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Expanded Audit Reports and Audit Fees – A Content Analysis on the Romanian Banking Sector

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Abstract

Nowadays, the communication between the auditors and both shareholders and stakeholders has a significant role in delivering value. Therefore, the new format of the audit reports that will be analysed in the following chapters, has not only the role to improve the dialogue between shareholders and directors, but also to provide the key to the audit „black box" in order to explain in details what is the work performed by an auditor, leading to an increase in the trust placed in an auditor by the shareholders.

This study has two main objectives, the first one being represented by the identification and analysis of the components of an audit report, while the second one is represented by identifying and analysing the key audit matters. The third objective which is an adjacent one is represented by a comparative analysis of the audit fees by taking into account different indicators, such as profit before tax or total assets.

Keywords: *banking sector, audit reports, key audit matters, voluntary disclosures, audit fees*

JEL Classification: *M42, G21*

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Introduction

An external auditor is a professional with the objective of serving the public good. In order to achieve this, auditors need to be transparent about their findings and about how these were reached. Until now, both shareholders and stakeholders have had solely the "black and white" binary opinion on the financial statements which had a standard wording, based on the theory that this facilitated comparability at global level.

Additionally, the financial crisis of 2008 brought into sharp an increased focus on the concerns of different investors and other stakeholders in regards to the effectiveness of entity stewardship, generally, and also in regards to the effectiveness of the audit in order to support this (FRC, 2015).

The International Auditing and Assurance Standards Board (IAASB) has been observing over the time the need of change in an audit report, by identifying a demand from users of financial statements for more detailed information to be presented in an auditor's report instead of only mentioning the output of the audit, „pass" in case of unmodified opinion or „fail" in case of modified opinion.

The new type of the audit report is to be applied starting from 2016 financial statements for listed entities and for the other companies starting with 2017, in accordance with ISA 700 (Revised) – Forming an opinion and reporting on financial statements, which becomes effective for periods ending on or after 15 December 2016.

The main changes in the new auditor report are the following: reorganization of the structure of the auditor's report in order for the paragraph with the opinion to be included even from the beginning in order to make the conclusions more clear and concise for the shareholders and other stakeholders; introduction of the concept of *key audit matters* including also the manner of addressing them; inclusion of a separate section in which the responsibilities of the auditors and also management and those charged with governance are presented; inclusion of the materiality and scoping, this being a voluntary disclosure and not a requirement, helping both the investors and the stakeholders to better understand the nature and levels of auditor's findings.

Specifically, the Regulation no. 537/2014 of the European Parliament and of the Council represents the legislative procedure which deals with the specific requirements in regards to the statutory audit of public-interest entities.

As defined in the Law no. 162/2017 on the statutory audit of annual individual and consolidated financial statements, public-interest entities (PIE) represent companies that have listed securities on a regulated market, or are credit institutions, or are insurance and reinsurance companies or are non-banking financial institutions defined in accordance with legal regulations, or payment institutions and other entities which issue electronic coins, or private pension funds or optional pension funds together with their administrators, or are state owned companies.

In this context, the aim of this study is to analyse the components of an expanded audit report issued in accordance with the most updated changes in the regulations, to identify and analyse the nature of key audit matters disclosed by the auditors in the audit reports and also to perform an analysis aiming on audit fees. We will focus on the public-interest entities, more specifically on credit institutions from the Romanian banking sector.

The contribution brought by this study is represented by the identification and analysis of the content of a long form audit report, including the key audit matters and also the analysis of the audit fees for the financial years ended 31 December 2017 and 31 December 2018 for top banks in Romanian banking sector. Aspects such as the number and nature of key audit matters and the weight of audit fees in total assets or profit before tax will be presented in the next chapters.

The article contains the following sections: the first section includes the literature review on audit report, key audit matters and audit fees, followed by a section with the research methodology which will include the presentation of the objectives together with the selected sample and data collection process. The next section is dedicated to the results and discussions obtained, being concluded with a section which will include the conclusions and the future directions in the following research studies.

1. Literature review

In the world's financial statements, the need for entities to be audited by an independent external auditor has been a cornerstone of confidence. An audit mission underpins both the trust and also the obligation of stewardship between the responsible persons with managing a company and the owners of an entity or otherwise those who own it have a need for a „true and fair" view (PwC, 2017).

