KPMG

Transparency Report 2020

Quality remains our highest priority

KPMG Australia

October 2020

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Foreword

There is little in this current moment that is not viewed through the lens of the global COVID-19 crisis.

In the case of audit at KPMG Australia, the pandemic has necessitated unprecedented change, whilst simultaneously reinforcing long-held core values.

The COVID response has changed myriad aspects of conducting an audit: how we assess assets and liabilities, how we work remotely and virtually, and – most importantly – how we deal with uncertainty.

This year has produced more uncertainty than any other in recent memory, and thus most of us have been making allowances and giving each other some leeway. Audit, however, looks at things at a certain point in time. And we know the reports we produce today will be examined in years to come.

We are more cognisant then ever of the need for rigour in documenting the process through which we reach conclusions. It is important for people looking back to find clear evidence of where we were and how we supported our conclusions.

More than ever, auditors have a responsibility to be disciplined about their independence and to scrutinise any potential bias in their assumptions.

I am tremendously proud of the way our audit team has reinforced its sense of purpose in the face of this crisis. It will stand us in good stead as we move forward into what may be a protracted period of difficult times.

We know the coming years will see more company collapses than usual. As the economy hits this challenging period, our ongoing ambition to explain more clearly the role of audit becomes increasingly important. In the face of collapses, auditors have a social responsibility to explain how the function of audit is to ensure financial reports are explicit when a company's future survival is uncertain.

Australian business earned a great deal of public trust during this year's crisis, by responding to the pandemic with humanity and by connecting with core purpose. Effective audit, that both challenges and supports companies, can help ensure Australian business retain the trust it earned in 2020.

Alison Kitchen
National Chairman,
KPMG Australia

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Introduction

This Transparency Report is guided by KPMG Australia's desire to explain clearly how we are striving to create, maintain, and improve audit quality.

We recognise transparency is key if we are to pursue our ongoing ambition for better public understanding of audit effectively. How an audit is conducted is as important as the final result. Effective and efficient audits are dependent on the demonstration of certain behaviours. We focus on these behaviours during the performance of the audit, through education sessions and coaching, and via our review processes.

Our approach to audit quality relies on people with questioning minds demonstrating professional scepticism. Our people are supported by industry-leading technology to create greater consistency in performance and to strengthen monitoring.

Over the past year, we have been updating our audit methodology and embedding it in our 'smart' audit platform, known as KPMG Clara, which unites our data and analytics capabilities, new technologies, and collaboration capabilities to improve data flows between the audit team and our clients.

We have also been working to implement the revised Australian equivalent to International Standard of Quality Management (ISQM) 1, expected to become mandatory in 2022. ISQM 1 has created an opportunity to refresh our Audit Quality Framework, which will now land in FY21.

This work overlaps with our open and constructive engagement with the Parliamentary Joint Committee (PJC) on Corporations and Financial Services Inquiry into the Regulation of Auditing in Australia, which delivered its interim report in February 2020.

We consider the ten consensus recommendations, which were largely consistent with KPMG's submission, to be sensible, balanced, and capable of promoting trust and confidence in the auditing profession. We will continue to engage with the PJC as it considers its interim report, with the final report expected to be tabled in Parliament in late 2020.

Of course, like so much this year, the PJC's work has been interrupted by the COVID-19 pandemic. COVID-19 has affected so much of our audit function this year and, in recognition of this, we have included in this report a special COVID-19 response summary page.

One thing COVID-19 has not affected, however, is our KPMG values. To link them to audit quality and our day-to-day work our Audit Leadership Group has recently created a mantra: "I take pride. I coach. I am present. Together for better." Along with helping us stay focused, this mantra has become our call to arms, reinforcing accountability and helping ensure a team approach to all our audits.

Andrew Yates
National Managing Partner,
Audit, Assurance &
Risk Consulting (AARC)

Eileen Hoggett

Eileen Hoggett
National Partner in Charge,
External Audit

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Auditing through the pandemic

Our response to COVID-19

Almost every aspect of auditing has had to be revised or reviewed this year, given the unique circumstances companies and auditors found themselves in. For KPMG, our response to the COVID-19 global pandemic was far more than simply implementing temporary measures to address restrictions. We have had to fundamentally alter the way our auditors worked and how we provided services to our clients in this new environment.

Firstly, there were the physical or logistical challenges facing audit teams and secondly the questions on how to approach the audit judgements in an environment of such inherent business uncertainty.

Remote working

The most obvious issue is that physical distancing changed the nature of traditional audit execution, which typically involves extensive face-to-face contact. In normal years, our audit teams are on client sites to do controls testing, walk-throughs, have meetings and watch management in their own environments. Losing that physical interaction and seeing how things work at first-hand provided a significant challenge. This was particularly acute for client sites overseas, where we would normally fly in audit teams.

To address these difficulties required extensive use of communication and technology. Firstly, within the audit team itself and secondly with the client staff. Regular leadership communications reinforced the importance of keeping in constant contact with team members to monitor our people's wellbeing as well as audit progress, using technology to engage collaboratively with one another, direct and supervise work. But use of video with clients was more of a challenge, especially in some cultures overseas where people were less comfortable using this form of communication. Building up trust and rapport required spending more time than usual in dialogue.

Technology was also used this year directly on audit procedures, which have traditionally required the engagement team to physically be at the client's site. KPMG got around this problem innovatively by, for example, conducting virtual inventory counts. Utilising guidance developed by technical experts in our Department of Professional Practice (DPP), audit engagement teams could be 'walked through' a stocktake whilst it was being conducted on site by the client using the video capabilities of Microsoft Skype. It enabled our team member to see everything the client was seeing, examine all locations of the warehouse, count stock, and, where necessary, zoom in to see the detail on inventory labels. The quality and quantity of audit evidence obtained was consistent with physically attending a count.

Auditing in an uncertain environment

But it is not only the logistical aspects of auditing which have changed this year. The entire approach to auditing company accounts has had to be revised. There will be many more disclosures and notes in the accounts than normal because of the inherent uncertainty in making accounting judgements in such an environment. Valuations, especially of intangible assets like goodwill, are based on expectations of future cashflow, which are exceptionally difficult now given that the economic data that drives forecasts are so changeable, as the health crisis continues to evolve.

Sectors with seasonal inventory, like fashion retail, are especially hard to audit. In this time of increased uncertainty, the financial services sector has had to deal with AASB9, which was introduced in FY19 and requires a forward-looking model for loan provisions. And for all companies, on the liability side of the balance sheet, accounting for the different subsidies and tax holidays introduced by governments in the COVID-19 era have been an area of external scrutiny.

Questions about going concern have been more frequent and auditors have had to test management assumptions using increasingly uncertain sources of economic data.

KPMG's approach to all these difficulties has been to urge companies to disclose as much as possible, so that judgments made now, which may prove to be inaccurate over time, can be later viewed with a proper understanding of the context in which the judgments were made.

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Adapting our tools

Our audit teams facing these unique challenges benefited from expert support from the DPP and the National Audit Quality Group, which developed a number of new tools to assist in identifying and responding to COVID-19 specific risks. They included:

- An extensive guide to assist teams in addressing the various accounting, reporting and audit related matters arising from the impacts of the COVID-19 pandemic.
- A template to document risk assessment and conclusions of our audit work having regard to the impact of COVID-19 on our clients' business and risk profile.

The AARC D&A Hub also developed a series of PowerBi dashboards to assist audit procedures in Revenue and Procurement. This helped audit teams unable to visit client sites with the task of obtaining data to perform our procedures efficiently, investigate unusual items, and complete independent calculations and analysis. The importance of this has never been greater.

The Revenue Dashboard, for example, assisted teams to perform the following analysis:

- Look for significant unusual transactions.
- Perform year on year comparisons.
- Identify new customers.
- Assess the impact of the loss of customers.
- Review the impact of credit notes and rebates.
- Assess Invoice Aging.
- Perform a revenue forecast (and adjust for the time period impacted by COVID-19).
- Identify Related Party transactions.
- Identify Revenue that relates to contractual agreements.

Other products and services were developed to help teams with the leasing standard AASB16 and in financial services audits.

Expanding our support networks

In terms of capacity, we added extra resource in May 2020 by introducing three additional risk management partners, with significant previous experience, to assist with the additional volume and complexity of consultations arising due to the impact of the COVID-19 pandemic.

Developing virtual learning

Despite all the challenges of getting client audits done, time must also be found for ongoing professional training of staff. We had to provide learning opportunities that respected the demands of balancing work and personal responsibilities in the COVID-19 era. Many of our lessons were redesigned to be virtual, so they were available when it suited the individual. We also designed two modules on the financial reporting and audit quality impacts arising from COVID-19. These modules were supplemented by virtual workshops, which were facilitated by the DPP, in conjunction with relevant specialists. The workshops were focused on the three audit areas most significantly impacted by COVID-19: going concern, impairment of non-financial assets and financial instruments, and expected credit losses and fair value measurements.

Conclusion

2020 has been a year unlike any other both for businesses and for the teams which audit their accounts. KPMG believes we, and our people, have risen to this unique challenge by focusing on our people's wellbeing throughout, revising our approach to both physical and judgemental auditing issues and equipping our teams with the tools and support necessary for them to do their jobs.

Some may question if – given the inherent uncertainties involved in auditing assumptions this year – the role of auditing has less importance in the COVID-19 era. On the contrary, KPMG believes the rigour and discipline instilled in management from the challenges that auditors provide, and the testing of their thinking, is even more crucial now. Auditors provide alternative points of view and then hold management to account on what has been disclosed, even if this year's conclusions may be less certain.

This represents the ongoing and crucial role of providing assurance on company accounts and supporting the capital markets at a time when it is urgently needed.

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Our commitment to audit quality

Audit quality is fundamental to maintaining public trust in the capital markets and the financial reports issued by audited organisations. When we talk about how we are striving to maintain and improve quality, it is not an abstract aspiration. Quality is fundamental to our purpose, and we constantly monitor and evaluate it.

We recognise that greater transparency is needed for the public to gain insight into audit services. This report outlines KPMG's approach and commitment to audit quality, including actions taken to enhance audit quality during the year.

KPMG defines audit quality as being the outcome when audits are:

- executed consistently, in line with the requirements and intent of applicable professional standards, within a strong system of quality controls and;
- undertaken in an environment of the utmost level of objectivity, independence, ethics and integrity.[0]

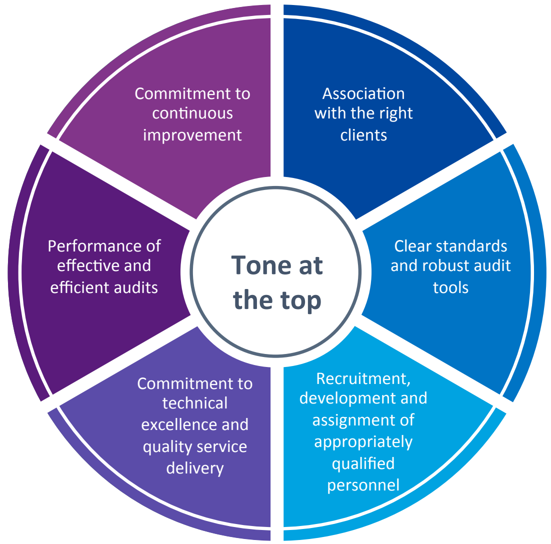
Our firm-wide commitment to audit quality is founded upon and delivered through our governance structures, the role of leadership and management, our culture, our people, our systems and processes, and our organisation.

It can be difficult for clients and stakeholders to determine whether the audit is of high quality because what drives audit quality is a complex set of direct and indirect factors that are often obscure and hard to measure. Our *Audit Quality Framework* focuses on the aspects we can directly control; however, we acknowledge several indirect influences exist including our legal and regulatory environment and client preparedness.

The *KPMG Audit Quality Framework* demonstrates we view audit quality as having seven key drivers. We comment on each of these on the following pages.

The KPMG Audit Quality Framework[1]

Looking forward:
Implementation of the revised Australian equivalent to International Standard of Quality Management (ISQM) 1, which is expected to become mandatory in 2022, brings an opportunity to refresh our Audit Quality Framework. Launching in FY21, our refreshed framework covers the critical quality focus areas more explicitly, including culture & values, communication, and monitoring and remediation.



Our commitment

This report focuses on how we as a firm drive quality, our systems of quality control, and the initiatives we are continuously pursuing to improve it. We highlight actions taken to enhance audit quality, having listened to feedback that actions speak louder than words. We recognise the risks associated with trying to measure something as hard to define as audit quality, along with unintended consequences such as managing to a particular number or benchmark.

Our approach to audit quality relies on exceptional people having access to the right knowledge at the right time, and harnessing industry leading technology on every engagement.

We consider this report helps users and purchasers of audit services, including audit committees, to evaluate our performance.

0 KPMG's definition is consistent with and builds on ASIC's definition of audit quality — see ASIC information sheet INFO222 Improving and maintaining audit quality, June 2017.

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1. Tone at the top

Code of Conduct

Coaching

In this chapter

- Our culture, values and Code of Conduct
- Our strategy — a foundation of uncompromising quality
- Governance structure
- Centres of Technical Excellence
- Embedded networks

Strong leadership and management are critical for audit quality. Setting the tone and establishing responsibility at the top builds accountability and consistency through the complete chain of leadership and our teams. Tone at the top is the core of our *Audit Quality Framework*.

There are several critical components to an effective tone at the top including:

- **Culture, values and Code of Conduct:** our commitment to audit quality is underpinned by our values, which form the foundation of our culture and set the tone for governance and leadership.
- **Focused and well-articulated strategy:** incorporating audit quality at all levels.
- **Governance structure:** our governance structure sets the formal framework for establishing, managing and monitoring audit quality.

Our culture, values and Code of Conduct

Doing the right thing in the right way for our people, our communities, our clients and the capital markets we serve is fundamental to who we are. And in this, we are guided by our values[2] and Code of Conduct. These spell out very clearly our expectations about our performance and our behaviour. They define for everyone at KPMG who we are and how we act.

The Code of Conduct reinforces the commitments we each make to foster trust, and to speak up when something isn't right.

Our values are our shared set of beliefs and principles - how we do things - and underpin everything we do. Refreshed globally in March 2020, our values are simple and powerful: Integrity, Excellence, Courage, Together, For better.

During the year we became aware there was a breach of our Code of Conduct, with improper sharing of answers to an internal training test. We immediately commenced an investigation and notified relevant regulators. We called out the behaviour to all our staff firmwide, to be transparent and reinforce that upholding the highest standards of conduct is crucial. The ongoing investigation incorporates the identification of root causes to enable effective remediation. Actions have included satisfactorily completing new and different testing to reinforce why completion as required is so important. We appreciate that by acting with integrity, and striving to improve, we build a stronger culture that brings out the best in our people, allowing them to learn from their mistakes and in turn, best serve our clients.

2 Refer to Appendix 3 KPMG's global values

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Our strategy — a foundation of uncompromising quality

The strategy of our division, Audit Assurance & Risk Consulting (AARC) states it is built on a foundation of uncompromising quality. The National Managing Partner Audit, Assurance and Risk Consulting (AARC), Andrew Yates, and the National Partner in Charge, External Audit, Eileen Hoggett, reinforce this in regular communications to and meetings with partners and staff.

Governance structure

Our governance structure sets the formal framework for establishing, managing and monitoring audit quality. In our view, strong leadership and management are critical for audit quality. Setting the tone and establishing responsibility at the top builds accountability and consistency through the complete chain of leadership and our teams.

The National Board is the principal governance and oversight body of KPMG in Australia[3]. Led by National Chairman, Alison Kitchen, the National Board's key responsibilities include overseeing strategy implementation, protecting and enhancing the KPMG brand and overseeing management of the firm.

Alison Kitchen also chairs KPMG's Global Audit Quality Committee (GAQC). GAQC plays a critical role in setting the quality agenda, working with regional and member firm leadership to promote audit quality, including a strong focus on global audit consistency and accountability.

The governance structure includes committees that have risk and quality responsibilities to oversee and influence the firm's audit quality agenda. Risk management and quality control are not simply the jurisdiction of one national group or leadership role. We view risk management and quality as the responsibility of every one of our people.

Leadership responsibilities for audit quality

Our CEO, Gary Wingrove, has overall responsibility for our system of quality control and the performance of the firm. All KPMG Australia's initiatives to improve audit quality are underpinned by strong leadership from the firm's National Executive Committee (NEC). Every member of the firm's NEC has an audit quality focused goal, which feeds directly into annual performance and remuneration outcomes. This is to ensure all our senior leaders, not just auditors, understand and are held accountable for audit quality.

An example of the audit quality goal for the National Managing Partners of divisions outside AARC is:

"Monitor and report bi-annually to the Chief Executive Officer the division's activities that have assisted in the enhancement of audit quality. This may include activities such as the training, accreditation and competency of specialists involved in the delivery of external audit services, client risk assessment approval and monitoring, and monitoring of services that may impact auditor independence. Additionally, any issues or actions arising from this reporting, as determined by the National Managing Partner, AARC will be included in the Audit Quality Action Plan, to enable subsequent monitoring and remediation."

Our National Partner in Charge, External Audit, is directly accountable to the National Managing Partner of KPMG's Audit, Assurance & Risk Consulting division, for the delivery of the firm's audit quality strategy.

Our National Head of Audit Quality and the Partner in Charge, Department of Professional Practice, Bernie Szentirmay, is responsible for monitoring internal and external audit quality signals and driving actions for continuous improvement. The National Head of Audit Quality is a member of the Global Audit Quality Council and responsible for leading the implementation in Australia of initiatives determined by the Global Audit Quality Steering Committee. Together with a dedicated Divisional Risk Management Partner, Marcus McArdle, they are accountable to the Chief Risk Officer, Tanya Gilerman, who retains overall operational responsibility for our system of quality control and risk management.

