The relationship between key audit matters in the new auditor's report and the risks reported in the management report and the estimates and judgments in the notes to the financial statements

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Summary

For decades, auditors have communicated their opinion on financial statements with standard wordings in the auditor's report. However, stakeholders expect more information from the auditor. The limited transparency regarding an auditor's actual activities, has contributed to the dissatisfaction concerning the functioning of auditors. The new (extended) auditor's report is an answer to the information needs of stakeholders. The key audit matters reported by the auditor provide new insights to financial statement users with respect to significant estimates and risks reported in the financial statements. It may be expected from the auditor that he pays extra attention to the most significant estimates and risks. This article contains an examination of the degree to which reported key audit matters match with the significant risks presented in the directors' reports, and with the significant accounting policies and estimates in the notes. We have studied management reports, financial statements and auditor's reports of 50 companies listed in the Netherlands (at the AEX and Midkap index) in 2015. Our study shows that the key audit matters in the new auditor's report often correspond with the significant accounting policies and estimates as they are reported by management in the notes. However, only in ten percent of the cases, the risks presented in the directors' reports are mentioned as key audit matters in the new auditor's report. Auditors have a strong focus on balance sheet items as key audit matters. Many companies recognize the riskiness of issues like reliability and continuity of IT systems and complying with regulation, but these are hardly mentioned as key audit matters. This is also a general finding of our study for issues related to the internal controls of the audited companies.

Practical relevance of the study

It is important for management board members, supervisory board members, financial statement users and auditors to take notice of the key audit matters that are presented in the new auditor's report. The differences and similarities between these key audit matters and the risks presented in the directors' reports, and the significant accounting policies and estimates in the notes of the financial statements, provide insights into the relevance of reported estimates and risks for the financial statements. In addition, the results suggest that auditors should evaluate the reported key audit matters in the light of the most important risks that are reported by the company.

1. Introduction

For many financial statement users, the auditor’s report is the only tangible evidence of the auditor’s work. For years, the auditor’s report contained standard wordings and provided no other information than the confirmation of the auditor that the financial statements entailed a true and fair view in accordance with the relevant laws and regulations. However, stakeholders felt, and feel, the need to gain more insight into the work of the auditor and into his judgments regarding the financial statements and the management report (see e.g., VEB, 2013, VEB 2015 and Eumedion 2013). To heed this call from stakeholders, auditors have improved their stakeholder communication in the past couple of years, for example by playing a more active role at the annual meetings of shareholders and with a pilot regarding a more informative auditor’s report for the annual report of the year 2013 (see e.g., NBA, 2013; Brouwer, et al., 2014; NBA, 2015; Eumedion, 2015; PwC, 2015 and VEB, 2016).

After the pilot with the more informative auditor’s report at several listed companies, the Werkgroep Toekomst Accountantsberoep (Working Group Future Audit Profession in the Netherlands) (2014) proposed a measure that is aimed at providing a new auditor’s report for all Public Interest Entities. Shortly after that proposal, the NBA has finalized Standard 702N in the equivalent in the Netherlands of the International Standards on Auditing (ISA), which mandates a new auditor’s report for all Public Interest Entities in The Netherlands. Together with the United Kingdom (UK), The Netherlands were the first movers worldwide in this respect (Eimers & De Groot, 2015). Based on EU-regulation (EU, 2014) and the ISA 701 *Communicating key audit matters in the independent auditor’s report* (IAASB, 2015), the application of the new auditor’s report became mandatory for the audit of listed companies concerning the fiscal year that starts on or after June 17 2016 (EU-regulation) or the fiscal that ends on or after December 15 2016 (ISA 701). US-regulation is still in the development stage (PCAOB, 2015). The temporary Standard 702N in the Netherlands will be replaced by Standard 701, complemented with several specific requirements concerning materiality and the scope of the group audit.

The new auditor’s report will provide a better understanding of the audit, for example by disclosing key audit matters, materiality, scope of the group audit (Standard 702N, par. 6b). Key audit matters are matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period (Standard 702N, par. 7). Standard 702N explicitly states in par. 18a that communicating key audit matters in the auditor’s report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation. Therefore, the auditor, in principle, provides information about, or as a result of, his audit.

