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# Convergent and Divergent Elements in the Reporting of Key Audit Matters at the Level of the Banking Sector from Central and Eastern Europe

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## Abstract

*The current economic turmoil manifested at international and national level is influencing the banking sector, situation which calls for an innovative approach to the informational value of the independent auditor's report. In order to reduce the information asymmetry of the audit reports from a stakeholder's perspective, competent authorities have issued a series of regulations aiming to change the structure and the content of these reports. The most important change relates to the reporting of the key audit matters, which are considered to bring many benefits to stakeholders.*

*In this context, this research aims to identify, analyze and compare the key audit matters reported by the statutory auditors of credit institutions operating in Central and Eastern Europe. The results revealed that the reported key audit matters reflect the particularity of the industry and of the activities carried out by these institutions. Also, the research highlighted a portfolio of convergent and divergent elements in the key audit matters reporting both at the level of the analyzed territories and at audit firm level. The results of the research are useful to stakeholders of the banking industry, professional bodies and regulators from two perspectives: firstly, by generating value added to the informational value of the audit report and secondly, by building an informational symmetry of the audit report in relation to its stakeholders.*

**Key words:** *statutory audit; independent auditor's report; key audit matters (KAM); credit institutions; Central and Eastern Europe*

**JEL Classification:** *M42, G29*

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## Introduction

In the current context dominated by COVID-19 pandemic and, implicitly, by the negative economic effects on entities, regardless of the industry in which they operate, but especially in the banking sector, the relevance and credibility of the audit reports issued by the statutory auditors recorded an upward trend. The structural and informational related issued of the audit reports issued by statutory auditors represent an area of interest for professional bodies, European and international regulators but also for the academic environment.

Thus, the requests for the extension of the statutory auditors' report have increased over the last decades. The traditional format of the audit report has been criticized by users for presenting limited information on the specifics of the audited entity (International Committee on Auditing and Assurance Standards – IAASB, 2015). The confidence of investors and other stakeholders in the independent audit and statutory auditors decreased following the scandals which led to the financial crisis and bankruptcy of some large corporations, considering that many of the reports issued in relation to those entities presented an unmodified opinion (Asare and Wright, 2012). Thus, a simple opinion that the financial statements give a true and fair view of the business, was no longer enough.

In response to the requests to reduce the information gap between the user's informational needs and those actually presented within the auditor's report, regulators such as IAASB, the Public Entities Accounting Supervisory Committee, the UK Financial Reporting Board or the European Commissions launched a series of initiatives to improve the content of the audit report and proposed changes aiming to significantly increase the information presented in these reports.

At European Union (EU) level, the European Parliament and the Council drafted proposals regarding the statutory audit, considered to enhance the transparency of the audit report and to increase the confidence in the statutory auditor profession. Following their endorsement, at EU level, two regulations addressing the audit activity reform were adopted, namely the Directive 2014/56/EU on the statutory audit and EU Regulation no. 537/2014 on specific requirements for statutory audits of public interest entities. These regulations were adopted on 16 April 2016 and entered

in force on 17 June 2016. All EU Member States transposed the new requirements in their national laws. In Romania, it was adopted Law no. 162/2017 on the statutory audit of the annual individual and consolidated financial statements.

IAASB launched a process to review the International Auditing Standards (IAS) related to the reporting activity of the statutory auditors and also a new related standard, ISA 701 "Communicating key audit matters in the independent auditor's report" (IAS 701). As a result, the structure and the content of the audit reports incurred many changes, the most significant being the presentation of the key audit matters (KAM), which is considered to bring many benefits to the numerous stakeholders, regulators, corporate governance professionals and audit firms. According to IAS 701, KAM represent those aspects that, in the professional opinion of the auditor, had a significant impact in performing the audit engagement. Consequently, the competent authorities in different states revised their national auditing standards to ensure compliance with the rules adopted at international level.

The research literature provides for several studies which envisaged the effects of KAM presentation on stakeholders, increase of the financial reporting quality and of the statutory audit, analyses of main KAM across industries. The majority of these studies are concentrated on KAM analyses from a selected territory (mainly Western European) and industries. Most frequently, the banking sector was excluded from the studies.

In this context, this paper aims to identify, analyze and compare the KAM included in the independent auditors' reports of credit institutions operating in three countries from Central and Eastern Europe, namely: Romania, Poland and Czech Republic. These countries represent a group of emerging economies, with close geographical position and similar institutional configuration (European Investment Bank, 2013).

The results of this research are useful to stakeholders of the banking industry, professional bodies and regulators in order to improve the informational value of the audit reports. Thus, against the background of economic instability and the vulnerability of the banking sector, the statutory audit report will better respond to the informational needs of stakeholders in terms of intelligibility, relevance and credibility.