In FY20 we began the roll out of globally consistent Audit Quality Role Profiles for those with leadership responsibilities for audit quality, starting with our National Partner in Charge, External Audit, and our National Head of Audit Quality and the Partner in Charge, Department of Professional Practice. Globally consistent Audit Quality Role Profiles for other leadership roles will be implemented over FY21 and FY22.

3 Refer to Appendix 5 and 6 for details on the Board

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Committee structures

A number of dedicated committees have risk and quality responsibilities to oversee and influence the firm's audit quality.

These include the below. Further details about the firm's governance bodies are contained in Appendix 5.

External Audit Leadership Group (ALG)

This group is the governance body for our external audit practice. Led by our National Partner in Charge, External Audit, it is responsible for the development and implementation of our external audit strategy and operations. Members include the National Head of Audit Quality and the Partners in Charge of each of the audit groups, structured by location. Audit quality is discussed by the National Head of Audit Quality during dedicated time at each meeting.

Audit Quality Committee

The Audit Quality Committee, chaired by the National Head of Audit Quality, reports to the ALG and ensures the quality of financial statement audits and associated risks are a priority for audit leadership.

Specifically, its responsibilities include:

- Evaluate proposed audit initiatives ensuring the objectives and outcomes align with maintaining or enhancing audit quality, including addressing matters arising from internal monitoring and external inspections and other relevant data sources, including root cause analysis.
- Assessing the strategic prioritisation, resourcing and timetabling of audit initiatives as they impact audit quality across all offices.
- Implementing global initiatives to deliver audit quality outcomes in a globally consistent manner.
- Overseeing the activities of the National Audit Quality Group led by the National Head of Audit Quality, including its strategy, work plan and resourcing.

Centres of Technical Excellence

National Audit Quality Group

The National Audit Quality Group, led by the National Head of Audit Quality, comprises senior auditors dedicated to developing, implementing and monitoring our strategy to continuously improve audit quality.

Key initiatives led by this group during the year included:

- Adapting the second line of defence (2LoD) program to allow the scope of audit areas examined to be tailored according to client and engagement specific circumstances.
- Introducing specific audit planning activities in the area of asset impairment: standardising the early design activities and documentation essential to a well executed audit approach to asset impairment.
- Introducing tighter boundaries on use of certain complicated analysis procedures, maximising the input of our DPP specialists with these procedures, while minimising risks to quality.
- Mandating the extent of the group auditor involvement in the component audit in certain scenarios.
- Automated monitoring of file assembly milestones: engagement teams are notified fortnightly of their file assembly status to encourage the timely collation of audit files.

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Department of Professional Practice

The Department of Professional Practice (DPP) is the national centre of technical excellence responsible for: conducting technical research, interacting with local and global professional standards-setters and regulators, and providing technical accounting and auditing guidance and support to our people in the field. It is organised into three areas: Audit Quality, Financial Reporting, and US Desk.

Partners and senior staff primarily from the audit groups are members of the DPP. They are our technical experts, with deep understanding of Australian and international standards. They challenge audit teams on positions taken, bringing a further independent lens, and are the firm's authority on audit matters.

The Australian DPP has an influential role in many specialist areas in our network's Asia Pacific region and internationally. Our partners can hold key positions with standard setters, professional bodies and other shareholders, taking a non-partisan and collaborative approach to improving industry standards.

KPMG Clara workflow Deployment Group

The KPMG Clara workflow Deployment Group, led by a Deployment Partner, Andrew Hounsell, is responsible for the staged implementation of our new audit workflow. Established in FY19, auditors are seconded to the group from lines of business including the DPP to specifically focus our support on this significant local and global investment to improve audit quality.

Profile of the National Audit Quality Group	FY20	FY19	FY18
No. of Full Time Equivalent professionals in the National Audit Quality Group	5	4	3
Average years of experience of the National Audit Quality Group professionals	15	18	19

Profile of the Department of Professional Practice	FY20	FY19	FY18
No. of Full Time Equivalent professionals in the DPP	34	30	39
Average years of experience of the DPP professionals	15	15	14

Profile of the KPMG Clara workflow Deployment Group	FY20	FY19	FY18
No. of Full Time Equivalent professionals in the KPMG Clara workflow Deployment Group	7	2	-
Average years of experience of the KCw Deployment Group	12	16	-

The figures disclosed throughout the report are as at 30 June each of financial year unless otherwise specified. The National Audit Quality Group and the KPMG Clara workflow Deployment Group were established to supplement the DPP. These groups and our other embedded networks work closely with the DPP in developing initiatives to maintain and improve audit quality.

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Our embedded networks

KPMG uses embedded networks within each of the audit groups and offices to maintain our focus on audit quality. To further develop the audit quality skills of our partner candidates, we put in place the Partner Promotion Policy and supporting activities. We require candidates to have specific audit quality oversight experience as part of their progression to partner, for example via a role in our embedded networks, either as a 2LoD reviewer, a Quality Performance (QP) reviewer, or spend at least 6 months within the DPP Audit Quality group or the National Audit Quality Group.

The visibility and proximity of the specialists in our embedded networks to audit teams makes it easy for our auditors to seek assistance and consult regularly. Our embedded networks include the following dedicated groups:

Second Line of Defence (2LoD) Reviewers

2LoD reviewers support specific audit teams during the conduct of their work and navigate key audit areas: revenue and a significant risk area bespoke to the specific audit. All 2LoD reviewers are specifically trained, high performing senior staff. They coach teams to develop and robustly evidence risk assessment, the audit approach, and execution of procedures in the key audit areas. Their goal is to improve audit quality on these specific audits as they are occurring and before opinions are issued, and more broadly through active engagement in the embedded quality networks.

Audit Quality Partners and Managers

Audit Quality Partners are responsible for supporting the local office, disseminating guidance and information to audit teams relating to our interpretations of auditing standards and national initiatives to enhance quality, identifying improvement opportunities and leading our Audit Quality Managers. Audit Quality Managers facilitate local workshops on topical matters, communicate new methodology guidance and key audit quality messages and provide input into the development of national audit quality initiatives.

Risk Management Partners

Risk Management Partners are responsible for providing leadership on audit quality and risk management and directing adherence to firm policy and professional standards. These highly experienced audit partners consult on audit technical issues, assist in the identification and management of risks to audit service delivery, and are consulted on all modified audit reports. Our Risk Management Partners dedicate significant amounts of time to one-on-one audit team support for complex issues such as going concern and impairment.

Profile of embedded networks	FY20	FY19	FY18
No. of Second Line of Defence reviewers	19	20	16
No. of Audit Quality Partners	14	15	15
No. of Audit Quality Managers	54	50	59
No. of Risk Management Partners	19	16	18

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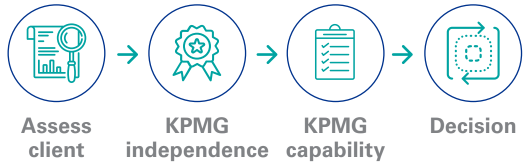
2. Association with the right clients



In this chapter

- Prospective client and engagement evaluation process
- Continuance process
- Safeguards and High Risk Register
- Managing Conflicts of Interest
- Client portfolio management

Understanding the nature of our clients and the issues they face is key to audit quality, allowing us to build a robust audit response to the identified risks.

We understand our clients are linked to the quality of our work and our reputation.

We have established policies and procedures for determining whether to accept or continue a client relationship, or perform a specific engagement. In FY20, we enhanced our "know your client" research protocols and assessments. Rigorous client acceptance and continuance policies are vital to our ability to provide high quality professional services.

Prospective client and engagement evaluation process

A key focus of our prospective client assessment is the integrity of management and those charged with governance. With every prospective client the partner responsible conducts an evaluation of the client's principals, business and other service-related matters. This evaluation includes completion of a customised questionnaire to assess the client's risk profile and obtaining background information on the client, its key management, directors and owners.

When the engagement is to provide audit services, at least two additional risk assessment steps are incorporated. These include focusing on whether we can deliver (have sufficient resources, industry expertise and consider persuasive evidence is obtainable) a quality audit, plus, for a first time audit, performing a review of any non-audit services provided to the client and any other relationships that may compromise audit independence.

We decline to act for a client where we are unable to deliver to our expected level of quality or would not be willing to be associated with them. Some circumstances where we consider declining are: potential impairment of independence, conflict of interest issues, concerns about management integrity, concerns about the client business model or governance structure, overly aggressive or conservative accounting policies, disputes with previous auditors or advisors, management being subject to investigation by authorities, and concerns about the competence of the client's financial management team.

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Continuance process

Regardless of the length of time we have been associated with an audit client, we regularly re-evaluate our association to ensure we remain capable of independence and audit quality. We evaluate client relationships at least annually; and additionally if there is significant change in their business, financial position, ownership structure, or issues reflecting on their integrity.

A Risk Management Partner, independent of the audit team, assesses the circumstances of our continuance and their acceptability.

Safeguards and High Risk Register

KPMG maintains a High Risk Register which is routinely reviewed by our Risk Management Partners.

Clients are placed on the High Risk Register when non-standard or additional risks are identified during acceptance or re-evaluation and we are still capable of ensuring independence and audit quality. In these cases, we mandate additional risk management or quality control safeguards to the conduct of the audit. Examples include supplementing the existing skills and experience of the audit team with an additional audit partner (Engagement Quality Control Reviewer), mandated consultations, specialist involvement to deliberate on a specific matter such as valuations and impairment, and performing additional audit testing. Prior to acceptance, and at least annually, an individual independent of the audit team, assesses circumstances of our continuance and the proposed safeguards for adequacy.

Managing Conflicts of Interest

Sentinel, KPMG's proprietary global web-based application, facilitates compliance with auditor independence requirements and identifies potential conflicts of interest for prospective engagements.

All KPMG partners and staff are responsible for identifying and managing conflicts of interest. KPMG engagement teams are required to use Sentinel to identify potential conflicts of interest so these can be addressed in accordance with legal and professional requirements. For example, any non-audit services proposed to be provided to audit clients are required to be entered into Sentinel, which assigns proposed engagements for consideration by the Lead Audit Engagement Partner prior to any approval.

A Commercial Conflicts Resolution Committee, comprising the National Managing Partners of all divisions and the Chief Risk Officer, assesses complex cases involving multiple areas of the firm. If a potential conflict of interest cannot be resolved, we decline the engagement or prospective client.

Client portfolio management

We review each audit partner's portfolio at least annually. The reviews consider the industry, nature and risk of the client portfolio as a whole along with the competence, capabilities and capacity of the partner to deliver a quality audit for every client.

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3. Clear standards and robust audit tools

Code of conduct | Data & analytics | Technology | Tools | Systems & processes | Audit manual

In this chapter

- KPMG Audit Manual
- KPMG Clara
- Accounting and financial reporting
- Ethics and Independence

Acting in the public interest, risk management and quality control are the responsibilities of every KPMG partner and staff member. We expect our people to adhere to the clear standards we set and provide a range of tools to support them in meeting these expectations.

These standards incorporate the relevant requirements of the *Corporations Act 2001* and of accounting[4], auditing[5], quality control[5], ethical and professional standards[6], and other relevant laws and regulations. We dedicate significant resources to keeping our standards and tools complete and up to date. Amendments to these are communicated by regular alerts and learning programs.

KPMG Audit Manual

KPMG's Global Solutions Group develops the audit methodology adopted by all KPMG member firms, based on the International Standards on Auditing[7] (ISAs) and compliant with the International Standard of Quality Control (ISQC 1). In Australia, auditing standards (ASAs[8]) are legally enforceable and the DPP customises the global methodology for these standards, relevant laws and regulations, and for additional requirements we believe enhance the quality of our audits. This is set out in our *KPMG Audit Manual* (KAM).

KPMG Clara

We use technology to improve audit quality by driving better audit insights, create greater consistency in the performance of audits and to strengthen monitoring of engagements. We believe that audit quality is best achieved when the power of smart technology is matched with inquiring minds and professional scepticism. We are updating our audit methodology and embedding it in our 'smart' audit platform, known as KPMG Clara. KPMG Clara unites in a single sharing platform our data and analytics (D&A) capabilities, innovative new technologies, collaboration capabilities to improve data flows between the audit team and our client, and audit capabilities and workflow to enhance quality and efficiency.

During FY20 we continued to focus on stability, simplicity and usability of KPMG Clara by providing additional features. Enhancements to the D&A capabilities delivered improvements in performance and automation.

Digital workflow to enhance audit quality

A cornerstone of our KPMG Clara platform is the new KPMG Clara workflow (KCw), a new global methodology for performing high quality audits combined with modernised look-and-feel and enhanced technology. Through it we will enhance global consistency.

It enables a better experience for our people powered by extensive libraries of standardised audit performance tools. We expect KCw to be used in all audits from December 2022 year-ends onwards. In FY20, 23 engagement teams participated in the Australian limited deployment of the KPMG Clara workflow. Feedback guided the KPMG Global Solutions Group to improve the global workflow and shaped our deployment plans.

Looking forward: Approximately 90 engagement teams are planning to use KCw in FY21.

4 Australian Accounting Standards Board www.aasb.gov.au
5 Auditing and Assurance Standards Board www.auasb.gov.au
6 Accounting Professional and Ethical Standards Board www.apesb.org.au
7 International Auditing and Assurance Standards Board www.iaasb.org
8 Australian Auditing Standards

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Our current audit workflow technology is eAudIT, KPMG's electronic audit tool. It integrates our methodology and industry knowledge with tools to facilitate the conduct of the audit and production of an electronic audit file. eAudIT's activity-based workflow is scalable to customise the audit approach for major multi-national groups through to small or medium enterprises.

Data and analytics (D&A) in the audit

We use D&A to better understand the entities we audit, contribute to risk assessment, and provide rich objective audit evidence, adding confidence and valuable insights. D&A allows us to identify and focus our judgments on higher risk areas and provide deeper business reporting to our clients.

In FY20, we extended our D&A capabilities in our audits with:

- **Journal entry analysis:** aids in understanding and analysing the client's general ledger journal entry population, leading to enhanced screening for high risk journal entries based on patterns, trends and client specific risk profiles for detailed testing.
- **Risk assessment dashboards:** aids in understanding, analysing and visualising client transactional data across specific accounts (e.g. revenue and trade receivables).
- **Process mining capabilities:** aids in understanding the flow of client transactions through their processes and controls (e.g. order to cash process), leading to identification of outliers to a standardised or expected pathway.
- **General IT Controls dashboards:** aids in evaluating and testing client general IT controls by providing system configuration details and change histories over access rights and program changes.
- **Automation scripts:** extracting, transforming and validating client data from common systems (e.g. SAP, Oracle) before data is ingested into KPMG D&A capabilities.
- **Matching routines:** tracing a client's revenue transactions from sales orders to delivery documents to invoices to cash, leading to identification of mismatches.

We retain a centralised team of D&A specialists: data scientists, data analysts and other science, technology, engineering and mathematics educated people in our audit business to support our audit capabilities.

Technology enabling evidence-gathering

KPMG's alliances with some of the world's most advanced technology companies, such as Microsoft, allow us to stay on the forefront of technology developments as well as D&A capabilities to effectively lead the future of audit.

We use a range of technologies in performing audit procedures, from off-the-shelf packages to customised in-house developed systems. No matter how big or small the procedure is we evaluate and test the software enabling our evidence-gathering process. Our digital solutions must be reliable and support high quality audits.

Other tools and templates to assist the audit process

To maximise audit effectiveness and efficiency, we continually develop and distribute audit quality updates. These include tools, templates, checklists, quick reference cards and practice aids. In FY20, we introduced tools improving the quality and efficiency of our audits including:

- An electronic tool assisting teams to audit the client's accounting under the new leasing accounting standard, AASB 16 *Leases.*
- A checklist to aid teams in designing and performing complicated analysis procedures.
- A checklist to aid planning the approach to auditing impairment.

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Accounting and financial reporting

Accounting and financial reporting knowledge is core to quality service delivery and the performance of effective and efficient audits. To support the technical excellence of our people the DPP produce publications and reference materials describing KPMG's positions on accounting standards. Our DPP financial reporting team dedicate significant time to supporting teams auditing their client's transition to the new suite of accounting standards, including most recently AASB 16 *Leases*, and upcoming AASB 17 *Insurance Contracts*. This ranges from one-on-one audit team support to developing and instructing learning on complex issues.

An important weekly publication is the *DPP Bulletin,* distributed to all audit partners and staff outlining relevant accounting, auditing and regulatory topics, new tools, and frequently asked questions and answers.

Ethics and Independence

Quality and Risk Management Manual

Our *Australian Quality and Risk Management Manual* collates our policies, procedures and guidance. Based on a globally developed manual it reflects the key elements of the IESBA[9] Code of Ethics combined with Australian specific provisions. Where applicable, US Securities and Exchange Commission (SEC)[10], US PCAOB[11] and other regulatory requirements are included. These policies and procedures cover personal independence, business relationships, post-employment relationships, partner rotation and approval of audit and non-audit services. Our people annually confirm their compliance with these policies and procedures. In FY20 the Australian Quality & Risk Management Manual was revised to align with the restructured APES[12] 110 *The Code of Ethics for Professional Accountants* which took effect on 1 January 2020.

A dedicated Ethics and Independence Partner with a core team of specialists assist with the interpretation of the independence policies and implement controls to safeguard against non-compliance or inconsistent application.

