i) adequately test key controls relied upon;

(ii) have an adequate sample size for substantive testing, considering deficiencies in controls;

(iii) adequately review and assess the reasonableness and appropriateness of assumptions and methods used by internal specialists;

(iv) adequately test the reliability of external information used in substantive testing; and

(v) review values for investments in external unlisted trusts by reference to the most recent audited information, rather than relying solely on manager quoted prices.

87 In connection with the valuation of contracts of insurance companies, we found instances where the auditor did not:

(a) for risk product liabilities:

(i) adequately understand actuarial systems and valuation processes, test controls over the completeness and accuracy of policy data, review the extraction and conversion of policy data for valuation purposes, and review the operation of the actuarial modelling system;

(ii) test system-generated information for actuarial data reconciliations, calculation of insurance liabilities, and the analysis of profit by products, and review IT general and application controls;

(iii) adequately test the completeness and accuracy of the policy data extraction and conversion, application of assumptions, changes to the valuation model, and the analysis of profit report; and

(iv) adequately evaluate the work performed by the actuary on data, assumptions, model changes and analysis of profit report;

(b) for investment linked product liabilities:

(i) test unit prices, and understand the pricing process or test controls;

(ii) adequately understand investment options and structure of underlying investment funds; and

(iii) test unit holdings or key reconciliations; and

(c) obtain sufficient evidence over the embedded values supporting the recoverability of goodwill.

Inventory and cost of sales

88 For inventory and cost of sales, we found instances where auditors did not:

(a) evaluate the qualitative, as well as quantitative factors, when concluding that inventory was not a significant risk area;

(b) when relying on controls, understand processes, identify and test relevant controls, or respond to known control deficiencies; and

(c) when using substantive analytical procedures, test data used to develop the expectation, assess the appropriateness of using prior year balances,

set thresholds for identifying differences for investigation, or
corroborate management explanations for differences.

Using the work of experts and other auditors

89 Auditors often need to rely on their own experts, particularly for impairment assessments. In particular, auditors should consider the need to use experts reviewing valuations of the reserves and other assets of extractive industry companies. Auditors may also need to rely on the work other auditors for the audits of group components and service organisations, or for other purposes.

90 When experts were used, we found instances where auditors did not:

(a) evaluate or test the work of management’s experts. For example, not reviewing the calculation of the provision for rehabilitation costs by management’s expert in an extractive industry client;

(b) use their own experts where members of the audit team had insufficient knowledge, skill and experience, including in testing and evaluating the information, estimates and opinions of management’s expert;

(c) sufficiently involve their own expert (e.g. the expert only reviewed the aspects of the discount rate calculation for impairment assessments);

(d) require their own expert to avoid disclaimers or scope limitations on their work that affects its use as audit evidence;

(e) appropriately scope, review and evaluate the work and reports of their own expert, consider the appropriateness of the work, and resolve issues raised by the expert;

(f) assess the completeness and accuracy of the source data used by experts;

(g) obtain sufficient evidence to support the reasonableness of assumptions used by management’s expert; and

(h) evaluate the competence and independence of experts.

91 Regarding the work of other auditors, we found instances where auditors did not:

(a) ascertain the work performed by the component auditor on a major area where significant risks were identified;

(b) review, or adequately review, the work of other auditors that they relied on, including where risks were identified;

(c) adequately review and evaluate reports from component auditors, or resolve matters raised in those reports;

(d) evaluate the competence and independence of component auditors;

(e) adequately assess the work of the auditor of service organisations; and

(f) consider the adequacy of controls or work of auditors of organisations administering investment assets, or the client's controls over investment reports and other information received.

Journal entry testing

92 Auditors should test the appropriateness of journal entries, particularly those made close to year end and when preparing the financial report. There may be a greater risk of errors or irregularities with journal entries because they are generally not systematically processed and may not be well controlled.

93 Journal entry testing was deficient in 14% of files reviewed. Because these findings are not associated with a specific key audit area, they are excluded from the findings in paragraph 3. Findings included instances where the auditor did not:

(a) test journal entries;

(b) respond to an identified risk;

(c) test automated journal entries and did not test controls;

(d) ensure completeness of the journal listing obtained for testing;

(e) define sample size and selection criteria; and

(f) test journal entries throughout the year and/or during the year end reporting or consolidation process.

E Key findings: Quality control systems

Key points

Audit firms need to further improve their quality control systems to:

- comply with the auditor independence requirements; and
- appropriately monitor audit quality.

Auditor independence

94 Larger firms have established policies and processes to facilitate compliance with the auditor independence requirements of the Corporations Act and professional standards. Nevertheless, the following instances of non-compliance with the requirements could undermine the actual or apparent independence and objectivity of auditors.

Auditor rotation

95 Two larger firms self-reported contraventions of the audit partner rotation requirements for listed entity audits and remedial actions taken. Of these:

(a) one firm extended the term of the lead audit partner for an additional two financial years (after the normal five successive years); however, due to a change in the client’s financial year, the partner had significant involvement in the eighth financial year audit; and

(b) the other firm identified breaches for nine engagements after transitioning from local office rotation registers to a national register. Most breaches resulted from a misunderstanding of the Corporations Act requirements on involvement in a half-year review in the sixth financial year before rotating off. In one instance, a partner was involved in both the review and audit for a sixth year due to an error in the local office register.