Information asymmetry represents a factor that determines the call for auditor services from the investors. In an efficient financial market, rational investors continuously search for those financial placements that can offer indications in regards to the attainment of a higher return with minimum risk. In different cases, investors that assume higher risk are more exposed to targets regarding the conflict of interests that might arise between them and the managers, on the one hand due to the existence of information mismatch and the other hand, due to the possibility that the information disclosed by the companies through the financial statements might include significant distortions (Robu and Robu, 2015).

Thus, a reduction in different misstatements whether due to fraud or error is made through audit services which are carried out by independent, professional and objective persons engaged by the company.

An audit's main purpose is to increase the level of confidence of intended users in regards to the financial statements. This objective is reached once the audit report is issued, including an opinion on whether the financial statements are prepared in accordance with an applicable financial reporting framework, in all material respects (IAASB, 2016).

Furthermore, companies can benefit from auditing activity by making timely decisions in order to avoid financial distress or to improve their internal control systems (Cenciarelly, Greco and Allegrini, 2018).

In order for his objectives to be met, an auditor must act with professional skepticism which is indicated by the judgements and decisions that reflect a heightened assessment of the risk that an assertion is not accurate (Nelson, 2009).

The audit report plays a significant role when making decisions because it affects both the investment and financing decisions carried out by credit institutions (Gómez-Guillmón, 2008).

Many archival and experimental studies have focused on the relevance of the audit reports. The experimental literature, in most of the cases, evaluates the relevance of audit opinions in the decision-making process of the users of financial statements, while archival studies examine the reactions on the stock markets of the audit reports, more specifically around the announcements of the qualified audit reports (Ittonen, 2012).

All the companies, no matter the size, are responsible with producing financial statements on which different stakeholders are interested. However, it is important to highlight the fact that in most of the cases, these stakeholders are more interested in larger public companies than in the others. The work performed by an auditor needs to be scaled in order to address the increased risk of material misstatement of the financial statement.

Past research indicated a positive relation between the quality of the audit and, respectively, of the financial statements, measured by earnings quality or information disclosure quality. Also, major results showed that, in general, both earnings and book value of equity audited by BIG 4 auditors are able to explain more variances in stock returns and hence are more value relevant that those of the companies which are audited by non-BIG 4 auditors (Lee and Lee, 2013).

Auditors had always more insight that they could share with the investors, gained through their audit procedures performed for a financial year. However, it has been observed that not only shareholders and investors, but all the other stakeholders showed a demand in a greater transparency in regards to the responsibilities of the auditor as well as insight into what were the key areas on which the auditor focused his attention (KPMG, 2015).

The Public Company Accounting Oversight Board („PCAOB"), IAASB and the U.K Financial Reporting Council (FRC) have proposed and approved standards that significantly change the report of the independent auditor. Based on current requirements, the auditor is required to make additional disclosures which are intended to close the information gap, meaning the gap between the information users desire and also the information available within the audited financial statements, other corporate disclosures within different type of reports, such as the annual report and the auditor's report. Therefore, the auditors are required to improve the relevancy of their summary of work performed disclosed in the audit report (Bédard et al., 2016).

In order to enhance the communicative value of the independent auditor's report by providing greater transparency about the audit mission carried out, key audit matters (KAM) were introduced through the adoption of new audit standard – ISA 701

„Communicating key audit matters in the independent auditor's report". These represent those matters that based on the professional judgement of the auditors, were of most significance in the process of auditing the financial statements, being selected from all the matters which are communicated to those charged with governance (IAASB, 2016).

All the auditor communications are able to influence audit quality, thus, an audit report that clearly conveys the outcome of the audit mission through disclosure of KAMs, is likely to influence the audit quality in a positive manner (Knechel et al., 2013).

The key audit matters have attention directing impact, in that intended users access the section with detailed information around them more rapidly and pay relatively more attention to them when they are communicated in the independent auditor's report. However, when in the auditor report more KAMs are disclosed, participants devote less attention to the remaining parts of the financial statements (Sirois et al., 2018).

In regards to the changes in auditing standards and related legislations, an impact on audit costs will arise, these being directly related to the extent of the resources which are consumed in conducting an audit (Prasad and Chand, 2017).

Also, the fees which are paid to the auditors can affect the audit quality in two ways, such as: on the one hand, large fees may increase the effort exercised by the auditors this leading to an increase in the audit quality, while, on the other hand, large fees which are paid to the auditors, especially for the non-audit services can lead to an increase in economically dependence of the auditor on their clients (Hoitash et al., 2007).