Personal independence

To help ensure independence, as prescribed by our policies and the *Corporations Act 2001* and Accounting Professional & Ethical Standards Board (APESB)[13], our partners and the staff members assigned to each audit engagement must be free from prohibited financial interests in, and prohibited relationships with, our audit clients, their management, directors and significant owners. Independence also extends to our contractors and subcontractors, using a process tailored to their circumstances. Our people are responsible for making appropriate enquiries to ensure they do not enter into or have any prohibited personal financial interests.

We use an online independence tracking system, KPMG Independence Compliance System (KICS), with other member firms in the KPMG global network to assist our partners and staff in complying with independence policies. This system contains a current inventory of publicly available investment products, specifically identifying restricted investments. All partners, client-facing managers and audit staff are required to maintain a record of all their investments in the system and check their permissibility before entering any personal investments. If investments become restricted, these individuals receive automatic notification to take appropriate action which may include prompt divestment.

Audit partner rotation

All audit partners are subject to the rotation provisions of the *Corporations Act 2001* and Australian professional and ethical requirements. Where relevant, the rotation requirements of foreign regulators such as the US SEC and other local regulatory requirements are also considered. Rotation requirements limit the number of years certain partners can provide audit services to a client.

Our Audit Regulatory Compliance database (ARC) logs and tracks a partner's period of service on a relevant audit client and is used to manage succession planning when appointing a new audit partner to a client. It is important to us, and our clients, to maintain high quality service over the transition period.

Looking forward:
Our ARC database will soon be replaced by KPMG's Global new automated Partner Rotation System (PRS). PRS will allow us to track and comply with increasingly complex regulations governing partner rotation for audits of Public Interest Entities (PIEs).

9 International Ethics Standards Board for Accountants www.ethicsboard.org
10 US Securities and Exchange Commission www.sec.gov
11 US Public Company Accounting Oversight Board www.pcaobus.org
12 Accounting Professional & Ethical Standard
13 Accounting Professional & Ethical Standards Board www.apesb.org.au

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Non-audit services provided to audit clients

The regulatory rules and systems relating to the provision of non-audit services to an audited entity are extensive. The *Corporations Act 2001 and Code* of Ethics for Professional Accountants[14] restrict certain non-audit services, for example, certain tax planning and other tax advisory services, designing or implementing certain IT systems and acting in an advocacy role in resolving a dispute or litigation. All other services require careful evaluation to ensure they do not create, or appear to create, an independence issue.

Lead Audit Engagement Partners are required to maintain group structures for their publicly traded and certain other audit clients, as well as related entities of these audit clients in Sentinel and to annually confirm compliance through a declaration process.

Certain information on all prospective engagements, including service descriptions and fees, must be entered into Sentinel as part of the engagement acceptance process. Sentinel enables Lead Audit Engagement Partners to review and approve, or deny, any proposed service for those entities worldwide.

Lead Audit Engagement Partners are responsible for identifying and evaluating any independence threats that may arise from the provision of a proposed non-audit service and ensuring that safeguards available to address them, or declining the services should there be an independence issue or the appearance of one. In FY20 we introduced an additional level of rigour, whereby any proposal for non-audit services to be provided to public interest audit clients of the Firm require review and approval by the Firm's Ethics and Independence Partner.

Whistleblower Hotline

Internal complaints

KPMG maintains a confidential Whistleblower Hotline, supported by supported by a third party, available to KPMG partners and staff globally. We encourage speaking up so we can take action when inappropriate behaviour is identified and seek to learn and improve from feedback. In FY20 and FY19 there were no calls to the hotline relating to audit quality.

The hotline is another method of reporting concerns about possible illegal, unethical or improper conduct in circumstances where our people feel uncomfortable reporting a concern through other channels. Callers' reports are handled confidentially with no retaliation or retribution.

External complaints

The Whistleblower Hotline is also available to external parties to confidentially report complaints relating to the quality of our work or our people. This is accessible through our website and via telephone and surface mail. In FY20 there was one complaint (FY19: none) regarding audit quality at KPMG in Australia to the international hotline and one direct correspondence (FY19: one) regarding audit quality.

Both matters referred to were promptly reviewed and we were satisfied appropriate procedures had been performed which addressed the matters raised.

14 APES 110 Code of Ethics for Professional Accountants

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4. Recruitment, development and assignment of appropriately qualified personnel

Accreditation and licensing

Industry experience

In this chapter

- Development of skills and personal qualities
- Accreditation and licensing
- Recognition and reward
- Retention and promotion
- Partner remuneration
- Partner and staff engagement
- Assignment of audit partners and staff to audit teams

Our people have a direct impact on the planning and performance of our audits, and therefore quality. The skills, experience, passion and purpose of our people are key to us being considered trustworthy.

The assignment of audit partners and staff members with deep understanding of the client's risks and industry is one of the key drivers of audit quality. We strive for a high performing audit culture embracing continuous improvement.

Profile of KPMG audit personnel	FY20	FY19	FY18
No. of audit partners	112	121	128
No. of client service audit staff (excluding partners)	1,187	1,142	1,205
No. of graduates appointed[15]	190	170	169
No. of client service audit staff in the Audit Capability Hub, established in October 2018, centralising common audit procedures for audit areas such as cash, fixed assets and data and analytics	21	23	-
Ratio of client service audit staff to audit partners	10.6:1	9.4:1	9.4:1
Ratio of client service audit staff below manager to those who are manager, senior manager and director	3.3:1	3.2:1	3.1:1

Average years of experience with KPMG (With the exception of partners, this table does not include time spent with other KPMG member firms)	FY20	FY19	FY18
Partner	22.9	22.8	22.2
Director	14.9	14.5	12.5
Senior manager	9.0	8.8	9.4
Manager	4.7	4.6	4.9
Senior team member	2.2	2.3	2.7
Team member	1.0	0.9	0.9

15 The number of graduates appointed consist of audit graduates as well as graduates appointed in the data and analytics team.

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Development of skills and personal qualities

We continually review and assess our people's capabilities and competence to perform engagements in accordance with professional standards, legal and regulatory requirements.

Recognising that investment is required now to continuously enhance audit quality, we have increased the number of graduates appointed over the past year.

We understand skills develop over time and through exposure to different experiences. In FY20, we introduced our AARC Graduate Rotation Program providing an enhanced career experience for our new joiners. The rotations give our graduates the unique opportunity to work across different service lines, exposing them to a wider variety of professional services, accelerating the growth of their skills and capabilities. In excess of 150 graduates participated in the AARC Graduate Rotation Program during the year, many of whom completed multiple rotations.

We invest significantly in equipping our people to do the best job by building their skills and capabilities. We cultivate a continuous learning environment and support a coaching culture. On-the-job development and training includes participating in interstate and overseas assignments, secondments, and community involvement through pro-bono and volunteering opportunities.

Our learning curriculum offers programs focusing on maintaining and developing capabilities in technical expertise, building industry and sector knowledge, innovation and emerging technologies, and leadership and behavioural capabilities.

In FY20 we launched a new framework for performance development, *Everyone a Leader*, to attract, develop and assess the performance of our people, and to develop our learning programs.

Accreditation and licensing

CA

Only Registered Company Auditors can perform audits conducted in accordance with the *Corporations Act 2001*. Registration is granted by ASIC[16] after an assessment of qualifications and competency. All our partners who sign statutory audit reports are Registered Company Auditors.

Our partners and directors are subject to additional internal accreditation and knowledge requirements in relation to International Financial Reporting Standards (IFRS)[17], US accounting and auditing standards, and an Assurance Accreditation framework, acknowledging the need for specific skills in auditing. These frameworks specify the professional qualifications, training and experience and results from the firm's Quality Performance Review Program to become accredited.

For the year ended 30 June 2020, 99[18] percent (FY19: 100 percent) of our eligible audit partners and directors maintained their relevant internal accreditations.

Recognition and reward

Formal goal setting and evaluation of performance is conducted and documented annually in our proprietary system, Open. Our approach to performance and career development is centred on regular, impactful and open coaching conversations between staff and their Performance Development Manager. Open focuses on development and skills transformation, enhancing our people's experience so they may inspire trust, seek growth and deliver impact.

An individual's accountability in achieving audit quality is a core benchmark used to assess performance and progression. Assessment of audit quality features explicitly in performance evaluation. The provision of example audit quality goals and role profiles, specifying audit quality and independence expectations, assist in both setting goals and evaluating performance against those expectations. Assessed competencies within our *Everyone a Leader* framework relating to audit quality include: drive quality, make sound decisions, and advance an ethical environment.

Looking forward: A global audit quality rating system is to be implemented in FY21. Whilst audit quality already significantly influences performance assessments of partners and directors, the new system provides a much more formal framework and introduces globally consistent metrics to be considered when determining an audit quality rating for a partner or director.

16 www.asic.gov.au (Australian Securities & Investment Commission)

17 www.ifrs.org

18 Recurring below satisfactory results from our internal monitoring processes resulted in the suspension of accreditation of one audit partner, pending the satisfactory outcome of future internal monitoring processes. Audit engagements performed by this audit partner while accreditation is suspended will be overseen by an experienced accredited audit partner.

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Retention and promotion

The results of our annual performance evaluation directly affects the promotion and remuneration of our partners and staff and, in some cases, their continued association with KPMG.

Partner remuneration

Partner remuneration is determined annually by our National Executive Committee (NEC) and subject to review by the Partner Remuneration and Nomination Committee before Board approval. Partners are remunerated out of the profits of the firm and are personally responsible for funding superannuation and most other benefits. The NEC determines the final profit allocation to partners after assessing each partner's contribution for the year.

There are two components to partner remuneration: a base distribution of profits reflective of role and seniority, and a variable distribution of profits, expressed as a percentage of base remuneration, reflective of performance against previously agreed goals, including audit quality.

Compensation is based on factors including results of internal and external reviews.

Partner and staff engagement

KPMG globally invites all partners and staff to participate in our independent Global People Survey. The results, by country and function, provide leadership with information about drivers of business performance, employee engagement and motivation, and enables us to see how we are progressing. In FY20 there was an increased number of questions in the survey which were directed at understanding our people's view of whether we were giving them all the support they needed to deliver on the firm's focus on audit quality. In light of responses received, we recognised that there were some areas where additional support of our staff was required and accordingly, in FY20 we launched a national wellbeing campaign to improve the wellbeing and work-life balance of our audit partners and staff during busy season. The campaign focused on a number of initiatives:

- **Everyone's a Coach** – getting us back to basics and ensuring every team member takes an active coaching role throughout an engagement.
- **Wellbeing planning meetings** – requiring everyone to agree a set of protocols about how to best achieve wellbeing outcomes for each team member.
- **Communications from the National Partner in Charge, External Audit** – reinforcing the importance of looking after everyone's wellbeing.

Assignment of audit partners and staff to audit teams

Composition of the audit team

Audit teams generally comprise an audit partner, manager, an assistant manager or in-charge, specialists, and junior team members. Some junior members may still be completing their post-graduate accounting qualification, usually the Chartered Accountants (CA) Program[19].

Larger audits often have more than one audit partner assigned to support the signing partner. With multi-national audits, appropriately capable audit partners and staff are assigned from the relevant KPMG member firms.

Audit partners consider the competence and capabilities of their team, including specialists. This includes considering whether the team has the appropriate resources, with the experience, skills and time to conduct a quality audit. We have a policy restricting the assignment of staff on higher risk engagements for a period of at least 12 months, where they are rated below 'Effective Performance', have failed 3 or more modules in the CA Program, or have received an unsatisfactory rating in internal or external reviews.

We know that the number of team members does not necessarily equate to the quality of the audit. We take care to assign the right people to the right clients.

Industry expertise

Our people generally align their profile of work to an industry specialised portfolio, maximising their understanding of the relevant business, operational and systems-based risks their clients face allowing them to respond appropriately to address any industry specific accounting issue.

19 Chartered Accountants Australia & New Zealand www.charteredaccountantsanz.com

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5. Commitment to technical excellence and quality service delivery

Training offering | Access to specialists | CA credential

In this chapter

- Learning programs
- Attendance and assessment of learning
- Continuing professional development
- Access to specialists

We provide learning opportunities enabling the most complex audit issues to be solved.

Learning programs

Our learning curriculum offers education programs to hone technical expertise, industry and sector knowledge, innovation and emerging technologies, and leadership and behavioural capabilities. Our Learning & Development groups develop global, regional and local learning to ensure both global consistency and local applicability.

The Chartered Accountants Program

The Chartered Accountant (CA) qualification, awarded by Chartered Accountants Australia and New Zealand[20], (CAANZ) is highly regarded by business, regulators and members of the public. It forms the foundation of our partners' and staff members' audit technical, business and ethical knowledge.

KPMG engages CAANZ to run tailored CA Study Masterclass sessions specifically for KPMG candidates. Sessions are held on KPMG premises and are facilitated by CAANZ accredited facilitators who are chartered accountants.

KPMG continues providing high quality support for our CA candidates and results show our people consistently achieve better results than the average national pass rate.

CA Program Results	FY20	FY19	FY18
No. of CA program exams undertaken by staff	1,235	1,200	1,313
No. of staff who completed the CA Program[21]	262	203	335
CA Program results – national KPMG pass rate	91.6%	89.4%	91.1%
CA Program results – (excl. KPMG) national pass rate	79.6%	77.0%	83.4%
No. of merits awarded to KPMG candidates (top 5%)	132[22]	93	105

Technical learning — auditing, financial reporting and independence

KPMG embraces a culture of active learning. We believe that our people need to continuously enhance their technical expertise in a relevant way that builds on their existing capabilities.

Technical courses covering independence, financial reporting and auditing topics are mandatory at all audit staff levels. These range from independence learning as part of induction and annually thereafter through to audit partners and qualified staff attending mandatory accounting and auditing technical updates.

20 Chartered Accountants Australia and New Zealand is a trading name for The Institute of Chartered Accountants in Australia and the New Zealand Institute of Chartered Accountants www.charteredaccountantsanz.com

21 Number of staff completing the CA Program in any given year coincides with the scheduling of the final CA Program module, Capstone

22 KPMG candidates received merits (top 5% nationally) in 12% of exams undertaken.

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Established towards the end of FY19, the Audit Learning Steering Committee identify and prioritise topics to be included in audit learning based on information from many sources such as:

- A needs analysis, conducted in Australia, and at a regional and global level.
- Findings from continuous improvement activities, including our quality performance reviews and ASIC audit inspections.
- New, revised or emerging standards and regulations.
- Feedback from learners' course evaluations, including post course assessments that indicate gaps in understanding.
- Input nationally from our embedded networks in each office or group.

In response to the COVID-19 pandemic, we re-developed our technical learning for staff working towards their CA qualification as interactive virtual classrooms for online delivery. These interactive virtual classrooms were delivered by our dedicated audit facilitators, who play a pivotal role in delivering high quality learning developing and engaging our people. This allows our people to deliver high quality performance, driving audit quality.

Developing business understanding and industry knowledge

To provide quality service delivery and valued insights to our clients we frame our technical expertise within broader business knowledge. Our learning curriculum includes courses to develop business acumen, relationship skills and industry knowledge.

Attendance and assessment of learning

Partners and staff must complete[23] mandatory technical learning and successfully complete a post course assessment if required. The assessment tests their understanding of the topics covered and has a minimum pass rate and completion deadline. Penalties for non-completion by the deadline include limiting their performance rating to 'Effective Performance', which may directly impact remuneration, and/or disciplinary action. Learning and development offered to audit partners and staff during FY20 included:

Core learning days	Team member	Senior team member	Manager & Senior manager	Director & Partner
Auditing and assurance (including professional judgement & skills)	15.1	9.2	0.4	1.0
Accounting and financial reporting (including new standards AASB 15 and 16, and new interpretation IFRIC 23)	-	1.1	1.1	1.1
CA candidate in-house[24]	5.8	5.8	-	-
Risk Management, including independence	0.9	0.9	0.9	0.9
Leadership and behavioural skills[25]	6.3	8.4	9.9	6.6
Total before specialised and non-core learning	**28.1**	**25.4**	**12.3**	**9.6**

23 If a partner or staff member fails to attend compulsory technical learning that contributes to their accreditation they are required to review either a video recording of the learning or the leader's manual to ensure there are no knowledge gaps.

24 A CA candidate completes 2 or 3 modules in a 12 month period depending on CAANZ module scheduling.

25 Leadership and behavioural skills learning follows our *Everyone a Leader* framework in the areas of leading client, leading firm, leading others and leading self, as well as in the areas of feedback and coaching. In addition, we offer transition pathways to support employees as they progress through career milestones.

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Specialised learning is offered depending on the individual's audit client profile and includes:

- US audit and accounting learning – 3.3 to 8 days mandatory learning depending on the extent to which the client's audit requires US specific audit and accounting application.
- Audit Quality Partners, Managers and 2LoD Reviewers learning – 1.4 to 3.2 additional days learning including audit methodology, recent monitoring findings, key review focus areas and coaching techniques, with a further 3.7 days mandatory learning for new sampling specialists.

Specialised industry knowledge is available through online resources and learning courses for industries and sectors including corporates, energy and natural resources, financial services and infrastructure, government and healthcare.

Other technical learning

A variety of just-in-time learning and webinars are available on topics including auditing, accounting and commercial behaviour concepts in addition to structured courses.

Continuing professional development

We require all our audit client service partners and staff to invest in continuing professional development (CPD). They must obtain a minimum of 30 CPD hours annually and at least 120 CPD hours over a three-year period. The CAANZ standard CPD is 120 hours over a three-year period with a minimum of 20 hours in any year. To assist our people in maintaining their CPD records we offer an attendance report tracking CPD hours.

We test a sample of our partners and staff compliance with the CPD requirements in the firm's annual monitoring program.

