Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

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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 controlled entities (together, the Group) is in accordance with the *Corporations Act 2001*, including:

a) giving a true and fair view of the Group's financial position as at 31 December 2016 and of its financial performance for the year then ended; and

b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

What we have audited

The Financial Report comprises:

- the consolidated balance sheet as at 31 December 2016;
- 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 the 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.

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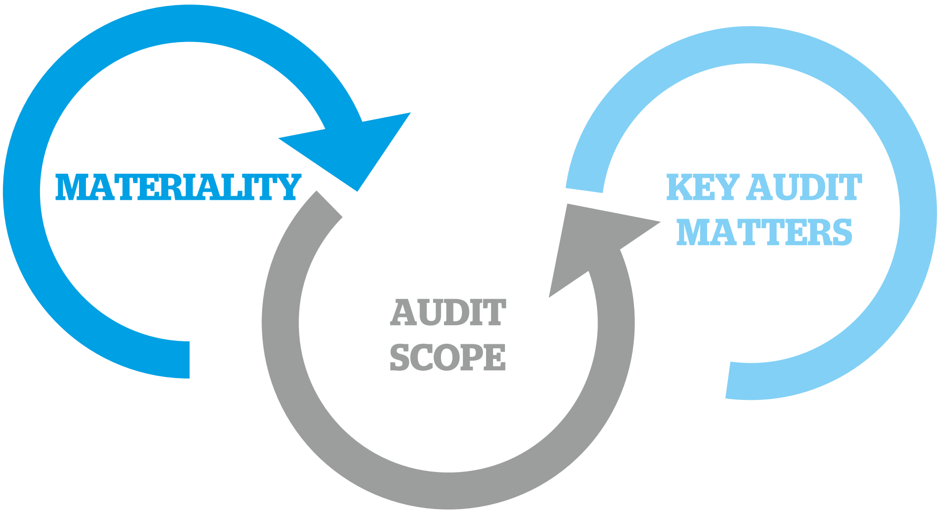
Our audit approach

An audit is designed to provide reasonable assurance about whether 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.

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the Financial Report as a whole, taking into account the geographic and management structure of the Group, its accounting processes and controls and the industry in which it operates.



MATERIALITY

- For the purpose of our audit we used overall Group materiality of $61 million, which represents approximately 0.5% of the Group's net earned premium.
- We applied this threshold, together with qualitative considerations, to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the Financial Report as a whole.
- 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.

AUDIT SCOPE

- Our audit focused on where the directors made subjective judgements; for example, significant accounting estimates involving assumptions and inherently uncertain future events.
- We ensured that the audit teams at both Group and operational levels possessed the appropriate skills and competencies needed for the audit of a complex global insurer. This included industry expertise in insurance, as well as IT specialists, actuarial, tax, treasury and valuation professionals.
- We conducted an audit of the most financially significant operations being the North American Operations, European Operations, Australian & New Zealand Operations and Equator Re (the "Operations"). In addition, we performed specified risk focused audit procedures on certain account balances for other Corporate and Emerging Market entities within the Group.
- For the work performed by 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 their audit work 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 visited the significant operations on a rotational basis and met with management and local audit teams in New York, London, Hong Kong, Singapore and Sydney.
- We performed further audit procedures at a Group level over the remaining balances and the consolidation of the Group's reporting units.
- 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.

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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. 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 these matters. Further, any commentary on the outcome of a particular audit procedure is made in that context.

KEY AUDIT MATTER	How our audit addressed the key audit matter

Valuation of net outstanding claims
Refer to Note 2.3 – $13,781 million

We focused on this net outstanding claims balance because of the complexity involved in the estimation process and the significant judgements that management and the directors make in determining the balance.

Note 2.3 to the financial statements describes the elements that make up the balance. We comment on the most judgemental aspects of these elements below.

(a) Gross discounted central estimate
Refer to Note 2.3.1 – $17,233 million

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.

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 as 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.

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 on the estimate.

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.

Our audit procedures included evaluating the design effectiveness and implementation of key actuarial controls, including key data reconciliations and the Group's review of the estimates.

Historical claims data is a key input to the actuarial estimates. Accordingly, we tested controls and performed detailed testing over a sample of claims case estimates and settlements. No material issues arose and so, in the context of our audit materiality, we were satisfied with the adequacy of the data used in the actuarial estimates in our sample.

We determined those classes of business where claims reserve estimates present a higher risk and focused on classes which inherently involve greater levels of judgement and have historically shown greater year on year variation over previous estimates. In the current year such portfolios included CTP in Australia and certain liability portfolios in North America and Europe.

In order to challenge management's methodologies and assumptions, with particular focus on the higher risk areas, we:

- 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 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 tested 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.

We were assisted by our own actuarial experts to understand and evaluate the Group's actuarial practices and the Group's gross discounted central estimate. We also considered the work and findings of external actuarial experts engaged by management.