However, in practice it is possible that the financial statement users get more information from the auditor's report than they have received from the company's annual report. Abma from Eumedion states the following about this issue in an interview (PwC, 2015):

"Regularly we notice discrepancies between the auditor's report and the report of the supervisory board. For example, in those cases there might be important issues in the auditor's report that are not mentioned in the report of the supervisory board. (...) Sometimes it's a topsy-turvy world: the management board and the supervisory board provide very little information about the risk-profile of the company and for those companies the auditor's report is more informative than the management report and the report of the supervisory board. That is not the way it should be."

The same conclusion can be drawn from an evaluation by Eumedion (2015) of the 2015 annual meetings season: in some cases the content of the auditor's report is more informative about the actual financial situation of the company than the reports of management and the supervisory board are.

De Bos en Strating (2014) state that the new auditor's report also influences the division of roles between the auditor, the management board and the supervisory board members and the reporting of management and audit committees in the management report.

Furthermore, the auditor chooses the matters that he includes in the auditor's report. Hence, the auditor's report can effectuate that the user's attention will be drawn towards the most relevant issues in the financial statements and in the management report. The past couple of years, many parties have addressed the magnitude of annual reporting and have indicated that this negatively influences the readability of the financial statements and in the management report (see e.g., FRC, 2009; ASB & FRC, 2011; Eumedion, 2012; Hoogervorst, 2012; Van Daelen, 2013 and Backhuijs & Roelofsen, 2014). The fact that the auditor presents the key audit matters in his auditor's report is, according to us, the most important feature of the auditor's report.

For that particular reason, the new auditor’s report not only provides more information by the auditor concerning his audit work, but also is a valuable addition to the information provided to financial statement users via the annual report. From that angle, we examine the contents of the new auditor’s report of listed companies in the Netherlands and combine those with the information that is provided by companies in the management report and the financial statements. Specifically, we focus on the risk section of the management report and the significant accounting policies and estimates in the financial statements. The significant risks that are mentioned in the directors’ report and management’s significant accounting policies and estimates of that are included in the financial statements can result in corresponding key audit matters of the auditor.

The purpose of this article is to examine whether, and to what degree, key audit matters in the new auditor’s report match with the important risks mentioned in the management report and with the significant accounting policies and estimates in the notes of the financial statements. First, the relevant regulation literature will be discussed in section 2. Section 3 contains the results of our empirical study. The article concludes with a summary and a discussion in section 4.

2. Regulation and literature on the new auditor's report, significant risks and significant estimates and judgments

2.1 The new auditor's report

For decades, auditors have communicated their opinion on the financial statements with standard wordings in the auditor's report. However, stakeholders expect more information from the auditor, as becomes apparent in, for example, publications from the VEB (2013 and 2015) and Eumedion (2013). The limited transparency regarding an auditor's actual activities has contributed to the dissatisfaction concerning the functioning of auditors. The Werkgroep Toekomst Accountantsberoep (2014) states that society has received too little information on what auditors actually do. Therefore, it cannot be expected that society bases her trust only on the standard auditor's report. Litjens en Vergoossen (2012) conclude that there is a correlation between the expectations-gap and the auditor's communication. They postulate that is profitable to include more information in the auditor's report on audit activities and audit findings. This information should be more specifically focused on the audited company. Also Wieringa (2015) emphasizes the importance of improved communication by auditors via, for example, the auditor's report and annual shareholder meetings. De Bos en Strating (2014) state that the expectations and information-gap is the cause of the new auditor's report. They believe that the new auditor's report is an important step towards meeting the expectations of society.

The international literature discussing the effects of these new developments is limited. In the run-up to the IAASB-standard and the discussions in the United States, several researchers have tried to map the possible effects. For example, Gold, et al. (2012) examine the possible effects of the new auditor's report on the expectations-gap. Czerney, et al. (2014) study whether additions to the auditor's statement suggest a heightened risk of material errors. Christensen, et al. (2014) examine the effect of reported key audit matters on investor behaviors. From an earlier date, publications by Turner, et al. (2010) and Gray, et al. (2011) studied the discontent with the old 'one-size-fits all' auditor's report.

Next to the appearance of the first more informative auditor reports, also reports are published (e.g., the yearly FRC-publication, FRC, 2016) and there is an annual award for the most informative auditor's report in the UK. Also in the Netherlands benchmark-reports are published (Brouwer, et al., 2014; NBA, 2015).

