Australian Securities & Investments Commission

Audit inspection report

1 July 2020 to 30 June 2021

Report 709 | November 2021

About this report

This report sets out findings from our review of audit files for the period 1 July 2020 to 30 June 2021. The report also considers and suggests approaches to audit firm culture and talent, outlines our focus areas for individual audits and our regulatory responses.

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

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Executive summary

Our inspection findings

The objective of an independent audit is to provide confidence in the quality of financial reports which is key to confident and informed markets and investors. Audit inspections are one of our activities directed at promoting high-quality financial reports.

ASIC regulates over 2,200 ASX listed entities and 3,500 registered company auditors and authorised audit companies. There are 62 audit firms that audit one or more listed entities.

Our audit inspections focus on a limited number of the more complex and challenging audits and higher risk key areas of the audit. Purely random selections of audit files could produce higher or lower levels of negative findings.

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

Our reviews for the 12 months to 30 June 2021 (this year) related to audits covering financial reports for years ended from 31 December 2019 to 31 December 2020. Many of these financial reports and audits occurred under COVID-19 conditions.

ASIC extended the deadlines for lodging audited financial reports for both listed and unlisted entities by one month for certain balance dates. We note that all audit firms and the entities they audit were required to adapt to remote work arrangements, global, national and local travel restrictions and other impacts of COVID-19.

This year we identified negative findings in 23% of the 115 key audit areas reviewed on a risk basis at the largest six audit firms (where most of our inspection effort is directed). This compares to 24% of the 156 key audit areas reviewed at the largest six firms for the 12 months to 30 June 2020 (last year).

The equivalent findings for 149 key audit areas reviewed across 16 firms was 32% this year and 27% for the 179 key audit areas reviewed across 13 firms last year.

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

Our separate risk-based reviews covering financial reports of listed and other public interest entities conducted this year led to material changes to net assets and profits for 3% of financial reports reviewed (this was 4–5% in previous years).

We set out our negative findings from reviewing audit files below in 'Overview of audit file reviews and other indicators' and 'Detailed audit file review findings'.

Improving audit quality

The increased overall level of negative findings is of concern and warrants deliberate and concerted efforts by all firms to improve audit quality and reduce the overall level of findings.

Firms should carefully evaluate the effectiveness of their existing initiatives to improve audit quality and implement improvements and further initiatives. This includes:

- promoting a strong culture focused on audit quality;
- attracting and retaining the right talent for complex audits;
- thorough supervision and review of audits; and
- holding partners, managers and staff accountable for audit quality.

To improve audit quality, we also expect audit firms to focus on identifying and addressing root causes of negative findings, developing and implementing action plans to address the identified root causes and monitoring and revising action plans to ensure they are effective. We will focus on the effectiveness of root cause analysis on negative findings at the largest six audit firms in the 12 months to 30 June 2022.

This year we reviewed aspects of the largest six firms' approaches to maintaining a culture focused on audit quality and attracting and retaining the right talent for complex audits. Each firm had a range of practices and initiatives focusing on culture and talent.

Changes in practices and initiatives by individual firms on culture may take time to show an impact on negative findings and need to be applied in combination with other initiatives to improve audit quality. The extent to which these practices and initiatives are delivering the intended outcomes therefore should continue to be regularly monitored and assessed.

The availability of audit staff resources may continue to be affected by COVID-19 conditions, pre-existing factors, and planned and future changes. This will require responses by all firms, across the profession and by other parties in the financial reporting chain.

We highlight these matters in 'Culture, talent, fees for service, audit firm action plans and the role of others'.

COVID-19 conditions heighten the importance of audit quality and the need to properly inform the market and investors through high-quality financial reports. There were and continue to be more difficult judgements on asset values, liabilities, solvency, going concern and disclosures. Conditions and circumstances have and will change significantly between reporting dates requiring robust reassessment of past judgements and assumptions. Auditors need to be especially vigilant about these conditions in their audits. We discuss these matters in 'Focus areas for audits in COVID-19 conditions' below.

ASIC's future regulatory activities will include:

- reviewing our programs for regulating auditors and financial reporting;
- consulting about routinely reporting findings from our audit file reviews to directors of the entities audited;
- focusing on enforcement actions for deficient audits, where appropriate;
- improving transparency of inspection results; and
- continuing to proactively review financial reports and audits.

We outline our initiatives to promote improved audit quality in 'ASIC's regulatory response' below.

Overview of audit file reviews and other indicators

Our findings

Our inspections focus on a limited number of higher risk key audit areas of audit files selected on a risk-based approach and do not report on positive audit quality. So, to that extent, this report does not represent a balanced scorecard and caution is needed in generalising the results across the entire market. Purely random selections of audit files could produce higher or lower levels of negative findings. [Information Sheet 224](#) *ASIC audit inspections* outlines in more detail how we measure and report findings.

Negative findings from our reviews of audits do not necessarily mean that the financial reports audited were in fact materially misstated. Rather, in our view, the auditor did not have a sufficient basis to support their opinion on the financial report.

For the largest six firms (where we direct most of our inspections) there were negative findings in 23% of the 115 key audit areas reviewed across 35 audit files this year. This compares to 24% of the 156 key audit areas across 46 audit files reviewed last year.

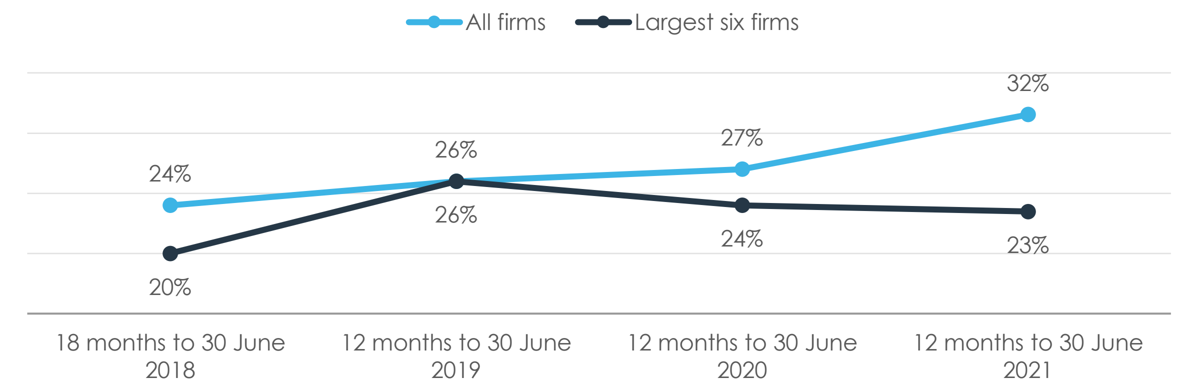
There were negative findings in 32% of the 149 key audit areas we reviewed on a risk basis across 45 audit files at 16 firms (including the largest six firms) this year. This compares to 27% for the 179 key audit areas reviewed across 53 audit files at 13 firms last year.

The level of negative findings based on the key audit areas reviewed this year for firms outside the largest six firms was 59% compared to 48% for those reviewed last year. However, the findings percentages for firms outside the largest six firms are not directly comparable between periods as six of the 10 firms inspected this year were not inspected last year.

The increased overall level of negative findings is of concern and warrants deliberate and concerted action by all firms to improve audit quality and to reduce the incidence of negative findings.

