ACCOUNTANCY EUROPE.

KEY AUDIT MATTERS IN EUROPEAN BANKS

REPORTING AUDIT RISKS

WHAT HAS CHANGED?

EU law and international standards recently required auditors to communicate Key Audit Matters (KAMs) when they audit the financial statements of listed companies and other 'public interest entities'. The new requirement aims to add value to the 'old' audit report. Many companies received 'clean' reports, which consisted of 2 pages of standardised 'boiler plate' language. The auditors' assessment did not have to signal the greatest audit risks, so stakeholders did not get insight into this. Reporting KAMs allows for higher quality audit reports which is vital for people to be able to rely on company information and have trust in markets.

2017 'NEW' AUDIT REPORTS

HOW DO KEY AUDIT MATTERS IMPROVE THE AUDIT REPORT?

The new audit report provides auditors the opportunity to share their innermost thoughts and concerns on their clients' audits. By requiring KAMs, regulators addressed issues raised in the aftermath of the financial crisis, namely:

- public concerns on audit's value and relevance
- stakeholders' request for more transparency and insight in the audit process

Reporting KAMs also opens up information to the public that previously was only accessible to the company's audit committee. It makes audit reports more entity specific, informative, and understandable. In the future, it also allows for benchmarking and comparing KAMs across sectors. Ultimately this serves to improve the quality of audits and it demonstrates the value of auditors in preserving financial stability.

WHY DID WE ANALYSE EUROPEAN BANKS' KEY AUDIT MATTERS?

The banking sector is essential to the EU economy and its financial stability. Reporting on KAMs there could demonstrate how informative and insightful reports can contribute to the sector's public trust and stability. Therefore, we analysed how auditors of 62 European banks reported on KAMs in the first year this was required: 2017.

19 COUNTRIES

62 BANKS

WHAT DID WE FIND?

ABOVE AVERAGE NUMBER OF KAMS

Each audit report contained an **average number of 4.4 KAMs**, which is higher than studies found in other sectors. This could be explained by the complexity of banking operations.

HIGH LEVEL OF RECURRENCE

There is no standard wording for reporting KAMs, so auditors can decide how they phrase these. The 62 banks we analysed reported 272 audit risks as KAMs. We classified these in **ten main categories** of recurring items, as outlined in the chart below. The top ten main categories represent **90% of the analysed KAMs**.

272 KAMS

90% IN 10 MAIN CATEGORIES

HIGH LEVEL OF CONCENTRATION

KAMs are highly concentrated in the European banking sector: the top three categories represent 49% of the total number of KAMs we analysed.

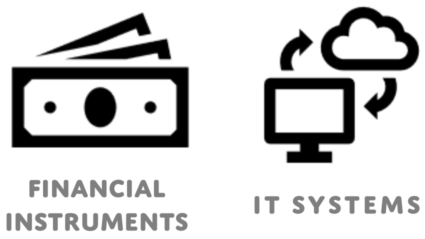
The 62 audit reports often showed the same KAMs, namely:

- impairment of loan and receivables: in 98% of reports
- IT systems: 61%
- classification and measurement of financial instruments: 58%

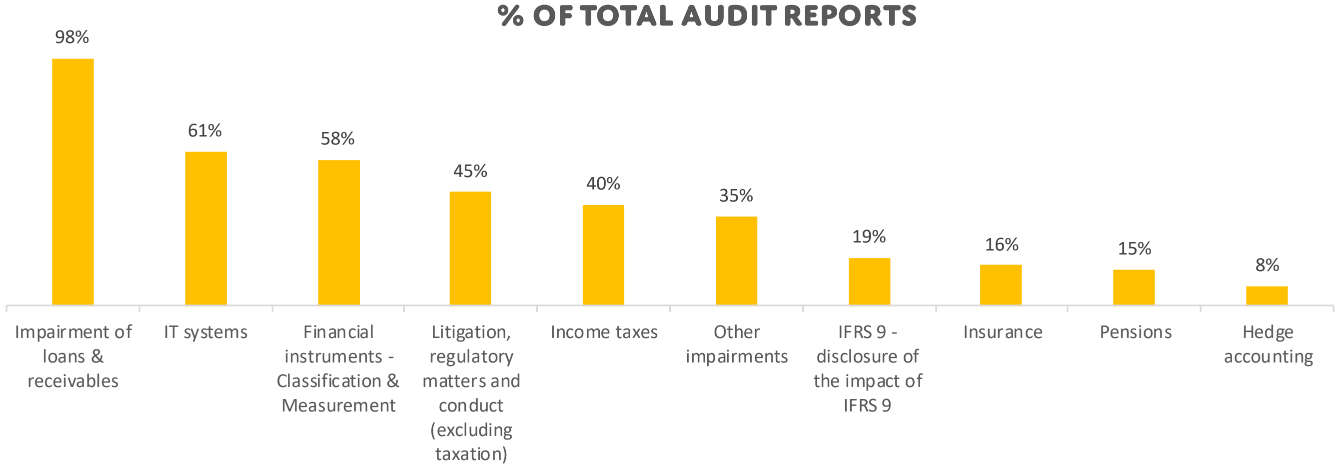
CRITICAL: FINANCIAL INSTRUMENTS & IT SYSTEMS

Our categorisation shows that financial instruments is the most critical area for banks, representing 35% of the total number of KAMs. Next crucial point are IT systems, representing the second main category (14%). KAMs on *IT systems* were mostly related to user access management (26%) and internal IT controls (55%). An important correlation that could be made here is that audit firms followed suit to keep up with the complexity of auditing requirements by investing heavily in the IFRS 9, *Financial Instruments* implementation as of 1 January 2018.

49 % OF KAMS ON:



MAIN KAM CATEGORIES
% OF TOTAL AUDIT REPORTS



WHAT ELSE DID WE FIND?

- **CLARITY:** Generally, KAMs are presented in a clear manner and are easy to peruse and understand, as most of the KAMs are clearly cross-referenced to the related financial statements disclosures.
- **COMPARISON AND BENCHMARKING:** As 2017 is only the first year of the KAM reporting requirement across the EU, this opens the way for more in-depth analysis in the future. Auditors will have to follow-up and explain the year-on-year developments of their key risk assessment, enabling users to perform comparison and benchmarking.

See our full survey to get the detailed insights on auditor's reporting on KAMs for 62 European banks