Deloitte Touche Tohmatsu Australia

Audit inspection report

1 July 2019 to 30 June 2020

Report 680 | December 2020

About this report

This report sets out our findings from reviewing audit files at Deloitte Touche Tohmatsu Australia from 1 July 2019 to 30 June 2020, and recommendations from reviews of conflicts of interest, governance and accountability.

Introduction

This report summarises findings from:

- reviews that we substantially completed in the 12 months to 30 June 2020 of key areas in selected financial report audits of listed entities and other public interest entities conducted by Deloitte Touche Tohmatsu Australia (Deloitte)
- reviews that we substantially completed in the 12 months to 30 June 2020 on work performed by Deloitte on client monies in the audit of an Australian financial services (AFS) licensee
- our reviews of aspects of Deloitte's approach to conflicts of interest, firm governance and accountability for audit quality, and
- financial reporting surveillances completed by us in the 12 months to 30 June 2020 relating to listed entities and other public interest entities audited by Deloitte.

This report:

- should not be taken to provide assurance that the firm's audits and systems, or audited financial reports, are free of other deficiencies not identified in this report
- does not include details of enforcement actions that may have been underway or finalised in the 12-month period relating to audits (if any) involving members of the firm, and
- is intended to communicate our findings in a clear and concise manner to leadership of the firm who are informed auditing and accounting professionals. Other readers of this report may not have the full context of this report and the findings summarised in it.

Information Sheet 224 *ASIC audit inspections* and Report 677 *Audit inspection report: 1 July 2019 to 30 June 2020* provide further information on our audit firm inspection process.

Our findings

In our view, Deloitte did not obtain reasonable assurance that the financial report was free of material misstatement in nine of the 26 key areas that we reviewed in total across seven audits by the firm, being 35% of the key areas reviewed by us. This compares to 32% for the 12 months ending 30 June 2019.

A limited number of audits and audit areas were selected for review on a risk basis, and so caution is needed in generalising from the results to all audits conducted by the firm and all areas of those audits.

Table 1 summarises the findings. The firm did not necessarily agree with all of our findings. The findings do not necessarily mean that the financial report was materially misstated, but rather that the auditor did not have a sufficient basis to support their opinion.

Table 1: Audit review findings—Risk of material misstatement

Entity	Areas with findings	Findings
Entity A	One of the three key areas reviewed	*Fee revenue*—The auditor did not appropriately test the accuracy of net asset values which were the basis for asset management fees.
Entity B	Two of the four key areas reviewed	*Receivables*—The auditor did not apply sufficient scepticism in assessing the recoverability and current classification of a major debtor that had been in dispute for several years. *Loans*—The auditor did not gather sufficient evidence on the recoverability of material loans owing from a joint venture, and did not adequately consider whether the loans should have been accounted for as part of the equity accounted investment, which had previously been written down to zero.
Entity C	One of the three key areas reviewed	*Goodwill impairment*—The auditor did not adequately test key assumptions for goodwill impairment for two cash generating units.
Entity D	Two of the four key areas reviewed	*Inventory*—The auditor did not perform appropriate tests on the existence and valuation of inventories. *Revenue and receivables*—The auditor did not obtain sufficient evidence about the recognition of sales revenue for a major component. The auditor did not adequately review the work of the component auditor.
Entity E	Two of the four key areas reviewed	*Business combinations*—The auditor did not identify that contingent consideration in 'earn-out' arrangements should have been accounted for as remuneration rather than goodwill, and resulted in a restatement of the entity's financial statements. *Goodwill impairment*—While the auditor had found significant errors in the impairment model reducing recoverable amount and resulting in impairment, the auditor did not obtain and test management's revised impairment model for a possible additional impairment.
Entity F	One of the four key areas reviewed	*Inventory*—The auditor did not perform audit procedures on the existence and valuation of material parts inventory.

Note: The auditor did not test journal entries at year end (other than consolidation entries) for Entity C and, as a result in our view, did not obtain reasonable assurance that the financial report was free of material misstatement. As journal entry testing is not treated as a key area, the finding was not taken into account in the findings percentage above.