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

Figure 1: Negative inspection findings

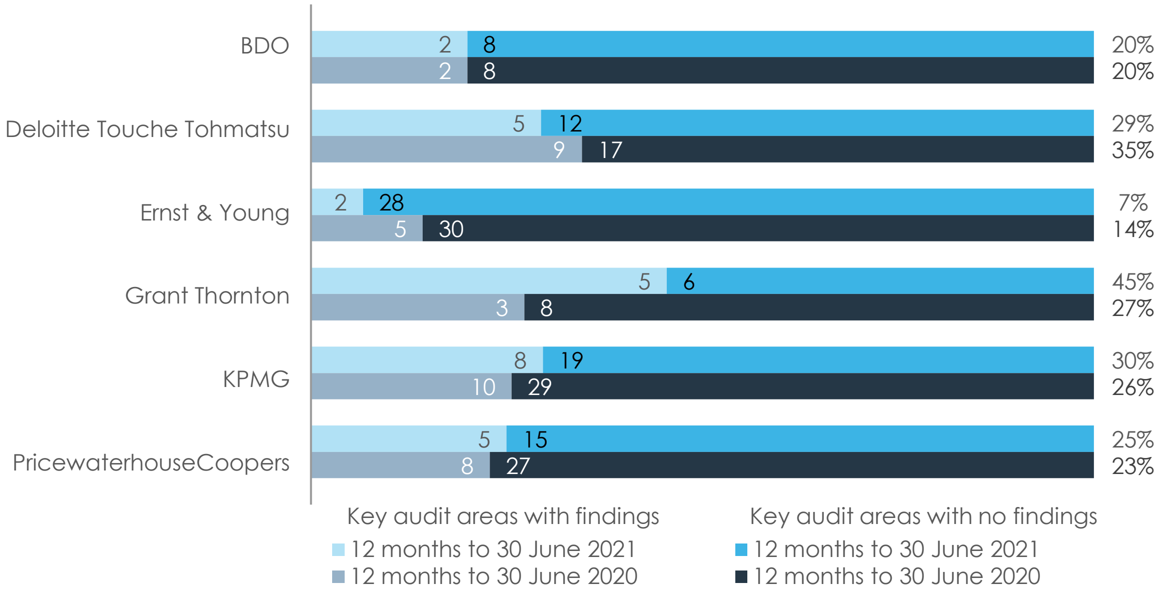


Note: See Table 9 for the data shown in this figure (accessible version).

Our separate risk-based reviews covering financial reports of listed and other public interest entities from 31 December 2019 to 31 December 2020 conducted this year led to material changes to net assets and profits for 3% of financial reports reviewed. This compares to 4–5% for previous years.

Figure 2 compares findings levels at each of the largest six audit firms this year and last year. These firms collectively audit 93% of ASX listed entities based on market capitalisation.

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



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

The individual ASIC inspection reports on each of the largest six firms are available on our website.

Severity of findings

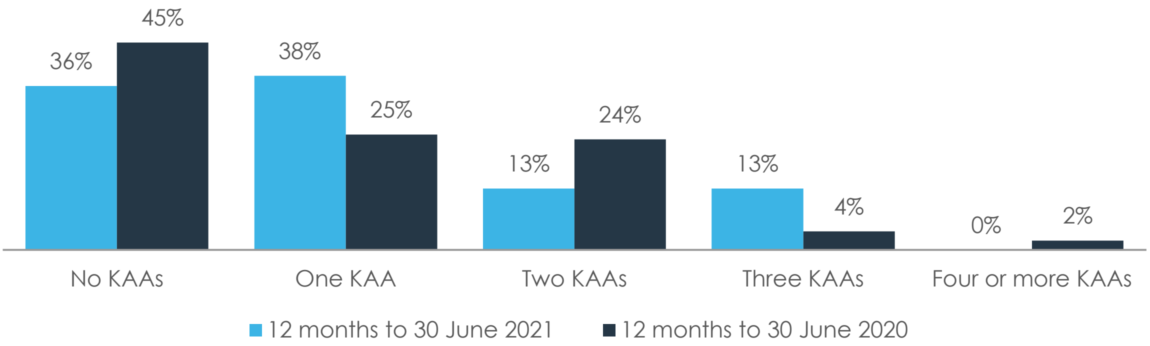
The objective of our audit firm inspection program is to promote high-quality external audits of financial reports. Accordingly, all findings reflected in Figures 1 and 2 are important and should be addressed because we consider the auditors had not performed all the work necessary to support their opinion on the financial report.

The level, nature and severity of our findings are consistent with those of audit regulators in other jurisdictions, as reflected in the results of the International Forum of Independent Audit Regulators' (IFIAR) Survey of inspection findings 2020 (PDF 857 KB) published in March 2021. However, the probability of a material misstatement remaining undetected in the financial report as a result of not performing required audit work will vary.

Although audit firms may take remedial actions based on our audit file review findings, firms do not necessarily agree with all our findings. Our findings percentage in Figures 1 and 2 exclude instances where we considered that individuals could reach different judgements.

Figure 3 shows the percentages of files reviewed that had negative findings between none and four or more key areas this year and last year. This is an indicator of the quality of the audit based on the number of key audit areas with findings. On average we reviewed three to four key areas on each audit file.

Figure 3: Percentage of files reviewed that had negative findings by number of key audit areas

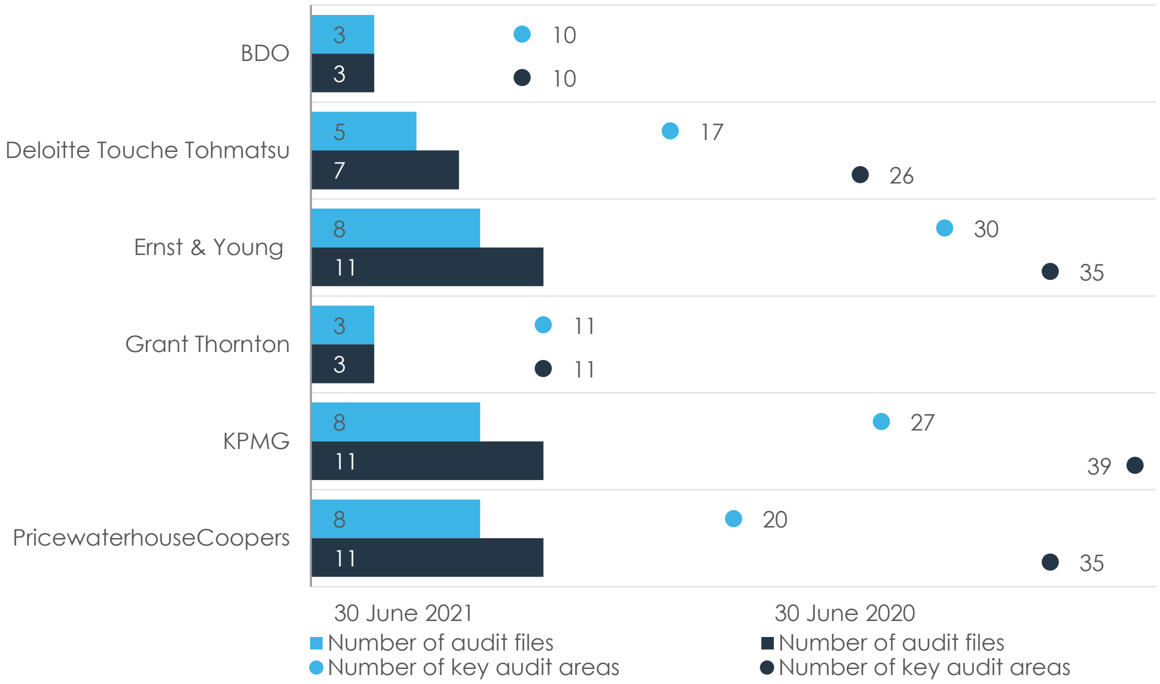


Note: See Table 11 for the data shown in this figure (accessible version).

Our coverage

The number of audit files and key audit areas reviewed at the largest six audit firms this year and last year is set out in Figure 4. Our reviews this year covered audits of financial reports for financial years ending from 31 December 2019 to 31 December 2020.

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



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

In total, we inspected 16 audit firms this year and 13 last year. We reviewed 149 key audit areas this year and 179 last year.

Comparability of our inspection process and findings between periods

We previously asked auditors to identify root causes where an entity had made material changes to net assets and profits following our inquiries on its financial report and undertake actions to address relevant matters. On this basis, from 1 July 2018 to 30 June 2020, we excluded such areas from our audit file reviews. Our review of a small sample of these cases at the largest four firms in 2019 indicated they did not conduct any such root cause analysis. Therefore, since 1 July 2020 we no longer exclude such areas from our audit file reviews.

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

There has been no overall change in the industry groups for the audit files reviewed this year compared to last year. For example, there were eight companies in the materials sector, five companies in consumer services and seven companies in the financials sector (banking, insurance and diversified financials companies) this year and 10 in the materials sector, seven in consumer services and five in the financials sector last year.

