



**ASIC**  
Australian Securities &  
Investments Commission

# Audit quality measures, indicators and other information: 2018–19

Report 649 | December 2019

## About this report

This report provides a broad group of audit quality measures, indicators and other information to supplement our audit inspection findings in [Report 648 Audit inspection report for 2018–19 \(REP 648\)](#).

It is intended to promote:

- discussion on the measures and indicators that might be used by auditors and audit committees in monitoring initiatives to improve audit quality, and
- good behaviours by auditors and audit committees that support audit quality.

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## **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 advice on measuring or monitoring audit quality. We encourage audit firms and audit committees to consider approaches to maintaining and improving audit quality that are relevant for the circumstances of each firm and each audit. It is your responsibility to determine your obligations. Measures and indicators in this report are not exhaustive and are not intended to imply that particular measures or indicators should be used by an audit firm or audit committee in measuring and monitoring audit quality.

# Introduction

## What is audit quality?

In our view, audit quality refers to matters that contribute to the likelihood that the auditor will:

- › achieve the fundamental objective of obtaining reasonable assurance that the financial report as a whole is free of material misstatement, and
- › ensure material deficiencies detected are addressed or communicated through the audit report.

## Why is audit quality important?

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 inspections

Each year we conduct audit firm inspections. This includes reviewing key areas in about 60 files relating to audits of financial reports of listed entities and other public interest entities.

The results from our proactive inspections of audit files are the best available measure of audit quality. However, a limited number of audits and audit areas are selected on a risk basis so great caution is needed in extrapolating from the results to the entire population of audits.

## Supplementary measures and indicators

We are at the forefront of developments internationally in the publication of audit quality measures and indicators. For example, neither the International Forum of Independent Audit Regulators nor the US Public Company Accounting Oversight Board has issued measures or indicators to date. The measures and indicators presented in this report are likely to change in future years as:

- › we reassess the relevance and usefulness of each measure and indicator, and
- › more information to support new measures becomes available.

In future, the largest six audit firms will collect information on material adjustments made to financial reports of ASX 300 entities before they are issued where the changes are prompted by the auditor, as well as immaterial errors reported to audit committees. The firms will also encourage ASX 300 entities to provide further analysis of fees paid to auditors for non-audit services in future financial reports.

Digital financial reporting would facilitate the collection of information in the future, and encouraging uptake of it should be considered.

**Note:** Where this report refers to ASX 300 listed entities, it only refers to those ASX 300 listed entities incorporated or formed in Australia where the group audit is conducted by an Australian audit firm or authorised audit company.

Changes and trends in the measures, indicators and other information over time may also provide useful additional information in the future.

## General limitations of measures and indicators

General limitations with the measures and indicators outlined in this report include:

- › the input indicators related to individual inputs that may contribute to audit quality do not provide a complete representation of the inputs relevant to supporting audit quality
- › the appropriate level for an input indicator may be difficult to identify at an aggregate level. The optimal result for any input indicator will vary from firm to firm and audit to audit
- › audit committees should consider the specific audit team, their experience, expertise, demonstration of professional scepticism, etc. (see also [Information Sheet 196](#) *Audit quality: The role of directors and audit committees* (INFO 196)), and
- › the measures and indicators to be used in monitoring initiatives to improve audit quality will vary between audit firms and audits.

# ASIC inspection results

## Overall findings

Our inspection findings are cases where, in our view, the auditor did not obtain reasonable assurance in a key audit area that the overall financial report was free of material misstatement. Figure 1 shows our overall adverse findings for the last four inspection periods for all firms and the largest six firms.

### Relevance

This is an independent and direct measure of audit quality.

### Limitation

We select a limited number of audits and audit areas on a risk basis so great caution should be exercised in extrapolating from the results to the entire population of audited entities.

Figure 1: Adverse inspection findings



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

## Key audit areas with adverse findings

Figure 2 shows the percentages of audit files reviewed with adverse findings in none, one, two, three and four or more key audit areas in the 12 months to 30 June 2019. On average, we reviewed 3.5 key audit areas in a file. The pattern was similar in previous periods.