The article is structured as follows: the first section addresses the KAM concept in a multidimensional way, while the second section is dedicated to the research on KAM reporting in the banking industry. The first part of the second section presents the theoretical framework and research methodology, followed by the section dedicated to the presentation and interpretation of results. The final section of the paper includes the conclusions, limitations of the study and future research directions.

## 1. Literature review

The importance of the changes brought to the statutory auditor's report, and implicitly, of KAM reporting, is also reflected at the level of the literature in this field through the diversity of the conceptual approaches taken by authors in their researches.

In this regard, Sneller et al. (2016) analyzed the importance of KAM presentation in correlation with IT for the stakeholders from Netherlands. The authors analyzed the audit reports issued during 2013 – 2015 for 25 entities listed on the Amsterdam Stock Exchange. The research results revealed that all 75 audit reports analyzed include 255 KAM, out of which 39 are IT related. Among the most important and frequently reported IT related KAM are: the reliability and continuity of IT systems, transformation programs and new business models and the outsourcing of IT services.

Abdullatif and Rahahleh (2019) explored the application of IAS 701 in Jordan by conducting an analysis of the audit reports issued by the financial auditors in 2017 (for 193 entities) and 2018 (for 192 entities) and by conducting interviews with 18 audit partners and directors involved in KAM reporting. The results indicated that the number of KAM reported in Jordan is relatively small, relating mostly to receivables, inventory, real estate investments and income. Also, the authors identified that, generally, audit firms have different approaches with regards to KAM nature and content, with a tendency to report KAM specific to the industry in which an entity operates and not specific to the audited entity.

Ciger et al. (2019) identified and analyzed the most significant KAM reported by the auditors of entities operating in the manufacturing sector, in order to determine the divergences between the KAM reported in Turkey, compared to Central and Eastern European

countries. The sample included 177 entities listed on Istanbul Stock Exchange. For the comparative study, the authors analyzed the audit reports of the following: 94 entities listed on Warsaw Stock Exchange, 38 entities listed on Bucharest Stock Exchange and 28 entities listed on Prague Stock Exchange. The results revealed that the nature and the average number of KAM reported are similar mainly in Turkey and Poland. More specifically, the nature of reported KAM is similar in Turkey, Poland and Romania for entities operating in the metal production sector. The most notable difference between Turkey and two of the Eastern European countries (Romania and Poland) envisage the presentation of business going concern.

Kend and Nguyen (2020) examined the KAM reported in 3,000 audit reports issued in 2017 and 2018 for a sample of Australian entities. Among the most commonly reported KAM are: goodwill and intangible assets impairment, valuation of assets, recognition of revenues and acquisitions, part of them being also identified by Abdullatif and Rahahleh (2019). Almost 70% of the audit reports analyzed include the same KAM reported both in 2017 and 2018. Also, the results revealed differences between the number of KAM reported depending on the size of the audit firm.

Li (2017) studied the benefits of KAM reporting by analyzing the 2016 audit reports for 84 entities listed on Beijing Stock Exchange. The research results revealed that the most commonly reported KAM are: revenue recognition, impairment of assets and deferred taxes. Moreover, the results indicated that KAM reporting had more of a symbolic significant rather than an informational one.

From a different perspective, Tudor et al. (2018) analyzed the responses of stakeholders to IAASB's invitation to comment on the proposed changes to the financial auditor's reports. The analysis was conducted using quantitative and qualitative methods, based on content analysis and statistical models. The authors concluded that KAM presentation is perceived as beneficial given that most of the stakeholders agreed with the proposed amendments.

Kitiwong and Sarapaivanich (2020) analyzed the extent to which the implementation of the extended auditor's report in Thailand, starting with 2016, and mainly of KAM reporting, contributed to an improvement in the audit quality. To respond to this question, the authors analyzed the quality of audit engagement carried out

during a four-year period, by analyzing 1,519 reports related to 312 entities. The results indicated that the quality of the audit process did not improve as a result of KAM reporting. Furthermore, the KAM number and the commonly reported aspects upon their nature, are not associated with the increase of audit quality.

Moroney et al. (2020) examined the impact of KAM reporting on Australian investors perception with regards to the audit quality and auditor's credibility. The results indicated that KAM reporting contributed to the increase of the credibility and value of the audit in case of entities that are not audited by a Big4 firm. In case the audit is conducted by a Big4 firm, the credibility and quality of the audit engagement is perceived at a high level regardless of KAM reporting. Also, the authors identified that KAM presentation may lead investors' attention being distracted from the basic information included in the audit report. Thus, the results of the studies carried out on stakeholders' perceptions with regards to the improvement of the financial audit quality as a result of KAM reporting are divergent.

Pratoomsuwan and Yolrabil (2020) investigated the effects of KAM reporting on the financial auditors' liability in case of fraud or error. The respondents, 174 financial auditors, assessed the existence of greater responsibility for the auditor when a misstatement appears due to an error rather than a fraud. Additionally, the results demonstrated that KAM reporting reduces the auditors' liability only in the event of frauds, not in case of errors. On a cumulative basis, the results support the view that KAM reporting reduces the discretionary opinions of stakeholders and consequently, the financial auditors' liability.

