Ernst & Young Australia

Audit inspection report

1 July 2021 to 30 June 2022

Report 746 | October 2022

About this report

This report sets out our findings from reviewing audit files at Ernst & Young Australia for the period 1 July 2021 to 30 June 2022 and better practices for Ernst & Young to consider in its approach to root cause analysis.

Introduction

This report includes:

- findings from reviews that we completed in the 12 months to 30 June 2022 (this year) of key audit areas in selected financial report audits of listed entities and one large unlisted entity conducted by Ernst & Young Australia (EY, the firm)
- financial reporting surveillance findings relating to audited by EY this year, and
- better practice considerations from the application of EY's policies, systems and processes for conducting root cause analysis.

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 underway or finalised in the 12-month period relating to audits (if any) involving members of the firm. For details, refer to the periodic updates of our enforcement outcomes
- is intended to communicate our findings in a clear and concise manner to the leadership of the firm who are informed auditing and accounting professionals. Other readers of this report should recognise they may not have the full context of this report and the findings summarised below, and
- does not represent a balanced scorecard as our negative findings are based on a limited number of audits focusing on higher risk audit areas and does not report on positive audit quality.

We note that the firm and the entities it audits were required to adapt to remote work arrangements; global, national and local travel restrictions; and other impacts of COVID-19 during the period covered by this report.

We consulted an independent external panel on the method of measuring and reporting our findings. The panel discussed and tested the conclusions reached (including firm responses) on a small number of anonymised findings. The panel agreed with our approach to measuring and reporting our findings.

Further details about our audit inspection program this year can be found in Report 743 *Audit inspection report: 1 July 2021 to 30 June 2022* (REP 743), including a glossary of key terms. Report 739 *Root cause analysis: Audit firm thematic review* (REP 739) outlines good practices in place at some of the largest six firms and better practice recommendations for performing root cause analysis. Information Sheet 224 *ASIC audit inspections* (INFO 224) provides further information on our audit firm inspection process.

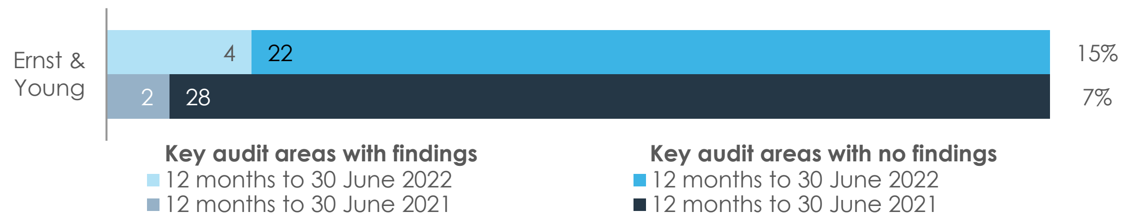
Our findings

EY did not, in our view, obtain reasonable assurance that the financial report was free of material misstatement (negative findings) in four of the 26 key audit areas reviewed (15%) across eight audits by the firm this year. This compares to two of the 30 key audit areas reviewed (7%) across eight audits for the 12 months ending 30 June 2021 (last year). See Figure 1.

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. We had no negative findings from our review of the one unlisted entity.

The level of negative findings has increased this year in comparison to last year. The firm should continue its initiatives to maintain and sustain improved audit quality.