2. Research methodology

2.1. Study approach: Defining objectives and research methodology

The aim of this study is to analyze the components of an expanded audit report issued in accordance with Revised International Standards on Auditing (ISA) for periods ending on or after 15 December 2016, with emphasis on key audit matters. As an adjacent objective, audit fees presented in the financial statements are analyzed in order to highlight their weight in total assets and profit for the year for group and bank standalone.

On the one hand, the results of the study will show the compliance of expanded audit reports with the requirements of ISA, highlighting the most significant innovation in the new auditor's reports, the introduction of key audit matters, a section pointed by the shareholders as being the most valuable.

On the other hand, the analysis of the audit fees presented by the banks in their consolidated and individual financial statements and reviewed by the Audit Committees, will show transparency in disclosure of a competitive yet sufficient level of audit fees in order to perform a proper quality audit by BIG 4.

In terms of research methodology, a disclosure index (DI) of sections of an audit report will be determined, in order to analyze the level of transparency adopted by BIG 4 when issuing audit reports for the credit institutions, in accordance with ISAs, such as ISA 700 (Revised) – Forming an opinion and reporting on financial statements and ISA 701 – Communicating key audit matters in the independent auditor's report. Also, when determining the disclosure index, we have also taken into account the voluntary disclosures included in the audit report, if any.

The method used is represented by content analysis with a qualitative approach through a coding process on the audit reports. The coding process was carried out manually. As Saldana (2009) mentions, manual coding is able to give ownership of the work performed and control over the study. In terms of audit fees, content analysis with manual coding process will be applied also, resulting an analysis of the level of audit fees which will present the weight of the audit fees in total assets and profit for the year for both group and bank standalone.

The first stage of content analysis is represented by reviewing the ISA requirements regarding the content of an audit report. Through this stage, we were able to identify only the requirements which apply for Public Interest Entities (PIE). The second stage is represented by identification of the key audit matters presented for the selected sample, followed by analyzing the financial statements in order to identify the audit fees, followed by manual coding of the information in order to allocate a score to each requirement based on which the DI will be developed.

2.2. Sample presentation

The population is represented by total credit institutions carrying out activities in Romania. According to NBR, as at 31 December 2017, we have identified a total number of 35 credit institutions activating in Romania, while as at 31 December 2018, 34 credit institutions activated on the banking system. We decided to select all the credit institutions for which the market share in terms of total assets reaches more than 50% in the Romanian banking system for both financial years ended 31 December 2018, respectively 31 December 2017.

Table no. 1. Analysis of the Romanian banking system based on total assets

Name	2018		2017	
	Total assets		Total assets	
	mil RON	%	mil RON	%
Banca Transilvania	74,354	16.48	59,315	13.87
Banca Comercială Română	67,909	15.05	67,735	15.83
BRD – Groupe Société Générale	54,089	11.99	53,491	12.50
UniCredit Bank	41,547	9.21	37,549	8.78
Raiffeisen Bank	40,042	8.88	36,085	8.44
ING Bank N.V., Amsterdam	38,372	8.51	33,657	7.87
CEC Bank	29,348	6.50	31,690	7.41
Alpha Bank	16,957	3.76	15,638	3.66
OTP Bank	11,062	2.45	9,152	2.14
Garanti Bank	10,255	2.27	9,985	2.33
Citibank Europe plc, Dublin	8,026	1.78	6,717	1.57
Banca de Export-Import a României – Eximbank	7,201	1.60	5,555	1.30
Banca Românească membră a Grupului National Bank of Greece	6,766	1.50	6,253	1.46
First Bank (Piraeus)	6,750	1.50	6,447	1.51
Banca Comercială Intesa SanPaolo	5,673	1.26	4,475	1.05
Libra Internet Bank	5,455	1.21	4,608	1.08
Credit Europe Bank	4,335	0.96	4,685	1.10
Patria Bank	3,454	0.77	3,645	0.85
BCR Banca pentru Locuinţe	2,801	0.62	2,922	0.68
Idea Bank	2,131	0.47	1,845	0.43
BNP Paribas Personal Finance S.A. Paris	2,039	0.45	0	0.00
Vista Bank (Marfin)	1,999	0.44	1,974	0.46
Credit Agricole Bank	1,900	0.42	1,361	0.32
ProCredit Bank	1,483	0.33	1,312	0.31
BNP Paribas S.A. Paris (Fortis Bruxelles)	1,396	0.31	993	0.23
Banca Centrală Cooperatistă Creditcoop	1,315	0.29	1,216	0.28
Bank Leumi	1,185	0.26	1,183	0.28
Blom Bank France S.A. Paris	765	0.17	795	0.19
Porsche Bank	738	0.16	568	0.13
TBI Bank EAD Sofia	587	0.13	623	0.13
Banca Comercială Feroviară	554	0.12	574	0.13
Raiffeisen Banca pentru Locuinţe	514	0.11	625	0.15
Banca Română de Credite şi Investiţii	120	0.03	128	0.03
Alior Bank S.A. Varşovia	49	0.01	18	0.00
Bancpost	0	0.00	10,923	2.55
Intesa Sanpaolo Spa Torino	0	0.00	4,054	0.95
Total	**451,170**	**100.00**	**427,793**	**100.00**

