ASIC

Australian Securities & Investments Commission

Ernst & Young Australia

Audit inspection report for 2018-19

December 2019

About this report

This report summarises findings from our reviews of key areas in audits at Ernst & Young Australia (EY) in the 12 months to 30 June 2019.

This report also lists any findings from our reviews of financial reports audited by the firm in the 12 months to 30 June 2019.

Although this report may describe deficiencies identified, this should not be taken to provide assurance that the firm's audits and systems, or audited financial reports, are free of other deficiencies.

This report is intended to communicate our findings in a clear and concise manner to leadership of the firm who are informed auditing and accounting professionals. While there are no restrictions on the firm providing this report to third parties or releasing the report to the public, other readers may not have the full context of this report and the findings summarised herein.

ASIC Information Sheet 224 *ASIC Audit Inspections* and ASIC Report 648 *Audit inspection report for 2018-19* provide further information on our audit firm inspection process.

Background

1 ASIC's audit inspections involve the review of key areas in the audits of listed entities and other public interest entities.

2 This report summarises our findings from audit reviews substantially completed in the 12 months to 30 June 2019, and financial reporting surveillances relating to entities audited by EY completed in the 12 months to 30 June 2019. If it has not already done so, the firm should identify underlying root causes for the matters reported, and for findings from internal and global firm reviews, and implement new and improved actions to achieve sustainable improvements in audit quality.

3 For more information refer to the detailed comment forms provided separately to the firm (matters in Tables 1 and 2) or in a media release available from the ASIC website (www.asic.gov.au) (matters in Table 3). The comment forms include the firm's response to our findings.

4 This report does not include details of enforcement actions (if any) involving members of the firm that may have been underway or finalised in the 12 month period.

Audit file review findings

5 In our view, the auditor did not obtain reasonable assurance that the financial report was free of material misstatement in 10 of the 45 key areas reviewed in total across 12 audits reviewed at the firm (22% of the key areas reviewed). 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.

6 Table 1 summarises the findings. The firm did not necessarily agree with all of our findings. The findings should not be taken to infer that the financial report was materially misstated, but rather that the auditor did not obtain sufficient evidence to support their opinion.

Table 1: Audit file review findings – risk of material misstatement

Entity	Areas with findings	Findings
Entity A	1 of the 3 key areas reviewed	• *Value of equity accounted interest* – in our opinion the auditor incorrectly accepted that a large loan to a 50% owned joint venture entity was not part of the investment in that entity. Had the loans been treated as part of the net investment, they would have been reduced by the entity's share of the losses of the joint venture.
Entity B	1 of the 3 key areas reviewed	• *Goodwill impairment* – the auditor did not adequately assess whether one of the entity's cash generating unit's cash flow assumptions, including growth rate, cost assumptions and discount rate, were reasonable and supportable. The sensitivity analysis

Entity	Areas with findings	Findings
		performed was inadequate. The auditor also did not adequately consider the entity's history of forecasting inaccuracy.
Entity C	3 of the 3 key areas reviewed	• *Sales revenue* – budgets used by the auditor to develop an expectation of the sales in a substantive analytical procedure (SAP) were not sufficiently tested, the population was not disaggregated to a product or customer level, and the threshold used for assessing an acceptable difference was too high. The sample sizes used for controls testing and substantive testing should have been determined separately for each of the entity's business units rather than for all sales as a single population. • *Inventories, cost of sales and trade purchases* –the auditor did not sufficiently consider when determining sample sizes, whether the population should have been stratified across business units for controls and substantive tests. • *Equity accounted investments* – in the impairment assessment the auditor did not sufficiently test whether the entity's cash flow assumptions including growth rates and future capital expenditure were reasonable and supportable. Further, the auditor did not consider appropriate evidence as to whether certain entities were controlled and whether a liability should have been recognised for financial guarantees given.
Entity D	1 of the 4 key areas reviewed	• *Property revenue* - the auditor used inappropriate bases for setting expectations of revenue in a SAP, which was developed by applying a 2% growth rate to prior year revenue. The auditor did not sufficiently consider inputs affecting different properties, the population was not sufficiently disaggregated by property and the acceptable difference threshold was set too high.
Entity E	4 of the 4 key areas reviewed	• *Sales & deferred revenue and trade receivables* - the auditor did not test whether the sales systems reconciled to the general ledger or whether the sales transactions selected for testing agreed to the subsidiary system sales reports. Deferred and prepaid revenue was not tested. The master sales agreement was not evaluated to ensure that the entity's revenue recognition policy was adequate. • *Costs of sales* - the auditor did not test whether the subsidiary cost systems reconciled to the general ledger or whether the sampled cost transactions agreed to the subsidiary system cost reports. • *Capitalised software costs* - the auditor did not adequately assess whether salary costs should have been capitalised and insufficient work was performed on impairment of a software platform that had poor performance and need for further development. Further, the auditor did not adequately evaluate the continuing relevance of prior period assumptions used by the entity in its current period forecasts. • *Related party loans* –the auditor did not adequately test related party loans including whether the loans were impaired, the calculation of interest, evidence of repayments and whether all personal expenses incurred by the related parties and paid by the entity had been identified and allocated to the loans. The nature of loans was not appropriately disclosed in the financial statements, including that the loans were for personal expenses on corporate credit cards and that interest was not passed on fully to the related parties.

Note: There was one finding relating to journal entry testing where, in our view, the auditor did not obtain reasonable assurance that the financial report was free of material misstatement. As journal entry testing is not a key area reviewed, the finding was not included in the percentage in paragraph 4 above.

7 Our audit file review findings which were reported to the firm in comment forms but not classified as involving a risk of material misstatement are summarised in Table 2.

Table 2: Audit review findings – other

Entity	Findings
Entity A	• *Indefinite life intangibles* – the auditor accepted the inclusion of restructuring cash flow savings in the value in use calculation for a CGU without obtaining evidence that the board had approved the restructure prior to balance date. • *Auditor rotation* – internal consultation undertaken was limited to one entity controlled by the group which had the same lead auditor. No internal consultation was undertaken or the reasons documented for extending the lead auditor's role in the audit from 5 years to 7 years.
Entity D	• *Equity accounted investments* – when assessing whether the entity had control or significant influence over the investees, the auditor did not adequately consider how all agreements operate for decision making and how disputes would be resolved in practice. • *Investment property valuation* – the auditor compared capitalisation rates used in valuing properties to ranges published by property valuers for Australia and compared rates for different types of properties but did not compare the capitalisation rates of properties within each State.
Entity E	• *Fraud risk assessment* – the auditor did not obtain an understanding of oversight by directors and of management's processes for identifying and responding to fraud risks. • *Supervision and review* – the auditor did not demonstrate an adequate level of direction, supervision and review of the work on significant risk areas of the audit.

Financial report findings

8 We completed risk-based reviews of aspects of 48 financial reports of listed and other public interest entities audited by the firm in the 12 months to 30 June 2019. Following our inquiries, two entities made material changes to net assets or profits as summarised in Table 3. More information can be found in media releases available from the ASIC website (www.asic.gov.au).

Table 3: Financial report findings – media releases issued

Entity	Year end	Findings
Prime Financial Group Limited	30 June 2018	The company had not accounted for a liability of $4.5 million in relation to a put option. It corrected a prior period error at 30 June 2018 in its financial report for the half-year ended 31 December 2018.
Premier Investments Limited	29 July 2017	The company wrote down the value of its casual wear brand name assets by $30 million in its financial report for the year ended 28 July 2018.