Segal (2019) analyzed the perceptions of financial auditors from South Africa regarding the improvement of the transparency of the audit report following KAM reporting and identified the main risks financial auditors are facing as a result of this presentation and the impact on client relationship. By using qualitative research methods and a constructivist and investigative approach, the author interviewed 20 audit partners and directors working for 6 audit firms (Big4 and second tier firms). The research results showed that respondents believe the audit report's transparency did not improve but, in fact, deteriorated, due to rising expectations and the public's perception of the financial auditors' role. Respondents argued that, while the available information in the audit report increased with KAM

reporting, the use of this information in a wrong context does not constitute valuable information. With regards to the new risks faced by the auditors, the respondents mentioned: increased threat of litigations, financial risks caused by higher fees disproportionate to the recoverability margins, KAM content misinterpretation by stakeholders without specialization in the field.

From a different perspective, Coram and Wang (2019) investigated the effect of KAM disclosure on the public's perception of the role of financial auditors. The sample included 240 respondents, inexperienced auditors. The results indicated that stakeholders' perceptions on the financial auditors' role did not change. In fact, the role of the financial auditor is positively perceived, especially when reported KAM are related to the new accounting standards implemented during the reporting period. These results are convergent with those obtained by Segal (2019) in the context of South Africa, where the expectations and the role of the financial auditors in the public perception highlighted an upward trend.

Kohler et al. (2020) studied the effects of KAM reporting on the informational value of the financial auditor's report. In particular, the author examined the informational value of the KAM related to goodwill impairment, from the perspective of professional and non-professional investors. Main results revealed that, when in the KAM section it is mentioned that a change in the key assumptions could determine a goodwill adjustment, professional investors assess the economic situation of entities as being significantly better than in the situation where it had been mentioned that only significant changes in the key assumptions could determine such an adjustment. Another conclusion is that, for non-professional investors, KAM reporting has no communicative value, which indicate that this category of investors has difficulties in interpreting the information from the audit report.

Pinto et al. (2020) examined whether the probability of reporting a KAM is influenced by the level of accuracy and detail of an accounting standard. The author used the Rules-Based Characteristics score to determine the accuracy of a standard (for example: more rules than principle based). The sample included 135 entities listed in the UK, France and the Netherlands, whose auditors issued extended audit reports in 2016. The results indicated that the probability of presenting a KAM increases with the standard accuracy. Also, the reporting of KAM deriving from accounting standards with a high

degree of standardization from the perspective of applied rules, leads to the decrease of the capacity to understand the content of the audit report.

Gold et al. (2020) analyzed the behavior of UK managers in terms of financial reporting in the context of KAM reporting as part of the audit report. The authors identified that the managers of the entities for which an extended audit report was issued show a more conservative reporting behavior compared to the managers of the entities for which KAM are not reported. The results also reveal a reduced tendency to make aggressive decisions from a financial reporting perspective when it is anticipated that a KAM will be reported for a particular topic. These results are consistent with those obtained by Reid et al. (2019), according to which, KAM disclosure lead to the significant improvement of the quality of financial reporting in the UK.

Velte (2019) studied the link between diversity (percentage of female members of the Audit Committee of UK entities) and KAM reported by the financial auditors. The sample included entities listed on the London Stock Exchange, having a premium status, during the period 2014 – 2015. Thus, 660 entities were analyzed (333 from 2014 and 327 from 2015), financial institutions being excluded. The results, measured using the Flesch index, indicated that entities with female-dominated Audit Committee members have a better KAM understanding.

Similarly, Abdelfattah et al. (2020) investigated whether the gender of the audit partner influences the degree and communication style of KAM reporting. The authors' hypotheses focused on the following: female audit partners report more KAM than male audit partners, female audit partners present KAM in more detail compared to male audit partners and the fact that female audit partners have a less optimistic approach than their male counterparts. The sample included all entities listed on the London Stock Exchange, excluding financial institutions, which formed the FTSE ALL Shares index between 2013 and 2017. The results indicated that female audit partners are more likely to report more KAM compared to male audit partners. Also, the audit reports prepared by female audit partners include a higher level of detail, using a less optimistic approach.

With regards to the banking industry, the literature on KAM reporting is limited. Boolaky and Quick (2016) studied the impact of KAM reporting on the perceptions

of the directors of credit institutions in Germany on the financial statements quality, on the audit process and auditor report, as well as lending decision. The study was conducted by interviewing 105 directors of such institutions and by using ANCOVA method to determine their perceptions and decisions. The authors couldn't demonstrate the fact that KAM reporting influences in a positive manner the perception of the directors. On the same note and using the same research method, Pansar and Hillstrom (2019) investigated the perceptions of the directors of Swedish credit institutions on the extended auditor's report. To conduct the study, quantitative and experimental research methods were used. The experiment included a control group, seven experimental groups and 122 participants, directors of credit institutions. The results revealed that KAM reporting led to an improvement in the perceptions of directors regarding the informational value of the audit report, in contrast with the result obtained by Boolaky and Quick.

