



Building trust

through

transparency

PwC's Audit Quality Balanced Scorecard | December 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.

A balanced scorecard on audit quality

In May 2019, we published our first balanced scorecard on audit quality, which not only put PwC’s ASIC audit inspection results on the public record, but also disclosed how we were performing against a range of other measures which contribute to an assessment of audit quality at our firm.

We did this because we believe transparency will drive accountability, lead to better and more balanced conversations about audit quality in Australia and ultimately build trust.

With the publication of ASIC’s latest audit inspection findings for the 12 months to June 2019, we are proud to publish our updated balanced scorecard for December 2019.



The disclosures we are making highlight that:

1

Based on ASIC's report for the 12 months ended 30 June 2019, in **18%** 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 **26%** across the whole industry, and **26%** at the six largest firms in Australia. There were no PwC files with multiple findings.

2

In PwC's globally coordinated internal inspection program, two files out of 45 reviewed were rated non-compliant with PwC standards. One finding related to a listed company.

3

Importantly, in the above cases where ASIC or PwC's internal inspection findings identified issues, there were **no** instances where the relevant financial statements required subsequent restatement. This compares to an industry average "restatement rate" from ASIC's financial reporting surveillance program of 4 to 5%.

4

On average in 2019 (to date), PwC has identified five 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 or they are 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 25% 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.

These discussions are starting to take place as part of the Parliamentary Joint Committee inquiry into the regulation of auditing and we look forward to continuing to be a part of them.

You can read our submission on the PJC website here www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/RegulationofAuditing/Submissions

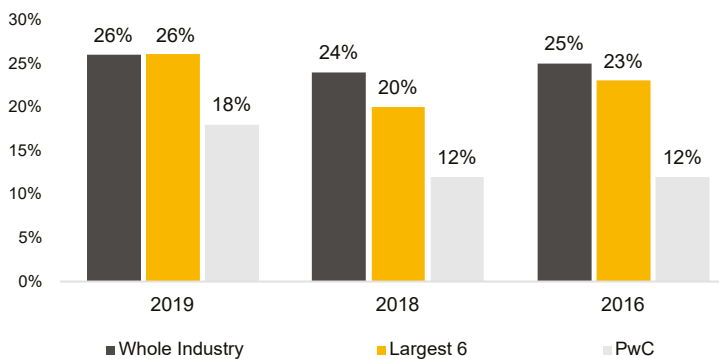


Matt Graham – Managing Partner, Assurance

Our Audit Quality Balanced Scorecard

1. ASIC audit inspection results

Audit areas with review findings



Data from ASIC's PwC Australia Audit Inspection Reports

As part of its audit inspection program, ASIC review a sample of audit files at each audit firm focusing on high risk areas in listed company audits. In its most recent report to PwC Australia (for the 12 months ended 30 June 2019) in six of the 34 key audit areas reviewed across ten PwC audits (18%), ASIC considered we did not obtain reasonable assurance that the financial report was free from material misstatement. There were no PwC files with multiple findings. For context, PwC signed approximately 10,000 audit opinions across 2,200 clients during the review period, against ASIC's risk focused sample size of 10.

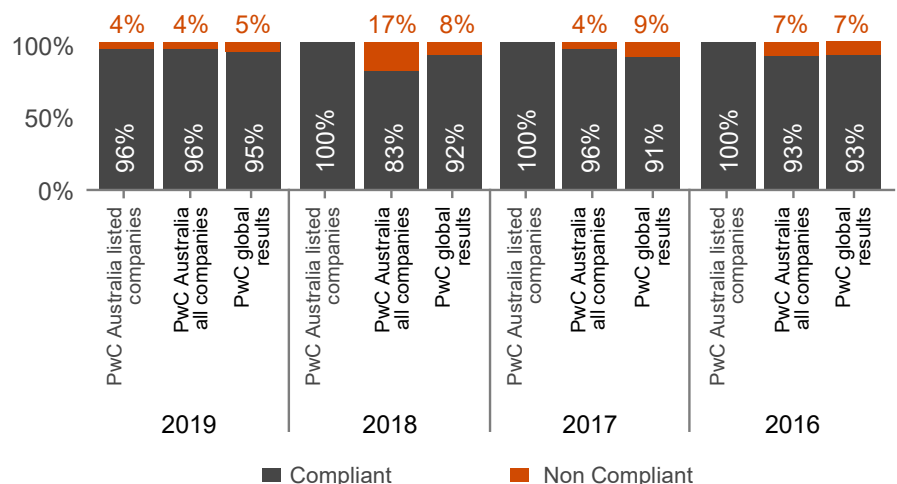
We have undertaken a root cause analysis of all the findings in our report and have built these learnings into our continuous improvement process. A full copy of ASIC's audit inspection report for PwC for the year ended 30 June 2019 is available on our website.

2. PwC internal inspection results

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 Quality Review 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).

PwC audit inspections



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

In 2019, two files out of 45 reviewed were rated non-compliant with PwC standards. One finding related to a listed company. Neither finding required the reissue of the audit report or a restatement, but instead a need for improvement in how the audit work was performed and documented. The findings have formed a key part of our Quality Improvement Plan going forward. This compares to five files of smaller, private companies rated as not compliant with PwC standards in 2018.