Access to specialists

We understand that not all audits are the same or managed in the same way, so KPMG specialists provide input on relevant significant risks in the audit. In certain situations, specialist involvement is mandated. Otherwise, the audit partner and manager determine whether to use a specialist by considering the risks for the engagement, and the nature and complexity of the information, data, or calculations to be audited. We provide additional learning on audit concepts to our specialists who are members of an audit team. Our most frequently used in-house specialist capabilities are in the areas of tax, information technology, actuarial, financial risk management and valuations. Our AARC structure includes specialists such as actuarial and financial risk management, optimising access for audit teams. Aligning reporting lines and objectives increases the opportunity for collaboration and consultation with specialists.

We ensure that the full resources of the firm across all areas of our business are available to assist our audit teams. This encourages them to "when in doubt, consult".

Looking forward: In FY21, we have implemented audit quality role profiles, establishing the minimum expectations for specialists involved in audits. Forming part of the goals against which performance is assessed, the audit quality role profiles ensure all professionals involved in audit delivery understand, own and prioritise their role in driving audit quality. An example of an expectation for specialists is: Keep up to date with technical developments in audit quality, audit standards, accounting standards, and comply with the latest quality directives, as directed by the audit function.

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6. Performance of effective and efficient audits

Exercise scepticism + judgement

Coaching

Gather evidence and opine

In this chapter

- Exercise of professional judgement and professional scepticism
- Timely partner and manager involvement
- Ongoing mentoring and on the job coaching, supervision and review
- Critical assessment of audit evidence
- Efficient and effective work practices
- Materiality and scoping
- Appropriately supported and documented conclusions
- Engagement Quality Control review partner involvement
- Insightful, open and honest two-way communications

We understand that how an audit is conducted is as important as the result. Effective and efficient audits are dependent on the demonstration of certain behaviours. We focus on these behaviours during the performance of the audit, through education sessions and coaching, and via our review processes.

Exercise of professional judgement and professional scepticism

Professional scepticism involves a questioning mind and alertness to inconsistencies. It features prominently throughout auditing standards and attracts significant focus from regulators. We recognise the exercise of professional scepticism is critically important to our role as auditor.

Our global professional judgement process[26] guides an individual in exercising their professional scepticism. Steps include consideration of possible alternatives, conflicting as well as confirming evidence, and documentation of our final judgements. The professional judgement process includes ways to mitigate the effects of traps and biases which may cloud our judgement.

We reinforce the use of the professional judgement process and the exercise of professional scepticism through coaching and education, acknowledging that judgement is a skill developed over time and informed by different experiences.

26 The International Auditing and Assurance Standards Board, the International Ethics Standards Board for Accountants and the International Accounting Education Standards Board jointly published *Toward Enhanced Professional Skepticism*, August 2017, outlining their observations of the current environment. They set out actions global standard-setting boards will take, and the role other stakeholders can play in enhancing professional scepticism. The Association of Chartered Certified Accountants published *Banishing Bias? Audit, objectivity and the value of professional scepticism*, May 2017, exploring the importance of cognitive biases to the audit process. It explains how cognitive biases are central to improving the exercise of professional scepticism and to understanding the fundamental ethical principle of objectivity. These elements are consistent with our professional judgement process.

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Timely partner and manager involvement

To identify and respond to the audit risks for each year's audit, team members require an understanding of the client's business, financial position and its operating environment. Leadership and participation from the partner early in the audit directs the scope and tone and maximises the benefit of the partner's experience and skill. During FY20, 98 percent (FY19: 97 percent) of our audits of listed entities complied with the strict milestones we introduced in FY19 for the completion of planning activities, to enhance audit quality.

The partner sets the tone on the audit by their actions and communications with the audit team, reinforcing the importance of professional scepticism and audit quality. The final audit report is also their responsibility.

The manager supports the partner in these responsibilities and the day-to-day liaison with the client and team, building deep business understanding to enable the team to deliver a quality audit and valued insights.

Ongoing mentoring and on-the-job coaching, supervision and review

Coaching and on-the-job experience play key roles in developing the personal qualities important for a successful career in auditing, including professional judgement and scepticism.

We understand that skills build over time and through exposure to different experiences. We use a continuous learning environment to invest in the building of skills and capabilities, acknowledging that a significant portion of learning occurs on the job and through others, supplementing learning programs. A key part of effective supervision is timely review of the work performed so significant matters are promptly identified, fed back to the individual responsible and addressed in the audit.

We support a culture where every team member is responsible for developing the capability of the team, coaching and sharing experiences.

Critical assessment of audit evidence

The fundamental role of the auditor is to design and perform procedures to gather persuasive evidence that the client's financial report is fairly stated and in compliance with accounting standards.

We focus on evidence gathering techniques to ensure the quality and the quantity of the evidence obtained is responsive to the assessed risks. We recognise externally sourced evidence is more persuasive. We consider all audit evidence obtained, including conflicting or missing information, since the consistency of the evidence and the picture it creates is just as important as the individual evidence. The analysis of evidence requires an auditor to use professional judgement and remain professionally sceptical to ensure it is enough and appropriate.

Efficient and effective work practices

A quality audit relies on a balance between effectiveness and efficiency. Inefficiency has the potential to impact quality service delivery and client satisfaction, the wellbeing of our people, and ultimately the quality of the audit itself. For example, if a partner fails to give timely and clear directions, staff may perform unnecessary procedures or lack focus, resulting in rework or overwork.

Efficient does not mean cutting corners. It means planning the audit well, leveraging technology, using tools and templates, and enhancing behaviours that drive audit quality and efficiency. To allow audit teams to focus on key audit judgements we optimise onshore and offshore processes in performing the audit.

Our onshore National Service Centre team members contribute to common engagement processes from audit areas such as cash, fixed assets, data & analytics and engagement set up. Using centralised resources and technology these Capability and Admin Hubs standardise testing, producing consistent and high quality outputs, freeing up our on-location staff to be face-to-face with our clients, focusing on critical judgements, and interpreting results.

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Materiality and scoping

Performing an audit uses the fundamental principles of materiality and scoping. Materiality references precision in performing our work and assessing errors, ordinarily based on a percentage of a key financial metric, such as profit. Scoping references the nature, timing and extent of procedures we perform across certain financial statement line items particularly where the client has multiple sites, businesses, subsidiaries, or other features suggesting a disaggregation of the procedures, or both. We develop our risk-focused audit approach, unique to each client, based on these fundamental principles.

Appropriately supported and documented conclusions

The audit documentation records the audit procedures performed, evidence obtained and conclusions reached on each audit engagement. It includes materials prepared by us, received from the client or from relevant third parties. Our policies require review of all working papers by a more experienced team member and audit documentation relating to critical areas of judgement must be reviewed by the partner.

Engagement Quality Control review partner involvement

All listed, high risk and high public profile entity audits must have an Engagement Quality Control Reviewer, an independent audit partner assigned as an objective additional reviewer on significant and judgemental elements of the audit. The Engagement Quality Control review is an important part of KPMG's framework for audit quality.

Engagement Quality Control Reviewers are experienced audit partners independent of the team, appointed by the local Risk Management Partner in consultation with the engagement partner and local Partner in Charge. Engagement Quality Control Reviewers must have the same accreditations as the partner and enough time to carry out their review, along with the appropriate experience and knowledge to perform an objective review.

The Engagement Quality Control Reviewer's review must be complete, and all significant questions resolved satisfactorily before the issuance of the audit report. The extent of the review depends on the risk and complexity of the audit and does not reduce the responsibilities of the partner. A review includes assessing appropriateness of the financial statements and disclosures, significant judgements made and conclusions reached, communications with those charged with governance, and the proposed audit report. The partner who signs the audit report is ultimately responsible for the resolution of accounting, auditing and financial reporting matters.

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Insightful, open and honest two-way communications

Communicating with and reporting to our clients with no surprises underpins the quality of our audit service.

We build relationships based on mutual respect.

Clear reporting of significant findings

A financial statement audit has two main deliverables, the formal audit report and s307C independence declaration[27], accompanying the signed financial report. These are the observable elements to shareholders. We believe the quality of our reporting is largely dependent on our ability to optimise the inputs, as depicted in our *Audit Quality Framework*.

Communications with those charged with governance

Two-way communication with our clients, including management and audit committees, is a key aspect of our reporting and service delivery. We achieve this through reports and presentations, attendance at audit committee or board meetings, and informal discussions with management and members of the audit committee. We stress the importance of keeping the client informed of issues arising throughout the audit and the need to listen and understand their views.

We share insights on the audit, our client's business practices, the appropriateness of accounting policies, the design and operation of financial reporting systems and controls, key accounting judgements, matters where we may disagree with management's view, and any audit differences or errors identified. We ensure these reports meet the requirements of auditing standards and share our industry experience to encourage discussion with the members of the audit committee. We see these insights as a key mechanism to support our clients in the execution of their responsibilities.

Formal audit reports

Auditing standards and the *Corporations Act 2001* largely dictate the format and content of the independence declaration and audit report; including statements on auditor independence and the truth and fairness of the historical financial statements of the client.

To comply with Australian Auditing Standards and enhance the informational value of the audit report beyond a binary pass/fail opinion, our audit reports include:

- **Key Audit Matters (KAMs[28])**: tailored narratives of the matters we considered to be key to the audit and where most audit attention was focused, and how our audit addressed those matters.
- **Material Uncertainty Related to Going Concern**: drawing attention of users to the existence of a material uncertainty related to going concern. These alerts were previously categorised, amongst others, as an emphasis of matter.
- **Emphasis of Matter (EOM):** drawing attention of users to an item disclosed in the client's financial report that is of fundamental importance to their reading and understanding of the financial position and performance.
- **Other Information**: outlining the auditor's responsibility to read the relevant information accompanying the financial statements and identifying material inconsistencies therein.

Experienced partners form the audit opinion after involvement in and review of work performed by the team. The importance of ensuring the clarification of any uncertainties before signing audit reports is emphasised and well understood.

Looking forward: To link KPMG's values to audit quality and what we do day-to-day, our Audit Leadership Group has created a mantra, "I take pride. I coach. I am present. Together for better." Not only will it help us stay focused, our mantra will be our call to arms: to enhance audit quality by driving the tone from the top, enhance coaching at all levels, reinforce accountability and help ensure a team approach to all our audits.

27 A s307C independence declaration is required for audits of financial reports prepared to meet the Corporations Act 2001 obligations and not other types of audit and assurance reports.

28 KAMs are applicable for audit reports of listed entities preparing general purpose financial reports

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7. Commitment to continuous improvement

Compliance reviews | QP review effort | Root cause analysis | Client feedback

In this chapter

- Internal monitoring
- Quality Performance Review (QPR) Program
- Other assessments of audit quality
- Assessments of compliance with ethics and independence requirements
- External inspections
- Parliamentary Joint Committee (PJC) on Corporations and Financial Services Inquiry into the Regulation of Auditing in Australia
- Evaluating and responding appropriately to feedback and findings
- Client feedback

To ensure our work continues to meet the needs of the capital markets we use a broad range of mechanisms to continuously monitor our performance, respond to feedback and seek opportunities for improvement.

The complexity and dynamic nature of the economic environment, our clients' businesses and the accounting and auditing frameworks are challenging. We always aim to optimise the inputs to the audit process, but opportunities to learn and improve arise. This is why continuous improvement is a specific driver of audit quality.

We use both internal monitoring and external inspections against accepted benchmarks, to evaluate our current performance, to understand the existing quality of our audit work and prioritise the areas for improvement. To maintain the confidence of our clients, the capital markets, regulators and shareholders, we are serious about learning from opportunities, no matter how small.

Internal monitoring

KPMG uses two formal internal inspection programs – the Quality Performance Review (QPR) Program and the Risk Compliance Program (RCP) – to annually assess audit quality and independence compliance respectively. The QPR program reviews a sample of audits and our compliance with audit methodology, and the RCP reviews compliance with the risk management and independence policies, and practices supporting our broader system of quality control. They are designed globally and incorporate the requirements of international and Australian quality control standards[29]. In addition to the annual programs, on a triennial basis we participate in a Global Compliance Review[30], performed by a specialised team of reviewers from other member firms, to assess significant governance, risk management, independence, IT security and finance processes. Participation is a condition of ongoing membership of the KPMG network (see Appendix 2 on network arrangements for further details).

These programs assess quality and independence by benchmarking against our global and local standards. The results enable us to provide assurance our system of quality control is complied with in practice, operating effectively and identifies any areas requiring focus and improvement.

29 International Standard on Quality Control ISQC1 Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements and Auditing Standard ASQC1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements.

30 A Global Compliance Review was undertaken during FY17. The next Global Compliance Review was scheduled to be undertaken in FY20 but was postponed to FY21.

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Quality Performance Review (QPR) Program

The global QPR Program is implemented in Australia under the authority of the Quality and Performance Liaison Partner, Marcus McArdle, assigned to oversee the independent and objective assessment of the firm. The program assesses performance at an engagement level and identifies opportunities to improve audit quality. Reviews are completed by a combination of members from a global core review team and Australian reviewers. The global core review team comprises experienced partners, directors and senior managers from member firms across the network. They conduct reviews of listed and related entity financial statement audits in other KPMG member firms, enhancing objectivity and consistency. Partners and directors are selected for review once in a three-year rotating schedule at a minimum.

QPR Program (audit)	FY20	FY19	FY18
Total QPR audit reviews performed	38	47	35
No. of partners reviewed as a percentage of total partners	37	40	33
Percentage of listed and related entity financial statement audit reviews conducted by global core review team	43	52	64

Total numbers will vary depending on the rotation schedule of our smaller offices and their relative size and repeat selection criteria.

Key components of the QPR Program

- Led by an experienced partner from another KPMG member firm. This non-local lead reviewer collaborates with the global core review team and team leaders, promoting consistency across all reviews.
- Our highest profile listed and related entity financial statement audit reviews are performed by a dedicated global core review team comprising experienced partners, directors and senior managers from member firms across the network.
- Additional financial statement audit reviews are performed by a core team of Australian partners and directors, from locations other than the office under review. They are active practitioners and up-to-date with auditing standard requirements.
- Review of partners and directors work is undertaken on a minimum three-year rotating schedule, more often where certain risk criteria are present, such as below satisfactory ratings or a significant number of high risk engagements portfolio.
- Benchmarking our work to the Australian Auditing Standards and KPMG's own standards: achieving a 'Satisfactory' rating represents our very high audit quality bar.
- Performed soon after the conduct of the work subject to review: using two phases during the year which optimises timeliness.
- Findings are provided to audit teams for remediation where needed and implementation on future audits.
- Results are provided to leadership at office, division and firm levels. Root Cause Analysis is performed for pervasive issues, specific accountabilities for remediation are identified, and detailed action plans drawn up. These are reported globally and subject to ongoing review.
- Partners and directors who receive 'Unsatisfactory' ratings are subject to additional reviews and remedial actions, amongst other outcomes including performance evaluations and/or remuneration adjustments. One audit of a public interest entity was rated as 'Unsatisfactory' (FY19: none). An area of improvement was identified that did not lead to a restatement of the financial statements or the audit report being reissued. The issue identified has been addressed.

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Other assessments of audit quality

Other audit quality monitoring mechanisms we use include:

- Accounting technical reviews of client financial statements: Performed on a sample basis by a qualified person outside of the audit team, prior to signing the audit opinion. Over a four-year period, the sample includes all listed and high risk clients.
- Key audit matter and audit report reviews: Performed on a sample basis by the DPP, supporting teams apply the audit reporting enhancements to auditing standards. Over a four-year period, the sample includes all listed clients.
- Targeted and real time reviews: Conducted by our 2LoD Reviewers using tailored programs to assess attributes or focus areas of an audit during the audit. These identify opportunities to improve quality and effectiveness by sharing leading practices. In FY20, twelve audits that were subject to 2LoD reviews were subsequently reviewed by QPR or ASIC, providing us an opportunity to assess the effectiveness of the program.
- Evaluation of common consultations: Capturing and evaluating the most common questions raised by our individual teams.
- Post course assessments: These test understanding of specific content and provide evidence about the quality of learning.
- Goal setting and performance evaluation processes: These include explicit evaluation of audit quality inputs and outcomes.

We also review audits in the rare circumstances where the financial statements or audit opinions are reissued. We reflect on the performance of the audit accordingly.

Evidence of unsatisfactory audit quality can directly impact both partner and staff performance ratings and/or remuneration. Findings from our risk and audit quality monitoring resulted in impacts to remuneration in FY20 for a small number of partners.

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Assessments of compliance with ethics and independence requirements

We monitor our compliance with independence requirements of the *Corporations Act 2001*, professional ethical standards, and our mandated internal policies, systems and processes. This monitoring includes clearance by the firm's Ethics and Independence team prior to any individual being recruited laterally as a partner, or internally promoted to partner, an annual declaration of compliance from partners and staff, mandatory annual independence learning, the performance of personal independence compliance audits on a sample basis, and partner rotation compliance audits on a sample of engagements. Our annual QPR program and RCP also test for compliance on a sample basis with these requirements, including partner terms on relevant audits and the appropriateness of non-audit services provided.

Our independence policies are set at or above the requirements of professional standards and the *Corporations Act 2001*. In the event of non-compliance, the actions of partners and staff are considered by our Ethics and Independence Disciplinary Committee (EIDC) in accordance with our disciplinary policy. The severity of disciplinary actions has regard to the seniority of the individual and/or when breaches are not self-reported, such as when identified by a compliance audit. Depending on the circumstances, disciplinary action could include: a caution letter, a disciplinary letter on the individual's personnel file, remuneration adjustment, failed promotion or separation from the firm.