The European Banking Institute (2019) conducted an empirical analysis of KAM identified in the financial industry. The sample included 90 credit institutions operating in the European Union, mainly in Germany, Netherlands, Italy, Spain and France, for which the 2017 audit reports were analyzed. The average number of reported KAM was of 3.4. The most common aspects identified relate to the impairment of loans and advances to customers, fair value of financial instruments, fiscal, legal and IT related matters. The results of Logit analysis indicated that there are certain factors that influence the nature of reported KAM. Thus, it was observed that the size of the credit institution influences the probability of reporting a key matter related to taxation and IT. Furthermore, the number of reported KAM is influenced by the increase in the value of the institutions' assets. Regarding the reporting upon the audit firm, it was identified that Deloitte has the highest average number of reported KAM. Compared to the other Big4 firm, Deloitte has a tendency to disclose tax related KAM.

A similar study was conducted by Accountancy Europe (2019), which analysed the main KAM reported at the level of the European banking sector in 2018. The sample included 62 European credit institutions which hold most of the assets of the European banking sector. The study showed that the analysed audit reports include 260 KAM, being calculated an average of 4.2 KAM per audit report, higher than the average reported for other industries (4 KAM per audit report). The highest

average number of KAM were reported in Ireland and Switzerland (7 KAM), while the lowest in Luxembourg and Slovenia (2 KAM). Regarding the nature of reported KAM, the most common relate to: impairment of loans and advances to customers, classification and measurement of financial instruments, IT, legal and regulatory aspects, deferred taxes and other allowance. Same matters were identified by the study carried out by the European Banking Institute for 2017.

Regarding the Romanian banking industry, Bătae (2019) performed an analysis of the components of the audit reports and of the KAM reported by the financial auditors of the Romanian credit institutions for 2017 and 2018. The results indicated that all financial auditors complied with IAS requirements for the new audit report, both in terms of structure and content. With regards to KAM, the author observed that the auditors reported between 2 and 4 KAM per report. The most common reported KAM relate to the impairment of loans and advances to clients, which were included in all the audit reports analyzed.

The results of the literature review indicate that the conceptual approaches to KAM are multidimensional, both in terms of research objectives but also industries, converging towards the impact on stakeholders and the improvement in the quality of financial reporting and the statutory audit process.

## **2. Research on the key audit matters reporting in the banking industry. The case of Central and Eastern Europe**

### **2.1. Research methodology**

The objective of this research is to identify and analyze the convergent and divergent elements in KAM reporting at the level of the banking sector in Central and Eastern Europe, more specifically, for credit institutions operating in three territories of Central and Eastern Europe, namely: Romania, Poland and Czech Republic. These states are members of the EU and are therefore required to transpose the provisions of EU Directives and Regulations in their national laws. According to EU Regulation 537/2014, credit institutions are classified as public interest entities. Thus, for these institutions, statutory auditors prepare an extended audit report,

which include KAM presentation, in accordance with IAS 701 requirements.

In order to achieve the research objectives, we made use of the institutional theory and qualitative research methods. The institutional theory provides a perspective that helps to understand how organizations respond to institutional pressures and expectations. It assumes that organizational practices, including financial reporting, are closely related to the values of the society where the entity operates, with a tendency to achieve homogeneity for maintaining organizational legitimacy (Deegan and Unerman, 2011). The process of homogenizing organizational practices is called isomorphism and is defined as a constraint process that forces a unit in a population to resemble other units that face the same environmental conditions (DiMaggio and Powell, 1983). There are three mechanisms that can be used for isomorphic change of organizations, namely: coercive isomorphism, through formal and informal pressures on organizations from third parties on which they depend on, mimetic isomorphism, through pressures to imitate organizations in conditions of ambiguity and uncertainty and normative isomorphism, through pressures to act professionally and to follow generally acceptable practices (DiMaggio and Powell, 1983).

The application of the institutional theory in the study of international audit practices is limited. Instead, this theory has been used by researchers to study the adoption of the International Financial Reporting Standards (Albu et al., 2014; Hassan et al., 2014; Aburous, 2019). The transposition at national level of the provisions of Directive 2014/56/EU and of EU Regulation 537/2014 was conducted based on coercive isomorphism, the EU Member States having the responsibility to adopt all normative acts issued by the European institutions. The revision of the national auditing standards was conducted based on the normative isomorphism; IAS being considered best practice standards at international level. The institutional theory is complemented by the use of qualitative research methods. The research was carried out in two stages: the first stage of the analysis includes the revision of IAS 701 requirements regarding the content of the audit report and KAM concept. The second stage assumes the identification of the reported KAM for the selected sample.

