



Building trust through transparency

PwC's Audit Quality Balanced Scorecard | May 2019



Introduction

“ At PwC, our purpose is to build trust in society and solve important problems. We recognise one of our fundamental roles in building trust is through the delivery of high quality external audits. In an environment where trust in institutions is in decline, this has never been more important.

Broadening our definition of audit quality

Over the past few years the public discussion regarding audit quality in Australia has centered on one measurement: the results of external inspections from our regulator, the Australian Securities and Investments Commission (ASIC). ASIC's inspection focus is, quite rightly, on the riskiest areas of public company audits. However, this means that the results represent a very small percentage of the thousands of audits carried out each year. As ASIC say in their most recent report, caution is needed in extrapolating these results to the entire market. Whilst ASIC's results are one important indicator of audit quality, there are many others, and we believe a broader, more balanced scorecard relating to audit quality is required to deliver a more accurate picture of audit quality in Australia.

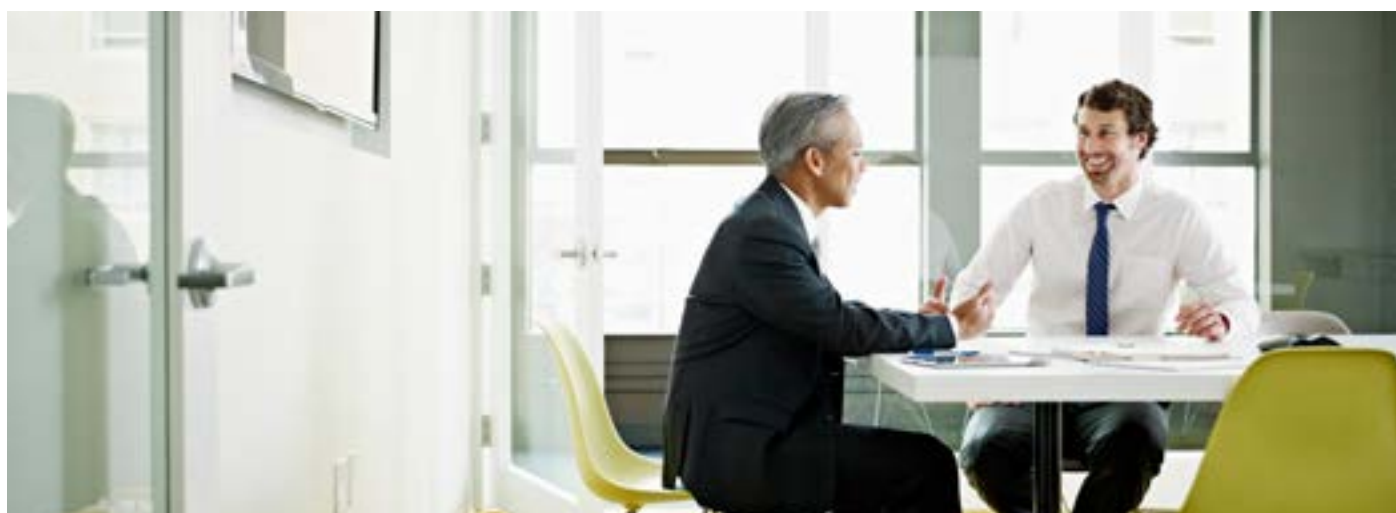
We also note that there have been public calls recently, including from the Financial Reporting Council (FRC), for ASIC to disclose individual firm results in its public report as is done by audit regulators in other parts of the world.

As Australia's largest audit practice we support this position and believe it's time for change. We have the opportunity to build greater trust in the audit through transparency. Transparency drives accountability, for auditors, the companies they audit and for ASIC.

Introducing a balanced scorecard on audit quality

We are proud to publish a balanced scorecard on audit quality which not only puts PwC's ASIC audit inspection results on the public record, but also discloses how we're performing against a range of other measures.

We are aware that by committing to this level of transparency there may be times in the future when the results we publish don't meet our own high expectations, let alone the public's. Indeed, ASIC's report identifies areas that are an opportunity for further improvement for PwC. Our ultimate goal is that ASIC considers that we have obtained reasonable assurance in all audit areas. We are driving a quality improvement plan aimed at achieving this goal.



We believe transparency will drive accountability, lead to better conversations across the market about audit quality and ultimately build trust.