Our compliance testing identified 42[31] (FY19: 44) instances of individuals not achieving full adherence to our policies and processes. The primary source of non-compliance was failure by individuals to enter or update all their, their spouse's, their spousal equivalent's or their dependant's other investments (including superannuation funds other than our firm's default superannuation fund) into our investments tracking system on a timely basis. A number of instances related to delays in completing mandatory annual independence training 6 percent (FY19: 10 percent) and annual declaration 13 percent (FY19: 23 percent), and Code of Conduct matters arising from responses to an assertion in the annual declaration.

Key performance indicators – Ethics and Independence	FY20	FY19	FY18
No. of partners and staff subject to an independence compliance audit	262	192	174
No. of engagements subject to a partner rotation compliance audit	20	20	20
Total no. of qualifications of an Auditors' Independence Declaration[32] – s9 Corporations Act listed companies and listed registered scheme audit clients	-	1[33]	1[34]
Total no. of qualifications of an Auditors' Independence Declaration – other audit clients	4[35]	1[36]	1[37]

31 In FY20 we did not consider a failure to record our KPMG default superannuation fund in our investments tracking system as non-compliance as it does not create an independence risk.

32 Required by the Corporations Act 2001 section 307C.

33 The qualification was due to an immediate family member of a partner holding a financial interest in an audit client with the lead audit engagement partner being located in the same office. The financial interest was disposed of as soon as practical. The partner did not provide any services to the audit client on behalf of the firm nor was a member of the audit team.

34 The qualification was a direct consequence of an audit client takeover of an entity whose CEO was a member of KPMG within the preceding two years and a member of KPMG's audit team of the acquirer.

35 Two qualifications were related to an immediate family member of a tax partner holding a financial interest in audit clients with the lead audit engagement partner being located in the same office, and two qualifications were related to instances of a partner holding a financial interest in an audit client with the lead audit engagement partner being located in the same office. In all cases, the financial interest was disposed of as soon as practical and the partners did not provide any services to the audit clients on behalf of the firm nor was a member of the audit teams.

36 The qualification was due to one tax partner holding a financial interest in an audit client with the lead audit engagement partner being located in the same office. Upon identification, the partner disposed of the investment immediately. The partner involved did not provide any services to the audit client on behalf of the firm.

37 The qualification was due to one tax partner holding a financial interest in the respective audit client with the lead audit engagement partner being located in the same office. Upon identification, the partner disposed of the investment immediately. The partner involved did not provide any services to the audit client on behalf of the firm.

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External inspections

We invest in continuous improvement and rectify any identified deficiencies in audit quality capable of eroding public trust. We also believe that the regulator has an important role to play in enhancing public confidence in the audit process.

Australian Securities and Investments Commission (ASIC)

ASIC conducts an annual audit inspection program involving a review of compliance with the auditor independence and audit quality provisions of the *Corporations Act 2001*. In terms of identifying which audits to inspect, ASIC understandably skews its sample selection to the most complex and high risk audits.

At the conclusion of each inspection period, ASIC issues a consolidated public report[38] outlining the findings across its audit firm inspections and issues a private report to each firm inspected during the period.

We take the findings seriously and believe that the process provides valuable insights to improve the quality of our audits.

Recognising that greater transparency is needed for the public to gain insight into audit quality, we were the first firm publicly to publish our full ASIC private inspection report to KPMG for the 12 months to 30 June 2019, and the 18 months ended 30 June 2018.

We conduct an evaluation of all matters identified by ASIC. We undertake extensive analysis of ASIC's thematic findings, perform deep-dive root cause analysis to identify possible root causes of issues raised and design solutions as appropriate.

We maintain a comprehensive audit quality action plan driven by feedback from monitoring activities, including ASIC inspections. Our audit quality action plan is shared and discussed with ASIC.

Our technical learning reinforces ASIC's messages and addresses findings from recently completed inspections and preliminary observations from the current inspection process.

ASIC Audit Inspection Report for 12 months to 30 June 2019

The most recently completed ASIC inspection of our audit files was finalised in December 2019, covering ten audits (selected from over 5,000 audit opinions signed) conducted for financial reporting years ending from 30 June 2017 to 31 July 2018. KPMG's inspection result was 33 percent[39] compared to 25 percent for the largest four firms inspected and 26 percent for all audit firms inspected. None of the financial reports or audit opinions relating to KPMG clients examined by ASIC (either as part of their audit inspection program, or their company surveillance program) were restated or reissued.

We acknowledge that continued effort is required to improve our audit quality results further, and to this end, consider that our continued investment and enhancements to our technology and processes will deliver sustainable improvements in the future.

ASIC Audit Inspection Report for KPMG Australia for 12 months to 30 June 2020

ASIC is currently completing its twelfth inspection of KPMG covering eleven financial statement audits conducted for financial reporting years ended from 30 June 2018 to 31 December 2019. Results are expected to be released by the end of the calendar year, which we anticipate will show an improvement on the previous 12-month inspection period.

As well as the inspection of audits, during the year ASIC conducted a review of aspects of our quality control systems regarding culture, governance, conflicts of interest, accountability and talent, primarily as they relate to the provision of financial statement audit services, and post audit reviews and root cause analysis. The results of these reviews are expected to be finalised in the current financial year.

Foreign regulators

No deficiencies were identified in the three audits reviewed by the PCAOB in its March 2017 inspection of the firm conducted in conjunction with ASIC. The PCAOB released its report[40] in February 2018. Our audit practice is registered with the US PCAOB[41], Japanese[42], Canadian[43], Luxembourg[44], UK[45] and German[46] authorities. This is necessary either to participate in audits of global clients or conduct audits of Australian clients who, owing to overseas stock exchange listing requirements, file financial statements in those jurisdictions. These regulators have not inspected our firm during FY20[47].

38 ASIC's most recent public consolidated report Audit inspection program public report for 2018-19 summarises the observations and findings identified by ASIC's audit inspection program in the 12 months to 30 June 2019 (Report 648). This includes observations from ASIC's tenth inspection of KPMG. The report is available on their website www.asic.gov.au

39 The inspection result is calculated as the number of key audit areas reviewed by ASIC, where in their view the auditor did not obtain reasonable assurance that the financial report as a whole was free of material misstatement, divided by the total number of key audit areas that ASIC reviewed.

40 The report is available on their website www.pcaobus.org

41 Public Company Accounting Oversight Board

42 Japanese Financial Services Authority

43 Canadian Public Accountability Board

44 Luxembourg Commission de Surveillance du Secteur Financier

45 UK Financial Reporting Council

46 German Audit Oversight Commission

47 The PCAOB inspection of the firm was due to be conducted in March 2020 but was postponed as a result of the COVID-19 pandemic. The inspection will now be conducted remotely in October 2020.

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Chartered Accountants Australia and New Zealand (CAANZ)

CAANZ regulates and governs the work of chartered accountants that perform audits in Australia. CAANZ has advised that it considers the work of ASIC in determining the scope and timing of any review of the large firms to reduce duplication.

As part of its oversight of the large firms, CAANZ has previously used an online qualitative audit quality survey assessing the perceptions of partner, manager, qualified staff and graduate respondent groups on drivers of audit quality.

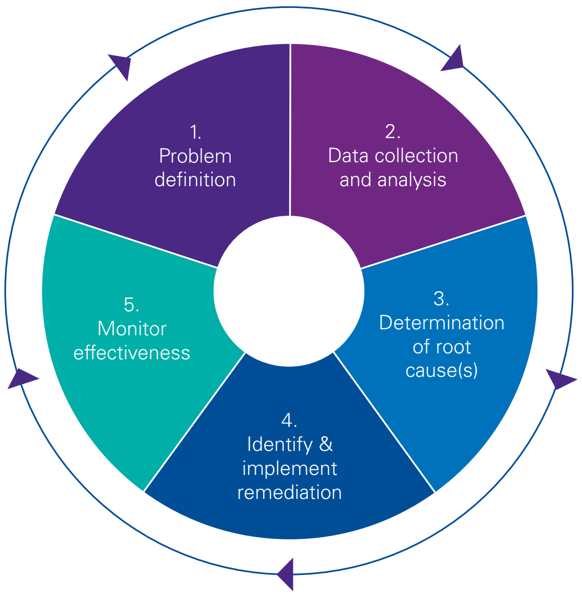
The results of the most recent CAANZ survey, conducted in November 2011 and reported in March 2012, highlight that our partners and staff see professional scepticism and objectivity as their most significant contribution to audit quality.

Evaluating and responding appropriately to feedback and findings

The effectiveness of any response to an issue is dependent on the understanding of the root cause, the pervasiveness of the issue, the ability to tailor a solution in differing circumstances and leadership support for the solution.

We use our knowledge from past experiences and our specifically designed root cause analysis framework[48] to fully understand the root cause of issues and design innovative and appropriate solutions.

Global Five Step Root Cause Analysis Principles[49]



48 Global Five Step Root Cause Analysis Principles, issued globally and adopted with local considerations
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We use the following solutions tailored for specific situations:

- Face-to-face briefings: with individuals, using coaching techniques, in facilitated workshops, group or office wide meetings, and local or national instructor led learning sessions.
- Topic specific guides and learning: online instruction, guidance papers, example tools and templates, podcasts, access to centrally logged frequently asked questions and answers, and other database resources.
- Reminders and alerts: emails, technical and organisational announcements, intranet alerts, animation and poster reminders.
- Practice management changes: reassignment of partners and/or staff, reassignment of internal operational roles, and additional support.
- Behavioural motivators: including recognition and reward.
- Automated tools: pre-programmed applications for a discrete audit activity.

In presenting the solutions to teams, we tell them why we are focusing on the topic and provide context to enable them to understand how these are driven from our monitoring findings.

We recognise objective feedback and a genuine commitment to continuous improvement is important to driving audit quality.

Client feedback

The KPMG Client Insights Program actively solicits feedback from clients on the quality of our services. This feedback is considered at an individual audit team level and a firm level to learn and improve our client service continually.

Parliamentary Joint Committee (PJC) on Corporations and Financial Services Inquiry into the Regulation of Auditing in Australia

From the outset we had hoped that the Inquiry would make a real contribution to increasing trust in the profession, which is paramount. The theme of our submission to the Inquiry was 'Advancing Trust in Audit', and we discussed 3 key areas:

First, some actionable ideas for strengthening trust in audit 'today', relating to independence, tenure and transparency of audit regulatory oversight.

Next, we turned the light on ourselves. Recognising that greater transparency is needed for the public to gain good insight into audit services, we outlined KPMG's approach and commitment to audit quality.

Finally, we looked to the future of audit, canvassing how the role and scope of audit relating to fraud, going concern and corporate governance might develop to meet the evolving needs of the market.

Our full submission is appended to this Transparency Report.

The PJC released its interim report[50] on 27 February 2020, which we believe presents balanced and sensible recommendations. We are pleased the report has the unanimous support of the PJC, offering 10 recommendations aimed at promoting trust and confidence in the auditing profession, as well as dealing with associated reforms.

KPMG approached the Inquiry in an open and constructive manner, and many of the interim recommendations are consistent with our submission.

50 https://parlinfo.aph.gov.au/parlInfo/download/committees/reportjnt/024330/toc_pdf/RegulationofAuditinginAustralia.pdf;fileType=application%2Fpdf

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Statement on effectiveness of system of quality control

We are confident that our framework for audit quality supports our people and enables them to provide a high level of audit quality in an independent, objective and ethical manner, maintaining public and stakeholder confidence.

This report describes our quality control system to conduct our audits in accordance with applicable standards and laws and highlights certain measures we consider in operating our external audit practice. The results of our internal monitoring programs, consideration of our reported measures, together with feedback from independent regulatory inspections, provides the KPMG Board with a basis to conclude that our system of quality control described in this Transparency Report are functioning effectively.

Alison Kitchen
National Chairman,
KPMG Australia

Gary Wingrove
CEO,
KPMG Australia

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Appendix

1. KPMG in Australia legal structure and ownership

The global KPMG network consists of separate independent firms that individually provide Audit, Tax and Advisory services to a wide variety of public and private sector organisations.

Effective from 1 October 2020, KPMG Australia is a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee (KPMG International Limited). Prior to 1 October 2020, KPMG in Australia was a member firm of KPMG International Cooperative ("KPMG International"), a Swiss cooperative which is a legal entity formed under Swiss law. Further details about KPMG International and its business, including our relationship with it, are available in the 2019 KPMG International Transparency Report[53].

KPMG Australia's primary focus is to serve clients based in Australia. KPMG operates in Australia through the KPMG Partnership (Australian Partnership) and other associated entities, including KPMG Financial Advisory Services (Australia) Pty Ltd, KPMG Holdings (Australia) Pty Ltd and KPMG Australian Service Trust. KPMG Australia has offices in Adelaide, Brisbane, Canberra, Darwin, Gold Coast, Hobart, Karratha, Melbourne, Parramatta, Penrith, Perth, Rhodes, Sydney and Wollongong.

Prior to 1 October 2020, the Australian firm also had two other KPMG practices sublicensed to use the name KPMG: KPMG Papua New Guinea (which is ultimately controlled by KPMG Australia) and KPMG Fiji Islands (which is not controlled by KPMG Australia). Both are known as "Sublicensees". The Australian Partnership and the Sublicensees are separate partnerships. However, under the terms of the Sublicense Agreement, the Sublicensees agreed to conduct their affairs in a manner consistent with the objectives, policies, standards and procedures adopted by the Australian firm, which seeks to maintain the prestige and high professional standards associated with the KPMG name. From 1 October 2020, KPMG Papua New Guinea (PNG) and KPMG Fiji are also members in, or have other legal connections to, KPMG International Limited.

2. Network arrangement

KPMG member firms can be found in 147 countries and collectively employ more than 219,000 people across a range of disciplines.

KPMG in Australia is affiliated with KPMG International. KPMG International Limited acts as the coordinating entity for the overall benefit of the KPMG member firms but does not provide professional services to clients. The structure is designed to support consistency of service quality and adherence to agreed values wherever in the world KPMG member firms operate. KPMG member firms commit to conduct their operations in compliance with a common set of values, standards and service quality expectations. Partners and employees within those firms commit to act with integrity at all times.

Professional services to clients are provided exclusively by member firms. For the year ended 30 September 2019, KPMG member firms reported total global revenue of US$29.75 billion[54]. Under agreements with KPMG International, member firms including KPMG in Australia are required to comply with KPMG International's policies and regulations including quality standards governing how they operate and how they provide services to clients. This includes having a structure that ensures continuity and stability and being able to adopt global and regional strategies, share resources (incoming and outgoing), service multi-national clients, manage risk, and deploy global methodologies and tools. Each member firm takes responsibility for its management and the quality of its work. Member firms are required to have the capability to provide certain types of core services and to refer work to other member firms where appropriate (for example, if the engagement concerns work in that other member firm's country and that other member firm has the required capacity and expertise to perform the work).

A firm's status as a KPMG member firm and its participation in the KPMG network may be terminated if, among other things, it has not complied with the policies and regulations set by KPMG International or any of its other obligations owed to KPMG International.

53 https://home.kpmg.com/xx/en/home/about/governance/transparency-report.html

54 Aggregated revenues generated by KPMG statutory auditors and audit firms, from EU and EEA Member States resulting from the statutory audit of annual and consolidated financial statements was Euro 2.9 billion. Revenues for the year ended 30 September 2020 will be published in December 2020 on kpmg.com, and contained within the 2020 KPMG Global Review. An updated statement of EU/EEA statutory audit revenues for the 12 months to 30 September 2020 will be available within the KPMG International Transparency Report, also to be published in December 2020 on kpmg.com. A list of KPMG network firms and sole practitioner statutory auditors in European Union/ European Economic Area Member States is available here (https://home.kpmg.com/xx/en/home/about/governance/list-of-kpmg-eu-eea-audit-firms.html).

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3. KPMG's Global Values

Our values guide our behaviours day-to-day, informing how we act, the decisions we make, and how we work with each other, our clients, companies that we audit, and all our stakeholders. Our global values are:

Integrity - We do what is right

Integrity means we are honest, fair and consistent in our words, actions and decisions – both inside and outside work. We take responsibility and accountability for our day-to-day behaviour and we always hold ourselves to the highest moral and ethical standards – even when under pressure. We keep our promises and set an example for others to follow. We demonstrate objectivity and scepticism in line with professional ethics and independence standards.

Excellence - We never stop learning and improving

Excellence means relentlessly delivering quality work to the highest professional standards. We do this by staying curious and taking personal responsibility for our learning. We constantly look to improve our work through data and insight and are open to new challenges and feedback because that is how we develop and improve. We maintain an unwavering focus on audit quality – in line with the requirements and intent of applicable professional standards. We mentor and coach each other to drive continuous learning and improvement.

Courage - We think and act boldly

Courage is about being open to new ideas and being honest about the limits of our own knowledge and experience. It's about applying professional scepticism to what we see and asking question where we have doubts. We speak up if we see something we believe is wrong and we support those who have the courage to speak up themselves. Courage is being bold enough to step outside of your comfort zone. We are decisive and collectively stand our ground in the face of difficult or challenging circumstances.

Together - We respect each other and draw strength from our differences

We do our best work when we do it together: in teams, across teams, and by working with others outside our organisation. Working together is important because we know it's collaboration that shapes opinions and drives creativity. We embrace people with diverse backgrounds, skills, perspectives and life experiences and ensure different voices are heard. We show care and consideration for others and strive to create an inclusive environment where everyone feels they belong.

For Better - We do what matters

For better means taking a long-term view, even in our day-to-day choices, because we want to build a stronger KPMG for the future. We never lose sight of the importance of our role in building trust in the capital markets in business. We make sustainable, positive change in our local communities and in society at large, striving to make the world a better place. We protect and service the capital markets and the wider public interest. We proactively help to shape the future of audit. We manage our portfolios of work in line with our values, professional standards and policies.