We reviewed similar key audit areas this year to those last year. The largest number of negative findings continued to be in the following audit areas:

- *revenue and receivables*— including deficiencies in tests of detail, accounting policy choices, substantive analytical procedures and audit of expected credit losses; and
- *asset values and impairment of non-financial assets*— including failing to challenge models, forecasts and key assumptions.

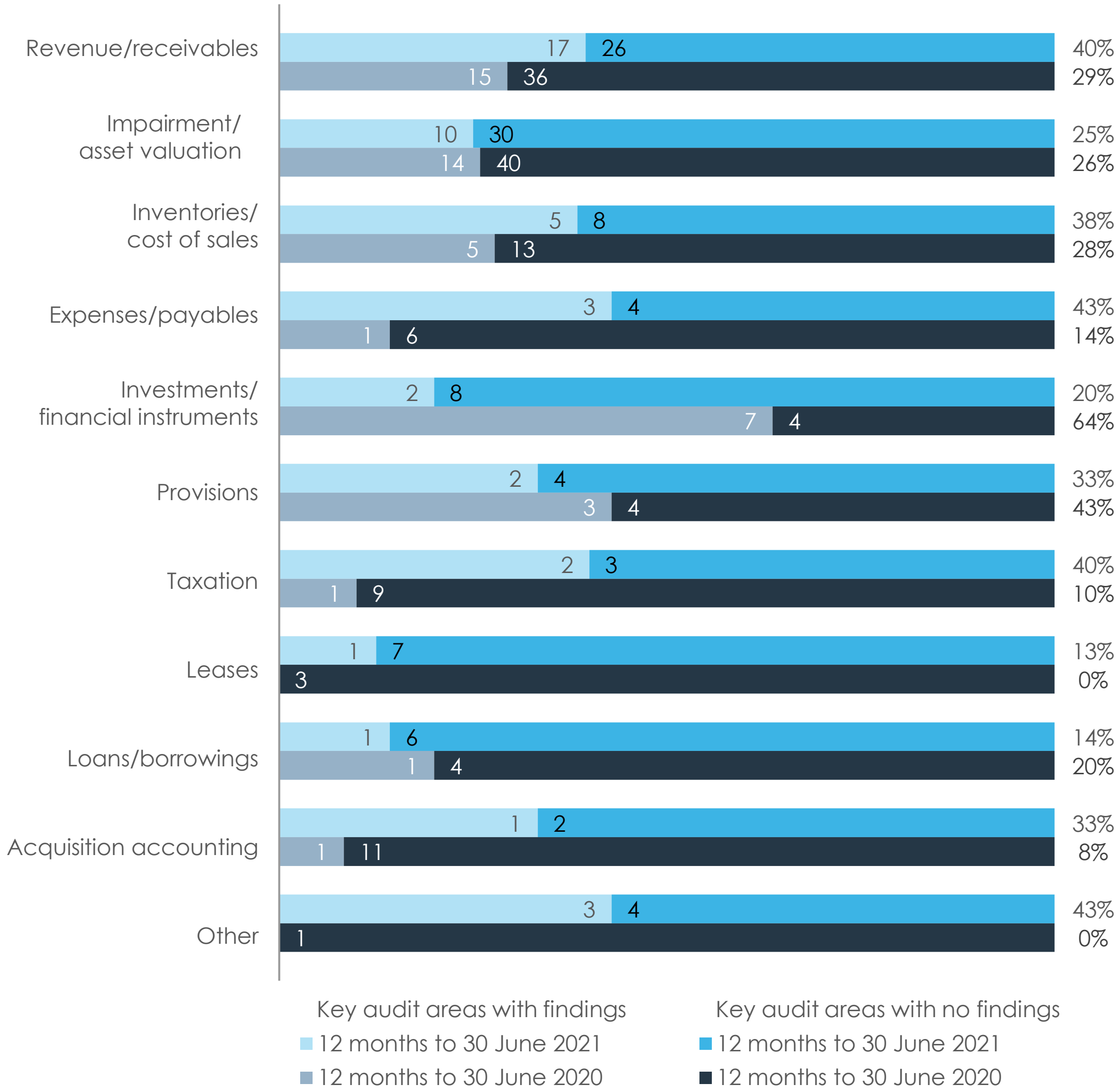
Figure 5 shows the number of key audit areas in which we had negative findings and the number of key audit areas that we reviewed for this year and last year.

Financial report misstatements

Figure 6 shows the percentage of audit files reviewed where we identified negative findings and where audited entities made material changes 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 7.

As noted above, from 1 July 2018 to 30 June 2020 we excluded areas from our audit file reviews where an entity had made material changes to net assets and profits following our inquiries of the audited entity on its financial report. This could be a reason for the lower percentages in Figure 6 during that period.

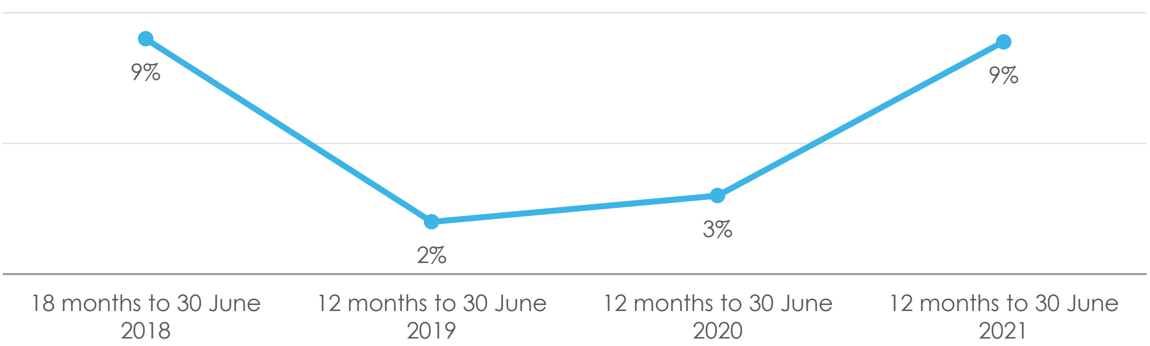
Figure 5: Key audit areas with negative findings and key audit areas reviewed in the 12 months to 30 June 2021 and the 12 months to 30 June 2020



Note 1: See Table 13 for the data shown in this figure (accessible version).

Note 2: Other key audit areas include deconsolidation, assets held for sale, discontinued operations and cash (last year: share-based payments).

Figure 6: Audits reviewed where the financial report was materially misstated



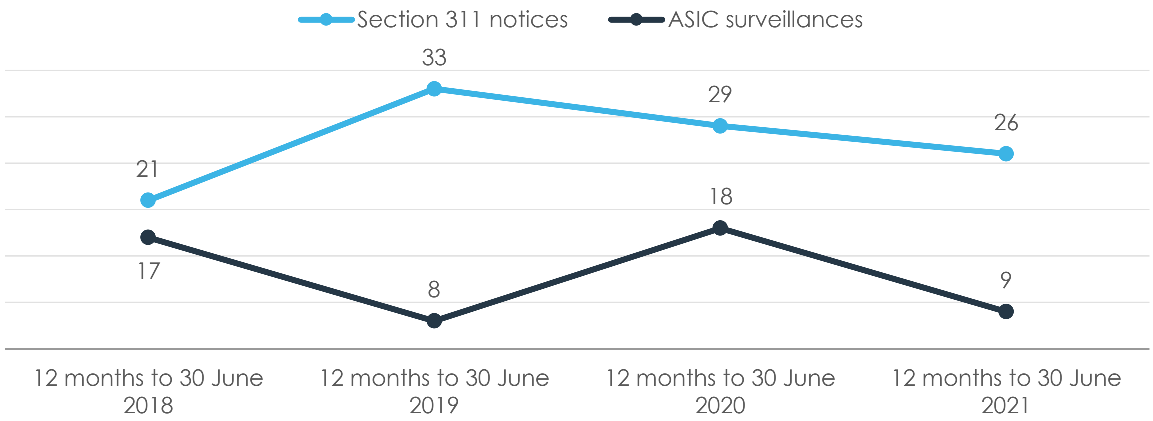
Note: See Table 14 for the data shown in this figure (accessible version).

