Ernst & Young Australia

Audit inspection report

1 July 2019 to 30 June 2020

Report 681 | December 2020

About this report

This report sets out our findings from reviewing audit files at Ernst & Young 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 Ernst & Young Australia (EY)
- reviews that we substantially completed in the 12 months to 30 June 2020 on work performed by EY on client monies in the audit of an Australian financial services (AFS) licensee
- our reviews of aspects of EY's approach to conflicts of interest, firm governance and accountability for audit quality and other quality control areas, 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 EY.

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 the 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, EY did not obtain reasonable assurance that the financial report was free of material misstatement in five of the 35 key areas that we reviewed in total across 11 audits by the firm, being 14% of the key areas reviewed by us. This compares to 22% 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 these 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 for 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	*Goodwill impairment*—The auditor did not appropriately conclude whether any of the existing goodwill should have been allocated to a held for sale group. The auditor relied on the direct valuation of properties without performing fair value cross-checks, despite the fact the company's discounted cash flow model may have indicated an impairment.
Entity B	Two of the two key areas reviewed	*Recoverability of receivables*—The auditor did not perform sufficient substantive testing on the expected credit losses on receivables, including assessing the value of third-party inventory used as collateral. *Investment property*—The auditor did not obtain sufficient evidence on the reasonableness of assumptions used in the valuations of properties, including considering whether properties with capitalisation rates within general regional property ranges should have had rates outside those ranges.
Entity C	Two of the two key areas reviewed	*Provision for impairment of loans and advances*—The auditor did not adequately test the operating controls over certain provisions and the reasonableness of inputs and assumptions used in the forward-looking information. The auditor did not adequately test the accuracy of the credit rating classification of certain loans and placed reliance on prior year audit work without documenting the basis of reliance or the relevance of that work. *Provisions and contingent liabilities*—The auditor did not obtain sufficient audit evidence about penalties for breaches of legislation and adequately assess the need for a provision.

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	*Contingent liability*—The auditor did not assess whether a contingent liability should be disclosed in the financial report or whether disclosure in relation to litigation and claims should have been made relating to a material buyback of asset entitlement rights.

Entity	Findings
Entity D	*Borrowings*—The auditor did not obtain confirmations for material borrowings, instead relying on other procedures. *Property, plant and equipment impairment*—The auditor did not fully evidence audit procedures on key inputs and assumptions for the impairment model, such as development feasibility, forecast sales and capitalised development costs. *Related party transaction disclosure*—The auditor did not review sales contract addendums that included material sale terms to a related party. The financial statement disclosure about this transaction could have been clearer. *Independence*—The auditor's actual or perceived independence would appear to be compromised given the nature and extent of non-audit services provided by the firm to the entity. These fees were over nine times the audit fees, and the non-audit services included tax advisory work supporting figures in the financial report.

Our findings from the review of work on client monies in the audit of one AFS licensee are detailed in Table 3.

Table 3: Audit review findings—AFS licensee client monies

Entity	Findings
Entity E	The auditor did not: • adequately test controls over daily and monthly reconciliations of client money liability ledgers to designated bank accounts • use an adequate sample size for testing client money reconciliations because they were viewed as an automated control when the licensee had manual processes for identifying and investigating differences.

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 include those summarised in Table 4.

Table 4: Better practice recommendations for 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. • Consulting more with the firm's independence experts on non-audit services to audited entities and the consultation being clearly documented. • Assessing whether the total fees earned 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.

Area	Better practice recommendations
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. • Ensuring partners and staff are fully aware of processes for escalating audit quality concerns with appropriate protections. • Clearly articulating the remit of internal governing boards for audit quality, including the authority they have to hold partners and staff accountable for audit quality deficiencies.
Accountability for audit quality	• Ensuring sanctions imposed on engagement partners for adverse findings in internal and external quality reviews are sufficient. • Holding engagement quality control reviewers and experts/specialists involved on audit engagements accountable for adverse findings from internal and external quality reviews. • Firm leadership seeking feedback on audit quality from audit committees and non-executive directors of 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 55 financial reports of listed and other public interest entities audited by the firm in the 12 months to 30 June 2020. Following our inquiries, one entity made material changes to net assets or profits as summarised in Table 5. More information can be found in media releases available from the ASIC website.

Table 5: Financial report findings—Media release issued

Media release	Entity	Year end	Findings
19-257MR	Tempo Australia Limited	31 December 2018	The company wrote down goodwill by $9.23 million, deferred tax assets by $5.32 million and intangibles by $470,000 in its financial report for the half year ended 30 June 2019.

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 4 is contained in detailed comment forms provided separately to the firm. The comment forms include the firm's responses to our findings.