Our audit file review findings which did not involve a risk of material misstatement are summarised in Table 2. These findings include matters that could be relevant to obtaining reasonable assurance for the audited entity in future or another audited entity.

Table 2: Audit review findings—Other

Entity	Findings
Entity A	*Materiality*—The auditor's materiality could have been set at a lower level, which may have led to an increase in the extent of testing.
Entity B	*Finance arrangements*—The notes to the financial statements could have better explained a significant financing arrangement.
Entity C	*Independence*—The firm was the largest trade debtor of the audited entity as a result of sales on normal commercial terms and conditions. This matter was identified during the firm's independence compliance testing.
Entity D	*Materiality*—The auditor's materiality could have been set at a lower level, which may have led to an increase in the extent of audit testing.
Entity F	*Independence*—The auditor did not adequately assess threats to independence where the firm continued to compile information to lenders relating to debt covenant compliance for an investee where there was a likely takeover of the investee.

There were no reportable findings from our review of the firm's work on client monies in the audit of an AFS licensee.

Conflicts of interest, firm governance and accountability

During the six months to 31 December 2019, we reviewed aspects of the firm's approach to conflicts of interest, firm governance and accountability for audit quality. We also reviewed whether root cause analysis was performed where there were material changes to financial reporting by an entity audited by the firm as a result of ASIC inquiries.

Our better practice recommendations are included in Table 3.

Table 3: Better practice recommendations for the firm

Area	Better practice recommendations
Conflicts of interest	• Considering the general requirement to be independent not just the specific independence requirements when considering the provision of non-audit services to audited entities. • Applying more scepticism when assessing whether to provide non-audit services to audited entities. • Performing quality reviews of non-audit service evaluations for compliance with the independence requirements. • Assessing whether the total fees from non-audit services compared to audit fees for an audited entity as well as the nature of those services causes any actual or perceived conflict.
Firm governance	• Having at least one experienced independent external person on internal governing boards or forming an advisory board with experienced independent persons to advise on audit quality initiatives at a high level.

Area	Better practice recommendations
Accountability for audit quality	• Ensuring sanctions imposed on engagement partners for adverse findings in internal and external quality reviews are sufficient. • Ensuring that the consequences for engagement partners for deficient audits are transparent to the partner group. • Holding engagement quality control reviewers and firm experts/specialists involved on audit engagements accountable for adverse findings identified in internal and external quality reviews. • Firm leadership seeking feedback on audit quality from audit committees and non-executive directors of audited entities. • Monitoring compliance with the firm's policy that audit partners cannot be remunerated for selling non-audit services to audited entities.
Root cause analysis	• Conducting root cause analysis where there is a material change in financial reporting by an entity audited by the firm as a result of ASIC inquiries.

Financial report findings

We completed risk-based reviews of aspects of 45 financial reports of listed and other public interest entities audited by the firm in the 12 months to 30 June 2020. Following our inquiries, four entities made material changes to net assets or profits as summarised in Table 4. More information can be found in media releases available from the ASIC website. In one case we had reviewed the relevant area of the audit and a finding is included in Table 1 (Entity E).

Table 4: Financial report findings—Media releases issued

Media release	Entity	Year end	Findings
19-237MR	Pental Limited	30 June 2019	The company wrote down its Country Life brand name by $1.38 million in its financial report for the year ended 30 June 2020.
20-095MR	Trimantium GrowthOps Limited	30 June 2019	The company wrote down goodwill by $10.3 million in its financial report for the half year ended 31 December 2019.
20-095MR	Ovato Limited	30 June 2019	The company wrote down goodwill of $35.2 million in its financial report for the half year ended 31 December 2019.
20-141MR	Capitol Health Limited	30 June 2019	The company derecognised goodwill of $5.3 million in its financial report for the year ended 30 June 2020.

Improving audit quality

If it has not already done so, the firm should identify underlying root causes for the matters reported from our audit reviews and financial reporting surveillances, and for findings from internal and global firm reviews, and implement further and improved actions to achieve sustainable improvements in audit quality.

Further information

More information on the matters in Table 1 to Table 3 is contained in detailed comment forms provided separately to the firm. The comment forms include the firm's responses to our findings.