Figure 7 shows the number of material adjustments to previously reported net assets and profits for listed entities as identified from:

- notices lodged by auditors under section 311 of the *Corporations Act 2001*; and
- material changes to net assets and profits resulting from ASIC financial reporting surveillances.

We only include matters from these two sources. There is no duplication of matters between the two sources.

Figure 7: Adjustments to financial reports



Note: See Table 15 for the data shown in this figure (accessible version).

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

Adjustments initiated by auditors

This year we did not obtain information about material adjustments to financial reports identified by the largest six firms, correcting net assets and net profits after tax, prior to the release of the financial reports of the 300 largest ASX listed Australian entities by market capitalisation. This was due to the time and effort required by the firms to collect this information.

In Report 678 *Audit quality measures, indicators and other information 2019–20* we reported that there were 78 cases of material adjustments for financial years that ended from 1 April 2019 to 31 March 2020.

External panel

We consulted an independent external panel on the method of measuring and reporting aggregate findings from our audit file reviews and the panel agreed with our approach. As part of this process, the panel discussed and tested the conclusions reached on a small number of our file review findings and agreed with them. For each of these findings, we provided the panel with an anonymised comment form which included the firm's response to our findings.

The panel consisted of Messrs Peter Day, Harley McHutchison 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 accounting bodies.

Detailed audit file review findings

Overview

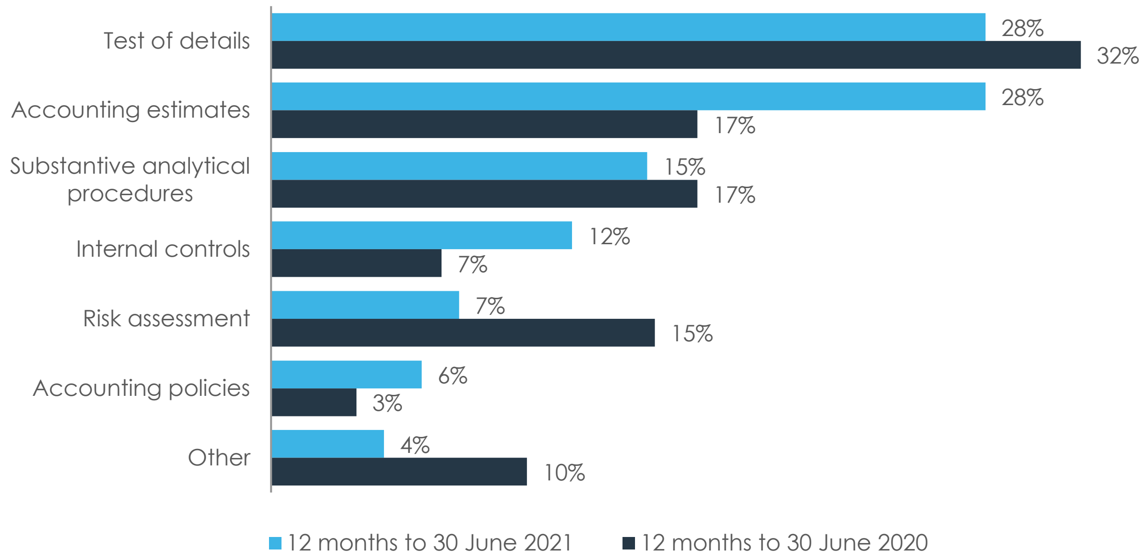
Audits of revenue and receivables and impairment of non-financial assets continue to be areas of the more common negative findings from our audit file reviews. This section contains details of the factors contributing to our negative findings across all audit areas reviewed. These factors may be useful to auditors of all firms when considering areas to improve audit quality.

In many cases we identified a combination of contributing factors that led to negative findings for a key audit area. However, not all contributing factors noted in this section applied in all cases where we had a finding in that area.

Revenue and receivables

Figure 8 shows the matters contributing to negative findings in relation to revenue and receivables. We reviewed revenue and receivables in 43 key audit areas this year and in 51 key audit areas last year.

Figure 8: Matters contributing to revenue and receivables negative findings in the 12 months to 30 June 2021 and the 12 months to 30 June 2020



Note: See Table 16 for the data shown in this figure (accessible version).

Tests of details, audit procedures on accounting estimates and substantive analytical procedures contribute to about 70% of our findings for revenue and receivables.

Table 1: Key factors contributing to revenue and receivables negative findings in the 12 months to 30 June 2021 and the 12 months to 30 June 2020

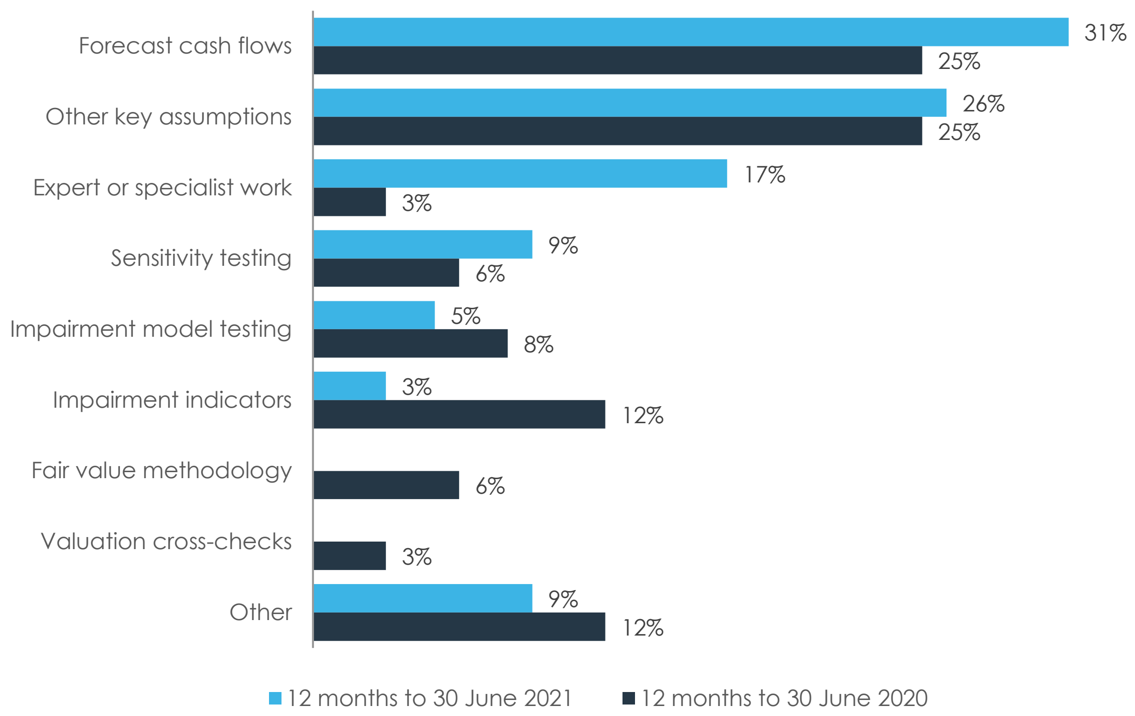
Contributing factors	12 months to 30 June 2021	12 months to 30 June 2020
Tests of details:		
› procedures performed did not address the level of risk assessed	13	8
› obtaining insufficient independent evidence for items selected	2	3
› sample sizes and sampling techniques were inadequate	2	1
› errors were not investigated or evaluated	1	2
› source data used was not tested for completeness or accuracy	1	5
Accounting estimates:		
› not testing and/or challenging the relevance and reliability of data and assumptions used in expected credit loss models	13	5
› insufficient testing of trade receivables	4	5
› insufficient testing of significant assumptions to estimate unearned/deferred income	2	–
Substantive analytical procedures:		
› thresholds for investigating differences were too high and/or population not disaggregated	3	2
› the relationship used was not plausible or did not consider key factors affecting the expectation	2	4
› data used to develop the auditor's expectation was not reliable or tested	2	3
› differences between recorded amounts and the auditor's expectation of those amounts that exceed the tolerable threshold were not identified or adequately investigated	2	1
Inappropriate reliance on internal controls	8	4
Risk assessment not performed appropriately or no procedures performed for risks/assertions	5	9
Accounting policies:		
› inappropriate accounting policy for revenue recognition, or not checking for consistency with key contract terms	2	2
› not obtaining an understanding of systems and controls relating to recognition of revenue	1	–

Contributing factors	12 months to 30 June 2021	12 months to 30 June 2020
Other:		
› deficiencies in instructions to or communication with component auditors, insufficient involvement in the work of component auditors or evaluation and review of work performed	2	5
› insufficient consideration of whether service providers met the definition of service organisations	1	–
› relied on assessments and testing performed in previous years audit without explaining the basis of the continued reliance	–	1

Impairment of non-financial assets

Figure 9 shows matters contributing to negative findings in relation to audit of asset values and impairment of assets. We reviewed work on impairment and asset values in 40 key audit areas this year and in 54 key audit areas last year.