KEY AUDIT MATTER	How our audit addressed the key audit matter

(b) Reinsurance and other recoveries
Refer to Note 2.3.2 – $4,540 million

The valuation of reinsurance assets requires a significant level of judgement, given its inherent dependence on underlying estimates of gross outstanding claims. 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)).	We obtained audit evidence in relation to 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. 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 inspected the work of management's actuarial experts, as well as directly testing a sample of relevant claims. We tested individually material new reinsurance arrangements including the program run off reinsurance in North America. Our work focused on reviewing all relevant contracts to ensure that the key terms contained therein had been appropriately reflected in the financial statements.

(c) Risk margins and Probability of Adequacy (PoA)
Refer to Note 2.3.3 – $1,088 million

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. PoA is a measure of the estimated overall sufficiency of reserves including a risk margin in light of that variability.	We assessed the Board's approach to setting the risk margin in accordance with the requirements of AASB 1023, 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 challenged these factors by considering the findings from our work performed on the net central estimate. We tested the Group's actuarial calculation of the Probability of Adequacy (PoA) for reasonableness and consistency with previous valuations. This included developing an understanding of 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.

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KEY AUDIT MATTER	How our audit addressed the key audit matter

Valuation of goodwill in North America
Refer to Note 7.2.1 – $1,543 million

We focused on goodwill in North America because the level of headroom between management's 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 reasonably possible changes in assumptions.

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.

We have evaluated management's identification of the North American cash generating unit, and evaluated the process by which the relevant cash flow forecasts were developed. We compared these forecasts with Board approved business plans and also compared previous forecasts to actual results to assess the performance of the business and the historical accuracy of forecasting.

We were satisfied that the three year forecast used in management's valuation model was consistent with the Board approved North America business plan, and that the key assumptions were subject to oversight from the directors.

We tested the assumptions and methodologies used in the model, in particular those relating to the discount rate and growth rates. To do this:

- 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.

We were satisfied that the growth rate assumptions were reasonable given the economic outlook and industry forecasts. Further, the discount rate used by management was consistent with market data and industry research available to us.

In testing the valuation model:

- 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.

We also considered the work and findings of external valuation experts engaged by management.

The impairment assessment remains sensitive to a range of assumptions, in particular to changes in the discount rate and achievement of forecast improvements in investment returns and combined operating ratios. Accordingly relevant disclosures have been made in note 7.2.1.

KEY AUDIT MATTER	How our audit addressed the key audit matter

Recoverability of deferred tax assets in North America
Refer to Note 6.2.3 – $573 million

We focused on this balance because there has been a history of tax 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.

Significant judgement is required over the recoverability of deferred tax assets arising from past tax losses because the realisation of tax benefits is dependent on future taxable profits and there are inherent uncertainties involved in forecasting such profits.

The ultimate recoverability of the deferred tax asset depends upon both continued improvement in the profitability of the North American business, and the period over which tax losses will be available for recovery.

We focused on whether sufficient evidence was available with regard to these two elements, as follows:

- Evaluated the progress made by management in improving the profitability of the business in recent periods, which includes the remediation of the causes of past losses through, amongst other things, run off reinsurance arrangements, implementation of a revised capital structure to reduce funding costs, business disposals, and other expense reduction initiatives. We noted that progress has been made in relation to 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 considered that the tax losses are legally available for the forecast recoupment period.

Valuation of investments
Refer to Note 3.2 – $24,374 million

This is the largest asset on the balance sheet, representing approximately 59% of total assets. Our audit effort has increased in this area as the Group's investment portfolio has become more diversified in recent years.

In particular, there is significant focus on considering whether the underlying investments are valued appropriately.

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.

We performed the following audit procedures over the valuation of investments held by the Group:

- Assessed the design and performed tests of 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.
- Assessed the Group's valuation of individual investment holdings. Where readily observable data was available, we sourced that independently and compared it to the company's valuation. 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. We did not identify any material differences from the company's valuations from performing this work.

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Other information

The directors are responsible for the other information. The other information comprises the Performance overview, Business review, Governance, Directors' Report, and Other information included in the Group's Annual Report for the year ended 31 December 2016 but does not include the Financial Report and our auditor's report thereon.

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 identified above 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.

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.

A further description of our responsibilities for the audit of the Financial Report is located at the Auditing and Assurance Standards Board website at:

http://www.auasb.gov.au/auditors_files/ar2.pdf. This description forms part of our auditor's report.

Report on the Remuneration Report

Our opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 68 to 102 of the Directors' Report for the year ended 31 December 2016.

In our opinion, the Remuneration Report of QBE Insurance Group Limited for the year ended 31 December 2016 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

SJ Hadfield
Partner

Sydney
24 February 2017