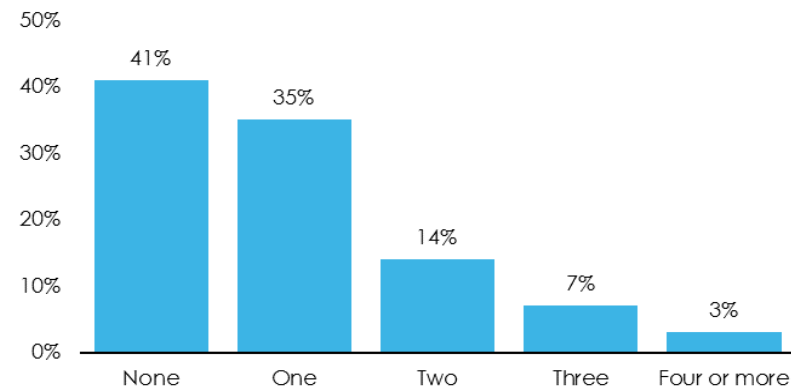
### Relevance

The number of adverse findings may indicate the relative quality of individual audits.

### Limitation

The relative severity of the individual findings is not shown in this figure. However, [REP 648](#) contains considerable information to assist in assessing the nature and severity of findings and our individual firm inspection reports describe each finding.

Figure 2: Percentages of key audit areas reviewed on a file that had adverse findings



Note: See Table 2 for the data shown in this figure (accessible version).

## Financial report misstatements

Figure 3 shows the percentage of audit files reviewed where ASIC had findings and where material changes were also made to net assets and profits in the relevant financial report or in a subsequent financial report which we believe related to concerns identified by ASIC. These matters are generally also included in 'ASIC surveillances' in Figure 4.

### Change

The decrease in the current period is due to a change in ASIC's approach. We now raise questions on a financial report with the audited entity before reviewing the audit file. The change in our approach is consistent with the entity having the primary responsibility for the financial report and may enable any issues with the financial report to be addressed on a more timely basis so that the market is properly informed. We continue to exclude areas from audit file reviews where an entity has made material changes to net assets and profit. We still ask audit firms to perform root cause analysis and identify actions to address such matters for future audits.

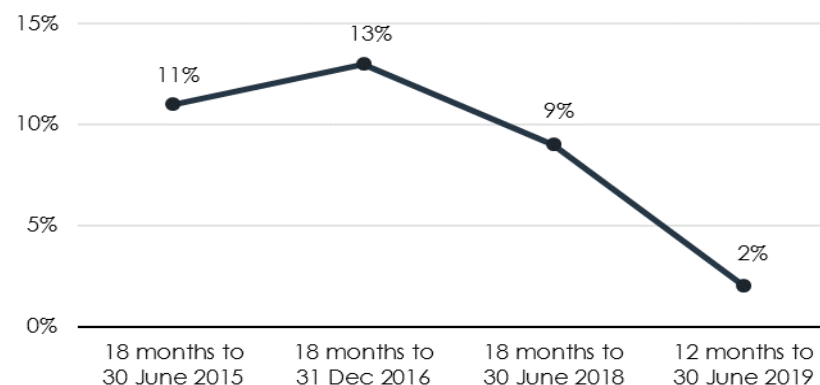
### Relevance

Material changes to audited financial reports may reflect the relative severity of ASIC audit findings.

## Limitations

Unlike this measure, ASIC's audit inspections identify where audit work is insufficient to support the auditor's opinion even if no material misstatement has been identified. Only a portion of files with findings were followed up by ASIC with the companies concerned.

Figure 3: Audits reviewed where the financial report was materially misstated



Note: See Table 3 for the data shown in this figure (accessible version).

Further information on the ASIC inspection findings and process can be found in [REP 648](#) and [Information Sheet 224 ASIC audit inspections \(INFO 224\)](#).

# Other output measures

## Adjustments to financial reports

Figure 4 shows the number of material adjustments to previously reported net assets and profit for listed entities as identified from:

- › notices lodged by auditors under s311 of the *Corporations Act 2001*, and
- › material changes to net assets and profits resulting from ASIC financial reporting surveillances.

There is no duplication of matters between these two sources.

### Change

While there was an apparent decrease in changes resulting from ASIC surveillances, a further 10 material changes were made by entities in the three months to 30 September 2019.