Figure 9: Matters contributing to impairment of non-financial assets negative findings in the 12 months to 30 June 2021 and the 12 months to 30 June 2020



Note: See Table 17 for the data shown in this figure (accessible version).

Audit procedures over forecast cash flows, other key assumptions and expert or specialist work contribute to about 75% of our findings for impairment of non-financial assets.

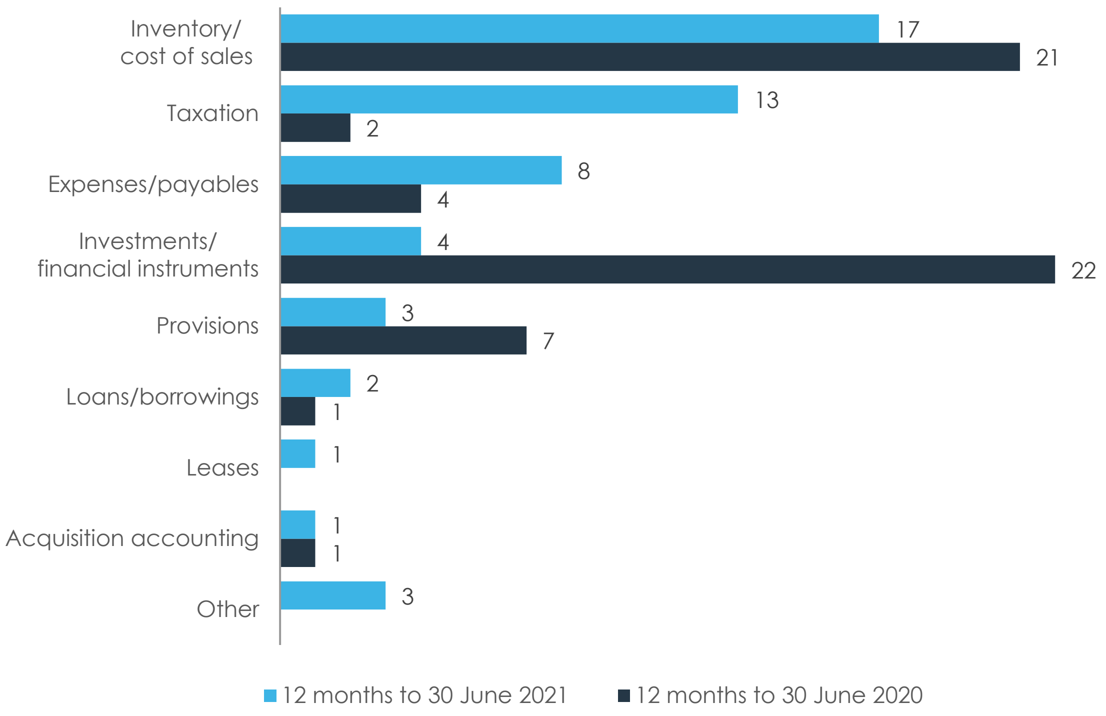
Table 2: Key factors contributing to impairment of non-financial assets negative findings in the 12 months to 30 June 2021 and the 12 months to 30 June 2020

Contributing factors	12 months to 30 June 2021	12 months to 30 June 2020
Forecast cash flows:		
› cash flows, including capital expenditure, or terminal value not reasonable or were not adequately tested	10	8
› not challenging forecasts where the entity has not met forecasts historically	1	5
Other key assumptions:		
› discount rate, exchange rate, commodity price or other key assumptions not appropriate or reasonable	6	13
› insufficient testing of recoverability of resources or mining approvals	3	–
Issues with work performed by audit firm's expert or specialist	6	2
Issues with sensitivity testing or no sensitivity testing performed	3	3
Impairment model not adequately tested, including:		
› mathematical accuracy	1	3
› impact of the new lease standard	1	–
› determination or calculation of cash-generating units	–	1
Impairment indicators:		
› did not ask management to perform impairment testing where there were indicators of impairment or there was goodwill or other indefinite life intangible assets	1	2
› were not assessed	–	4
Other:		
› deficiencies in disclosures not identified or corrected	1	3
› deficiencies in instructions to or communication with component auditors, insufficient involvement in the work of component auditors or evaluation and review of work performed	2	1
› risks not appropriately assessed	–	1
› insufficient skills and expertise to adequately assess and conclude on impairment calculations	–	1

Other negative findings

Figure 10 and Table 3 show the factors contributing to the negative findings from all other key audit areas. We reviewed 66 other key audit areas this year and 74 other key audit areas last year.

Figure 10: Number of key factors contributing to negative findings by key audit area in the 12 months to 30 June 2021 and the 12 months to 30 June 2020



Note: See Table 18 for the data shown in this figure (accessible version).

Table 3: All other key factors contributing to negative findings in the 12 months to 30 June 2021 and the 12 months to 30 June 2020

Contributing factors	12 months to 30 June 2021	12 months to 30 June 2020
For inventory and cost of sales, we found instances where auditors did not:		
› adequately test the accuracy and value of inventories, including provisions for stock obsolescence	8	8
› evaluate the design and implementation of systems, processes and controls or test key controls	5	1
› adequately test the existence and cut-off of inventories, including stocktake attendance by component auditors	3	6
› appropriately scope and evaluate the work of the component auditor or management expert	1	6
For taxation balances, we found instances where auditors did not:		
› include all tax workpapers on file, adequately test the accuracy of tax workings, assess the tax treatment of material items or review relevant transfer pricing documents	6	1
› sufficiently test the entity's compliance with relevant tax legislation	3	–
› appropriately evaluate the work of management's expert, or use their own expert	3	1
› evaluate the design and implementation of systems, processes and controls or test key controls	1	–

Contributing factors	12 months to 30 June 2021	12 months to 30 June 2020
For expenses and payables, we found instances where auditors did not:		
› test the relevance and reliability of data and assumptions used	5	–
› adequately test the completeness and accuracy of expenses	2	1
› test key controls or perform tests of detail using a representative sample	1	1
› evaluate the design and implementation of systems, processes and controls	–	1
› sufficiently evidence work performed by the component auditor	–	1
For financial instruments and investments, we found instances where auditors did not:		
› perform sufficient or appropriate tests of details over underlying assets, or use an adequate sample size for the assessed risk	3	6
› consider whether an investment should have been equity accounted	1	1
› test the relevance and reliability of data and assumptions used for valuations, including comparisons to market data	–	8
› appropriately evaluate the work and reports of their own or management's expert, including resolving issues raised by the expert	–	4
› evaluate the design and implementation of systems, processes and controls or test key controls	–	1
› consider the requirements for a service organisation and whether reporting was appropriate in the circumstances	–	1
› consider whether a loan to a joint venture was part of the net investment and should have been written down for significant losses of the joint venture	–	1
For provisions, we found instances where auditors did not:		
› adequately test the completeness and accuracy of provisions, or identify and investigate variances	2	6
› assess the relevance, completeness and accuracy of the methods and source data used by experts	1	2
› test the relevance and reliability of data and assumptions used	–	1
› use their own expert where the audit team did not have sufficient knowledge, experience or expertise	–	1
› evaluate whether the recognition criteria for a provision had been met under the accounting standard	–	1