Source: NBR, 2019

In Table no. 1 it can be observed that the first four banks reach a market share in terms of total assets of 52.73% as at 31 December 2018, respectively 50.98% as at 31 December 2017. Thus, the sample consists of four credit institutions, such as: Banca Transilvania, Banca Comercială Română, BRD – Groupe Société Générale and UniCredit Bank.

The period of the analysis is represented by 2017-2018, due to the fact that 2017 represents the second year when expanded audit reports are adopted, this meaning the year of challenge, 2016, has successfully passed and the audit companies are more experienced with the long form of audit reports. Also, 2018 was chosen because it represents a year of transition to IFRS 9 – Financial Instruments which brought many challenges to the banking sector, in this study meaning updated key audit matters presentation with focus on expected credit losses.

2.3. Data collection and description of the model

All data have been collected from the official websites of the banks, by examining different types of reports such as: annual reports, independent auditor's reports, consolidated and individual financial statements and any other report if needed.

The starting point is represented by ISA requirements together with the one from Regulation EU no 537/2014 of the European Parliament and of the Council and Law 162/2017. We looked into more details in the content of an audit report and we have considered our input data as being the one collected from ISA, referring to both sections and also sub-items from the report. The sub-items represent specific details required by ISA which were obtained through manual coding process.

The output data is represented by obtaining the DI applicable at the level of each ISA requirement, including the voluntary disclosures, in the assumption that we look at an unmodified opinion included in an audit report which is issued under a compliance framework. Generally, a score of 1 is given if the item is disclosed and a score of 0 otherwise.

For each requirement, we determined the existent number of sub-items (taken from what we considered our input data) and we analyzed the content of the audit reports determining the number of sub-items which were disclosed per each requirement. A disclosure index can be obtained based on the formula mentioned by Tsalavoutas *et al.* (2010):

$$C_j = \frac{T}{M} \tag{1}$$

Where C_j represents the total compliance score for each company and its value is included in the interval [0;1]. T represents the total number of items disclosed by the company and M represents the maximum number of applicable disclosure items that could have been disclosed by the company.

We adapted the formula in order to compute the DI as:

$$\frac{total\ number\ of\ items\ that\ are\ disclosed}{total\ number\ of\ items\ that\ could\ have\ been\ disclosed} \tag{2}$$

In this case, DI represents the audit disclosure index for each analyzed bank and its value is included in the interval [0;1].

For KAMs, we were focused on identifying and analysing them in terms of number and nature. Where a specific type of key audit matter was observed, then additional work was performed to better understand the topic.

For audit fees, a variance analysis was performed for both groups and banks standalone, including explanations based on correlation of the information with other increases or decreases of indicators.

3. Results and discussions

Before getting into details regarding our first main objective, we performed an analysis over the type of opinions included in the audit reports for the selected sample in the selected period. The main focus is to see the distribution of the PIEs to the audit firms.

As it can be observed in Table no. 2, all selected banks are audited by BIG 4, top 2 banks being audited by the same auditor, PwC. In all cases, unmodified opinion was included in the issued audit reports for both analysed financial years, 2017 and 2018.

In case of the audit reports issued for 3 banks, there were no changes in terms of the engagement partners responsible for the audit missions.