4. Financial and other information

This section sets out financial and other information on the firm that shows the importance of statutory audit work to our overall business and results.

Revenue	FY20 $b	FY19 $b	FY18 $b
Total revenue for KPMG in Australia for the financial years ending 30 June	1.91	1.78	1.64

Note: All figures are in Australian dollars and exclude KPMG PNG and Fiji

Total revenue split for the firm can be further analysed on the following percentage basis	FY20 %	FY19 %	FY18 %
Audits of financial statements[55]	19	20	20
Assurance and other services for audit clients	7	9	8
Services for non-audit clients	74	71	72
Total	100	100	100

55 Includes audits and reviews conducted of financial statements, prepared pursuant to sections 292, 295, 302 and 303 of the Corporations Act 2001. Includes AU$15million revenues from the statutory audit of annual and consolidated financial statements and AU$4 million revenues from other services to Australian clients considered EU public interest entities (definition contained in Appendix 7).

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5. Governance structure

The National Board is the principal governance and oversight body of KPMG in Australia.

The National Board is responsible and accountable to partners for:

- (a) the stewardship of the Partnership for the benefit of current and future partners
- (b) the successful conduct of the firm
- (c) enhancing the image and profile of the firm
- (d) the implementation of issues voted on by the partners.

The current standing sub-committees of the National Board are the:

- (a) Audit Committee
- (b) Board Investment Committee
- (c) Nomination Committee.

The CEO is appointed by the National Board on the recommendation of the National Chair. The CEO leads a National Executive Committee, with individual appointments recommended by the CEO to the National Board for approval.

The National Executive Committee is the principal management body of KPMG in Australia. It is responsible for driving the financial performance of the business, the development and execution of strategy and establishing the processes to monitor and enforce policy compliance. Its members include the National Managing Partners of each of the Audit, Assurance & Risk Consulting, Deals Tax & Legal, Management Consulting and Enterprise divisions, along with the Chief Risk Officer (CRO) and leaders of each of the Business Service areas.

Through the CRO's membership of the NEC, the CRO provides regular updates and escalates key messages from the Service Delivery Risk Committee[56], the Ethics and Independence Disciplinary Committee and Risk Management and the Office of General Counsel (OGC) function.

Primary role as it relates to quality

Service Delivery Risk Committee

- Oversight of risk management arrangements relating to service delivery to clients.
- Discuss emerging business risks, and their potential impact, as they affect service delivery.
- Recommend improvements to firm systems and processes as needed.
- Support the efficient application of quality and risk management practices across the firm.

Risk Management and OGC Function

- Promote processes and structures to support risk management and quality.
- Develop risk and quality policies, systems and procedures.
- Support the implementation of risk and quality systems and procedures to comply with local and global requirements.
- Monitor and test risk and quality policies, systems and procedures.
- Create tools and templates to manage compliance obligations.
- Provide support and guidance to all professionals on application of appropriate policies and systems.

Ethics and Independence Disciplinary Committee

- Deal with referrals of non-compliance with the firm's ethics and independence policies.
- Determine disciplinary sanctions with the approval of the National Executive Committee and/or Board.
- Recommend improvements to firm policies, systems and processes as needed.

56 The CRO chairs the Service Delivery Risk Committee

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6. Board members and NEC members

The Board comprises the National Chairman, the CEO, nine other members currently drawn from our Brisbane, Melbourne and Sydney offices, and one independent member. The Board met 16 times in the year to 30 June 2020.

Board members as at the date of this report are:

Alison Kitchen
Melbourne
National Chairman

Gary Wingrove
Sydney CEO

Eileen Hoggett
Sydney

James Stewart
Melbourne

Mathew Herring
Melbourne

Peter Griffiths
Melbourne

Michael Hiller
Brisbane

Julian Edwards
Sydney

Corrina Bertram
Melbourne

Brett Mitchell
Sydney

Martin Dalgleish
Independent Board member

NEC members as at the date of this report are:

Gary Wingrove
CEO

David Heathcote
Deals, Tax & Legal

Andrew Yates
Audit, Assurance & Risk Consulting

Ian Hancock
Management Consulting

Paul Howes
Enterprise

Tanya Gilerman
CRO

Martin Sheppard
Clients & Markets

Damian Templeton
CFO and COO

Sarah Vega
Innovation Solutions & Ventures

Deborah Yates
People, Performance & Culture and Corporate Affairs

Amanda Hicks
Brand & Marketing

Angus Reynolds
Corporate Development & Investment

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7. Public interest audit clients of the firm

The Australian listed companies, listed registered schemes, Authorised Deposit-Taking Institutions[57], General Insurers[58], Life Companies[59] and EU public interest entities[60] for which KPMG in Australia[61] is statutory auditor for the financial years ended in the 12 months to 30 June 2020 are:

A2B Australia Limited
AAI Limited
Ainsworth Game Technology Limited
ALE Property Group
Alloy Resources Limited
Alpha HPA Limited
AMA Group Limited
Ampol Limited (fka Caltex Australia Limited)
Ansell Limited
ANZ Lenders Mortgage Insurance Pty Limited
Appen Limited
Argent Minerals Limited
Asteron Life & Superannuation Limited
Atomo Diagnostics Limited
AusNet Services Holdings Pty Ltd
AusNet Services Limited
Austral Gold Limited
Australia and New Zealand Banking Group Limited (ANZ)
Australian Agricultural Company Limited
Australian Central Credit Union Ltd
Australian Ethical Investment Limited
Australian Governance and Ethical Index Fund
Australian Leisure & Entertainment Property Management Limited
Australian Leisure & Entertainment Property Trust
Australian Military Bank Limited
Australian Mutual Bank Limited
Australian Pharmaceutical Industries Limited
Australian United Investment Company Limited
Auto & General Insurance Company Limited
Bank of Queensland Limited
Barristers Sickness & Accident Fund Pty Ltd
Base Resources Limited
Battery Minerals Limited
Bell Financial Group Limited
Berkley Insurance Company
Beyond Bank Australia Limited
Bigtincan Holdings Limited
Biotron Limited
Bisalloy Steel Group Limited
BNK Banking Corporation Limited
Boom Logistics Limited
BOQ Covered Bond Trust
Boral Limited
Buru Energy Limited
BWP Trust
Cardno Limited
Carlton Investments Limited
Centaurus Metals Limited
Centrex Metals Limited
Centuria Capital Fund
Centuria Capital Group
Centuria Capital Limited
Centuria Industrial REIT
Centuria Life Limited
Centuria Office REIT
Citigroup Pty Ltd
Clean TeQ Holdings Limited
Cochlear Limited
Codan Limited
Collection House Limited
Community First Credit Union Limited
Consolidated Tin Mines Limited
Corrvas Insurance Pty Ltd
Costa Group Holdings Limited
Coventry Group Limited
Credicorp Insurance Pty Ltd
Credit Union Australia Ltd
Credit Union SA Ltd
Cronos Australia Limited
CTI Logistics Limited
CUE Energy Resources Limited
Dacian Gold Limited
Diversified United Investment Limited
Downer EDI Limited
Downer Group Finance Pty Limited
Duxton Water Limited
Eclipx Group Limited
Employers Mutual Limited
Enero Group Limited
Engenco Limited
Equus Mining Limited
Evans & Partners Australian Flagship Fund
Evans & Partners Global Flagship Fund
Evans & Partners Global Healthcare Fund
Event Hospitality and Entertainment Ltd
Finbar Group Limited
Fire Service Credit Union Limited
First American Title Insurance Company of Australia Pty Ltd

57 Within the meaning of the Banking Act 1959
58 Within the meaning of section 11 of the Insurance Act 1973
59 As registered under section 21 of the Life Insurance Act 1995
60 Within the meaning of Directive 2006/43/EC issued by The European Parliament and of the Council, where a public interest entity is an issuer whose transferable securities are admitted to trading on a regulated market, specific to the EU jurisdiction.
61 Excludes KPMG PNG and KPMG Fiji

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Flinders Mines Limited
Gateway Bank Limited
Generation Development Group Limited
Generation Life Limited
Genworth Financial Mortgage Indemnity Limited
Genworth Financial Mortgage Insurance Pty Limited
Genworth Mortgage Insurance Australia Limited
Gold Road Resources Limited
Goodman Group
Goodman Industrial Trust
Goodman Limited
Gordian RunOff Limited
GUD Holdings Limited
GWA Group Limited
Hallmark General Insurance Company Limited
Hallmark Life Insurance Company Limited
Hammer Metals Limited
Heritage Bank Limited
Hills Limited
Hospitality Employers Mutual Limited
Hotel Property Investments
Hotel Property Investments Limited
Hotel Property Investments Trust
Houston We Have Limited
IMB Ltd
IncentiaPay Limited
Indue Ltd
ING Bank (Australia) Limited
Inghams Group Limited
Insurance Australia Group Limited
Insurance Australia Limited
Insurance Manufacturers of Australia Pty Limited
Intega Group Limited
IOOF Holdings Limited
IOOF Ltd
IVE Group Limited
Japara Healthcare Limited
King Island Scheelite Limited
Kogan.com Ltd
Korvest Ltd
Latitude Insurance Holdings Pty Ltd
Lendlease Corporation Limited
Lendlease Group
Lendlease Trust
LFI Group Pty Ltd
Linius Technologies Limited
Link Administration Holdings Limited
Lovisa Holdings Limited
Lysaght Credit Union Ltd
Macmahon Holdings Limited
MaxiTRANS Industries Limited
McGrath Limited
Medical Insurance Australia Pty Limited
Mercedes-Benz Australia/Pacific Pty Ltd
Metrics Credit Partner Income Opportunities Trust
Metrics Credit Partner Master Income Trust
Midway Limited
Mitsui Sumitomo Insurance Company Pty Limited
Monash IVF Group Limited
Motorcycle Holdings Limited
Munich Reinsurance Company of Australasia Limited
Nearmap Ltd
Next Science Limited
Nickel Mines Limited
NuEnergy Gas Limited
Nufarm Limited
Oilex Limited
oOh!media Limited
Optus Insurance Services Pty Ltd (Singtel)
Ora Banda Mining Limited
Orica Limited
Over Fifty Guardian Friendly Society Limited (Centuria)
OZ Minerals Limited
Pacific Smiles Group Limited
Palla Pharma Limited
Perpetual Credit Income Trust
Perpetual Equity Investment Company Limited
Perpetual Limited
Petsec Energy Limited
Phoslock Environmental Technologies Limited
Pilbara Minerals Limited
Police Credit Union Ltd
Police Financial Services Limited (trading as BankVic)
Poseidon Nickel Limited
PWR Holdings Limited
Qantas Airways Limited
QMS Media Ltd
Qualitas Real Estate Income Fund (RE: The Trust Company (RE Services) Limited)
Qudos Mutual Ltd
Quickstep Holdings Limited
RAA Insurance Holdings Limited
RAA Insurance Limited
RACT Insurance Pty Ltd
Red 5 Limited
Redcape Hotel Group
Redcape Hotel Trust I
Redcape Hotel Trust II
Reece Limited
Regional Australia Bank Ltd
Regis Resources Limited
Reliance Worldwide Corporation Limited
Rex Minerals Limited
Ridley Corporation Limited
Rightcrowd Limited
Santana Minerals Limited
Seven West Media Limited
SG Fleet Group Limited

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Silver Lake Resources Limited
SIV CAPITAL LIMITED
Sky and Space Global Limited
Sky Metals Limited
Smiles Inclusive Limited
South West Slopes Credit Union Ltd
South32 Limited
Southern Cross Electrical Engineering Limited
Spectrum Metals Limited
St Andrews Insurance (Australia) Pty Ltd
St Andrews Life Insurance Pty Ltd
StateCover Mutual Limited
Steadfast Group Limited
Suncorp Group Limited
Suncorp Insurance Holdings Limited
Suncorp-Metway Limited
Sydney Airport
Sydney Airport Limited
Sydney Airport Trust 1
TAL Dai-ichi Life Australia Pty Limited
TAL Life Limited
Tanami Gold NL
Teaminvest Private Group Limited
The Lutheran Laypeople's League of Australia Inc
The Northern Trust Company
Think Childcare Development Limited
Think Childcare Group
Think Childcare Limited
TNG Limited
TPG Telecom Limited
Treasury Wine Estates Limited
Veris Limited
Vimy Resources Limited
Virgin Australia Holdings Limited
White Rock Minerals Limited
Whitebark Energy Limited
Wisetech Global Limited
Wiseway Group Limited

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Advancing trust in audit

A submission to the Parliamentary Joint Committee on Corporations and Financial Services on regulation of auditing in Australia

1. Introduction

The audit profession is under significant scrutiny in a number of markets around the world by regulators, politicians and civil society. High profile market events, such as corporate collapses, have raised questions about the role of the auditor and whether the auditor could, and should, do more. As the issues differ country-to-country, so do the potential responses.

Auditors play a crucial public role within society. To serve the public interest, the work of auditors must engender confidence in capital markets. Despite evidence indicating satisfaction with the work and function of auditors among companies and shareholders in Australia[1], there is a gap between what the public expects from statutory audits and what auditors do.

There is always room to improve, develop and evolve. Understanding this, our submission focuses on the following areas, linking to a number of key elements of the Committee's terms of reference:

- We begin by presenting some actionable ideas for strengthening trust in audit today, relating to **independence**, **tenure** and **transparency of audit regulatory oversight.**
- Next, we turn the light on ourselves. Recognising that greater transparency is needed for the public to gain good insight into audit services, we outline KPMG's approach and commitment to **audit quality**.
- Finally, we look to the future of audit, canvassing how the **role and scope of audit** relating to **fraud**, **going concern** and **corporate governance and culture** might develop to meet the evolving needs of the market.

Throughout this document we have identified areas for consideration for change. In doing so, we emphasise the importance of further research and consultation to avoid unintended consequences, or negative impacts on the market and organisations' productivity resulting from any changes.

Thank you for the opportunity to contribute to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the regulation of auditing in Australia by presenting our ideas for advancing trust in audit.

[1] a. The 2018 survey by the Financial Reporting Council (FRC), with the AUASB, of Audit Committee chairs of top 300 ASX listed companies to gather their perspectives on audit quality. Overall, 92 per cent of respondents rated their external auditor as either "excellent" or "above average". We consider this to be significant given Audit Committee chairs observe first-hand the workings and output of the company's external audit team and are therefore ideally placed to make this assessment. b. The March 2019 survey by the FRC and AUASB of professional investors. Over 90 per cent of respondents rated audit quality as average or above average. c. The 2019 survey of retail investors by CAANZ, showing 87 per cent are confident about the quality of audited financial information, and auditors are ranked Number One as the most effective entities in advancing investor protection.

2. Strengthening trust in audit today

As auditors, we understand we have an important responsibility to the public. We know that continuous quality improvement is fundamental to advancing the public's trust in the profession and the work we deliver. It is fundamental to meeting the expectations of investors, regulators, the organisations we audit, our people, the capital markets and the communities we live in.

We need to do a better job demystifying the role of audit and the audit process to the public.

Auditors, audited companies and regulators all have important roles to play in strengthening trust in audit. When considering opportunities for strengthening trust in the current audit framework, we have focused on auditor independence (which includes conflicts of interest) and on audit tenure – both areas of significant international focus. We also believe that trust can be strengthened by providing the public with greater transparency and clarity on the process and results of regulatory oversight.

Below, we outline our perspectives.

2.1 Independence

2.1.1 KPMG's approach to independence

Auditor independence is a cornerstone of international and domestic professional standards, and of legal and regulatory requirements.

In Australia, independence requirements have been enshrined in the Corporations Act. The audit profession is legally required to be mindful, not only of actual conflicts of interest, but also of the perception of conflicts of interest. Compliance with these obligations requires us to continually reinforce the importance of independence.

At KPMG, we have globally prescribed policies, procedures and guidance, combining global and local regulatory, independence and ethical requirements. These include:

- KPMG International's independence policies and procedures, which incorporate the IESBA (International Ethics Standards Board for Accountants) Code of Ethics requirements, are set out in the Global Quality & Risk Management Manual. KPMG Australia's independence policies and procedures, with Australian-specific provisions, including those relating to APES 110 (Code of Ethics for Professional Accountants) are set out in the Australian Quality & Risk Management Manual.
- The Partner-in-Charge of KPMG's Global Independence Group is supported by a core team of specialists who help ensure the firm has robust and consistent independence policies and procedures globally, and assist member firms and their partners and staff to comply with the requirements.
- KPMG Australia also has its own designated Ethics & Independence Partner and team, which has primary responsibility for the oversight of compliance with Ethics & Independence policies and procedures.
- All KPMG Australia partners and client service professionals must complete independence training upon joining the firm, and on an annual basis thereafter.
- Upon commencement with the firm, all KPMG partners and staff are required to confirm that they understand and will comply with the Ethics & Independence policies. Thereafter, all KPMG people are required to complete an annual declaration stating that they have remained in compliance during the previous year. One specific example is personal financial relationships: KPMG partners and relevant staff (including their immediate family members) must be free from prohibited financial relationships with audit clients, their management and directors. All Australian partners (including their immediate family members) are prohibited from owning any financial interest (e.g. shares, options, warrants, mutual funds) with any KPMG audit client, globally.

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KPMG's Ethics & Independence team undertakes an ongoing process of conducting independence compliance audits of the firm's partners and staff. Non-compliance is subject to internal sanctions, including the possibility of dismissal from the firm.

All KPMG partners and staff are required to report an independence breach to the Ethics & Independence Partner as soon as they become aware of it. Any breaches of auditor independence regulations or standards are required to be reported to Those Charged With Governance at the related client.

Confirmation of our independence is provided at least annually to our clients' Audit Committees to inform their evaluation of our compliance with all relevant independence requirements.