Contributing factors	12 months to 30 June 2021	12 months to 30 June 2020
For loans and borrowings, we found instances where auditors did not:		
› obtain sufficient evidence over completeness of borrowings, including compliance with covenants	1	1
› perform adequate procedures over management's assessment of going concern and consider whether a material uncertainty existed	1	–
For an acquisition, we found an auditor did not:		
› identify whether the acquisition treatment was incorrect	1	–
› consider whether contingent consideration in a business combination should have been accounted for as remuneration rather than goodwill	–	1
For leases, we found an instance where auditors did not:		
› sufficiently assess whether make good provisions should have been recognised for leased premises	1	–
For cash, we found instances where auditors did not:		
› confirm cash held or bonds issued by foreign financial institutions	2	–
For a disposal of operations, we found an auditor did not:		
› obtain sufficient evidence that the disposal was highly probable at balance date	1	–

Experts and other auditors

In Tables 1, 2 and 3, we outline factors contributing to negative findings when using experts and component auditors to review impairment of non-financial assets, values of investment properties and other assets and auditing revenues and receivables, provisions and tax balances. In summary we found cases where the auditor did not:

- use their own expert where the audit team did not have sufficient knowledge and experience, or relied on an expert's review performed a number of years earlier without demonstrating or testing the continued relevance and reliability;
- sufficiently use their own expert (e.g. to review all relevant aspects of the determination of the discount rate used in an impairment assessment);
- appropriately scope, review and evaluate the work and reports of their own expert, consider the appropriateness of the work and/or resolve issues raised by the expert;
- test the work of management's expert such as obtaining evidence supporting and challenging assumptions and forecasts, re-performing calculations and reviewing any model used;
- assess the relevance, completeness and accuracy of source data used by experts or assess the competence, capabilities and objectivity of experts;

- have sufficient group audit strategies and instructions to, or communication with, component auditors; and
- sufficiently review and evaluate the work of component auditors.

Journal entries

We identified deficiencies in journal entry testing in 7% of audit files reviewed this year, compared to 4% of files reviewed last year. Findings included instances where the auditor did not test journal entries and adjustments made at year end or did not evaluate whether journal entries and adjustments needed to be tested throughout the year.

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

Culture, talent, fees for service, audit firm action plans and the role of others

Overview

Promoting a strong culture focused on audit quality, attracting and retaining the right talent for complex audits, avoiding fee-related conflicts of interest, and revising firm action plans to promote audit quality are important. Directors and management can also have a role in supporting audit quality.

Culture

Culture is key to achieving and maintaining audit quality and should continue to be an area for focus by the leadership and partners of firms. Audit quality, a focus on the public interest, professional scepticism, professionalism, integrity and ethics all contribute to a firm's brand, reputation and confidence in a firm's independent audit opinions on financial reports.

This year we reviewed how the largest six audit firms establish and maintain a culture focused on audit quality. Each firm reviewed had a range of practices and initiatives to promote such a culture. We made no better practice recommendations for any firms reviewed in relation to culture.

Changes in practices and initiatives by individual firms on culture may take time to show an impact on negative findings from audit file inspections and need to be applied in combination with other initiatives to improve audit quality. The extent to which these practices and initiatives are delivering the intended outcomes therefore should continue to be regularly monitored and assessed.

Firm leadership, partners, managers and staff all have important roles in contributing to a culture focused on audit quality. This includes the considerations in Table 4, which are not an exhaustive list.

Table 4: Audit quality culture focuses for firm leadership, partners and staff

Who	Examples of considerations
Firm leadership	› Giving strong, genuine, consistent and frequent messages to partners and staff that audit quality is not negotiable › Providing genuine support for partners and staff in challenging accounting policies, estimates and disclosures in individual audits, and making necessary calls to issue a modified audit report › Ensuring that the firm and assurance division have a prominent focus on audit quality, in comparison to other objectives such as selling other services to audited entities › Monitoring and assessing culture through means such as people surveys, 360-degree reviews of partners, interviews with the boards and audit committees of audited entities and interviews with staff › Ensuring that whistleblowers are protected and the matters they raise are appropriately actioned

Who	Examples of considerations
Partners and staff	› Embracing the need to improve audit quality and the consistency of audit execution › Understanding and being accountable for their roles in conducting quality audits › Focusing on the information needs of, and potential harm to, investors and creditors

Talent

Audit firms depend on adequate partner and staff resources, experience and expertise for complex audits and timely completion, supervision and review of audit work. Audits require a good understanding of businesses and the risks inherent in complex corporate groups, and the ability to deal with difficult judgements on accounting treatments and estimates.

This year we reviewed how the largest six audit firms manage and maintain the right talent for complex audits, including how they attract, retain and upskill partners, staff and experts.

Each firm had a range of practices and initiatives with the objective of ensuring that they resource audits with appropriately qualified and experienced staff. We made no better practice recommendations for any firm reviewed in relation to talent.

The availability of audit staff resources may continue to be affected by COVID-19 conditions, pre-existing factors and future changes, and will require responses by all firms, across the profession and by other parties in the financial reporting chain.

Having the necessary talent relies on firm approaches and strategies for attracting, developing and retaining staff to meet requirements now and in the future. Continued COVID-19 conditions may increase pressures on resources and difficult judgements on accounting estimates.

Table 5: Attracting, developing and retaining the talent needed for complex audits

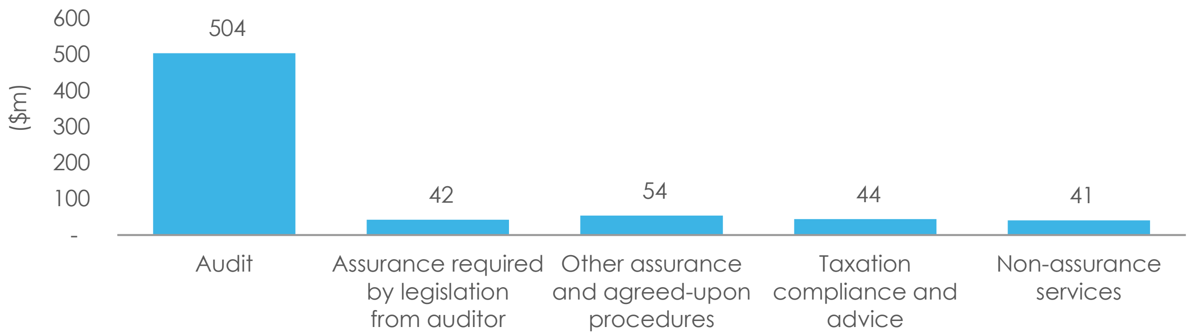
Area	Examples of considerations
Possible pressures under COVID-19 conditions	› Addressing the impact of restrictions on travel into Australia and within Australia and increases in staff turnover. As travel restrictions are lifted, there could be imbalances between staff resources entering and exiting Australia › Addressing increased competition for staff through retention strategies such as increased remuneration and focusing on staff wellbeing › Using virtual secondments of staff from foreign firms in their network
Delivering the experience and expertise required for complex audits	› Attracting and retaining audit staff (including lateral hires) with interesting work, opportunities to develop (including training, secondments, mentoring), adherence to high standards of audit and ethics, work/life balance, remuneration, rewarding quality, pathways to promotion and focusing on the wellbeing of staff › Attracting and retaining experts in different disciplines and industries, including industry experts, valuers, actuaries, geologists, financial instrument experts and IT experts › Addressing the impact of barriers to mobility of staff across borders › Reviewing workloads, adopting strategies to address deadline pressures and spreading peak work periods › Embracing diversity (including gender, race, culture, disability, age and sexual preference, profession, country of work experience), addressing unconscious biases and providing equal opportunity. Diversity is important to attracting and retaining talent and bringing different perspectives to issues

Area	Examples of considerations
Delivering the experience and expertise required for complex audits (cont.)	› Addressing bullying and harassment, addressing staff feedback and concerns, protecting whistleblowers and considering the expectations of different generations. These are important to retaining talent and ensuring that staff can focus on delivering quality audits › Ensuring that the firm has audit partners and staff with the experience and expertise required for the firm's audits of complex corporate groups and to identify and deal with complex and contentious issues on accounting treatments and estimates › Ensuring that directors and audit committees understand the value of the audit, support properly resourced quality audits and pay reasonable fees. This includes understanding the need to use appropriate experience and expertise in audits (including the auditor's own experts), the importance of firm technical support and quality controls, and the cost of new audit technologies and techniques › Working with accounting bodies and tertiary institutions to ensure the future availability of auditors and experts with appropriate experience and expertise, professional scepticism, ethics and a focus on the public interest
The future	› Upskilling staff for new technologies and techniques used by audited entities and in audits and attracting specialists › Upskilling staff and employing experts as climate and sustainability reporting frameworks develop and independent assurance is sought over the information reported › Ensuring that a focus on new technologies by audited entities and in audits and areas of assurance does not detract from the resourcing of, and focus on, the conduct of quality audits of financial reports

Fees for services provided to audited entities

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

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



Note: See Table 19 for the data shown in this figure (accessible version).

