

Independent auditor's report

TO THE MEMBERS OF QBE INSURANCE GROUP LIMITED



Report on the audit of the Financial Report

Our opinion

In our opinion:

The accompanying Financial Report of QBE Insurance Group Limited (the Company) and its subsidiaries (together the Group) is in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the Group's financial position as at 31 December 2015 and of its financial performance for the year then ended; and
- complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

What we have audited

The Group's Financial Report comprises:

- the consolidated balance sheet as at 31 December 2015;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the notes to the consolidated financial statements, which include summaries of significant accounting policies; and
- the directors' declaration.

Basis for opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

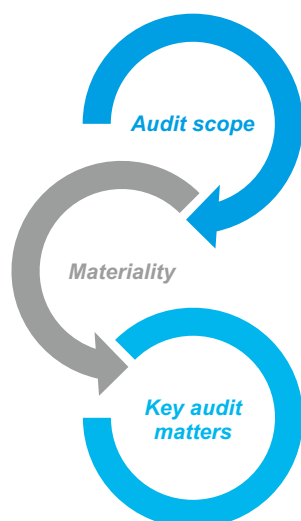
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (the Code) that are relevant to our audit of the Financial Report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

Our audit approach

Overview



Audit scope

We conducted:

- An audit of the most significant operations being the North American Operations, European Operations, Equator Re and the material insurance operations within the Australian & New Zealand Operations
- Specific audit procedures in Emerging Markets and on other account balances to ensure we obtained sufficient appropriate audit evidence to express an opinion on the Group Financial Report as a whole

Materiality

- For the purposes of our audit, we used a threshold for overall Group materiality of \$62 million which represents 0.5% of net earned premium

Key audit matters

- Valuation of net outstanding claims
- Valuation of goodwill in North America
- Recoverability of deferred tax assets in North America
- Valuation of investments

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Audit scope

We designed our audit by determining materiality and assessing the risks of material misstatement in the Financial Report. In particular, we considered where the directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the Financial Report as a whole, taking into account the structure of the Group, the significance and risk profile of each operation, the accounting processes and controls, and the industry in which the Group operates. We also ensured that the audit teams both at Group and at operational levels included the appropriate skills and competencies which are needed for the audit of a complex global insurer. This included industry expertise in insurance, as well as specialists and experts including IT auditors, actuarial, tax, treasury and valuation specialists.

We conducted an audit of the most significant operations being the North American Operations, European Operations, Equator Re and the material insurance operations within Australian & New Zealand Operations. These operations represent 86% of the Group by net earned premium, 89% of profit before tax and 89% of net assets. In addition, we performed specified audit procedures on certain account balances for a further five entities.

For the work performed by local auditors within PwC Australia or from other PwC network firms operating under our instructions, we determined the level of involvement we needed to have in the audit work at those locations to be satisfied that sufficient audit evidence had been obtained for the purposes of our opinion. We kept in regular communication with audit teams throughout the year with phone calls, discussions and written instructions, where appropriate. Further, we visit the significant operations on a rotational basis and this year met with management and our local audit teams in New York, London and Sydney.

Further audit procedures were performed by the Group engagement team, including substantive and review procedures over the remaining balances and the consolidation process. The work carried out in the operations, together with these additional procedures performed at the Group level, provided us with sufficient evidence to express an opinion on the Group Financial Report as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. Our audit opinion aims to provide reasonable assurance that the Financial Report is free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Group materiality for the Financial Report as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate, on the Financial Report as a whole.

Overall group materiality	\$62 million
How we determined it	0.5% of net earned premium
Rationale for the materiality benchmark applied	We chose net earned premium as the benchmark because, in our view, it is a key financial statement metric used in assessing the performance of the Group and is not as volatile as other profit and loss measures. We selected 0.5% based on our professional judgement, noting that it is also within the range of commonly accepted revenue-related benchmarks.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Report for the current period. We have communicated the key audit matters to the Audit Committee, but they are not a comprehensive reflection of all matters that were identified by our audit and that were discussed with the Committee. In the table below we have described the key audit matters we identified and have included a summary of the audit procedures we performed to address those matters.

The key audit matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on each of these matters. Further, any commentary on the outcomes of a particular audit procedure is made in that context.