The sample includes credit institutions from Romania, Poland and Czech Republic, as follows:

- Top 15 credit institutions from Romania, ranked upon the value of their net assets as at 31 December 2019. According to the annual report of the National Bank of Romania, as at 31 December 2019, in the Romanian banking market operated 34 credit institutions, out of which 7 are branches of foreign credit institutions, whose financial statements are prepared and audited at group level. The credit institutions included in the sample have a

total market share of 83.86% (Table no. 1). The fourth ranked institution in Romania (ING Bank N.V. Amsterdam) is a branch of a foreign credit institutions, whose financial statements are prepared and audited at group level. Thus, this institution was excluded from the sample. This aspect represents a limitation of this study because, if included, the total market share of the analyzed sample would have accounted for 92.87% of the Romanian banking sector.

**Table no. 1. Sample of credit institutions from Romania, ranked upon their net assets value**

No.	Name of the credit institution	Net assets value (RON million) as at 31 December 2019	Market share as at 31 December 2019
1	Banca Transilvania	87,741	17.72%
2	Banca Comercială Română	71,450	14.43%
3	BRD Groupe Societe Generale	55,853	11.28%
4	Unicredit Bank	44,541	8.99%
5	Raiffeisen Bank	42,876	8.66%
6	CEC Bank	32,898	6.64%
7	Alpha Bank	17,821	3.60%
8	OTP Bank	13,253	2.68%
9	Garanti Bank	10,870	2.19%
10	Banca de Export-Import a României	7,751	1.57%
11	Banca Românească	6,647	1.34%
12	Banca Comercială Intesa SanPaolo	6,583	1.33%
13	Libra Internet Bank	6,527	1.32%
14	First Bank	6,417	1.30%
15	Credit Europe Bank	4,031	0.81%
<b>Total</b>		<b>415,259</b>	<b>83.86%</b>

Source: Annual report of the National Bank of Romania for 2019, page 165, available online at: <https://www.bnr.ro/PublicationDocuments.aspx?icid=3043>

- Credit institution listed on the primary market of Warsaw Stock Exchange as at 31 December 2019 (Table no. 2)

**Table no. 2. Sample of credit institutions listed on the primary market of Warsaw Stock Exchange**

No.	Name of the credit institution
1	Alior Bank Spolka
2	Banco Santander
3	Bank Handlowy W
4	Bank Millennium
5	Bank Ochrony Srodowiska
6	Bank Polska Kasa Opieki
7	BNP Paribas Bank Polska
8	Getin Noble Bank Spolka
9	Idea Bank Spolka

Source: <https://www.gpw.pl/list-of-companies>

Regarding this sample, we mention that the audit report of Alior Bank Spolka and Idea Bank Spolka could not be retrieved neither from the official website of the institutions, nor from that of the Warsaw Stock Exchange. Thus, these two institutions were excluded from the sample.

- Credit institutions listed on the primary market of Prague Stock Exchange as at 31 December 2019 (Table no. 3).

**Table no. 3. Sample of credit institutions listed on the primary market of Prague Stock Exchange**

No.	Name of the credit institution
1	Česká spořitelna (Erste Group)
2	Komerční Banka
3	Moneta Money Bank

Source: <https://www.pse.cz/en/market-data/shares/prime-market>

Thus, the final sample includes 25 credit institutions. All the necessary information to carry out this study was retrieved from the statutory auditors' reports in relation to the financial statements prepared for the financial year ended 31 December 2019. The audit reports were obtained from public sources, being available on the official websites of the credit institutions or of the stock exchanges. The content of the audit reports was analyzed in detail, in particular, the section dedicated to KAM reporting and auditors' responses. All information was manually collected from the audit reports.

## 2.2. Results and discussions

Prior to the content analysis conducted in order to identify the KAM reported by the statutory auditors of the credit institutions included in the sample, we investigated the typology of audit opinions issued. Thus, we identified that for all 25 credit institutions analyzed, the statutory auditors issued an unmodified opinion, according to which the financial statements give a true and fair view, in all material aspects, of the financial position as at 31 December 2019, respectively of the financial performance and cash flows for the financial year ended 31 December 2019.

The research on the distribution of audit firms that perform the statutory audit of the analyzed credit institutions and on the identification of the number of KAM reported per each institution revealed the following: at Romania level, there are 28 KAM reported for the 15 institutions analysed, which translates into an average number of 1.86 KAM reported at institution level. The frequency distribution of KAM revealed the following: there are 6 cases in which only one KAM was reported, 5 cases in which 2 KAM were presented, respectively 4 cases in which 3 KAM were presented. We mention that for all credit institutions included in the sample, the statutory auditors reported at least one KAM (Table no. 4).

With regards to KAM reporting at firm level (Table no. 4), the analysis evidenced that all 15 institutions are audited by Big4 audit firms, as follows: 33% audited by KPMG, 27% audited by Deloitte and the remaining 40% are distributed equally between PwC and EY.