Figure 1: Negative findings from reviews of key audit areas in audit files



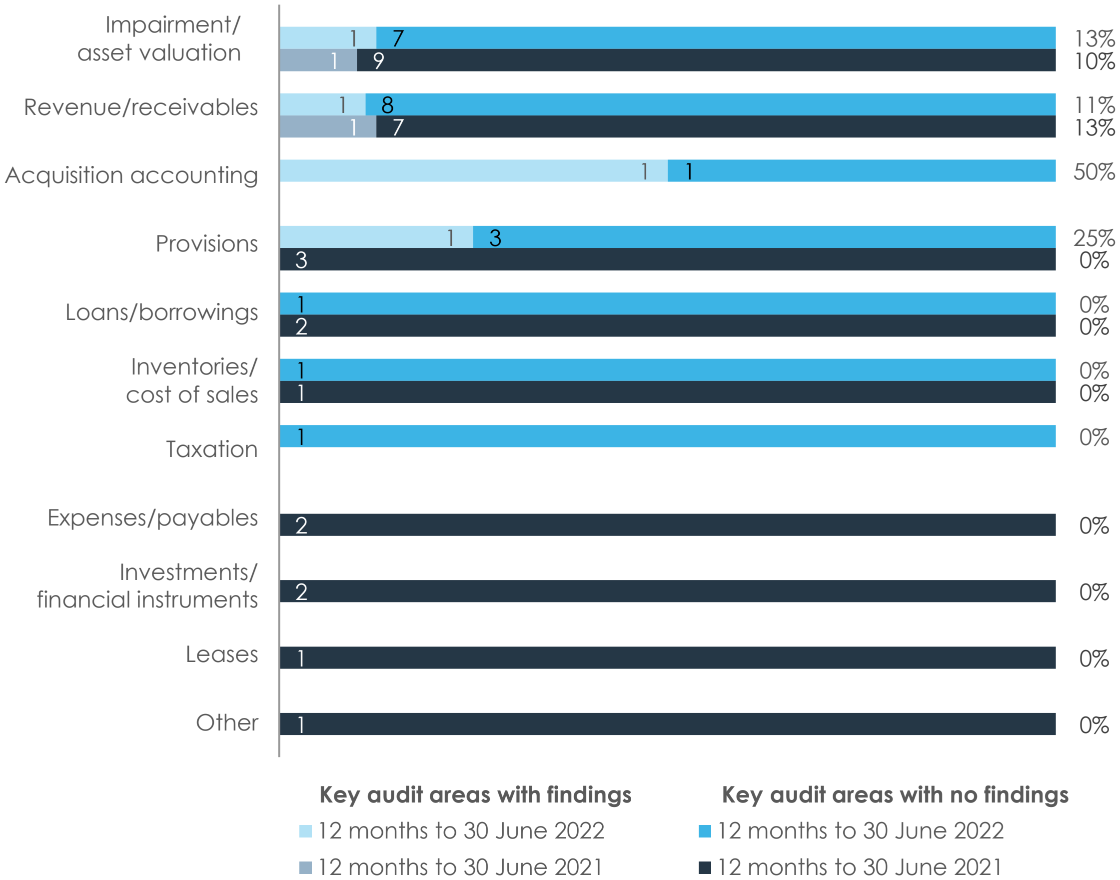
Note: See Table 4 for the data shown in this figure (accessible version).

The firm did not agree with all of our findings. The findings do not necessarily mean the financial report was materially misstated. Rather, in our view, the auditor did not have a sufficient basis for their opinion.

Our negative findings relate to audit of asset values, revenue, provisions and acquisition accounting.

Figure 2 shows the areas we reviewed and the frequency of our findings this year and last year.

Figure 2: Key audit areas with negative findings, and key audit areas reviewed in the 12 months to 30 June 2022 and the 12 months to 30 June 2021



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

Table 1 summarises our findings that were classified as a risk of material misstatement.

Table 1: Audit review findings—risk of material misstatement

Entity	Areas with findings	Findings
Entity A	1 of 4 key audit areas reviewed	› *Restoration provision*—The auditor did not obtain sufficient evidence to support the basis on which the provision for restoration was calculated and did not ensure the entity disclosed the basis of the calculation in the financial report
Entity B	1 of 2 key audit areas reviewed	› *Revenue*—The auditor did not sufficiently test the accuracy of fee revenue amounts billed and whether the amounts billed were in compliance with relevant legislative requirements
Entity C	2 of 4 key audit areas reviewed	› *Capitalised software costs*—The auditor did not obtain sufficient evidence over the accuracy of time recorded for capitalised software costs › *Acquisition of another company—Recognition of contingent consideration*—The auditor did not obtain sufficient evidence over the probability that contingent consideration would be payable

Our audit file review findings that 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 D	› *Revenue and receivables*—The auditor should have performed additional audit procedures to address the completeness, occurrence and accuracy of revenue inputs used to calculate a material revenue stream
Entity E	› *Revenue recognition*—The auditor could have better documented their assessment and reliance on controls performed by an internal risk team of the entity in relation to commission revenue which accounted for about 15% of total revenue
Entity F	› *Provision for rehabilitation*—The auditor could have better documented audit evidence obtained, evaluation of use of internal specialists, and understanding of management's process for preparing estimates of mine closure costs

Financial report findings

We completed risk-based reviews of aspects of 29 financial reports of entities audited by the firm this year. Following our inquiries, one entity made material changes to net assets, profits or information previously provided to the market as summarised in Table 3. More information can be found in media releases available from the ASIC website.