2.1.2 Managing conflicts of interest

Sentinel, KPMG's proprietary global web-based application, facilitates compliance with auditor independence requirements and identifies potential conflicts of interest for prospective engagements.

All KPMG partners and staff are responsible for identifying and managing conflicts of interest. KPMG engagement teams are required to use Sentinel to identify potential conflicts of interest so that these can be addressed in accordance with legal and professional requirements. For example, any non-audit services proposed to be provided to audit clients are required to be entered into Sentinel, which assigns proposed engagements for consideration by the Lead Audit Engagement Partner prior to any approval.

2.1.3 The important role of Audit Committees

No discussion of auditor independence would be complete without acknowledging the increasingly important and beneficial role that company Audit Committees play. Audit Committee oversight provides a valuable safeguard in preventing conflicts of interest from occurring in the provision of other assurance and audit-related services and non-audit services.

All public companies are required to have an independent auditor. Audit Committees closely scrutinise and challenge auditors' work, including considering the relationship between auditing and consulting services, and potential conflicts of interest. The focus of Audit Committees on independence and audit quality is driven by the need to meet fiduciary responsibilities as directors, which relies on the robustness of the financial reporting and auditing carried out, as well as reputation management.

Audit Committees have an important role to play in the governance of a company by overseeing the work of auditors and ensuring they are rigorously held to account. The increasingly prominent role of Audit Committees means companies are now highly analytical when considering auditor appointments and managing stakeholder expectations.

Guidance published by ASIC[2] has provided useful direction to Audit Committees in the performance of their roles and in particular in relation to assessing the independence and quality of their auditor.

2.1.4 Non-audit services provided to audit clients

The regulatory rules and systems relating to the provision of non-audit services to an audited entity are extensive and, in our view, effective in safeguarding auditor independence.

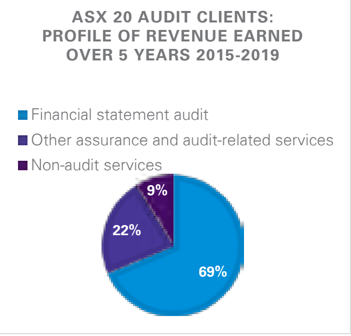
The Corporations Act and Code of Ethics for Professional Accountants[3] restrict certain non-audit services, for example certain tax planning and other tax advisory services, designing or implementing certain IT systems and acting in an advocacy role in resolving a dispute or litigation. All other services require careful evaluation to ensure they do not create, or appear to create, an independence issue.

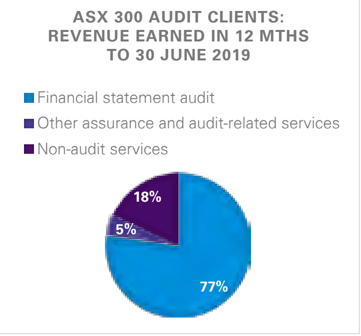
Certain information on all prospective engagements, including service descriptions and fees, must be entered into Sentinel as part of the engagement acceptance process.

[2] ASIC information sheet INFO 196, Audit quality – the role of directors and Audit Committees, June 2017
[3] APES 110 Code of Ethics for Professional Accountants

Lead Audit Engagement Partners are required to maintain group structures for their publicly traded and certain other audit clients, as well as related entities of these audit clients, in Sentinel and to annually confirm compliance through a declaration process. They are also responsible for identifying and evaluating any independence threats that may arise from the provision of a proposed non-audit service, and the safeguards available to address them. For entities where group structures are maintained, Sentinel enables Lead Audit Engagement Partners to review and approve, or deny, any proposed service for those entities worldwide. From 1 November 2019, the approval of the Ethics & Independence Partner is also required for all non-audit services to listed audit clients.

Over the past five years, 69 per cent of revenue for KPMG's six audit clients in the ASX20 was earned from the financial statement audit, 22 per cent from other assurance and audit-related services and 9 per cent from non-audit services. In FY2019, 5 per cent of the revenue earned from our ASX 300 audit clients was from other assurance and audit-related services and 18 per cent from non-audit services.





2.1.5 Areas for consideration

While we consider our controls and processes to be robust and the regulatory framework to have served Australia's capital markets well, we recognise that there is room for improvement. Here, we outline some ideas for improving transparency and clarity relating to auditor independence.

Consideration: Enact industry-wide definitions of other assurance and audit-related services and non-audit services

There are no industry-wide definitions of other assurance and audit-related services and non-audit services. This can result in public confusion, as well as inconsistencies when companies are considering the nature of permitted services performed and related fees paid to their auditor. To enable transparency, we strongly favour the national standard setters issuing proposals to define specifically what is meant by "financial statement audit", "other assurance and audit-related services" and "non-audit services."

Consideration: Mandate clearer disclosure of 'financial statement audit', 'other assurance and audit-related services' and 'non-audit services' in company annual reports, and specify the nature of any non-audit and assurance services provided

While disclosure of auditor's remuneration is already required in company annual reports, we believe additional transparency and clarity can be added to the system by mandating more specific and consistent disclosures in line with industry-wide definitions (mentioned above). This could be accompanied by more details on the defined types of permitted assurance and audit-related services, and non-audit services that have been provided by the financial statement auditor.

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Consideration: Expand requirement that audit partners cannot be remunerated for selling non-audit services

KPMG has a clear policy of not remunerating any audit partners for selling non-audit services to any audit clients of the firm. There is zero financial incentive for audit partners to put revenue ahead of audit quality.

By contrast, actions taken – or not taken – by an audit partner that risk impairing audit quality can, and do, have a direct negative impact on remuneration.

Given audit partners in Australia are required to sign both audit reports and a personal attestation of independence in their own names annually, there are also reputational incentives and legal obligations requiring the delivery of quality audits while being independent in both fact and appearance.

We believe our remuneration policy builds trust in our client engagements and in the system more broadly. We consider this approach should be extended across the profession. We support revising the Code of Ethics standard, APES 110, to include the concept that no audit partner can be remunerated for selling non-audit services to any audit clients of a firm, as a mandatory safeguard that all firms need to apply to mitigate risks of potential conflicts of interest.

Consideration: Cap non-audit services (excluding other assurance and audit-related services) for ASX300 listed companies

The provision of non-audit services by auditors is currently managed by a combination of the law, regulators, Audit Committees and audit firms. In general, we consider this works effectively, however we acknowledge there is increased focus on ensuring the provision of non-audit work does not compromise independence, in reality or perception.

Currently, auditors perform an important role in providing a defined range of services beyond, but closely related to, the financial statement audit. These services are provided in a manner that leverages existing knowledge, processes and cost efficiencies, while being fully compliant with all legal and professional independence requirements. Auditors are also, subject to compliance with legal and professional independence requirements, permitted to provide non-audit services.

To help provide clarity and certainty, consideration could be given to capping non-audit services (excluding other assurance and audit-related services) for ASX 300 listed companies. Capping would involve allowing permitted non-audit services to be provided by the statutory auditor up to a set percentage of the fee paid for the statutory audit.

2.2 Tenure

There has been much debate over the years, internationally and domestically, about individual auditor and audit firm tenure with clients. Questions have been asked as to whether longer tenure may lead to over-familiarity and, through that, the erosion of professional scepticism.

For listed company audits in Australia, key audit partners are required to rotate every five or seven years. There is no requirement for the mandatory rotation of audit firms.

We believe that current auditor rotation requirements, together with the increasing rotation that occurs naturally amongst CEOs and CFOs, and the frequency of change in membership of Audit Committees, significantly reduce familiarity risk.

We note that the European Parliament's Committee on Economic and Monetary Affairs recently published the findings of a study on the impact of audit reform in the EU on costs, concentration and competition[4]. The study noted that: "When we focus on firm rotation and auditor tenure in the auditor independence literature, the evidence generally shows that a longer tenure is not associated with lower quality audits and that mandatory rotation does not necessarily lead to enhanced audit quality."

[4] *EU Statutory Audit Reform: Impact on costs, concentration and competition, study requested by European Parliament's Committee on Economic and Monetary Affairs (ECON), April 2019*

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2.2.1 Areas for consideration

While we don't advocate mandatory audit firm rotation, we do have suggestions for improving transparency and clarity relating to audit firm tenure and tendering.

Consideration: Mandate explicit disclosure of auditor tenure in company annual reports

US PCAOB auditing standards require specific disclosures relating to auditor tenure in the auditor's report. Mandating explicit disclosure of auditor tenure should be considered for the Australian market.

Consideration: Mandate time-bound 'comply or explain' tendering regime

We believe there is merit in considering a transparent process requiring Audit Committees to put their audit out to tender within a specified timeframe.

This could be done on the basis of a 'comply or explain' regime, where audits are put out for tender based on a certain timeline or companies are required to explain to shareholders why this has not occurred.

Consideration: Introduce mandatory tendering

We are aware that in overseas jurisdictions, mandatory audit firm rotation has been proposed and, in some cases, introduced. Some nations, for example Canada, South Korea, Spain and Brazil, have subsequently repealed it. In July 2013 the US House of Representatives passed a bill to prohibit mandatory firm rotation, although rules requiring mandatory audit firm rotation have been implemented in the EU.

Over the years, the majority of academic studies have concluded that the research in relation to audit firm tenure and audit quality do not support mandatory firm rotation. One such study[5] concluded: "Considering all research… it can be concluded that mandatory audit firm rotation certainly increases audit costs, decreases audit quality and reduces competition in the audit market… Because mandatory audit firm rotation decreases audit quality it cannot be justified."

Given this context, and as an alternative to the 'comply or explain' tendering regime suggested above, consideration could be given to a mandatory tendering regime rather than audit firm rotation. We believe this may increase transparency and better safeguard audit quality than mandatory audit firm rotation. It should be noted that a tendering process may, appropriately, result in a company's current auditor being reselected.

2.3 Transparency of audit regulatory oversight

2.3.1 The importance of regulatory oversight

We believe it is the responsibility of audit firms to invest in continuous improvement and rectify any identified deficiencies in audit quality capable of eroding trust in the system. We also believe that the regulator has a vital role to play in enhancing public confidence in the audit process.

We take findings from ASIC's inspection process seriously and believe that process provides valuable insights to improve the quality of our audits. We conduct an evaluation of all matters identified by ASIC, including through a process of root cause analysis. We take action to address the findings in an appropriate manner, consistent with auditing standards and our policies and procedures. This includes timely and appropriate remediation of audit files, where inspection findings indicate concerns.

In terms of identifying which audits to inspect, ASIC understandably skews its sample selection to the most complex and high-risk audits. We therefore welcome the regulator's approach to clearly warn against the extrapolation of its results to make wider conclusions about a firm's audit quality.

[5] Mandatory Audit Firm Rotation: A cure or a placebo?, Onur Aslan, Tilburg University, Netherlands 2011/12

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ASIC's audit inspection process compares well to international best practice[6]. We commend ASIC for its continued willingness to engage with the profession about ways in which the audit inspection program can be improved.

2.3.2 Areas for consideration

The following considerations are noted as a basis for advancing this discussion.

We outline some ideas for improving transparency and clarity relating to regulatory oversight of auditing.

Consideration: ASIC's inspection findings to be graded

We suggest a system of 'grading' or rating be introduced in order to help the public interpret ASIC's findings. This should help shareholders distinguish between findings that indicate an audit opinion may be unsupported and other, less significant findings such as areas for improvement in documented audit evidence.

The current system used by ASIC can result in inspection findings that vary markedly in terms of significance being presented as like-for-like. Formally stratifying or grading the significance of ASIC's findings would help provide more clarity to all stakeholders.

A system of contextualising ASIC's findings in relation to the overall audit opinion on the financial statements would also be useful, providing a better overall picture of the relative significance of the regulator's findings.

In considering this change, ASIC might refer to the inspection processes in jurisdictions including the UK, Canada and France, where inspections are categorised to reflect the overall significance of the findings on each audit[7].

Consideration: Establish an appeals process with formal protocols to provide clarity to all parties

Given the expertise, experience and judgement involved in conducting an audit, and considering the application of accounting requirements, the inspection process conducted by ASIC could be strengthened through more transparent protocols that involve a final determination of any areas of disagreement. At present ASIC and the firms are not always aligned in their respective views and positions. Misalignment may impact trust.

As acknowledged by the OECD, "well-publicised, adequate and trusted possibilities to appeal decisions"[8] are an important part of any inspections regime. We consider there is an opportunity to clarify the process for appeal or other escalation procedures to enhance transparency and trust in the system. Current possibilities for appeal are limited to the ASIC inspection team itself, are time-consuming for all parties, and often fail to resolve the differences in opinion.

ASIC's submission to the Inquiry proposes that it should be granted powers to compel auditors to remediate deficiencies on individual audits and across the firm, or to remove firms from specific audits[9]. Should this new power be created the need to efficiently and effectively resolve any areas of disagreement would have even greater importance.

We encourage ASIC to establish formal protocols to provide clarity to all parties in relation to the appeal process, and to consider involving a third party expert, who is independent to the firm making an appeal, to support procedural fairness.

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[6] See IFIAR Core Principles for Independent Audit Regulators; OECD Best Practice Principles for Regulatory Enforcement and Inspection (2014); and OECD Regulatory Enforcement and Inspections Toolkit (2018)
[7] The UK regulator uses Good / Limited improvements required / Improvements required / Significant improvements required; Canada refers to files with significant findings, files with other findings, and files with no findings.
[8] OECD Regulatory Enforcement and Inspections Toolkit (2018)
[9] Table 2, Page 13, ASIC submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the regulation of auditing in Australia

Consideration: Mandatory publication of individual firm inspection reports on the ASIC website

Greater transparency is needed to give more insight into the quality offered by the audit sector in Australia. Currently ASIC publishes findings from audit firm inspections and financial reporting surveillance program of companies.

We note ASIC's decision to report individual percentage findings from its audit file reviews in its next public audit inspection program report, due by December 2019. However, we encourage the mandatory publication of individual audit firm inspection reports on the ASIC website to provide important context to the percentage finding. This would bring Australia in line with other jurisdictions including the UK and US.

Consideration: Review the effectiveness of Transparency Reports and identify means of improvement

KPMG was the first firm in Australia to voluntarily publish a report giving greater insight into the role and quality of audit (a transparency report). Transparency Reports are now a legal requirement[10] for reporting on audit firms and audit quality in Australia (they are also required in the EU) and should be used to help build public confidence.

Transparency Reports are intended to provide relevant, reliable and useful information to stakeholders. They aim to facilitate engagement between firms and users of financial information, and promote confidence in our systems, processes and governance.

The UK Financial Reporting Council recently released a review of Transparency Reports in which it noted:

- Transparency Reports are not being read:
  - there is a lack of awareness amongst investors and Audit Committee Chairs – with 84 per cent of Audit Committee Chairs unaware they exist; and of the 16 per cent who were aware, few had actually read the report relevant to the firm they engage with;
  - those who know about them think the reports are too long and overly positive to be useful; and
  - Transparency Reporting currently is not effective.

We believe there may be an opportunity to conduct a similar review of the effectiveness of Transparency Reports in Australia, with a view to implementing changes that contribute to better, clearer and more useful reporting on audit firms and audit quality.

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[10] Under section 322A of the *Corporations Act 2001* (Cth).

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3. Our commitment to audit quality

Audit quality is fundamental to maintaining public trust in the capital markets and the financial reports issued by audited organisations. When we talk about how we are striving to maintain and improve quality, it is not an abstract aspiration. Quality is fundamental to our purpose, and we constantly monitor and evaluate it.

In this section, we focus on audit quality – how we as a firm drive quality, our systems of quality control, and the initiatives we are continuously pursuing to improve it.

Although there is no agreed industry definition, KPMG globally believes that 'audit quality' is the outcome when audits are:

- executed consistently, in line with the requirements and intent of applicable professional standards, within a strong system of quality controls; and
- undertaken in an environment of the utmost level of objectivity, independence, ethics and integrity[11].

Our firm-wide commitment to audit quality is founded upon and delivered through our governance structures, the role of leadership and management, our culture, our people, our systems and processes and our organisation.

We comment on each of these areas below. Additional detail can be found in our Transparency Report, publishing 31 October 2019.

3.1 Governance

Our governance structure sets the formal framework for establishing, managing and monitoring audit quality.

KPMG's Global Board last year made a number of significant governance changes squarely focused on improving audit quality. This included appointing a Global Head of Audit Quality, reporting to a new Global Audit Quality Committee (GAQC) of the Global Board.

GAQC plays a critical role in setting the quality agenda, working with regional and member firm leadership to:

- establish and communicate audit quality and risk management policies - KPMG's Global Quality and Risk Management Manual;
- enable effective and efficient processes to promote audit quality, including a strong focus on consistency of our methodology;
- drive strategy implementation in member firm's audit functions, including standards of audit quality; and
- evaluate audit quality issues - including those arising from internal quality performance and external regulatory reviews - and communicate learnings and best practice back to member firms.

Domestically, the Board of KPMG Australia is the principal governance and oversight body for the firm. The governance structure includes committees that have risk and quality responsibilities to oversee and influence the firm's audit quality.

[11] KPMG's definition is consistent with and builds on ASIC's definition of audit quality – see ASIC information sheet INFO222 *Improving and maintaining audit quality*, June 2017.

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3.2 Leadership and Management

In our view, strong leadership and management are critical for audit quality. Setting the tone and establishing responsibility at the top builds accountability and consistency through the complete chain of leadership and our teams.