3. Restatements

Restatements on ASIC or PwC reviewed audits

Between 2016-2019, 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 to 5%** 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.*

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

The identification of a finding in an ASIC or PwC audit inspection 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.

In fact, between 2016 and 2019, when issues have been identified in external or internal audit inspections of PwC audits of publicly listed companies, there are no cases where there was a resulting restatement to previously issued financial statements.

4. Adjustments arising from PwC audits

(Note 2019 adjustment figure will not be finalised until March 2020)

Adjustments

2019 year ends

To date, PwC has performed 124 listed company audits with 2019 year ends. An average of 5 adjustments were identified per audit and reported to the relevant company.

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.

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.

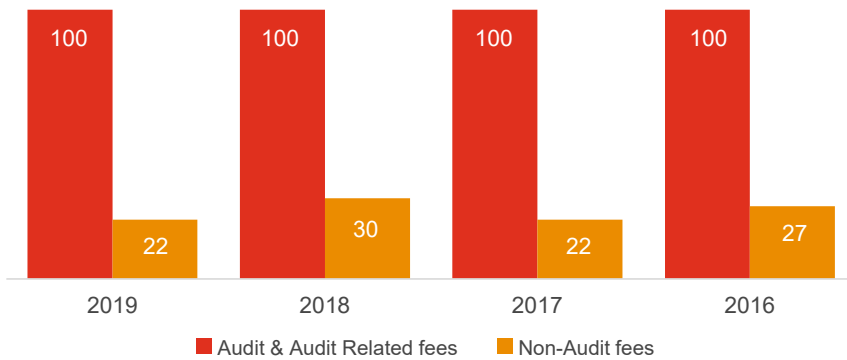
In 2019, PwC audits of listed companies have identified to date, on average, 5 potential adjustments per audit, and ensured their appropriate treatment, prior to finalisation of the company's financial statements.



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.

5. 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 25% of audit fees, which equates to less than 2% of PwC’s total revenue in FY19.

6. 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 2019 and in 2018

Non audit fees from ASX200 audit clients represent, on average, approximately **25%** of audit fees over the past three years

This equates to less than **2%** of total PwC Australia revenue

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

In FY19 our total revenue relating to audits of financial statements was \$443m representing 17% of total firm revenue. In FY18 it was \$396m, representing 17% of total firm revenue.

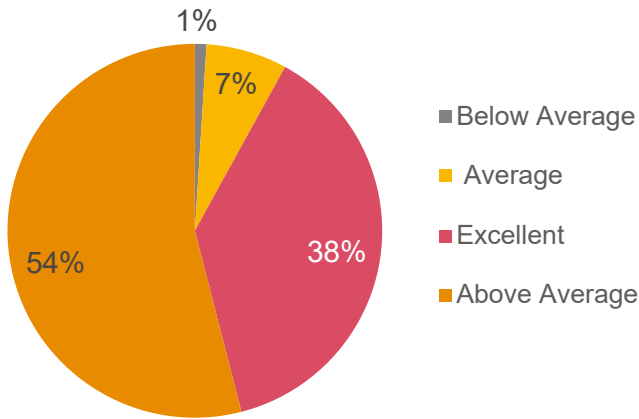
Our audit business does not position PwC for other services at our audit clients. From time to time, when independence regulations allow, PwC may be the best option for our audit clients when a project needs external assistance. This work will be considered through our own internal independence and conflict processes when they arise before any work commences. Non-audit fees from ASX 200 audit clients have approximated 25% of total audit fees over the past three years and represent on average less than 2% of total firm revenue. No PwC audit partner is incentivised for selling non-audit services to clients which they audit.

In addition to PwC specific indicators, two recent independent surveys have provided market based perspectives on audit quality across the industry in Australia.

7. 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.

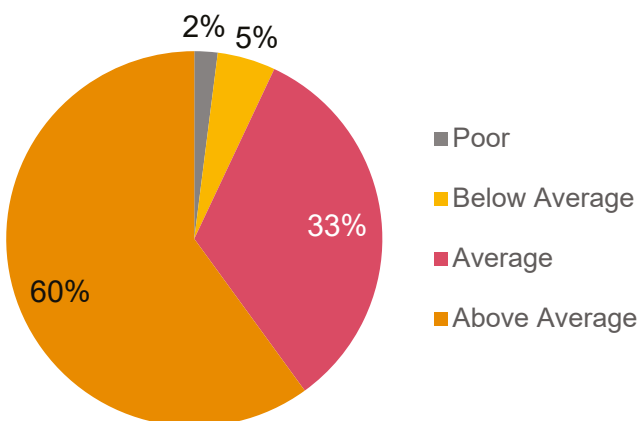
Audit Committees, who represent shareholders in their interactions with auditors, have a unique view of audit quality, as they are witness to the many judgements and conversations that occur prior to the publication of their company's financial statements.

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".

8. 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".

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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.

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