The overall average proportion of fees for non-assurance services (including taxation services) to audit fees was 17%. The proportion was 50% or more for 23 of the 300 entities and 100% or more for 18 of the entities.

Audit firm action plans

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

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

Information Sheet 222 *Improving and maintaining audit quality* outlines considerations and examples of initiatives for audit firms to improve and maintain audit quality. This information sheet will be updated to include examples of how firm leadership, partners and staff can contribute to a culture focused on audit quality and considerations for audit firms to attract, develop and retain the talent needed for complex audits.

We will focus on the effectiveness of root cause analysis and the development and monitoring of action plan initiatives at the largest six audit firms in the 12 months to 30 June 2022. We will continue to discuss with the largest six audit firms their action plans, progress against those plans and how they assess the impact of these plans on audit quality.

The role of directors, audit committees and management

Company directors, audit committees and management have roles in supporting quality audits. Among other matters, directors and audit committees should consider:

- non-executive directors recommending audit firm appointments and setting audit fees;
- assessing the commitment of the auditors to audit quality;
- reviewing the resources devoted to the audit, including the amount of partner time, the need for the auditor to use experts and the appropriate use of other auditors;
- accountability of the lead audit partner, the review partner, specialists and audit team members for audit quality;
- facilitating the audit process, including support by entity management for the audit process;
- two-way communication with the auditor on concerns and risk areas;
- assessing the auditor's professional scepticism in challenging accounting treatments and estimates;
- ensuring independence of the auditor; and
- asking for the results of any ASIC review of the audit files and asking the auditor how they have responded to any ASIC findings.

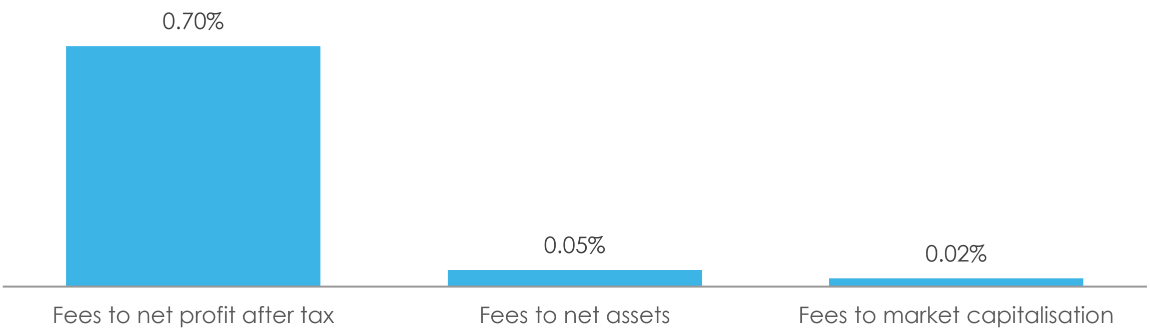
Directors and audit committees should ensure the company's internal governance and risk frameworks are robust and support the preparation of financial statements free of material misstatements.

See Information Sheet 196 *Audit quality: The role of directors and audit committees* and Information Sheet 223 *Audit quality – The role of others* for more information.

Directors and audit committees should also ensure that audit fees are set at a level that supports the audit work required. Audit fees are usually a very small proportion of costs and reducing them does not generally have a significant impact on a company's profit.

Figure 12 shows audit fees as a percentage of net profit after tax, net assets and market capitalisation for the 300 largest ASX listed Australian entities by market capitalisation for financial years ended 1 April 2020 to 31 March 2021. The figures for the previous 12 months were almost identical.

Figure 12: Audit fees to net assets, net profit after tax and market capitalisation for the 300 largest ASX listed Australian entities



Note: See Table 20 for the data shown in this figure (accessible version).

Focus areas for audits in COVID-19 conditions

COVID-19 conditions heighten the importance of delivering high-quality audits and the need for listed entities and other public interest entities to properly inform the market and investors through high-quality financial reports. There can be more difficult judgements on asset values, liabilities, solvency, going concern and disclosures.

Conditions and circumstances can also change significantly between reporting dates requiring reassessment of past judgements and assumptions. Auditors need to be especially vigilant about these conditions in their audits.

Table 6: Focus areas for audits of financial reports under COVID-19 conditions

Focus area	Details
Reporting focuses under COVID-19 conditions	Whether the auditor has addressed the key focus areas for financial reporting under COVID-19 conditions, including asset values, liabilities, solvency, going concern and disclosures. In particular, the auditor should have considered: › the areas, factors and matters outlined in COVID-19 implications for financial reporting and audit: Frequently asked questions (FAQs), FAQs 1, 2 and 3 and the matters outlined in Media Release (21-129MR) *ASIC highlights focus areas for 30 June 2021 financial reports under COVID-19 conditions* (7 June 2021); › the adequacy of disclosures on matters such as estimation uncertainties, key assumptions and government support, which are likely to be important information for investors and other report users (including in half-year reports); and › the operating and financial review or review of operations for material inconsistencies with the financial report and the auditor's knowledge, including the matters outlined in FAQ 4, and reported any suspected contraventions to ASIC in accordance with section 311 of the *Corporations Act 2001*.
How the business is affected under COVID-19 conditions	Whether the auditor has: › understood how the businesses of the entity being audited have been, and are likely to be, affected by factors such as those listed in FAQ 2 (including the impact of such factors on suppliers, customers, investees and others); › assessed the adequacy of data, assumptions and approaches in supporting asset values and other estimates; › understood the impact of changed circumstances from period to period and after reporting date, including lockdowns, changing restrictions, vaccine rollouts, changes in domestic and international economic conditions, and changes in government support; › identified any uncertainties and difficult judgement areas; and › identified the impact of non-COVID-19 changes affecting the businesses of the audited entity, such as new competitors and changes in technology, that need to be addressed and separately identified in the financial report.

Focus area	Details
Applying required experience and scepticism under COVID-19 conditions	Whether the auditor has: › ensured that the required experience and expertise has been applied to the audit given the challenges and judgements involved under COVID-19 conditions. This includes applying appropriate professional scepticism in challenging estimates, assumptions, assessments, accounting treatments and the sufficiency of audit evidence; and › considered the need for increased partner involvement, supervision and review, and use of the auditor's own experts. Audit engagement partners should be involved in understanding the business and risks and consider and review risk areas of the audit on a timely and comprehensive basis.
Remote work under COVID-19 conditions	Whether the auditor has: › considered the impact on internal controls of remote work arrangements; and › used appropriate processes for remote auditing (e.g. virtual inventory counts).

ASIC's regulatory response

ASIC's activities

ASIC's Corporate Plan 2021–25 outlines ASIC's regulatory activities in relation to financial reporting and audit, focusing on the 12 months to 30 June 2022 (see page 18 of the Corporate Plan). These activities are outlined in more detail in Table 7.

Table 7: ASIC's key focus areas for financial reporting and audit

Focus	Key actions
Review of audit inspection and financial reporting surveillance programs	› Reviewing our activities for regulating auditors and financial reporting, focusing on the audit inspection and financial reporting surveillance programs, to identify potential areas of improvement › Implementing changes and communicating with key stakeholder groups
Communicating findings from audit reviews to directors	› Consulting on whether to routinely communicate negative findings from our audit file reviews directly to the directors of the entity audited
Enforcement of auditor matters	› Enforcement of auditor matters is a priority for ASIC. We have identified additional matters to consider for possible enforcement actions against auditors for defective audits and auditor independence issues
Transparency	› Continuing to disclose the results for the six largest firms in aggregate and individual firm reports on our website
Financial reporting quality	› Reviews and surveillances of financial reports of listed entities and other public interest entities on a risk basis › Communicating with the public about focus areas (e.g. asset values and provisions) and outcomes
Audit quality	› Reviewing audits of listed entities and other public interest entities on a risk basis, with focus areas to include asset impairment and revenue › Reviewing aspects of quality control systems at the largest six audit firms

ASIC's work with international regulators

ASIC works with regulators in other countries to promote audit quality: see Table 8. This is important because many corporations operate across borders and the larger audit firms are part of global networks. Australia's auditing and ethical standards are based on international standards and our markets are affected by international economic and other developments.