96 The firms took appropriate action to rectify the situation by changing quality control systems, making disclosures in subsequent independence declarations under s307C, and taking disciplinary action (including financial penalties) against the partners concerned.

Other independence-related findings

97 Across firms of all sizes, we found instances where firms needed to:

(a) robustly evaluate the appropriateness of providing non-audit services to audit clients;

(b) ensure that specialists within the firm that work as members of the audit team complete engagement-specific independence confirmations;

(c) improve engagement-specific independence declarations to cover specific independence issues. In one case, a threat to independence was not assessed where an audit partner had a long association with a client as part of the engagement team before becoming the signing partner;

(d) consider potential independence threats as a result of significant role extensions for the lead and review audit partners; and

(e) review their independence policy for financial interests in listed parent entities held by audit team members (or their immediate family) involved in subsidiary audits, and ensure that matters reported in annual independence declarations are reviewed and resolved.

Monitoring audit quality

98 Effective firm quality review processes are key to maintaining and improving audit quality.

99 We reviewed the internal file quality review processes and policies at the largest four national firms and the two largest 'other national and network firms'. These firms have established and refined their programs over a number of years and some are in the process of changing their programs. Although we did not report findings at all firms, we found the following common or important matters at one or more firms:

(a) no overall approved three-year project plan of scheduled office reviews, inadequate partner coverage at each office and insufficient moderation of disagreement over review findings;

(b) deferral of internal file reviews, without relevant approval:

(c) lack of resourcing for file reviews, which affected the number and depth of reviews conducted;

(d) the need to clarify file review rating criteria along with policies and procedures for instituting remedial actions and penalties, and documenting the rationale to support the firm's action in this area;

(e) development opportunities were not identified from file review deficiencies; and

(f) absence of remuneration and other impacts on the EQCR where there were deficiencies in significant risk or judgemental areas.

100 Some smaller firms have not established required processes for monitoring the relevance, adequacy and effective operation of quality controls.

101 Two of the smaller firms did not have systems and procedures to ensure that engagement files were archived in a timely manner.

Appendix 1: Accessible version of figures

This appendix is for people with visual or other impairments. It provides the underlying data for Figure 1 in this report.

Table 8: Industry groups for the audit files reviewed in the current and previous 18 months using Global Industry Classification Standard (GICS)

Industry	18 months to 31 December 2016	18 months to 30 June 2015
Automobiles and components	1	1
Banks/Insurance	4	4
Capital Goods	10	8
Commercial and Professional Services	4	1
Consumer Durables and Apparel	3	3
Consumer Services	5	11
Diversified Financials	6	6
Energy	10	8
Food categories	2	2
Health Care Equipment and Services	1	4
Materials	17	30
Media	4	0
Pharmaceuticals, Biotechnology and Life Sciences	1	5
Real Estate	5	7
Retail	5	3
Software and services	6	7
Technology hardware and equipment	2	1
Telecommunication services	2	2
Transportation	1	4
Utilities	4	1
Other	0	2

Key terms

Term	Meaning in this document
AASB 136 (for example)	An accounting standard (in this example numbered 136)
accounting standards	Standards issued by the Australian Accounting Standards Board under s334 of the Corporations Act
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
auditing standards	Standards issued by the Auditing and Assurance Standards Board under s336 of the Corporations Act
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
engagement quality control review	A process designed to provide an objective evaluation, before the auditor's report is issued, of the significant judgements made in the audit and conclusions reached in formulating the auditor's report
EQCR	Engagement quality control reviewer
IFIAR	International Forum of Independent Audit Regulators
INFO 203 (for example)	An ASIC information sheet (in this example numbered 203)
largest four national firms	Large firms that audit listed entities with the largest aggregate market capitalisation, and are national partnerships and members of a global network
other national and network firms	Firms with national partnerships or individual offices that audit many listed entities and are members of a national or international network
public interest entities	Listed entities and other entities of public interest with a large number and wide range of stakeholders considering factors like the nature and size of the business and the number of employees
s307C (for example)	A section of the Corporations Act (in this example numbered 307C), unless otherwise specified
smaller firms	Firms that audit a limited number of listed entities and have a small number of audit partners

Related information

Regulatory guides

RG 34 *Auditor's obligations: Reporting to ASIC*

RG 260 *Communicating findings from audit files to directors, audit committees or senior managers*

Information sheets

INFO 183 *Directors and financial reporting*

INFO 196 *Audit quality: The role of directors and audit committees*

INFO 203 *Impairment of non-financial assets: Materials for directors*

INFO 222 *Improving and maintaining audit quality*

INFO 223 *Audit quality: The role of others*

INFO 224 *ASIC audit inspections*

Legislation

Corporations Act, s307C

Standards

AASB 5 *Non-current assets held for sale and discontinued operations*

AASB 6 *Exploration for and evaluation of mineral resources*

AASB 13 *Fair value measurement*

AASB 136 *Impairment of assets*

Other documents

IFIAR, *2016 Survey of inspection findings*