Table no. 2. Audit firms and type of opinions distributed over selected PIEs

Name of the Bank	Audit firm – 2017	Type of opinion – 2017	Audit firm – 2018	Type of opinion – 2018
Banca Transilvania SA (BT)	PricewaterhouseCoopers Audit SRL (PwC)	Unmodified opinion	PricewaterhouseCoopers Audit SRL (PwC)	Unmodified opinion
Banca Comercială Română SA (BCR)	PricewaterhouseCoopers Audit SRL (PwC)	Unmodified opinion	PricewaterhouseCoopers Audit SRL (PwC)	Unmodified opinion
BRD Groupe Société Générale SA (BRD)	Ernst & Young Assurance Services SRL (EY)	Unmodified opinion	Ernst & Young Assurance Services SRL (EY)	Unmodified opinion
UniCredit Bank SA (UniCredit)	Deloitte Audit SRL (Deloitte)	Unmodified opinion	Deloitte Audit SRL (Deloitte)	Unmodified opinion

Source: Author's analysis

In Table no. 3, the audit disclosure index is computed for the banks BT, BCR, BRD and UniCredit for financial years ended 31 December 2017, respectively 31 December 2018, this representing the output data. As described in the previous chapter, the audit disclosure index is determined by dividing the maximum number of sub-items that are required to be disclosed to the number of sub-items that are actually disclosed in the audit reports issued for the banks.

It is important to mention that in our analysis, we included also the voluntary disclosures in the maximum number of sub-items that are required to be disclosed in order to highlight the actual results identified within the study.

Also, it is important to highlight the fact that our analysis contains the elements of the audit report in the case where unmodified opinions were issued, as observed in Table no. 2, and where going concern is not an applicable section for the selected sample, as observed throughout the data collection process. In respect to other sections which would have been applicable, we did not include the requirements as per ISAs in cases where uncorrected misstatements were identified in case of other reported information, or when the auditor chose not to report a specific key audit matter in order not to affect the public, in accordance with applicable standards and requirements.

Thus, the input data is defined as the sub-items identified per each ISA requirement regarding the content of the audit report and is based on the data collected from ISA 700, ISA 701 and ISA 720, while the results of the content analysis method represent the disclosed sub-items per each requirement used in the computation of the disclosure index.

Table no. 3. Computation of DI for 2018 and 2017

Requirement with sub-items	Index per requirement – 2018				Index per requirement – 2017			
	BT	BCR	BRD	UniCredit	BT	BCR	BRD	UniCredit
Title	1	1	1	1	1	1	1	1
Addressee	1	1	1	1	1	1	1	1
Auditor's Opinion	1	1	1	1	1	1	1	1
Basis for opinion	1	1	1	1	1	1	1	1
Key audit matters	1	1	0.67	0.67	1	1	0.67	0.67
Other information	1	1	1	1	1	1	1	1
Responsibilities of Management and Those Charged with Governance for the financial statements	1	1	1	1	1	1	1	1

Requirement with sub-items	Index per requirement – 2018				Index per requirement – 2017			
	BT	BCR	BRD	UniCredit	BT	BCR	BRD	UniCredit
Auditor's responsibilities for the audit of the financial statements	1	1	1	1	1	1	1	1
Location of the description of the auditor's responsibilities for the audit of the financial statements	1	1	1	1	1	1	1	1
Other Reporting Responsibilities	1	1	1	1	1	1	1	1
Name of the Engagement Partner	1	1	1	1	1	1	1	1
Signature of the Auditor	1	1	1	1	1	1	1	1
Auditor's Address	1	1	1	1	1	1	1	1
Date of the Auditor's Report	1	1	1	1	1	1	1	1
Total	**1**	**1**	**0.94**	**0.94**	**1**	**1**	**0.94**	**0.94**

Source: Author's analysis

As it can be observed in **Table no. 3**, the level of compliance of the expanded audit reports with ISA requirements, together with Regulation EU no. 537/2014 of the European Parliament and of the Council and Law 162/2017, is very high, being able to conclude it is 100% if voluntary disclosures are not taken into account, for both financial years ended 31 December 2017 and 31 December 2018.

No changes have occurred in terms of DI computed for the selected sample from one financial year to another. However, in case of BRD and UniCredit, we can observe a DI of 0.94 which is due to the DI obtained for the key audit matters requirement, this being computed by also taking into account the voluntary disclosures which were included in the audit reports issued by PwC for BT and BCR. These voluntary disclosures refer to overview but also details regarding the materiality and group scoping. These are not specifically required by ISA, however ISA 701 "Communicating key audit matters in the independent auditor's report" mentions that the process of determination of key audit matters is a limited one to those of most significance in the audit. In order to analyse the significance of these matters, the auditor takes into account the nature and materiality, both quantitatively or qualitatively of corrected or uncorrected accumulated misstatements, if any. The professional judgement applied by the auditor when determining the key audit matters also takes into consideration the scope of work and the materiality.