2.2 Information-disclosure concerning significant risks

Based on art. 2:391 lid 1 BW, the directors' report contains a description of the most important risks and uncertainties that face the legal entity. Accounting Guideline RJ 400.110a for Management reports of the Council of Annual Reporting in the Netherlands reads that this description should not be an exhaustive account of all possible risks and uncertainties, but that it should be a selection of the most significant risks and uncertainties facing the legal entity. This regulation also applies to management reports in the Netherlands of companies which have their financial statements based on IFRS. According to RJ 400.110b, a company is expected to, at least, cover the risks related to strategy, operational activities, financial position, financial reporting and laws and regulations. For listed companies, the Netherlands Corporate Governance Code requires that the management report to include a description of the most significant risks related to the strategy of the legal entity.

Van Daelen and De Groot (2014) state that these requirements in laws, regulations and codes do not exist in isolation, but are an answer to the criticism and questions of stakeholders regarding the information-disclosure about risks and risk management. Also in her proposals for amending the Netherlands Corporate Governance Code (Monitoring Commissie Corporate Governance Code, 2016), the Monitoring Committee Corporate Governance Code suggests several stipulations in order to strengthen risk management.

De Ridder and Steggink (2009) conclude that stakeholders feel the need for a specific clarification of the risks, which are significant for the company. At a minimum, a ranking should be applied to those risks, but preferably the probability and impact of the risks are also quantified. Stakeholders do not need a list with general risks. However, studies by Mertens and Blij (2008) and Van Daelen and De Groot (2014) show that companies insufficiently recognize the stakeholders needs, because in general they tend to report a large number of risks without providing good insights into the importance of these risks. Van Daelen and De Groot (2014) determine that the majority of companies report 12 or more risks and label that as a 'rather broad interpretation of the most important risks'. Eumedion (2012) therefore states: "*A second suggestion in this regard is not to publish an extensive list of possible risks for the company, but to confine it to the most important* *('top') risks*". Van Daelen (2013) gives an overview of the international information-needs and international research sketches a similar picture concerning the information-disclosure.

Risk analysis is an important starting point for the audit and the auditor should develop an audit program that adequately addresses the material errors in the financial statements (see e.g., Standards 300, 315 and 330). Therefore, the most important risks are driving the audit. Although not all risks identified by the legal entity are always translated into audit risks, it may be expected that they are an important source for the auditor's risk assessments. The comparison between the risks that are reported by the company and those covered in the key audit matters delivers relevant information for the financial statement users when evaluating the most important risks.

2.3 Information disclosure regarding significant estimates and judgments in the notes

The preparation of the financial statements, for example based in IFRS, involves many judgments and estimates. The relevance of these has historically increased. Arnold Schilder, the chairman of the IAASB, makes the following statement about this (PwC, 2016): "*Currently, hard figures play a smaller, and words and assessments play a bigger role. The valuation process needs much more explanation now, think about, for example, banks' expected credit losses. That requires assumptions. These items comprise a much bigger part of the balance sheet than before.*"

Despite the fact that there are several possible outcomes, and that this is dependent on the assumptions used, in contemporary reporting it is necessary that this is translated into one single amount that will be included in the balance sheet or in the profit and loss statement. However, that amount, as such, does not give information on the estimation insecurities and possible other outcomes for this item (see also, Backhuijs & Roelofsen, 2014). Camfferman and Eeftink (2006) point out that this insecurity is an additional attribute of the amount recorded in the financial statements.

Because of the importance of estimations and assumptions, Backhuijs en Roelofsen (2014) label the paragraph on critical policies and estimation uncertainties "perhaps the most important element of the IFRS financial statements, after the four primary statements".

The information disclosure concerning critical accounting policies and estimation uncertainties is regulated in IAS 1 (Presentation of Financial Statements). IAS 1.125 requires that an entity discloses information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. IAS 1.127 further clarifies what type of estimates one should consider. According to IAS 1.127 it relates to the estimates that require management's most difficult, subjective or complex judgements. Based on IAS 1.129, examples of the types of disclosures an entity makes are:

(a) the nature of the assumption or other estimation uncertainty;
(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

IAS 1.122 furthermore indicates that in the summary of significant accounting policies or other notes, an entity shall disclose the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Equal to the information about risks, existing research shows that companies report a large number of significant accounting policies and estimation insecurities (for an overview, see Backhuijs en Roelofsen, 2014), which makes it difficult for users to judge what is really important.