Table 8: Examples of work with international regulators

International organisation	Details
International Organization of Securities Commissions	Work with other securities regulators on matters such as: › seeking improvements to the international auditing and ethical standards; and › meeting with the largest six audit firms internationally to understand their approach to auditing and financial reporting under COVID-19 conditions.
International Forum of Independent Audit Regulators	Work with other major audit regulators on matters such as: › discussing actions to improve audit quality with the largest six audit firms internationally; › seeking improvements to the international auditing and ethical standards; and › discussing approaches to audit inspections and enforcement with other regulators.

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 9: Negative inspection findings

Period	Overall percentage	Largest six firms percentage
18 months to 30 June 2018	24%	20%
12 months to 30 June 2019	26%	26%
12 months to 30 June 2020	27%	24%
12 months to 30 June 2021	32%	23%

Note: This is the data shown in Figure 1.

Table 10: Negative findings from reviews of key audit areas in audit files at each of the largest six audit firms

Audit firm	12 months to 30 June 2021			12 months to 30 June 2020		
	Key audit areas with findings	Key audit areas reviewed	Percentage	Key audit areas with findings	Key audit areas reviewed	Percentage
BDO	2	10	20%	2	10	20%
Deloitte	5	17	29%	9	26	35%
Ernst & Young	2	30	7%	5	35	14%
Grant Thornton	5	11	45%	3	11	27%
KPMG	8	27	30%	10	39	26%
Pricewaterhouse-Coopers	5	20	25%	8	35	23%

Note: This is the data shown in Figure 2.

Table 11: Percentage of files reviewed that had negative findings by number of key audit areas

Number of areas with findings	12 months to 30 June 2021	12 months to 30 June 2020
None	36%	45%
One	38%	25%
Two	13%	24%
Three	13%	4%
Four or more	0%	2%

Note: This is the data shown in Figure 3.

Table 12: Number of files and key audit areas reviewed at the largest six audit firms

Audit firm	Number of audit files: 12 months to 30 June 2021	Number of audit files: 12 months to 30 June 2020	Number of key audit areas: 12 months to 30 June 2021	Number of key audit areas: 12 months to 30 June 2020
BDO	3	3	10	10
Deloitte Touche Tohmatsu	5	7	17	26
Ernst & Young	8	11	30	35
Grant Thornton	3	3	11	11
KPMG	8	11	27	39
PricewaterhouseCoopers	8	11	20	35

Note: This is the data shown in Figure 4.

Table 13: Key audit areas with negative findings and key audit areas reviewed in the 12 months to 30 June 2021 and the 12 months to 30 June 2020

Audit firm	12 months to 30 June 2021: Key audit areas with findings	12 months to 30 June 2021: Key audit areas reviewed	12 months to 30 June 2021: Percentage	12 months to 30 June 2020: Key audit areas with findings	12 months to 30 June 2020: Key audit areas reviewed	12 months to 30 June 2020: Percentage
Revenue/ receivables	17	43	40%	15	51	29%
Impairment/asset valuation	10	40	25%	14	54	26%
Inventory/cost of sales	5	13	38%	5	18	28%
Expenses/payables	3	7	43%	1	7	14%
Investments/ financial instruments	2	10	20%	7	11	64%
Provisions	2	6	33%	3	7	43%
Taxation	2	5	40%	1	10	10%
Leases	1	8	13%	–	3	0%
Loans/borrowings	1	7	14%	1	5	20%
Acquisition accounting	1	3	33%	1	12	8%
Other	3	7	43%	–	1	0%
Total	**47**	**149**	**32%**	**48**	**179**	**27%**

Note: This is the data shown in Figure 5.

Table 14: Audits reviewed where the financial report was materially misstated

Period	Percentage
18 months to 30 June 2018	9%
12 months to 30 June 2019	2%
12 months to 30 June 2020	3%
12 months to 30 June 2021	9%

Note: This is the data shown in Figure 6.

Table 15: Adjustments to financial reports

Period	Section 311 notices	ASIC surveillances
12 months to 30 June 2018	21	17
12 months to 30 June 2019	33	8
12 months to 30 June 2020	29	18
12 months to 30 June 2021	26	9

Note: This is the data shown in Figure 7.

Table 16: Matters contributing to revenue and receivables negative findings in the 12 months to 30 June 2021 and the 12 months to 30 June 2020

Matters	12 months to 30 June 2021	12 months to 30 June 2020
Test of details	28%	32%
Accounting estimates	28%	17%
Substantive analytical procedures	15%	17%
Internal controls	12%	7%
Risk assessment	7%	15%
Accounting policies	6%	3%
Other	4%	10%

Note: This is the data shown in Figure 8.

Table 17: Matters contributing to impairment of non-financial assets negative findings in the 12 months to 30 June 2021 and the 12 months to 30 June 2020

Matters	12 months to 30 June 2021	12 months to 30 June 2020
Forecast cash flows	31%	25%
Other key assumptions	26%	25%
Expert or specialist work	17%	3%
Sensitivity testing	9%	6%
Impairment model testing	5%	8%
Impairment indicators	3%	12%
Fair value methodology	–	6%
Valuation cross-checks	–	3%
Other	9%	12%

Note: This is the data shown in Figure 9.

Table 18: Number of key factors contributing to negative findings by key audit area in the 12 months to 30 June 2021 and the 12 months to 30 June 2020

Matters	12 months to 30 June 2021	12 months to 30 June 2020
Inventory/cost of sales	17	21
Taxation	13	2
Expenses/payables	8	4
Investments/financial instruments	4	22
Provisions	3	7
Loans/borrowings	2	1
Leases	1	–
Acquisition accounting	1	1
Other	3	–

Note: This is the data shown in Figure 10.

Table 19: Fees payable to auditors of the 300 largest ASX listed Australian entities

Fee category	$ million
Audit	504
Assurance required by legislation from auditor	42
Other assurance and agreed-upon procedures	54
Taxation compliance and advice	44
Non-assurance services	41

Note: This is the data shown in Figure 11.

Table 20: Audit fees to net assets, net profit after tax and market capitalisation for the 300 largest ASX listed Australian entities

Audit fee ratio	Percentage
Fees to net profit after tax	0.70%
Fees to net assets	0.05%
Fees to market capitalisation	0.02%

Note: This is the data shown in Figure 12.

Key terms

accounting standards	Standards issued by the Australian Accounting Standards Board under section 334 of the Corporations Act
ASIC	Australian Securities and Investments Commission
auditing standards	Standards issued by the Auditing and Assurance Standards Board under section 336 of the Corporations Act
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
INFO 224 (for example)	An ASIC information sheet (in this example numbered 224)
key audit area (KAA)	An area of an audit selected for review by ASIC on a risk basis that generally relates to a financial statement line
largest six firms	Large firms that audit listed entities with the largest aggregate market capitalisation. These firms may operate through national partnerships, an authorised audit company or a national network of firms. They are the BDO firms in Australia, Deloitte Touche Tohmatsu Australia, Ernst & Young Australia, Grant Thornton Audit Pty Ltd, KPMG Australia and PricewaterhouseCoopers Australia
last year	Files reviewed in the 12 months to 30 June 2020 which covered audits of financial reports for financial years ending from 31 December 2018 to 31 December 2019
negative findings	Where in our view auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement
professional accounting bodies	Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants
public interest entities	Listed entities and other entities of public interest with a large number of investors and other stakeholders
RG 260 (for example)	An ASIC regulatory guide (in this example numbered 260)
this year	Files reviewed in the 12 months to 30 June 2021 which covered audits of financial reports for financial years ending from 31 December 2019 to 31 December 2020