Therefore, in terms of output data, we can observe in Table no. 3 that the requirement related to key audit matters has a DI of 1 in case of BT and BCR, the maximum level that can be reached, while in case of BRD and UniCredit, the DI is 0.67 due to non-disclosure of voluntary sub-sections such as materiality and group scoping.

Since the information was disclosed in case of two banks for two financial years by PwC, we performed an analysis on the levels of materiality and group scoping used by the auditor when determining the key audit matters, a very important element from the content of the audit report. This is shown in **Table no. 4**.

Table no. 4. Analysis of voluntary disclosures from the audit report

Details	BT		BCR	
	2018	2017	2018	2017
Benchmark	Profit before tax	Profit before tax	Profit before tax	Profit before tax
Threshold applied to benchmark	5%	5%	5%	5%
Overall materiality – RON million	82	69	59.5	43.6
Level of communication of misstatements to the management – RON million	4	3.45	2.9	2.1
Significant component for the audit	BT Standalone and Victoriabank SA	BT Standalone	BCR Standalone	BCR Standalone

Source: author's analysis

For both PIEs analysed above, profit before tax was chosen as the materiality benchmark by taking into account the fact that this is the indicator by which the stakeholders measure the performance of the Group and the Bank. The overall materiality was determined by applying a percentage of 5% to the benchmark, this percentage being the acceptable quantitative materiality threshold, as documented by the auditors. We can observe a higher materiality for both banks in 2018, compared to 2017, this meaning that the credit institutions were more profitable.

The second main objective of this study is to identify and analyse the key audit matters presented in the audit reports. In order for the key audit matters to be established by the auditors, the requirements of ISA 701 are applied. The following are taken into consideration: areas for which significant risks were identified, significant judgements of the auditor in regards to the significant judgements of the management, including accounting estimates for which high degree of uncertainty is estimated and also the effect of the significant transactions or events on the audit.

The main purpose of communicating the key audit matters is to provide greater transparency about the audit mission that was performed, by disclosing additional information to the users of the financial statements so they can better understand the entity and the areas which require significant management judgement. These matters are selected from the ones communicated with those charged with governance in accordance with Article 11 from Regulation EU no. 537/2014 of the European Parliament and of the Council, which refers to the additional report to the audit committee.

In **Table no. 5**, we can observe that in terms of the number of the key audit matters reported, nothing has changed in 2018 compared to 2017. For our selected sample, we have twelve key audit matters reported each year, the ones reported to the shareholders of BCR representing 33% in the total, followed by BT and BRD, representing each 25% and by UniCredit with 17% having two key audit matters reported both in 2018 and 2017.

Table no. 5. No. of key audit matters per bank

Bank	No. of KAM reported in 2018	No. of KAM reported in 2017	Weight (%)
BT	3	3	25%
BCR	4	4	33%
BRD	3	3	25%
UniCredit	2	2	17%
Totals	**12**	**12**	**100%**

Source: Author's analysis

Furthermore, the nature of the key audit matters was analysed in **Table no. 6**. In 2018 compared to 2017, there was only one change in terms of the nature of key audit matters, in case of BT, as reflected in **Table no. 6**. All the other key audit matters had no changes from a period to another.

Table no. 6. Nature of key audit matters per bank

Nature of KAM	BT	BCR	BRD	UniCredit	Totals	Weight (%)
Impairment of loans and advances to customers	1	1	1	1	4	33%
Litigation provisions for allegedly abusive clauses in loan contracts	1	1	0	0	2	17%
Tax matters resulting from the tax inspection performed by Romanian Tax Authorities	0	1	0	0	1	8%
Non-current tax asset resulting from the fiscal treatment of impairment of subsidiaries	0	1	0	0	1	8%

Nature of KAM	BT	BCR	BRD	UniCredit	Totals	Weight (%)
Business Combinations (2018) / Tax treatment of the bargain gain that arose from the acquisition of Volksbank SA in 2015 (2017)	1	0	0	0	1	8%
Provisions for litigations and other risks	0	0	1	0	1	8%
Information Technology (IT) systems relevant for financial reporting	0	0	1	0	1	8%
Interest and fee income recognition	0	0	0	1	1	8%
Totals	**3**	**4**	**3**	**2**	**12**	**100%**

Source: Author's analysis

The results show that out of the total of 12 key audit matters identified for both 2018 and 2017, 33% are represented by the impairment of loans and advances to customers, being reported for each bank by all 3 different audit firms, followed by litigation provisions for allegedly abusive clauses in loan contracts which represent 17%. The remaining 6 different type of key audit matters represent in both analysed periods a percentage of 8%, being specific to each credit institution.