Judgment and the audit of estimates takes an important place within the audit. Schilder states: *“If you look at all existing standards, you will see that half of them relate to professional judgment”* (PwC, 2016). For example, Standard 540 specifically discusses the audit of estimates and Standard 260 (par. 16 and addendum 2) explicitly mentions the bases for financial reporting and estimates as topics that should be communicated by the auditor with the persons charged with governance. Hence, it may be expected that in many instances the most significant accounting policies and estimates will be included in the key audit matters. Also here, a confrontation of the significant accounting policies and estimates reported by the company versus the key audit matters reported by the auditor will provide relevant information for financial statement users.

3. Results of the empirical study

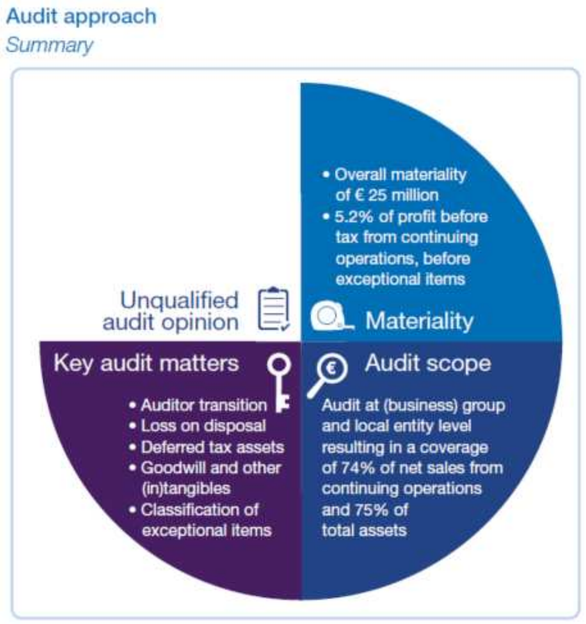
3.1 Sample

We have examined the management reports, financial statements and auditor reports of 50 companies listed on the Dutch AEX and Midkap, for the year 2015. For two AEX-companies (Arcelor Mittal and Unibail-Rodamco) and four Midkap-companies (Air France - KLM, Aperam, Galapagos and WDP), the auditor has not issued a new auditor's report. These companies have a non-domestic legal form and as a result they are no formal Public Interest Entity in the Netherlands, which makes a new auditor's report non-mandatory. This will change when the EU-regulation will take effect. It is remarkable that the positive stakeholder responses in the environment in the Netherlands regarding the non-mandatory new auditor's reports for the year 2014, has not been an trigger for these companies to require their auditors to also provide a new auditor report for the year 2015. Therefore, the results of this study comprise the 44 AEX- and Midkap-companies that did have a new auditor's report.

3.2 The auditor's report

The new auditor's report contains information on, among other things, materiality, scope of the group audit and the key audit matters. This extra information has significantly increased the length of the auditor's report to several pages, whereas the auditor's report used to cover only one page. In order to disclose this information in an accessible way, several auditors have chosen to present the most important information in one glance. An example of this approach is shown as best practice 1.

Best practice 1 – Royal DSM Integrated Annual Report 2015, p. 199 (KPMG)



Our study focuses on the information about the key audit matters in the auditor's report. According to Standard 702N, key audit matters are matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. In the examined auditor reports, two to six key audit matters are presented. For the AEX-companies, the mean number of key audit matters presented is 4.43 and for the Midkap-companies the mean number is 3.95 (see table 1).

Table 1. Number of reported key audit matters

Number of key audit matters	**AEX**		**Midkap**		**Total**	
	n	**%**	**n**	**%**	**n**	**%**
1	0	0	0	0	0	0
2	1	4	2	10	3	7
3	6	26	7	33	13	30
4	3	13	5	24	8	18
5	8	35	4	19	12	27
6	5	22	3	14	8	18
Total number of listed companies	23	100	21	100	44	100

Total number of key audit matters	102		83		185	
Mean number of key audit matters	4.43		3.95		4.20	

The nature of the reported key audit matters is summarized in table 2. The table shows that the majority of key audit matters are related to specific balance sheet items. From the AEX-companies, 66% of the reported key audit matters are related to the balance sheet and for the Midkap-companies that is 57%. In particular, the audit of the tax position (27 companies, 61% of the population) and the valuation of goodwill (25 companies, 57% of the population) are frequently reported by the auditor as key audit matters. In total, 87% of the key audit matters concern specific financial statements items or the notes in the financial statements. The key audit matters that are most frequently mentioned are: tax position (15%), valuation of goodwill (14%, including impairment) and revenue recognition (11%). These results resemble the empirical findings of the FRC (2016) in the United Kingdom.