We are also conscious that it is difficult to entirely capture the day-to-day reality of a complex and challenging audit. For example, there are many cases where a company makes adjustments to its financial statements, or clarifies or enhances disclosures, before they're published, as a result of the audit process. The market only sees a clean set of financial statements and an unqualified opinion, but there is often a lot of work behind the scenes by the auditor with the client to achieve this outcome.

The disclosures we are making highlight that:

1

Based on ASIC's most recent report (for the 18 months ended 30 June 2018), in **12% of the key audit areas** that ASIC reviewed across PwC audit files, ASIC considered we did not obtain reasonable assurance that the financial report was free from material misstatement. This compares to **24%** across the whole industry, and **20%** at the six largest firms in Australia.

2

In PwC's globally coordinated internal inspection program, in the period between 2016-2018, there have been no public company audits in Australia rated as "non-compliant" with PwC's guidelines and auditing standards. In 2018, the global audit of smaller private companies found five sample files were non-compliant. All instances of non-compliance identified did not involve inappropriate opinions being issued, but rather a need for improvement in how the audit work was performed and documented. These findings have formed a key element of our 2019 Quality Improvement Plan.

3

Importantly, where ASIC or PwC's internal inspection findings identified issues with a public company audit, there were no instances where the relevant financial statements required subsequent restatement. This compares to an industry average "restatement rate" of 4% from ASIC's financial reporting surveillance program of public companies.

4

On average in 2018, PwC identified six adjustments to the financial statements of listed companies, and ensured their appropriate treatment, before they were finalised and published. Adjustments included changes to numbers in the primary financial statements as well as disclosures in the supporting notes.

5

PwC's audit business is a thriving, sustainable business in its own right. It's profitability is broadly consistent with the other practice areas of our firm. The performance assessment of audit partners is not based on, nor are they incentivised to sell non-audit work to audit clients. The level of non-audit work at PwC audit clients in the ASX200 represents, on average, approximately 26% of audit fees over the past three years.



What's next?

Whilst we believe greater transparency will help to improve trust in the audit industry - it is only one part of the solution. Another critical component is how the audit needs to evolve.

Expectations around what the audit could – and should – look like in the future to better serve the interests of investors, and society more broadly are shifting rapidly - both in Australia and overseas.

This includes questions around whether an audit should look beyond historical information, include new levels of coverage with respect to fraud and provide assurance on non-financial measures in a company's annual report. The discussion should also include the rapid development of technology and the need for both auditing standards and market expectations to move to a modernised, technology enabled audit.

We look forward to leading these conversations with our clients and other stakeholders.

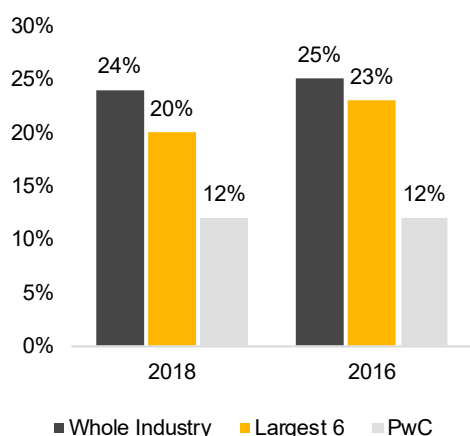


Matt Graham – Managing Partner, Assurance

Our Audit Quality Balanced Scorecard

ASIC audit inspection results

Audit areas with review findings



Data from ASIC's PwC Australia Audit Inspection Reports

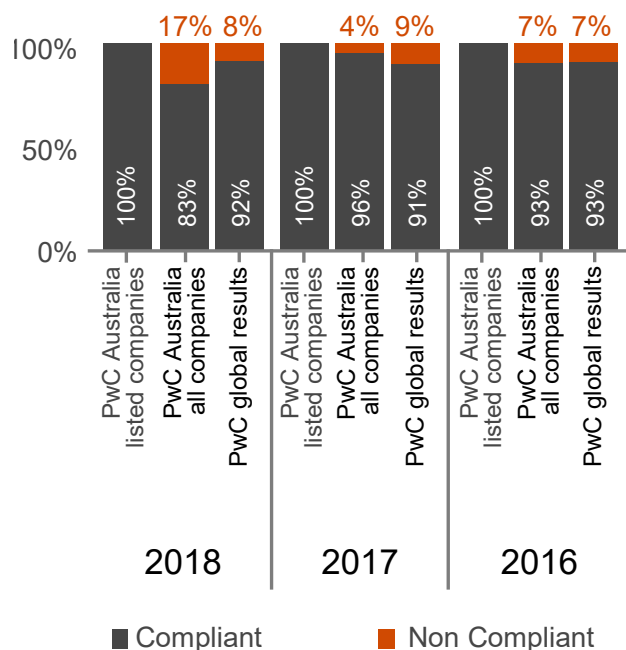
ASIC review a sample of files in each eighteen month reporting period, focussing on high risk areas in listed companies.