Table 3: Financial report findings—media release issued

Entity	Year end	Findings
Woodside Petroleum Limited	31 December 2021	The company provided an additional $239 million for restoration costs on the future decommissioning of offshore oil rigs and associated infrastructure assets, and improved disclosure of the basis for providing for future restoration costs See Media Release (22-027MR) *Woodside Petroleum increases restoration provision and enhances associated disclosure* (21 February 2022)

Root cause analysis

We performed a detailed review of the firm's approach to root cause analysis by reviewing a sample of two root cause analyses conducted by the firm, and related observations based on benchmarking the largest six firms' processes in conducting root cause analysis at the audit engagement level.

While the firm had implemented a range of good practices in its root cause analysis (RCA) processes, our additional better practice recommendations are summarised below for the firm's consideration:

- The population for root cause analysis should include ASIC's other findings noted in Table 2.
- For restatements, the firm should develop criteria to determine when a root cause analysis should be performed and, if a decision is made not to perform a root cause analysis, the reason for the decision should be documented.
- Interviews should include all engagement team members in the area under review including experts, specialists and engagement quality control reviewers.
- Documentation of interviews should be improved to support the identification and evaluation of causal factors and to comply with firm interview methodologies.
- Using alternative interview techniques and RCA methodologies such as the 5 Whys, which could enhance the tools available.
- Using milestone data, for example, on planning and execution when considering root causes.

The firm should continue to explore the wide range of underlying root causes in its RCA program on both negative findings and positive outcomes, to ensure that the real root causes are identified and actioned, including the robustness and adequacy of the supervision and review that contribute to the findings.

REP 739 summarises thematic findings from our review of root cause analysis by audit firms on audit file quality occurrences for the period 1 July 2020 to 31 December 2021. This report also outlines good practices in place at some of the largest six firms and further better practice recommendations for performing root cause analysis.

Improving audit quality

The level of negative findings from our review of a limited number of audit files has increased since last year. The firm should continue to identify and address the root causes for the matters reported from our audit file reviews and for findings from internal and global firm reviews. The firm should also continue to implement enhanced actions to maintain and sustain improved audit quality.

Further information

More information on the matters in Figures 1 and 2 and Tables 1, 2 and 3 is contained in REP 743 and detailed comment forms provided separately to the firm. The comment forms include the firm's responses to our findings.

Appendix: Accessible versions of figures

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

Table 4: Negative findings from reviews of key audit areas in audit files

Firm	FY 2021–22 Key audit areas with findings	FY 2021–22 Key audit areas reviewed	FY 2021–22 Percentage	FY 2020–21 Key audit areas with findings	FY 2020–21 Key audit areas reviewed	FY 2020–21 Percentage
EY	4	26	15%	2	30	7%

Note: This is the data shown Figure 1.

Table 5: Key audit areas with negative findings, and key audit areas reviewed in the 12 months to 30 June 2022 and the 12 months to 30 June 2021

Key audit areas	FY 2021–22 Key audit areas with findings	FY 2021–22 Key audit areas reviewed	FY 2021–22 Percentage	FY 2020–21 Key audit areas with findings	FY 2020–21 Key audit areas reviewed	FY 2020–21 Percentage
Impairment/asset valuation	1	8	13%	1	10	10%
Revenue/receivables	1	9	11%	1	8	13%
Acquisition accounting	1	2	50%	0	0	0%
Provisions	1	4	25%	0	3	0%
Loans/borrowings	0	1	0%	0	2	0%
Inventory/cost of sales	0	1	0%	0	1	0%
Taxation	0	1	0%	0	0	0%
Expenses/payables	0	0	0%	0	2	0%
Investments/financial instruments	0	0	0%	0	2	0%
Leases	0	0	0%	0	1	0%
Other	0	0	0%	0	1	0%
Total	**4**	**26**	**15%**	**2**	**30**	**7%**

Note: This is the data shown in Figure 2.