Only 14% of the key audit matters cover internal control (7%), first year audit (5%) or other issues (2%). These results resemble the empirical findings in a study of the FRC (2016, pp. 14-16) regarding the FTSE 350 in the UK, where the reported key audit matters primarily relate to financial statements items, as well.

Table 2. Nature of the reported key audit matters

Matters	AEX		Midkap		Total	
	n	**%**	**n**	**%**	**n**	**%**
Financial statements – balance sheet items						
Tax position	16	16%	11	13%	27	15%
Valuation of goodwill (incl. impairment)	13	13%	12	14%	25	14%
Valuation of other intangible and tangible assets	7	7%	10	12%	17	9%
Provisions for claims and litigations	7	7%	4	5%	11	6%
Reorganization provision	6	6%	1	1%	7	4%
Pension provisions	3	3%	1	1%	4	2%
Other provisions	4	4%	1	1%	5	3%
Complex financial instruments	3	3%	3	4%	6	3%
Participations and joint ventures	3	3%	1	1%	4	2%
Other balance sheet items	5	5%	3	4%	8	4%
Total balance sheet items	**67**	**66%**	**47**	**57%**	**114**	**62%**
Financial statements – Profit and loss account						
Revenue recognition	9	9%	11	13%	20	11%
Total profit and loss account	**9**	**9%**	**11**	**13%**	**20**	**11%**
Financial statements – other						
Acquisitions	5	5%	5	6%	10	5%
Sales activities	3	3%	3	4%	6	3%
Effects of listing/delisting	1	1%	2	2%	3	2%
Financing / going concern	-	-	3	4%	3	2%
Other	3	3%	1	1%	4	2%
Total financial statements – other	**12**	**12%**	**14**	**17%**	**26**	**14%**
Internal control						

Reliability and continuity IT	3	3%	3	4%	6	3%
Other internal control	3	3%	4	5%	7	4%
Total internal control	**6**	**6%**	**7**	**8%**	**13**	**7%**
Other matters						
First year audit	6	6%	3	4%	9	5%
Other	**2**	2%	**1**	1%	**3**	**2%**
Total other matters	**8**	**8%**	**4**	**5%**	**12**	**6%**
Total	**102**	**100%**	**83**	**100%**	**185**	**100%**

The degree to which key audit matters have been made company-specific differs per audit. Several auditors, for example, describe in a generic fashion the reasons why the valuation of goodwill is a key audit matter (its considerable amount and the use of estimates), without elaborating on specific components of the total amount of goodwill that were the focus of the audit. Alternatively, they describe in general terms that a first year audit requires specific information from the auditor. Best practice 2 contains an example regarding a key audit matter where the auditor specifically addresses in what country or segment uncertainty is present.

Best practice 2 – SBM Offshore Annual report 2015, p. 216 (PwC)

Key audit matter	How our audit addressed the matter
Difficult market conditions, no new projects from Brazil (their main market), and the Company's restructuring actions The drop in the oil price and the need for the Company's clients to reassess and reduce their capex plans and embark on other cost savings initiatives, together with the situation in Brazil whereby the company was excluded from participating in tenders, has caused the Company to reassess its business model. They have initiated a number of alignment and restructuring initiatives aimed at reducing the Company's work force. The continued deterioration of market conditions could have an impact on the Company's financial position and results – particularly its Turnkey segment – and we therefore focused significantly on matters such as judgements, valuations, provisioning and future scenarios, all of these are disclosed in more detail below as it regards to key audit matters.	We have had discussions with management to understand their plans and business changes. We have considered management's assessment whether the Company would face liquidity problems as a result from the downturn in the industry, and the circumstances the Company is facing in Brazil as described in note 6.3.1 of the financial statements. Our audit procedures included obtaining a liquidity forecast and assessment of the effects of the different liquidity scenarios on the Company's compliance with its bank loan covenants. We have compared the business plans and assumptions with market data as well as with the lease contracts commenced that generate cash flows in the upcoming years. We have compared this to management's estimates included in the liquidity scenarios and concur with management's conclusion that there are no material uncertainties with respect to going concern. We have assessed the appropriateness and timing of expenses incurred for restructuring.