Furthermore, there is a general tendency of the audit firms to report the same number of KAM for each credit institution, with only two situations in which additional KAM were reported. Thus, Deloitte reported 2 KAM per audited credit institution, EY reported 3 KAM, KPMG reported 1 KAM for four out of the five audited institutions while PwC reported 1 KAM for two out of the three credit institutions.

**Table no. 4. Number of KAM reported by the statutory auditors of credit institutions from Romania**

No.	Name of the credit institution	Number of reported KAM	Statutory auditor
1	Banca Transilvania	1	PwC
2	Banca Comercială Română	3	PwC
3	BRD Groupe Societe Generale	3	EY
4	Unicredit Bank	2	Deloitte
5	Raiffeisen Bank	3	EY
6	CEC Bank	1	KPMG
7	Alpha Bank	2	Deloitte
8	OTP Bank	2	Deloitte
9	Garanti Bank	2	KPMG
10	Banca de Export-Import a României	1	KPMG
11	Banca Românească	1	PwC
12	Banca Comercială Intesa SanPaolo	1	KPMG
13	Libra Internet Bank	1	KPMG
14	First Bank	2	Deloitte
15	Credit Europe Bank	3	EY
<b>Total</b>		<b>28</b>	

Source: Authors' own analysis



The research at the level of the credit institutions listed on Warsaw Stock Exchange revealed a number of 21 KAM reported for the 7 credit institutions analyzed, which translated into an average of 3 KAM reported at institution level, higher than the level recorded in Romania (Table no. 5).

A maximum of 5 KAM was reported at the level of a credit institution and a minimum of 2 KAM, in both situations, the level being higher than the one registered in Romania (Table no. 5). The frequency distribution of the number of reported KAM is as follows: 1 case in

which 5 and respectively 4 KAM were presented, 2 cases with 3 KAM and 3 cases with 2 KAM reported. Regarding the KAM reporting at audit firm level, we mention that all 7 credit institutions from Poland included in the sample are audited by Big4 audit firms, except for Bank Ochrony Srodowiska, whose 2019 financial statements were audited by Mazars. Given the small sample, we could not identify a specific trend in the KAM reporting by audit firm. Only Deloitte and KPMG audited 2 credit institutions each. In both cases, KPMG reported 2 KAM.

**Table no 5. Number of KAM reported by the statutory auditors of credit institutions from Poland**

No.	Name of the credit institution	Number of reported KAM	Statutory auditor
1	Banco Santander	3	PwC
2	Bank Handlowy W	2	KPMG
3	Bank Millennium	2	Deloitte
4	Bank Ochrony Srodowiska	3	Mazars
5	Bank Polska Kasa Opieki	2	KPMG
6	BNP Paribas Bank Polska	4	Deloitte
7	Getin Noble Bank Spolka	5	EY
<b>Total</b>		<b>21</b>	

Source: Authors' own analysis

The research at the level of the credit institutions listed on Prague Stock Exchange revealed a number of 6 KAM reported for the 3 credit institutions analyzed, which translated into an average of 2 KAM reported at institution level, higher than the level recorded in Romania (Table no. 6). Also, it was identified a similarity in the reporting trend of KAM, compared to Romania.

Thus, PwC Czech Republic reported only 1 KAM, similar to PwC Romania, which reported the same KAM number for two out of the three audited credit institutions. Furthermore, Deloitte Czech Republic reported at least 2 KAM for both audited institutions, similar to Deloitte Romania, which reported the same KAM number for all the credit institutions audited in Romania.

**Table no 6. Number of KAM reported by the statutory auditors of credit institutions from Czech Republic**

No.	Name of the credit institution	Number of reported KAM	Statutory auditor
1	Česká spořitelna (Erste Group)	1	PwC
2	Komerční Banka	2	Deloitte
3	Moneta Money Bank	3	Deloitte
<b>Total</b>		<b>6</b>	

Source: Authors' own analysis

The analysis of the nature of the KAM presented in the audit reports of credit institutions from Romania highlighted that the most frequently reported KAM relates to the impairment of loans and advances to clients, which was reported for all analyzed credit institutions (Table no. 7). The impairment of loans and

advances to clients is calculated in accordance with IFRS 9 "Financial instruments" principles and it is a complex process requiring the management of the credit institutions to apply a high degree of professional judgment, using subjective assumptions to determine the recognition period and to compute the amount to be

recognized. This area was considered by the statutory auditors as a KAM because the loans and advances to clients represent a significant part of the total assets of a credit institution and also due to the significant professional judgment applied by the management to determine the impairment level.

The provisions for litigations were reported as KAM for four out of the 15 analyzed credit institutions (Table no. 7). According to the auditors' reports, the provisions relate to the debts that will result following the outcome of ongoing litigations, which concern fiscal matters and customer disputes. Provisions for litigations were considered as KAM due to the significant judgment applied by the management of the credit institutions in estimating the final outcome of ongoing disputes, respectively for determining the value of provisions.