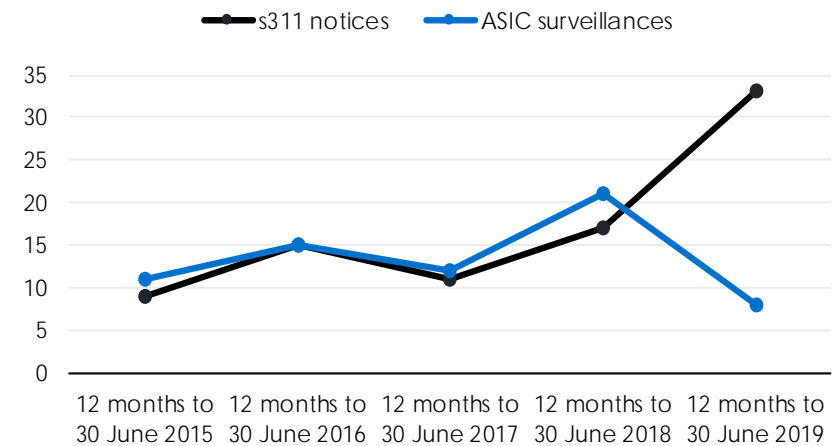
### Relevance

Adjustments to financial reports may be a direct measure of the need to improve audit quality. Adjustments concern matters not identified or addressed during a previous audit. The matter may have been subsequently identified by the company or ASIC rather than an auditor.

## Limitations

Matters are only included from two sources. The measure may also be a lag indicator because it relates to past completed audits.

Figure 4: Adjustments to financial reports



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

# Input indicators

## Staff mix

Figure 5 shows the proportion of partner, manager and staff time on audits of ASX 300 listed entities by the largest six firms (including audits of foreign operations by network firms) for years ended 1 April 2018 to 31 March 2019. The total number of audit hours was 2,733,433, or an average of about 10,000 hours per Australian formed ASX 300 entity.

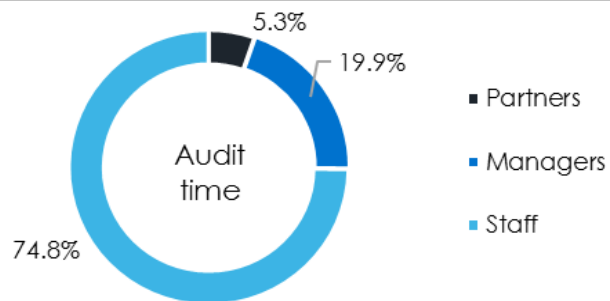
### Relevance

This may indicate whether adequate experience and expertise is applied to audits. The hours reflect overall audit effort.

### Limitations

The appropriate mix of partners, managers and staff will vary with the nature and complexity of each audit. The audit hours required will vary with the size and complexity of each audited entity and group. The data was provided by the firms and has not been subject to independent verification.

Figure 5: Staff mix on ASX 300 listed entity audits



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

## Training

Audit partners and audit managers of the largest six firms completed an average of 41.6 hours of structured training in financial reporting, audit or ethics in the 12 months to 30 June 2019 (40.6 hours in the 12 months to 30 June 2018).

### Relevance

The hours may indicate whether partners and managers keep up to date with changing requirements. Members of the large professional accounting bodies must undertake 120 hours of continuing professional education over three years, with at least 50% being structured (e.g. courses).

### Limitations

The relevance or quality of training undertaken and the appropriate training needed is not measured. The data was provided by the firms and has not been subject to independent verification.



## Fees to net profit after tax, net assets and market capitalisation

Figure 6 shows audit fees as a percentage of net profit after tax, net assets and market capitalisation for ASX 300 listed entities for years ended 1 April 2018 to 31 March 2019. The figures for the previous 12 months were almost identical.

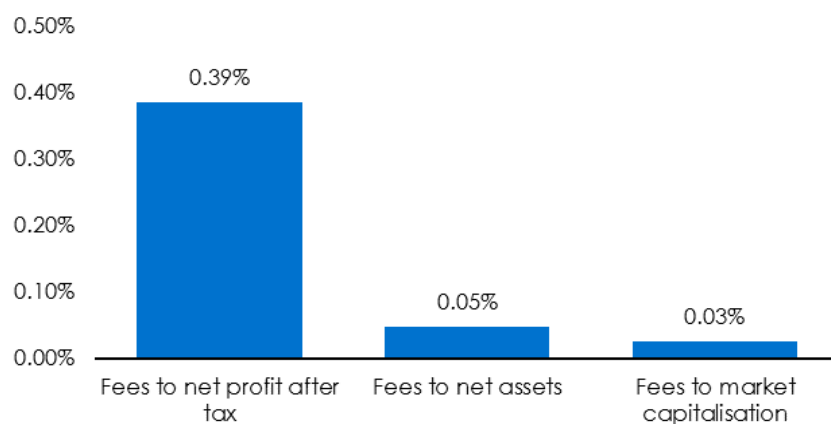
### Relevance

The figures may indicate the adequacy of audit fees. For further information, see [INFO 196](#).

### Limitations

The appropriate fees depend on the size and complexity of each audited entity/group.