One of the other topics presented as a key audit matter, is one presented by EY in their auditor's report for KPN (see best practice 3). EY does not limit the key audit matters to the audit of the financial statements, but adds a key audit matter on the assurance activities regarding the sustainability information in the management report. This is a tight fit with the stakeholders' question that asks the auditor to explicitly give an opinion on the management report and other information that is relevant in judging the company. It should be noted that the auditor only provides statements on his activities and does not address potential sensitivities of the assumptions made.

Best practice 3 – KPN Integrated Annual Report 2015, p. 169 (EY)

For the assurance procedures concerning the sustainability information in scope, we identified the following key assurance matter:

Key assurance matter	How our assurance procedures addressed the matter
Estimations in Scope 3 emissions and energy reduction by customers	
Inherent to the nature of scope 3 emissions, KPN uses estimates and underlying assumptions to determine the indirect emissions in its value chain. As of 2014, KPN started reporting on the estimated reduced energy consumption by KPN's customers through the use of its products and services. KPN implemented a model to estimate the positive impact of its products and services, while taking potential negative impacts into account.	Our review procedures focused on understanding the model used and assessing the mathematical accuracy of the calculations applied and validated the assumptions with underlying sources.

3.3 The auditor's report in comparison with the risk paragraph in the management report and significant accounting policies and estimates in the financial statements

As mentioned in section 2, the auditor's report can be useful by sharing insights from the auditor regarding the risks and estimates that were critical for the audit. In table 3, the number of reported key audit matters is confronted with the risks and the significant accounting policies/estimates that were reported by the company

Table 3. The number of reported key audit matters, risks and the significant accounting policies/estimates

	Key audit matters	Significant accounting policies/estimates	Risks
Minimum	2	1	2
Median	4	5	14
Maximum	6	11	28
Mean	4.20	4.93	14.55
Total	185	217	640

Table 3 shows that the mean, minimum and median of the number of key audit matters in the new auditor's report are relatively similar to the mean, minimum and median of the significant accounting policies/estimates in the notes. However, the maximum, mean and median of the number of the number of key audit matters is lower than the number of significant accounting policies/estimates. The mean, median and maximum number of risks is much larger than the number of key audit matters and significant accounting policies/estimates. This supports the literature discussed in section 2.2 that mentions the fact that in general companies report many risks instead of reporting only the most important risks. An exception is Delta Lloyd (see best practice 4), which explicitly and separately reports the five most important risks.

Best practice 4 – Delta Lloyd Annual report 2015, p. 20

In 2015, we identified the following five risks as having the greatest potential impact on Delta Lloyd:

- Inadequate solvency, due to regulatory changes
- Reputational damage, due to declining share price and S&P downgrade
- Volatile financial markets
- Geopolitical instability
- Increased exposure to cloud computing, cybercrime and data manipulation

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We will look at this from three different angles. Table 4 contains an overview of the nature of the reported key audit matters and to what extent the reported key audit matters match with the reported significant accounting policies/estimates or risks. In table 5, the relationship between the reported significant accounting policies/estimates and the reported key audit matters, viewed from the angle of the significant accounting policies. Table 6 shows the risks reported by the company and which of those are also reported as a key audit matter.

Table 4. Comparison of key audit matters with risk paragraph and significant accounting policies/estimates

Matters	Included as key audit matter		Also included as significant accounting policy/ estimate		Also included in risk paragraph		Not included as significant accounting policy/ estimate or risk	
	n		n	%	n	%	n	%
Financial statements – balance sheet items								
Tax position	27		24	89%	16	59%	-	0%
Valuation of goodwill (incl. impairment)	25		23	92%	4	16%	2	8%
Valuation of other intangible and tangible assets	17		13	76%	7	41%	3	18%
Provisions for claims and litigations	11		5	45%	5	45%	4	36%
Reorganization provision	7		2	29%	5	71%	2	29%
Pension provisions	4		4	100%	4	100%	-	0%
Other provisions	5		5	100%	1	20%	-	0%
Complex financial instruments	6		6	100%	4	67%	-	0%
Participations and joint ventures	4		3	75%	1	25%	1	25%
Other balance sheet items	8		6	75%	3	38%	1	13%
Total balance sheet items	**114**		**91**	**80%**	**50**	**44%**	**13**	**11%**