A similar reporting frequency was observed also for the recognition of interest and commission income, for which, the accounting recognition method is specific to the credit institutions (Table no. 7). Thus, interest income is recognized over the estimated life of a financial instruments, using the effective interest rate method, while the recognition of the income from

commissions depends on the nature of those commission and can be recognized either using the effective interest rate or at the moment when the credit institution provides a service to a client. The interest income and commissions recognition were considered a KAM given the particularity of the accounting recognition methods and the large volume of low value individual transactions. Deloitte reported this KAM for all 4 credit institutions audited, from our sample.

Another KAM identified related to IT and relevant systems used by credit institutions for financial reporting (Table no. 7). EY reported this KAM for all 3 credit institutions audited, from our sample. The complexity of the IT environment within a credit institution and the automation degree of the relevant processes for financial reporting are the main reasons for which IT and information systems used for financial reporting have been considered a KAM. The investigation of the audit reports also highlighted KAM that relate to fiscal aspects and goodwill impairment (Table no. 7). These KAM represent specific aspects encountered in the activity of certain credit institutions.

**Table no. 7. KAM reporting frequency for credit institutions from Romania, based on their nature**

No.	KAM description	Reporting frequency (number)	Share in total reported KAM
1	Impairment of loans and advances to clients	15	54%
2	Provisions for litigations	4	14%
3	Recognition of interest and commission income	4	14%
4	IT and information systems relevant for financial reporting	3	11%
5	Fiscal aspects	1	4%
6	Goodwill impairment	1	4%
<b>Total</b>		<b>28</b>	<b>100%</b>

Source: Authors' own analysis

In terms of KAM reporting frequency, the research revealed that the impairment for loans and advances to clients are the most frequently reported KAM also in the case of credit institutions from Poland, being included in all 7 audit reports analyzed (Table no. 8). In addition to the reports from Romania, Polish auditors reported as KAM the provisions for off-balance sheet client commitments (in case of 3 credit institutions). Mainly, these commitments represent approved credit facilities, not yet utilized by clients and letters of guarantee.

The second most frequently reported KAM also covers the provision area, namely the provisions for ongoing litigations with clients for the reimbursement of commissions and fees related to consumer loans prepaid by clients, respectively litigations for abusive clauses included in the CHF loan contracts (Table no. 8). Credit institutions operate in a regulated market and are exposed to the risk of ongoing regulatory changes but also to events which can generate changes in the contractual cash flows deriving from the contracts

concluded with clients, respectively in an obligation arising from past events, whose settlement will involve the use of the resources of those respective institutions. Practically, as at 31 December 201, the statutory auditors identified two rulings of the EU Court of Justice, namely from 11 September 2019 (case C383/18, related to the change in the interpretation of consumer loans legislation) and from 3 October 2019 (case C260/18, related to the abusive clauses included in the loan contracts concluded in foreign currency in Poland), which, although did not refer directly to the analyzed credit institutions, had generated several consequences for them. The estimation of the risks deriving from these two rulings required the application of management professional judgment regarding, inter alia, the number of reimbursement requests, future prepayment rate, number of possible litigations involving loan contracts in CHF and the outcome of current and future litigations. All these elements contributed to the reporting of these

provisions as KAM. Contrary to Poland, at the level of the credit institutions from Romania, the provisions for litigations disputing over loan contracts concluded with clients were reported as KAM in 3 situations, namely for the credit institutions audited by EY. However, the context of recording these provisions is not detailed, but it is specified that the provisions have been recorded for ongoing litigations concerning loan contracts with clients.

Another reported KAM envisage the recognition of interest and commission income (**Table no. 8**). As in the case of credit institutions from Romania, Deloitte reported this KAM for the two audited institutions included in the sample. The remaining reported KAM envisage aspects specific to the activity of particular credit institutions, such as: the acquisition of BNP Paribas Bank of Raiffeisen Bank Polska, fiscal aspects regarding the recoverability of the deferred tax asset recognized by Getin Noble Spolka Bank, valuation of related parties' transactions performed by Getin Noble Bank Spolka.

**Table no. 8. KAM reporting frequency for credit institutions from Poland, based on their nature**

No.	KAM description	Reporting frequency (number)	Share in total reported KAM
1	Impairment for loans and advances to clients	7	33%
2	Provisions for litigations related to mortgage loans in CHF	5	24%
3	Provisions for off-balance sheet commitments	3	14%
4	Recognition of interest and commission income	2	10%
5	Accounting for an acquisition of a credit institution	1	5%
6	Valuation of related parties' balances and transactions	1	5%
7	Recoverability of deferred tax assets	1	5%
8	Valuation of shares owned in non-listed entities	1	5%
<b>Total</b>		<b>21</b>	<b>100%</b>

Source: Authors' own analysis

Similar to the situation in Romania and Poland, also in the case of Czech Republic (**Table no. 9**), the impairment for loans and advances to clients were reported as KAM for all three analyzed credit

institutions. Another KAM envisaged the recognition of interest and commission income. Deloitte reported this aspect for both audited credit institutions, included in our sample.