Figure 6: Fees to net assets, net profit after tax and market capitalisation for ASX 300 listed entities



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

## Fees for audit services, other assurance services and non-audit services provided to audited entities

Figure 7 shows total fees for audit services, other assurance services and non-audit services provided by the auditors of ASX 300 listed entities for years ended 1 April 2018 to 31 March 2019. The figures for the previous 12 months were similar.

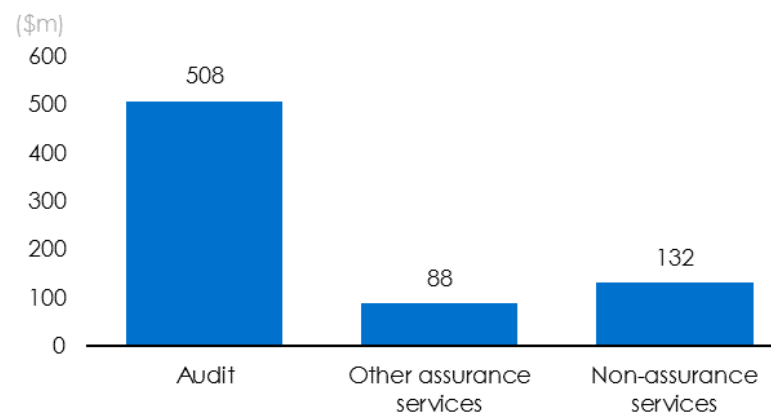
### Relevance

The level or nature of non-audit services may be perceived to affect the independence and objectivity of the auditor in some cases.

### Limitations

In considering whether fees for non-audit services are appropriate in any specific case, both the size of the fee and the nature of the services need to be considered.

Figure 7: Fees for audit services, other assurance services and non-audit services provided by auditors of ASX 300 listed entities (\$ million)



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

## Firm revenue from audit services and other services

Figure 8 shows total revenue of the largest six audit firms from audit services and other services for the 12 months to 30 June 2019 or 12 months to 31 May 2019.

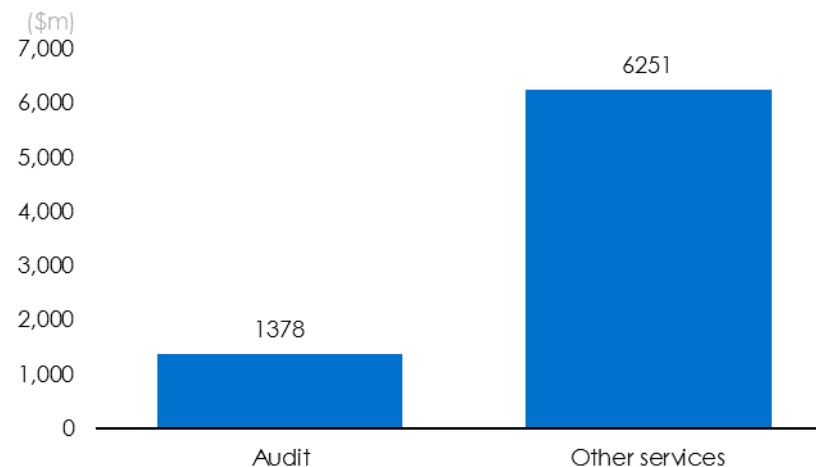
### Relevance

The level of other services may indicate the capability to support audit in specialist areas such as tax, valuations and actuarial. A higher level of other services might also indicate a reduced focus on audit quality by the firm as a whole.

### Limitations

The revenue for other services includes services that may not provide a capability to assist in audits.

Figure 8: Firm revenue from audit services and other services (\$ million)



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

# Other information

## Surveys

The Financial Reporting Council and Auditing and Assurance Standards Board surveyed audit committee chairs (2018) and investors (2019) on audit quality for ASX 300 entities: the [full reports](#) can be seen on the Financial Reporting Council website.

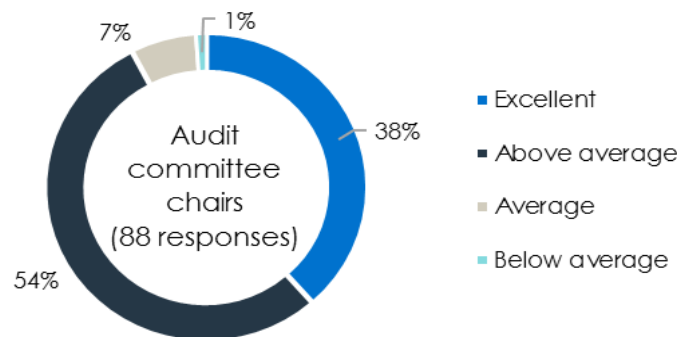
### Relevance

The survey results reflect sentiment and perceptions of audit quality.