Matters	Included as key audit matter		Also included as significant accounting policy/ estimate		Also included in risk paragraph		Not included as significant accounting policy/ estimate or risk	
Financial statements – Profit and loss account								
Revenue recognition	20		11	55%	5	25%	7	35%
Total Profit and loss account	**20**		**11**	**55%**	**5**	**25%**	**7**	**35%**
Financial statements – company specific								
Acquisitions	10		7	70%	1	10%	3	30%
Sales activities	6		4	67%	-	0%	2	33%
Effects of listing/delisting	3		-	0%	1	33%	2	67%
Financing / going concern	3		1	33%	2	67%	-	0%
Other	4		1	25%	-	0%	3	75%
Total Financial statements – company specific	**26**		**13**	**50%**	**4**	**15%**	**10**	**38%**
Internal control								
Reliability and continuity IT	6		-	0%	6	100%	-	0%
Other internal control	7		-	0%	2	29%	5	71%
Total internal control	**13**		**-**	**0%**	**8**	**62%**	**5**	**38%**
Other matters								
First year audit	9		-	0%	-	0%	9	100%
Other	3		-	0%	3	100%	-	0%
Total other matters	**12**		**-**	**0%**	**3**	**25%**	**9**	**75%**
Total	**185**		**115**	**62%**	**70**	**38%**	**45**	**24%**

It can be concluded from table 4 that many key audit matters are related to issues, which are also recognized by the company as being a significant accounting policy and/or estimate. This holds for 62% of the key audit matters. This finding fits the fact that a large portion of the key audit matters is related to balance sheet items, since also the significant accounting policies/estimates are mainly focused on the processing and valuation of balance sheet items (see also table 5). For a lesser number of the key audit matters (38%) a related risk is presented in the risk paragraph. However, it should be noted that the valuation of goodwill and other assets are not specifically mentioned in the risk paragraph, but 41 companies do report 149 risks (see table 6) that are related to their strategy and business model. Those risks are also of influence on valuation of goodwill and other assets.

For 45 key audit matters (24%), companies do not report significant accounting policies/estimates or risks. This is logical for key audit matters concerning a first year audit, because they are purely related to the audit and not focused on a specific account or business process of the company. Nine out of 45 (20%) key audit matters for which there are no reported significant accounting policies or risks are related to a first year audit. Other key audit matters for which relatively often no significant accounting policies/estimates or risks are reported, are revenue recognition (7 cases, 16% of the key audit matters without significant accounting policy or risk) and internal control (5 cases, 11%).

It is remarkable that the auditor identifies key audit matters in those instances, while the management board does not indicate a risk or estimation element with an important influence on the financial statements.

Table 5. The significant accounting policies/estimates reported by the company and their inclusion in the key audit matters

Matter significant accounting policy/estimate	Included as significant accounting policy/estimate		Also included as key audit matter	
	n	%	n	% (*)
Balance sheet items				
Tax position	33	15%	24	73%
Valuation of goodwill (incl. impairment)	28	13%	23	82%

Matter significant accounting policy/estimate	Included as significant accounting policy/estimate		Also included as key audit matter	
Valuation of other intangible and tangible assets	30	14%	13	43%
Pension provisions	21	10%	4	19%
Provisions for claims and litigations	10	5%	5	50%
Other provisions	21	10%	7	33%
Complex financial instruments	12	6%	6	50%
Participations and joint ventures	6	3%	3	50%
Other balance sheet items	18	8%	6	33%
Total balance sheet items	**179**	**83%**	**91**	**51%**
Profit and loss account				
Revenue recognition	12	6%	11	92%
Total profit and loss account	**12**	**6%**	**11**	**92%**
Other				
Acquisitions	10	5%	7	70%
Sales activities	6	3%	4	67%
Consolidation	2	1%	-	0%
Leases	2	1%	-	0%
Other	4	2%	2	50%
Total other	**24**	**11%**	**13**	**54%**
Total	**215**	**100%**	**115**	**53%**

(*) NB: this is the percentage of cases for which the significant accounting policy/estimate is reflected in the key audit matters in the auditor's report.