**Table no. 9. KAM reporting frequency for credit institutions from Czech Republic, based on their nature**

No.	KAM description	Reporting frequency (number)	Share in total reported KAM
1	Impairment for loans and advances to clients	3	50%
2	Recognition of interest and commission income	2	33%
3	Impairment for investments in subsidiaries	1	17%
<b>Total</b>		<b>6</b>	<b>100%</b>

Source: Authors' own analysis

The research results revealed a series of convergent and divergent elements in reporting KAM at the level of the three territories from Central and Eastern Europe. In terms of convergence, we identified that the impairment for the loans and advances to clients were reported for all 25 credit institutions included in the sample, being considered the most significant aspect of the audit process. This result is in line with those obtained by previous studies conducted at the level of the European banking sector (European Banking Institute, 2019; Accountancy Europe, 2019). Another frequently reported KAM at the level of the three states relate to the provisions for litigations and recognition of interest and commission income.

As divergent elements, unlike Poland and Czech Republic, a KAM reported at the level of the credit institutions in Romania relate to IT and information systems relevant for financial reporting. This KAM was reported by EY Romania for all audited credit institutions. IT and information systems were not reported as KAM for none of the institutions from Poland and Czech Republic, nor in the case of Getin Noble Bank Spolka, audited by EY Poland. Another significant aspect identified is the particular importance given by the statutory auditors from Poland to provisions for litigations in the context of the two rulings of EU Court of Justice, one of them specifically addressing Polish debtors. At the level of Romania, the provisions for litigations were reported as KAM by EY, but without presenting in details, as in the case of Poland, the context for recording these provisions. At the level of the Czech Republic, no KAM of this nature have been reported.

From KAM nature point of view, the results indicated the tendency of statutory auditors to report KAM similar to the audited credit institutions from a particular country, but also at the level of the region. For example, Deloitte reported the impairment for loans and advances to clients and the recognition of interest and commission income for all audited credit institutions from the three territories. At Romanian level, KPMG reported for all audited institutions only one KAM, namely the impairment for loans and advances to clients, except for one case. This tendency was observed also at the level of Poland. A similar situation was identified for PwC, which reported only one KAM for two out of three audited credit institutions, included in our sample. EY Romania reported same KAM for the three audited credit

institutions. Out of these KAM, only the one related to IT and financial reporting systems is not included for the credit institutions from Poland.

## Conclusions

The legislative changes regarding the statutory audit and of the International Auditing Standards had as objective the issuance, by the statutory auditors, of an audit report that would improve the public's credibility in the statutory audit process and in the related financial statements, which have benefited from intense media coverage in recent years. The significance of the changes brought to the statutory auditor's report, and implicitly, of KAM reporting, was reflected at the level of the specialized literature, the conceptual assertions on KAM being multidimensional both in terms of research objectives and industries, and converge towards their impact on stakeholders and the improvement in the quality of financial reporting and auditing process.

The research results highlight that KAM reported at the level of the credit institutions included in the sample reflect the particularities of the banking industry and the activities of these institutions. These results are validated by comparison with previous studies envisaging KAM reporting area for entities operating in other industries (Sneller et al., 2016; Abdullatif and Rahahleh, 2019; Ciger et al., 2019; Kend and Nguyen, 2020).

The research on the KAM reported in the audit reports of the credit institutions from Romania, Poland and Czech Republic revealed a series of convergent and divergent elements. In terms of convergence, the impairment for the loans and is the most significant KAM of the audit process, being reported for all the analyzed credit institutions. Other frequently reported KAM at the level of the three states relate to the provisions for litigations and recognition of interest and commission income. Among the divergent elements, we mention the reporting of KAM related to IT and information systems for the credit institutions in Romania, as well as the increased attention paid by the auditors in Poland to the provisions for litigations, as opposed to those in Romania and Czech Republic. Regarding the nature of reported KAM at the level of the statutory auditor, it was observed their tendency to report similar KAM at the level of the audited credit institutions from a particular territory but also at the level of the region.

With reference to the research limitation, we consider that one of the limitations of this study is the lack of the audit report for the fourth ranked credit institution in Romania, a branch of a foreign credit institutions, whose financial statements are prepared and audited at the level of the parent institution. However, considering the total market share of the credit institutions included in the sample, the research results are not significantly

influenced. Another limitation is the lack of the audit reports for two of the credit institutions listed on the primary market of the Warsaw Stock Exchange.

As future research directions, we envisage to continue the research on the identification and analysis of the main key audit matters presented by the statutory auditors in their audit reports issued for credit institutions operating in other EU territories.

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