Key audit matter	How our audit addressed the key audit matter
<p>Valuation of net outstanding claims – \$15.4b</p> <p>(Refer to Note 2.3)</p> <p>We focused on this balance because of the complexity involved in the estimation process, and the significant judgements that management and the directors make in determining the balance.</p> <p>Note 2.3 to the financial statements describes the elements that make up the net outstanding claims balance. We comment on the most judgemental aspects of these elements below.</p>	
<p>a) Gross discounted central estimate – \$17.3b</p> <p>(Refer to Note 2.3.1)</p> <p>The estimation of outstanding claims involves significant judgement given the size of the liability and inherent uncertainty in estimating the expected future payments for claims incurred.</p> <p>In particular, judgement arises over the estimation of payments for claims that have been incurred at the reporting date but have not yet been reported to the Group. There is generally less information available in relation to these claims. Classes of business where there is a greater length of time between the initial claim event and settlement (such as workers' compensation, professional indemnity and other liability classes) also tend to display greater variability between initial estimates and final settlement.</p> <p>The valuation of outstanding claims relies on the quality of the underlying data. It involves complex and subjective judgements about future events, both internal and external to the business, for which small changes in assumptions can result in material impacts to the estimate.</p> <p>The estimate of expected future payments is discounted to present value using a risk-free rate of return in order to reflect the time value of money. Judgement is involved in estimating the period over which claims are expected to settle.</p>	<p>Our audit procedures included, amongst others, evaluating the design effectiveness and implementation of key actuarial controls, including key data reconciliations and management's review of the estimates.</p> <p>In addition, because historical claims data is a key input to the actuarial estimates, we tested controls and performed detailed substantive testing over claims case estimates and settlements. No significant issues arose in this area and so, in the context of our audit materiality, we were satisfied with the adequacy of the data used in the actuarial estimates.</p> <p>We performed a risk-based assessment to determine those classes of business where claims reserve estimates are higher risk. These included classes which inherently involve greater levels of judgement and have historically shown greater year on year variation over previous estimates.</p> <p>In order to challenge management's methodologies and assumptions, with particular focus on the higher risk areas, we:</p> <ul style="list-style-type: none"> Evaluated whether the Group's actuarial methodologies were consistent with those used in the industry and with prior periods. We sought sufficient justification for any significant differences. Assessed key actuarial assumptions including claims ratios, and expected frequency and severity of claims. We challenged these assumptions by comparing them with our expectations based on the Group's historical experience, current trends and our own industry knowledge. For some classes of business, we also performed our own independent actuarial projections and compared the results with management's estimates. Based on this work, we concluded that the methodologies and assumptions were materially consistent with our independent expectations and analysis. Tested the discount applied for classes of business where there is a greater length of time between the initial claim event and settlement by territory and line of business. <p>We were assisted by our own actuarial experts to understand and evaluate the Group's actuarial practices and the provisions established. We also considered the work and findings of external actuarial experts engaged by management to corroborate our own findings.</p>
<p>b) Reinsurance and other recoveries – \$3.2b</p> <p>(Refer to Note 2.3.2)</p> <p>The valuation of reinsurance assets requires a significant level of judgement, given its inherent dependence on underlying estimates of gross outstanding claims.</p> <p>In addition, significant management judgement may be required to ensure contractual terms on the most material contracts are correctly accounted for (such as the Group's aggregate large risk and catastrophe reinsurance program (GLRC)).</p>	<p>We obtained audit evidence over the data and actuarial processes for estimating reinsurance recoveries on outstanding claims by performing the same audit procedures as those outlined above for gross claims estimates.</p> <p>With regards to the GLRC contract, we gave particular focus to assessing and challenging management's estimate of claims that will be subject to recovery under the contract. We reviewed the work of management's actuarial experts, as well as directly testing some relevant claims.</p>

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Key audit matter	How our audit addressed the key audit matter
<p>c) Risk margins and Probability of Adequacy (PoA) – \$1.3b (Refer to Note 2.3.3)</p> <p>The net outstanding claims provision includes, in addition to the central estimate of the present value of the expected future payments, a risk margin which relates to the inherent uncertainty in that estimate. In determining the risk margin, management must make judgements about the variability of each class of business underwritten and the extent of correlation within each division and between different geographical locations.</p> <p>PoA is a measure of the estimated overall sufficiency of reserves including a risk margin in light of that variability.</p>	<p>We assessed the Board's approach to setting the risk margin, with a particular focus on the assessed level of uncertainty in the net central estimate leading to a change in the margin year on year. We have challenged these factors by considering the findings from our work performed on the net central estimate.</p> <p>We tested the Group's actuarial calculation of the PoA for reasonableness and consistency with previous valuations. This included understanding and testing the actuarial techniques applied by management, and comparing the results with industry benchmarks. We found the variability assumptions to be aligned with industry benchmarks and prior year.</p>
<p>Valuation of goodwill in North America – \$1.5b (Refer to Note 7.2.1)</p> <p>We focused on goodwill in North America because the level of headroom between the valuation and the balance sheet carrying value remains limited following impairment in 2013. The carrying value is material, and the impairment test remains sensitive to a reasonably possible change in assumptions.</p> <p>The valuation is based on the Board approved business plan for North America. The most significant judgements relate to the discount rate applied together with the assumptions supporting the underlying forecast cash flows, in particular the terminal growth rate and the forecast combined operating ratios in the projection period and investment return assumptions.</p>	<p>We evaluated management's cash flow forecasts for North America and the process by which they were developed. We compared these forecasts to Board approved business plans and also compared previous forecasts to actual results to assess the performance of the business and the accuracy of forecasting.</p> <p>We confirmed that the three year forecast used in the valuation model was consistent with the Board approved North America business plan, and that the key assumptions were subject to oversight from the directors.</p> <p>We tested the assumptions and methodologies used, in particular those relating to the discount rate and growth rates. To do this:</p> <ul style="list-style-type: none"> • Our valuation experts evaluated these assumptions with reference to valuations of similar companies. • We compared the key assumptions to externally derived data where possible, including market expectations of investment return, projected economic growth and interest rates. • We applied sensitivities in evaluating the directors' assessment of the planned growth rate in cash flows, including forecast premium growth and combined operating ratios. <p>We concluded that the growth rate assumptions were reasonable given historic results, economic outlook and industry forecasts. Further, the discount rate used by management was consistent with market data and industry research.</p> <p>In testing the valuation model:</p> <ul style="list-style-type: none"> • We checked the calculations for mathematical accuracy, noting no exceptions. • We considered the sensitivity of the calculation by varying the assumptions and applying other values within a reasonably possible range for North America. <p>We also used the work and findings of external valuation experts engaged by management to corroborate our own findings.</p> <p>As indicated in note 7.2.1 the impairment assessment remains sensitive to a range of assumptions, in particular to changes in the discount rate and achievement of forecast investment returns and combined operating ratios.</p>