In its most recent report to PwC Australia (for the eighteen months ended 30 June 2018) ASIC found that in 12% of audit areas reviewed, auditors had not obtained reasonable assurance that the financial report was free from material misstatement (2016: 12%). This compares to an industry average of 24% (2016: 25%) and an average of 20% at the six largest firms (2016: 23%).

Areas of focus that have been included in our quality improvement plan arising from ASIC inspections include challenging management's assumptions in impairment calculations and consistent use of project management milestones for audits across the practice.

PwC internal inspection results

PwC audit inspections



Results from Audit files prepared by PwC Australia which are independently reviewed by member firms of the PwC Global network

PwC Australia is subject to globally coordinated quality inspections because we are part of the PwC network. The inspections are coordinated by a global team and led by representatives from other PwC network firms, not Australian representatives. The findings are independently moderated by our Global Assurance Risk & Quality team.

PwC inspections summarise outcomes by rating an overall audit file as "compliant" or "non-compliant" with PwC standards, which are based on International Standards on Auditing (ISAs).

With respect to listed companies, in the period between 2016-2018 no files for the Australian firm were rated as non-compliant with PwC standards. In 2018, our global inspections identified a higher than usual number of non-compliant findings in relation to the audit sample of smaller, private companies. The main areas of focus to address these findings include the consistent application of PwC methodology in the audit of revenue transactions and the accuracy of terminology in audit opinions. All instances of non-compliance identified do not involve inappropriate opinions being issued, but rather a need for improvement in how the audit work was performed and documented. These findings have formed a key element of our 2019 Quality Improvement Plan.

Restatements

Between 2016-2018, where issues had been identified by ASIC or PwC inspections of PwC audits of public companies, no financial statements required a restatement.

Industry wide, 4% of financial statements required a restatement as part of ASIC's risk-based inspection program for reporting periods ending 30 June 2010 to 31 December 2017.*

The identification of a finding from an audit inspection from ASIC or PwC's global inspection program means that a certain element of the auditing standard, be it design, execution or documentation of audit testing has not, in the opinion of the reviewer, met the requirements of the relevant auditing standard.

This does not, however, mean that the underlying financial statements to which the audit relates are materially misstated.

**ASIC risk-based surveillance of the financial reports of public interest entities for reporting periods ended 30 June 2010 to 30 June 2017*

Adjustments arising from PwC audits

2018 year ends

PwC performed 164 listed company audits with 2018 year ends. An average of 6 adjustments were identified per audit and reported to the relevant company.

2017 year ends

PwC performed 164 listed company audits with 2017 year ends. An average of 8 adjustments were identified per audit and reported to the relevant company.

There are many cases where a company makes adjustments to its financial statements, or clarifies or enhances its disclosure, before they are published, as a result of the audit.

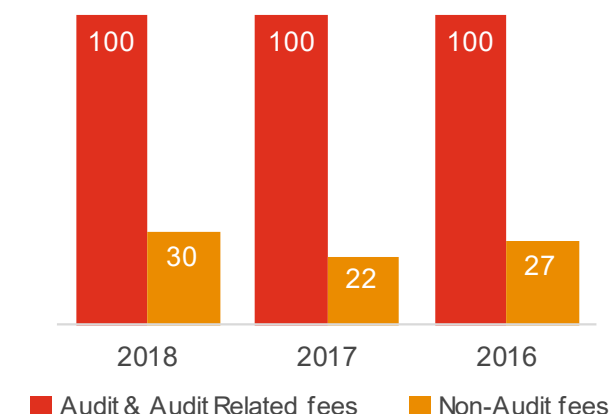
This is a critical and important part of a quality audit. It requires sound risk assessment, deep technical knowledge and an ability to raise issues with management and the Audit Committee, sometimes in difficult situations.

In 2018, PwC audits of listed companies identified, on average, 6 potential adjustments per audit, and ensured their appropriate treatment, prior to finalisation of the company's financial statements.