In Australia, our CEO has overall responsibility for our system of quality control and the performance of the firm. All KPMG Australia's initiatives to improve audit quality are underpinned by strong leadership from the firm's National Executive Committee. From 1 July 2018, our CEO assigned every member of the firm's National Executive Committee an audit quality-focused goal, which feeds directly into annual performance and remuneration outcomes. This is to ensure that all our senior leaders – not just auditors – understand, and are held accountable for audit quality.

As an example, the audit quality goal for the National Managing Partner of the firm's Management Consulting division is:

"Monitor and report bi-annually to the Chief Executive Officer the division's activities that have assisted in the enhancement of audit quality. (This may include activities such as training, accreditation and competency of specialists involved in the delivery of external audit services, client risk assessment approval and monitoring, and the monitoring of other services that may impact auditor independence). Additionally, any issues or actions arising from this reporting will be included in the Audit Quality Action Plan, to enable subsequent monitoring and remediation."

Our National Partner in Charge of External Audit is directly accountable to the National Managing Partner of KPMG's Audit, Assurance & Risk Consulting division for the delivery of the firm's audit quality strategy.

Our National Head of Audit Quality is responsible for monitoring internal and external audit quality signals and driving actions for continuous improvement. The National Head of Audit Quality is a member of the Global Audit Quality Steering Committee and responsible for leading the implementation in Australia of initiatives determined by the Global Audit Quality Steering Committee. Together with a dedicated Divisional Risk Management Partner, they are accountable to the Chief Risk Officer, who retains overall operational responsibility for our system of quality control and risk management.

An Engagement Quality Control (EQC) reviewer is appointed for all listed company audits. The EQC review is an important part of KPMG's framework for audit quality. These reviewers are independent of the engagement team and have the appropriate experience and knowledge to perform an objective review of the more critical decisions and judgements, including the appropriateness of the financial statements and audit report. An audit is completed only when the EQC reviewer is satisfied that all significant questions have been resolved.

Audit quality is also integral when we appoint and promote new partners in our audit practice. We require audit partner candidates to have specific audit quality oversight experience as part of their progression to partner.

3.3 Culture

Our commitment to audit quality is underpinned by our values, which form the foundation of our culture and set the tone for governance and leadership. They define our diverse and inclusive culture and our commitment to personal and professional conduct.

Our values emphasise that, above all, we act with integrity. We uphold the highest professional standards and provide sound advice – while rigorously maintaining our independence and complying with laws, regulations and professional standards. We communicate our values clearly to our people and embed them in people processes including induction, performance development and reward.

Building on our values is the KPMG Global Code of Conduct. All partners and staff are required to act in line with this. Everyone at KPMG is required to take regular training covering the Code, and to confirm their compliance. Adherence is monitored and managed.

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The firm has clear procedures and established channels of communication in place so that anyone can report ethical, quality or other issues. In addition, KPMG International has a Whistleblower Hotline for all KPMG partners, employees, clients and other external parties to report any concerns they may have. We encourage speaking up so that we can take action when inappropriate behaviour is identified and seek to learn and improve from feedback.

Our culture promotes consultation, challenge and open discussion of issues and is a fundamental contributor to audit quality. This encourages partners and staff to debate and discuss difficult or contentious matters.

We have embedded a culture of continuous improvement, as evidenced through initiatives including:

- An independent team that reviews and challenges the work of audit teams as the audit is taking place, focusing on higher risk companies and audit areas where formal inspection and monitoring processes suggest we can do better. We call this our 'second line of defence'.
- Mandatory policies and data monitoring processes to ensure our teams plan their public company audits, and understand significant risk areas earlier and more consistently so senior team member input is delivered when it most matters.
- Dedicated teams that centralise and standardise certain audit procedures, freeing up senior audit team capacity to focus on high-risk audit areas.

3.4 People

Our people have a direct impact on the planning and performance of our audits, and therefore audit quality. Their calibre and integrity are key to us being considered trustworthy. Our people's knowledge and experience, enabled by technology, are essential to meeting the challenges of evolving stakeholder expectations.

We invest significantly in equipping our people to do the best job by building their skills and capabilities. We cultivate a continuous learning environment and support a coaching culture.

On-the-job development and training includes participating in interstate and overseas assignments, secondments and community involvement through pro-bono and volunteering opportunities. Our learning curriculum offers programs focusing on maintaining and developing capabilities in technical competence, building industry knowledge, innovation and emerging technologies and leadership behaviours.

Technical courses covering independence, financial reporting and auditing topics are mandatory at all audit staff levels. These range from independence learning as part of induction (and annually thereafter), through to audit partners and qualified staff attending mandatory accounting and auditing technical updates. We develop specific learning to address priority audit quality areas. For example, our learning forums are heavily weighted to reinforcing ASIC's messages and addressing their findings from recently completed inspections and preliminary observations from current inspections. In recent years this has included auditing revenue and auditing impairment[12]. These courses also instil in our staff the importance of professional scepticism and ethical behaviour in conducting our audits.

KPMG partners and staff must also successfully complete a post course assessment for mandatory technical learning. The assessment tests their understanding of the topics covered and has a minimum pass rate and completion deadline.

KPMG's recruitment process for audit is focused on attracting people from diverse backgrounds with capabilities and values that will help drive audit quality, be able to constructively challenge our clients and maintain professional scepticism. In addition to accounting professionals, technologists and data scientists are increasingly being hired, reflecting the changing needs of our audit processes.

To deliver audit quality, our audits are undertaken with input from a range of other experts called upon from within KPMG. These can include IT specialists, actuaries, tax experts, forensic accountants, experts in financial instrument valuation, cyber experts and macro economists. The input from skilled

[12] Refer to KPMG's Transparency Report 2018, page 21.

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and experienced specialists in an audit for a large multi-national company is critical for audit quality. For our ASX300 audit clients, specialists represent around 13 percent of the time spent on the audit.

Audit partners consider the competence and capabilities of their team, including specialists. This includes considering whether the team has the appropriate resources, with the experience, skills and time to conduct a quality audit.

3.5 Systems & processes

We use technology to improve audit quality by driving better audit insights, creating greater consistency in the performance of audits and to strengthen monitoring of engagements. We believe that audit quality is best achieved when the power of smart technology is matched with inquiring minds and professional scepticism.

We are updating our audit methodology and embedding it in our recently launched 'smart' audit platform, known as KPMG Clara. KPMG Clara unites, in a single platform, our data and analytic capabilities, innovative new technologies, audit capabilities and workflow to enhance quality and efficiency. It also includes collaboration capabilities that improve data flows between the audit team and the company. Our new audit workflow, KPMG Clara Workflow, is being deployed globally from 2020.

From a shareholder perspective, KPMG Clara Workflow will enhance audit quality through:

- enhancing global consistency;
- allowing audit teams to access a deep wealth of information and resources relevant to the company's industry and circumstances, resulting in better understanding of client risks and a more targeted audit approach;
- enabling audit teams to easily access auditing standards and guidance through the workflow; and
- enhancing data and analytic capabilities to allow audit teams to quickly identify data or transactions that warrant further investigation.

Our increasing ability to use data and analytic techniques allows us to audit entire data sets, instead of using sampling techniques, giving greater coverage.

We will continue to scale and enhance our audit technology platform, enabling us to incorporate emerging technologies such as AI (artificial intelligence), predictive analytics, machine learning and cognitive technologies as they advance and mature. The KPMG global audit development team has spent approximately $175m over the past year on enhancing audit technology, which directly benefits the Australian firm. In FY19, KPMG in Australia invested approximately $20m in technology, innovation, training and technical support focused on audit quality.

3.6 Organisation

Audit is the foundation of our firm. Throughout our history, our audit clients have been key beneficiaries of significant investment made by the firm into new services, technology and leading edge talent. Today, we bring the best of our diverse firm, to our audits. As a multi-disciplinary firm, audit is a critical part of our business, which we want to expand and grow.

We strongly believe that being a multi-disciplinary firm enhances audit quality, allowing us to:

- **Attract the best talent:** allows us to attract, develop and retain people who have a wide range of skills, interests and backgrounds. Giving great people the opportunity to expand and grow their careers allows us to better serve the evolving needs of the market and our clients.
- **Access specialists:** allows us to utilise people from across audit, tax and advisory to build balanced and high performing audit teams. This gives us access to talent that would not be available to clients in an audit-only firm.
- **Invest:** allows us to invest in the development and deployment of new technology, which in a digital world is critical to ensuring that quality and consistency is at the heart of everything we do.

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- **Access industry and country expertise:** allows us to offer the market deep industry and country knowledge, from multiple perspectives. This is only possible through a global, multi-disciplinary firm.

Maintaining specialist skills would pose significant challenges to an audit-only firm. Indeed, this expertise is necessarily developed from undertaking a variety of work. Sourcing such expertise from outside an audit-only firm would likely result in additional costs, which would ultimately be borne by shareholders of the client company. Utilising experts from external parties would also pose significant regulatory challenges[13].

4. The future of audit

With the market rapidly changing, and expectations along with it, we believe there are opportunities to evolve the function and scope of audit. Given the rapid rise of technology and the increasing sophistication of auditor and specialist skills, there are a range of possibilities to constructively expand the role of audit and auditors where there is market demand and it is beneficial to the operation of capital markets. Our vision is for audits that are more digitally enabled, data-driven and ultimately more real time.

We outline some areas for consideration, pertinent to the Inquiry's terms of reference that could realistically expand and enhance the role of audit in the public interest; and potentially help to better meet public expectations in the future.

4.1 Fraud

According to a recent independent survey, 40 percent of the Australian public expects auditors to always detect any fraud[14]. While we understand the public's notion that detection of fraud should be a priority within an audit, in reality the nature of fraud means that it is typically identified from other sources.

KPMG International's most recent global study, *Global Profiles of the Fraudster 2016*, found that 14 percent of frauds were detected by internal audit, 22 percent by company management reviews and 44 percent through tips offs and formal whistleblower hotlines[15].

So why don't external auditors find more frauds?

KPMG's forensic and fraud specialists refer to the "Fraud Triangle"[16], which identifies the three key conditions allowing fraud to take place as being 'motivation', 'justification' and 'internal control breakdown'.

Further, our global research has shown that:

- individual motivations/rationalisations are very strong drivers of fraud;
- collusion is common, including with people outside of the organisation;
- fraud events are continually changing;

[13] Within a multidisciplinary firm, experts working on individual audit engagements maintain personal independence in accordance with legal and ethical requirements, just like any member of staff or partner in the audit profession. If these experts were sourced from another firm, these independence requirements would be significantly more difficult to satisfy. There would be significant potential for trust in audit integrity to be eroded under such a system. Similar regulatory challenges would exist around the need to regulate the potential for inappropriate use of audit knowledge post audit completion.
[14] *What the public wants from audit*, May 2019, ACCA, CAANZ.
[15] These findings are consistent with those identified in the Association of Certified Fraud Examiners, Report to the Nations: 2018 Global Study on Occupational Fraud and Abuse, April 2018
[16] Based on the work of American criminologist Dr Donald Ray Cressey.

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- almost a quarter of fraudsters rely on technology, with cyber fraud emerging as the largest growing threat;
- anti-fraud controls are not strong enough and weak internal controls are a contributing factor in around 75 percent of frauds;
- even if controls are strong, ever more sophisticated fraudsters evade or over-ride them; and
- 44 percent of fraudsters have unlimited authority in their company and are able to override controls.

Fraud often involves sophisticated and carefully organised schemes designed to conceal it – forgery, deliberate failure to record transactions, intentional misrepresentations being made by company representatives and more. Such attempts at concealment may be even more difficult to detect when accompanied by collusion – which can cause auditors to believe audit evidence is persuasive when in fact it is forged or false. Ability to detect fraud depends on many factors including the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated and the seniority of those involved.

Today, auditors' duties in relation to fraud detection are limited. The auditor's role plays peripherally into 'motivation' and 'justification', with the key link to our role being involvement with 'internal controls'. Corporate governance, management of risk, and fraud prevention are primarily the responsibility of the company's board and executive management.

The independent auditor plays a role in detecting certain material types of fraud relevant to financial reporting, but this role is driven directly by the requirements of existing legally enforceable standards, which auditors must follow in performing each audit. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is often very difficult to determine whether misstatements in judgement areas, such as accounting estimates, are caused by fraud, or error. Auditors select samples for testing, rather than whole populations of transactions – meaning fraudulent transactions may go undetected through the external audit process.

An audit today therefore provides reasonable, not absolute, assurance in relation to detecting material fraud, rather than all fraudulent activity.

We believe that there are opportunities to revisit these responsibilities. In particular, the following initiatives may warrant further consideration.

Consideration: Strengthen the requirement for an auditor to consider the adequacy of company internal controls

A breakdown in internal controls is a common ingredient in the existence of fraud by management. We would support strengthening the requirement for an auditor to consider the adequacy of company internal controls that help to prevent or detect material fraud. Additional guidance or changes to existing auditing standards could be considered, to have auditors report any significant weaknesses to the company's Audit Committee for remediation.

Consideration: Strengthen reporting on fraud in audit reports

We would support additional content being included in audit reports which communicates the auditor's obligations to detect or prevent fraud, and which further specifies the audit procedures undertaken to address the risk of material fraud as part of the audit.

The content should be tailored to the client based on specific knowledge of the relevant industry and avoid the use of 'boilerplate' language. Disclosures should enable a user to understand how fraud might occur, and the specific audit tests designed to enable the auditor to obtain reasonable assurance that the financial statements are free of material misstatement. For example in a major retail client you may see a discussion which refers to customer sales rebates and inventory balances, and the specific audit tests designed to address the risk of a material fraud in those areas. These tests could include confirming directly with customers relevant contract terms and net amounts owing at period end, and observing inventory counts on an unannounced basis.

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4.2 Going concern

We appreciate there is a gap between the historical nature of an audit and public concerns about company viability and agree that audit needs to evolve to meet expectations in this area.

We believe that there are opportunities to revisit these responsibilities. In particular, the following perspective is presented for further consideration.

Consideration: Implement a new reporting requirement for auditors to report on management's assessment of going concern

We support implementing a new reporting requirement for the auditor of listed entities to provide a clear statement on whether management's assessment of going concern satisfies the reporting requirements, and to set out the work done in this respect.

This should be accompanied by strengthening the ASX Corporate Governance Principles, so companies are required to provide a 'viability statement' in financial reports. This statement should include disclosures on how the board has assessed the prospects of the company, over what period, and an explanation as to why that time period is appropriate.

The UK regulator has recently issued revised requirements to increase the work auditors are required to do when assessing whether an entity is a going concern. The revisions require more work on the part of the auditor to robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias and make greater use of the company's viability statement.

We consider the need to address public expectations through greater transparency outweighs the additional costs that would be associated with these proposals, including those arising from the need for further regulation of both companies and auditors.

4.3 Using auditors to promote better corporate governance

Recent research has shown when retail investors read financial reports they do not just focus on financial performance. Rather, Australian retail investors are keenly aware of the importance of reputation, transparency, ethical behaviour, values alignment and social responsibility.[17] As trust in organisations has fallen, the focus on boards acting ethically and responsibly has intensified.

The findings from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry have heightened focus in Australia around governance and risk-management responsibilities and capabilities – along with the need for the risk culture to address underlying causes of misconduct. Commissioner Hayne noted: "after the Global Financial Crisis financial services entities and regulators, in Australia and elsewhere, gave close attention to financial risk. Until recently, however, too little attention has been given in Australia to regulatory, compliance and conduct risks. Too little attention has been given to the evident connections between compensation, incentive and remuneration practices and regulatory, compliance and conduct risks".

In this context, we believe there are opportunities to revisit auditor responsibilities. In particular, the following initiative may warrant further consideration.

Consideration: Obtain independent assurance over non-financial information

Currently there are standards and principles in place requiring the reporting and auditing of financial information provided to boards. However, the way in which companies capture and report non-financial matters varies considerably, and is not normally subject to any form of independent assurance. These non-financial matters (for example, customer complaints, whistleblower events, and staff and customer satisfaction data) typically support operational risk management and may be leading indicators of underlying control or culture issues within a company.

[17] *Shareholder value: Shareholder values: What motivates Australian retail investors*, KPMG Australia, September 2019

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Consideration may be given to encouraging companies to obtain independent assurance on non-financial information in an effort to enhance corporate governance. We would support consultation to identify the governance matters of most value and relevance to shareholders.

4.4 Evaluation of audit quality by Audit Committees

Guidance published by ASIC[18] has provided useful direction to Audit Committees on the performance of their roles and in particular in relation to assessing the independence and audit quality of their auditor. Greater transparency on the interaction of auditors and Audit Committees may be considered of value to shareholders and help engender greater trust in the system.

Consideration: Require companies to report to shareholders on Audit Committees' oversight of the external auditor

Companies could be required to report to shareholders annually on the Audit Committee's oversight of the external auditor. For example, under the Corporate Governance Code in the UK, the annual report of a listed company describes the work of the Audit Committee, including how it has assessed the independence and effectiveness of the external audit process, and how the decision to appoint or reappoint the external auditor was arrived at.

The description of the Audit Committee's work in the UK also includes information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any re-tendering plans. This model is, in our view, worthy of consideration in the Australian market.

5. Conclusion

At KPMG, audit is core to our business, critical to our brand and fundamental to our identity. We are acutely aware of the vital role audit plays in maintaining trust in the capital markets and society more broadly.

Ranked against the rest of the world, we can feel proud of the strength and integrity of our system in Australia. Nevertheless, there is always room to improve, develop and evolve.

We see the interest in audit as an opportunity to enable fresh thought about traditional practice and stimulate thinking about advancing trust in audit.

[18] ASIC information sheet INFO 196, Audit quality – the role of directors and Audit Committees, June 2017

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Our Transparency Report describes our systems of quality control in place during the year ended 30 June 2020 to manage the quality of our financial statement audits.

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