In addition, by taking into account the high level of disclosure of one out of 8 different key audit matters (KAM) identified in the audit reports, we analysed the reasons based on which KAM were identified and the procedures performed by the auditors to address them.

In all the audit reports inspected, for both financial years ended 2018, respectively 2017, impairment of loans and advances to customers was considered a key audit matter due to: significant subjective judgements made over both timing and the estimation of impairment, adoption of IFRS 9 "Financial instruments" starting with 1 January 2018 and estimated impact, estimates of impairment for certain categories of mortgage loans were impacted since 2016 by the Law 77/2016 regarding deed in payment for some real estate assets in order to cancel / write-off the obligations of debtors, the process is complex and involves judgement and use of estimates, being inherently uncertain, involving various assumptions in estimating expected future cash flows, expected net selling prices of collaterals together with timing of recovery of collateral, significant subjective judgements made over both timing and the estimation of expected credit losses (ECL) after adoption to IFRS 9, effects of local Government Ordinance 114/2018 regarding the establishment of measures in the field of public investments and fiscal-budgetary measures, professional judgement exercised when identifying the exposures with significant deterioration in credit quality.

In terms of addressing the key audit matter which was communicated in the audit reports for all selected PIEs, the following procedures were performed in 2018: assessment of compliance of key methodologies and models with the requirements of IFRS 9, review and assessment of independent model validation framework, results and overall model governance for IFRS 9, testing on a sample basis the key controls over the inputs of critical data into source systems and also the flow and transformation of data between source systems to ECL calculation engine, substantive testing performed over the critical data used, testing a sample of the statistical models used by the banks to determine the key assumptions such as probability of default, loss given default and exposure at default, independent recalculation of ECL for a sample of loans, assessment of management's user acceptance testing over the ECL calculation engine to ensure it is performed in line with all the business requirements, verification of the reconciliation of the output of ECL calculation engine with the accounting records, testing the approval of key inputs, assumptions and discounted cash flows, including recoveries from collateral that support the significant individual ECL, testing the application of default definition, including the appropriateness of the default flagging, assessment of the model performance controls for main risk parameters across key portfolios, assessment of adequacy of the banks' disclosures in the financial statements regarding the exposure to credit risk, verification of the implementation of new ECL methodology into the IT systems, by testing the general IT controls related to data sources and computations for ECL.

All the audit procedures mentioned above are a combination from all the audit reports analysed for the selected sample.

As an adjacent objective, we have identified the audit fees disclosed by the banks in the consolidated and separate financial statements and we have analysed the weight of these fees in significant indicators of the credit institutions, such as total assets and profit before tax (**Tables no. 7 and no.8**).

Table no. 7. Analysis of audit fees in relation to total assets of each bank

Weight of audit fees in total assets (%)	Group – 2018	Group – 2017	Bank – 2018	Bank – 2017	Variance (%) – Group	Variance (%) – Bank
BT	0.006%	0.004%	0.004%	0.003%	54%	41%
BCR	0.005%	0.006%	0.005%	0.006%	-16%	-17%
BRD	0.005%	0.007%	0.004%	0.006%	-23%	-29%
UniCredit	0.008%	0.006%	0.007%	0.004%	37%	82%

Source: Author's analysis

For BT and UniCredit, the weight of total audit fees in total assets have increased in 2018 compared to 2017 for both consolidated and individual level. In case of BT, the increase is significant and this is explained by the acquisition of Bancpost SA, both total assets and audit fees increasing in 2018. The increase in total assets for BT is significant, 30% for the group and 25% for the bank, while the fees doubled for the group and increased by 76% for the bank.

In case of UniCredit, total assets for both the group and the bank increased by 11%, while the audit fees doubled for the bank standalone.

In case of BRD, we observe a decrease of 23% for the group, followed by 29% for the bank and this is explained by a decrease in the audit fees by 22% for the group and 28% for the bank, while total assets have increased by 1% for both the group and the bank standalone.

In case of BCR, there was a decrease of the weight of the audit fees in total assets and it is explained by a decrease in the audit fees in 2018 compared to 2017 by 15% for the group and 16% for the bank, while total assets have slightly increased for the group by 1%, while for the bank standalone the increase was by 0.3%.