Auditor independence - the provision of non-audit services

Non-audit to audit fees for ASX 200 audit clients



ASX200 calculated based on market cap at time of submission of financial statements (top 200 market cap)
Non audit fees shown as a percentage of audit and audit related fees

Independence is a fundamental part of audit quality. It ensures our objectivity.

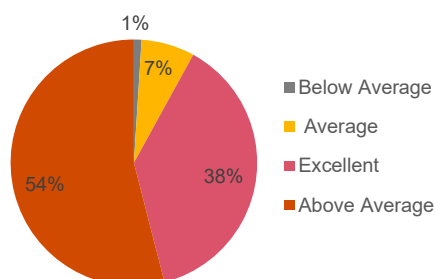
The Corporations Act prohibits several types of services from being performed for a client by its external auditor. These include engagements where the audit firm might act in a management capacity or find itself auditing its own work.

PwC has comprehensive internal policies so that our independence is not impaired. More broadly, while we note that there are no regulations in Australia that require a “cap” on non-audit services provided by the auditor, the amount of non-audit services provided to PwC’s ASX200 audit clients in the past three years has averaged approximately 26% of audit fees, which equates to less than 3% of PwC’s total revenue in 2018.

A client view of audit quality

Feedback from companies on audit industry

Taking all aspects of your service into consideration, which of the following best describes your overall view of your external auditor?



Feedback from ASX300 detailed in **2018 Audit Quality in Australia: The Perspective of Audit Committee Chairs**, authored by the Financial Reporting Council and The Auditing and Assurance Standards Board.

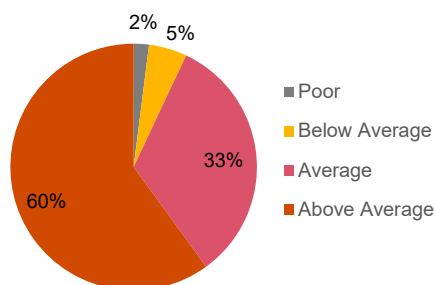
Audit Committees, who represent shareholders in their interactions with auditors, have a unique view of audit quality, as they are witness to the many judgements and conversations that occur prior to the publication of their company’s financial statements.

In 2018, the Financial Reporting Council commissioned a survey of ASX300 Audit Committee Chairs. 92% of this cohort described their overall view of their external auditor as either “excellent” or “above average”.

An investor view of audit quality

Feedback from investors on audit industry

Which of the following best describes your overall view of audit quality in Australia?



Feedback from professional investors detailed in **2019 Audit Quality in Australia: The perspectives of professional investors**, authored by the Financial Reporting Council and The Auditing and Assurance Standards Board

The quality of financial reports is key to confident and informed markets and the views of investors are particularly important. In 2019, the Financial Reporting Council commissioned a survey of professional investors and analysts in the ASX300 to gather their perspectives on audit quality and the value of audit. 93% of respondents believe audit quality is “average” or “above average”.

PwC's audit business

Recent commentary about the professional services industry, both in Australia and overseas, has suggested that professional services firms have unprofitable audit businesses that are used as a “loss leader” to promote other services within the firm. In our experience, this view is without any basis of fact.

PwC audits **30%** of ASX200 companies

Fees from our statutory audit services represented **17%** of total firm revenue in 2018 and **19%** in 2017

Non audit fees from ASX200 audit clients represent, on average, approximately **26%** of audit fees over the past three years

This equates to less than **3%** of total PwC Australia revenue

PwC is proud to be the leading audit firm in Australia, auditing 30% of the ASX200.

In FY18 our total revenue relating to audits of financial statements was \$409m representing 17% of total firm revenue. In FY17 it was \$396m, representing 19% of total firm revenue.

Our audit business does not position PwC for other services at our audit clients. From time to time, when independence regulations allow, PwC may be the best option for our audit clients when a project needs external assistance. This work will be considered through our own internal independence and conflict processes when they arise before any work commences. Non-audit fees from ASX200 audit clients have approximated 26% of total audit fees over the past three years and represent on average less than 3% of total firm revenue. No PwC audit partner is incentivised for selling non-audit services to clients which they audit.

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At PwC Australia our purpose is to build trust in society and solve important problems. PwC is a network of firms in 158 countries with over 250,000 people who are committed to delivering quality in assurance, advisory and tax services.

Find out more and tell us what matters to you by visiting us at www.pwc.com.au.