### Limitations

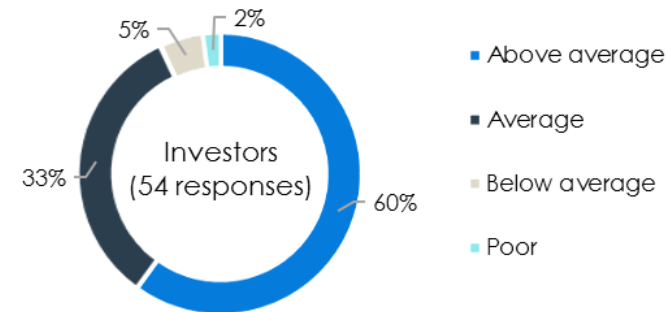
'Audit quality' was not defined for the surveys. Investors may depend on public information to measure audit quality. We have suggested that the FRC/AUASB consider such a definition for future surveys.

Figure 9: Survey of audit committee chairs



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

Figure 10: Survey of investors



Note: See Table 10 for the data shown in this figure (accessible version).

## 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 1: Adverse inspection findings**

Period	Overall percentage	Largest six firms percentage
18 months to 30 June 2015	19%	18%
18 months to 31 December 2016	25%	23%
18 months to 30 June 2018	24%	20%
12 months to 30 June 2019	26%	26%

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

**Table 2: Percentages of key audit areas reviewed on a file that had adverse findings**

Number of areas with findings	Percentage
None	41%
One	35%
Two	14%
Three	7%
Four or more	3%

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

**Table 3: Audits reviewed where the financial report was materially misstated**

Period	Percentage
18 months to 30 June 2015	11%
18 months to 31 December 2016	13%
18 months to 30 June 2018	9%
12 months to 30 June 2019	2%

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

**Table 4: Adjustments to financial reports**

Period	Section 311 notices	ASIC surveillances
12 months to 30 June 2015	9	11
12 months to 30 June 2016	15	15
12 months to 30 June 2017	11	12
12 months to 30 June 2018	21	17
12 months to 30 June 2019	33	8

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

**Table 5: Staff mix on ASX 300 listed entity audits**

Category	Percentage
Partners	5.3%
Managers	19.9%
Staff	74.8%

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

**Table 6: Fees to net assets, net profit after tax and market capitalisation for ASX 300 listed entities**

Audit fee ratio	Percentage
Fees to net profit after tax	0.39%
Fees to net assets	0.05%
Fees to market capitalisation	0.03%

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

**Table 7: Fees for audit services, other assurance services and non-audit services provided by auditors of ASX 300 listed entities**

Fee category	\$ million
Audit	508
Other assurance services	88
Non-assurance services	132

**Note:** This is the data shown in Figure 7.

**Table 8: Firm revenue from audit services and other services**

Revenue	\$ million
Audit	1378
Other services	6251

**Note:** This is the data shown in Figure 8.

**Table 9: Survey of audit committee chairs**

View of audit quality	Percentage
Excellent	38%
Above average	54%
Average	7%
Below average	1%

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

**Table 10: Survey of investors**

View of audit quality	Percentage
Above average	60%
Average	33%
Below average	5%
Poor	2%

**Note:** This is the data shown in Figure 10.

# Key terms and related information

## Key terms

<b>ASIC</b>	Australian Securities and Investments Commission
<b>ASX 300 listed entity</b>	An entity with securities listed on the Australian Securities Exchange that is within the top 300 such entities by market capitalisation. In this report a reference to an ASX 300 listed entity refers to only those entities incorporated or formed in Australia where the group audit is conducted by an Australian audit firm or authorised audit company
<b>finding</b>	A finding from a review of a key audit area in an audit file where ASIC concluded that the auditor did not obtain reasonable assurance that the financial report as a whole was free of material misstatement
<b>INFO 196 (for example)</b>	An ASIC information sheet (in this example numbered 196)
<b>key audit area</b>	An area of an audit engagement selected for review in our inspections on a risk basis that generally relates to a financial statement line
<b>largest six firms</b>	Large firms that audit listed entities with the largest aggregate market capitalisation, which may operate through national partnerships, an authorised audit company or a national network of firms
<b>REP 648 (for example)</b>	An ASIC report (in this example numbered 648)

## Related information

### ASIC documents

[INFO 196](#) *Audit quality: The role of directors and audit committees*

[INFO 224](#) *ASIC audit inspections*

[REP 648](#) *Audit inspection report for 2018–19*