Table no. 8. Analysis of audit fees in relation to PBT of each bank

Weight of audit fees in PBT (%)	Group – 2018	Group – 2017	Bank – 2018	Bank – 2017	Variance (%) – Group	Variance (%) – Bank
BT	0.265%	0.157%	0.183%	0.124%	69%	48%
BCR	0.265%	0.494%	0.272%	0.480%	-46%	-43%
BRD	0.150%	0.215%	0.123%	0.192%	-30%	-36%
UniCredit	0.579%	0.500%	0.447%	0.373%	16%	20%

Source: Author's analysis

The most significant increase was recorded for BT, the weight of the audit fees in PBT increasing by 69% for the group and by 48% for the bank standalone, this being explained by both increase in audit fees but also in the PBT by 18% for the group and by 19% for the bank. BT reached the second place on the market in terms of profit before tax, after BRD, recording as at 31 December 2018 the sum of RON 1.7 billion at the level of the group and RON 1.37 billion at the level of bank standalone.

In case of BCR, the decrease of 46%, respectively 43% is explained by the decrease in the audit fees, PBT increasing by 58% for the group and 48% in case of the bank standalone.

For BRD, the weight of audit fees in PBT also decreased and this is due to decrease in the audit fees, while the PBT increased by 11% for the group and 12% at the bank level, reaching the first place in the Romanian banking system, as at 31 December 2018, in terms of profit, RON 1.85 billion for the group and RON 1.82 billion for the bank.

UniCredit recorded increases for both audit fees and PBT, the last one increasing significantly in 2018, by 31% for the group, respectively 69% for the bank standalone.

Conclusions

The banking sector represents one of the pillars for economic growth in the EU and now auditors are producing more insightful and informative reports in order to contribute to both public trust and stability in the sector (*Accountancy Europe*, 2018).

In order for both confidence in and the liability of the auditors and the audit firms carrying out audit missions to increase, it is a must to increase the transparency of the reporting performed by them, this being done by the introduction of KAMs. The shortcomings of the old audit report were removed through the new expanded audit report, the new one providing useful information to the intended users.

KAMs are very important in a better understanding of a company by its stakeholders due to the fact that they provide additional explanations that are directly linked to the audited entity rather than generic or abstract explanations in a standardized language.

In regards to our first main objective, the results show that the level of compliance of the expanded audit reports with ISA requirements, together with Regulation EU no. 537/2014 of the European Parliament and of the Council and Law 162/2017, is very high, being able to conclude it is 100% if voluntary disclosures are not taken into account, for both financial years ended 31 December 2017 and 31 December 2018.

In terms of presentation of voluntary matters such as materiality and scoping, we have observed that PwC was the only firm out of 3 analysed from BIG 4 which presented details regarding the materiality and scoping, reaching a 100% level of disclosure of all sections in the audit report, both mandatory and voluntary. Additionally, it has been observed that PwC tends to include longer descriptions of risk in all their audit reports, reflecting that the audit firm has sought to provide greater transparency and detail in the reporting process of the risk, but, however, highlights the challenge of meeting potentially expectations which are contradictory from the users of the audit reports (FRC, 2016).

In regards to our second main objective, we observed that the number of KAMs vary between 2-4, while 33% are represented by details offered on impairment of loans and advances to customers, being found in each out of 12 audit reports analysed.

However, we have observed that in both 2017 and 2018, the nature, description and actions on addressing the KAMs have not changed significantly, 3 out of 4 credit institutions suffering no changes, excluding the audit procedures that were required to be performed around IFRS 9 implementation. This might be a risk of KAMs becoming standardized in the future.

Nevertheless, based on our analysis of the KAMs, we consider there are many benefits of the changes such as: enhanced communication between auditors and investors, as well as those charged with corporate governance, increased user confidence in audit reports and financial statements, increased transparency, audit quality and enhanced information value, renewed auditor focus on matters to be reported that resulted in an increase in professional skepticism, enhanced financial reporting in the public interest.

In respect to our adjacent objective, audit fees suffered changes over the analysed period, both in terms of the weight in total assets or total profit before tax of the credit institutions. We observed that in case of two banks, the introduction of KAMs did not lead to an increase in audit fees as it would have been expected, while for the remaining two, an increase in audit fees occurred, however in case of BT the increase is explained by the merger with Bancpost SA.

Regarding forward looking information, the study can be extended to the level of the parents for all selected credit institutions, except of Banca Transilvania which is not controlled by a foreign parent.

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