Key audit matter	How our audit addressed the key audit matter
<p>Recoverability of deferred tax assets in North America – \$0.6b (Refer to Note 6.2.3)</p> <p>We have focused on this balance because there has been a history of losses in North America, and as such, the recoverability of the deferred tax asset in North America is particularly sensitive to expectations about the future profitability of this business. This in turn depends on the achievement of underlying business plans.</p> <p>Significant judgement is required over the recoverability of deferred tax assets arising from past losses because the realisation of tax benefits is often dependent on future taxable profits and there are inherent uncertainties involved in forecasting such profits.</p>	<p>The ultimate recoverability of the tax losses depends upon both continued improvement in the profitability of the North American business, and the period over which the losses will be available for recovery.</p> <p>We focused on whether convincing evidence was available with regard to these two elements, as follows:</p> <ul style="list-style-type: none"> • Evaluated the progress made by management in improving the profitability of the business to date, which includes the remediation of the causes of past losses through, amongst other things, business disposals, implementation of a revised capital structure to reduce funding costs and other expense reduction initiatives. We noted that progress has been made against each of these. • Assessed the credibility of the business plans used in the deferred tax asset recoverability assessment. These were based on the same three year forecast used in the goodwill valuation model, and were therefore assessed as part of our goodwill testing as outlined above. • Used our tax experts, who confirmed that the tax losses are legally available for up to 19 years.
<p>Valuation of investments - \$26.0b (Refer to Note 3.2)</p> <p>This is the largest asset on the balance sheet, representing 62% of total assets. Our audit effort has increased in this area as the Group's investment portfolio has become more diversified in recent years, with further strategic asset allocations to growth assets in 2015.</p> <p>In particular, there is significant focus in ensuring the underlying investments are valued appropriately.</p> <p>The valuation of financial investments held at fair value is based on a range of inputs. Many of the inputs required can be obtained from readily available liquid market prices and rates. Where observable market data is not available, for example, when determining the valuation of certain infrastructure debt, estimates must be developed based on the most appropriate source data and are subject to a higher level of judgement.</p>	<p>We performed the following audit procedures over the valuation of investments held by the Group:</p> <ul style="list-style-type: none"> • We assessed the design and tested the implementation and operating effectiveness of the key controls over the investment function carried out by Group Investments, which is responsible for managing the majority of investments for the Group. • We assessed the Group's valuation of individual investment holdings. Where readily observable data was available, we sourced that independently. For investments where there was less or little observable market data, including level 3 holdings as disclosed in note 3.2.1, we obtained and assessed other relevant valuation data or carried out our own independent valuations. No material variances arose from performing this work.

Independent auditor's report

TO THE MEMBERS OF QBE INSURANCE GROUP LIMITED

Responsibilities of the directors for the Financial Report

The directors of the company are responsible for the preparation of the Financial Report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the Financial Report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the Financial Report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Financial Report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the Financial Report, including the disclosures, and whether the Financial Report represents the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the Financial Report. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, amongst other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the Financial Report of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Other information

The other information comprises the information included in the Group's Annual Report for the year ended 31 December 2015, other than the Financial Report and our Auditor's Report thereon. The directors are responsible for the other information.

Our opinion on the Financial Report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the Financial Report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Financial Report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information we are required to report that fact. We have nothing to report in this regard.

Report on the audit of the Remuneration Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 58 to 88 of the Directors' Report for the year ended 31 December 2015.

In our opinion, the Remuneration Report of QBE Insurance Group Limited, for the year ended 31 December 2015 complies with section 300A of the *Corporations Act 2001*.

Responsibilities

The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

PricewaterhouseCoopers

RJ Clark
Partner

Sydney
23 February 2016

SJ Hadfield
Partner