Table 5 shows that more than half (53%) of the significant accounting policies and estimates reported by companies are reflected in the auditors' reported key audit matters. Significant accounting policies and estimates, which are both reported by the company and in the auditor's key audit matters, are revenue recognition (92%), valuation of goodwill (82%) and the tax position

(73%). It is noticeable that pension provisions and other provisions are relatively often reported by companies as significant accounting policies/estimates (both are reported as such by 21 companies), but that those are reported as key audit matters by the auditor in only a couple of cases. For only 19% of the companies that report the pension provision as a significant accounting policy/estimate, the auditor also reports those as a key audit matter (4 cases), and for 33% of the companies concerning other provisions.

The correlation between the reported significant estimates and the key audit matters reported by the auditor is explicitly addressed in the reported key audit matters by some of the auditors. An example of such an auditor's report is the report from the financial statements of Arcadis (best practice 5).

Best practice 5 – Arcadis Annual report 2015, p. 238 (PwC)

Key audit matter	**How our audit addressed the matter**
Project revenue recognition and valuation of (un)billed receivables Project revenue recognition and the valuation of (un)billed receivables are significant to the financial statements based on the quantitative materiality and the degree of management judgement required for revenue recognition and valuation of (un)billed receivables. The complexity and judgments are mainly related to estimation of the cost to complete the projects, expected revenues and the related percentage of completion which the Company applies for recognizing revenues and assessing provisions for projects and loss making contracts. Management has also considered this area to be a key accounting estimate as disclosed in the 'accounting estimates and management judgements' note to the Consolidated financial statements on page 167.	We tested the key internal controls and IT systems which support the project management and accounting. These included controls in the policies and procedures concerning determination of the percentage of completion, estimates to complete for both revenue and costs and provisions for loss making projects or (un)billed receivables. Detailed substantive procedures have been performed on individually significant projects as well as high risk projects. This includes challenging the assumptions and estimates applied by management and substantiating transactions with underlying documents like contracts, variation/change orders, correspondence on claims & disputes, legal opinions and agreements with subcontractors. In addition, we discussed the progress of these projects with the respective

project managers and management. Besides aforementioned procedures, specific attention has been given to the completeness and timing of the €14 million provision recognized for the US environmental remediation project cost overruns as explained on page 97 of the Report by the Executive Board.

We further focused on the Company's disclosures concerning the (un)billed receivables and the related risks such as credit risk, liquidity risk and the ageing of receivables in note 28 to the Consolidated financial statements.

Table 6. Risks reported by the company and their inclusion in the key audit matters

Matters risk paragraph	Included as risk		Also included as key audit matter	
	n	%	n	%
External economic and political factors	66	10%	-	0%
Consumer preferences	23	4%	-	0%
Competition	20	3%	-	0%
Other risks related to the strategy and the business model	40	6%	-	0%
Financing	20	3%	2	10%
Other treasury-related risks	44	7%	-	0%
Reliability and continuity IT	44	7%	6	14%
Compliance with laws and regulations	42	7%	1	2%
Continuity production and delivery	39	6%	-	0%
Talent / human capital	32	5%	-	0%
Tax position	21	3%	16	76%

Health and safety	21	3%	-	0%
Investment decisions	19	3%	-	0%
Environmental effects	17	3%	1	6%
Restructuring	16	3%	2	13%
Calamities and insurance	16	3%	-	0%
Financial reporting	15	2%	-	0%
Reputation	12	2%	-	0%
Intellectual property	12	2%	-	0%
Integration of acquisitions	12	2%	-	0%
Research and development	11	2%	1	9%
Other risks	98	15%	36	37%
Total	**640**	**100%**	**65**	10%

Table 6 shows that companies report 640 risks in total, and that only 65 risks (10 percent) are mentioned as a key audit matter (but also here it should be noticed that in total 42 key audit matters have been reported concerning the valuation of goodwill and other assets and that the risks regarding external economic and political factors, consumer preferences, competition and other risks related to strategy and the business model do have a relationship with these risks. Risks concerning the tax position are reflected in a key audit matter in 76 percent of the cases. Many other risks that are often reported by companies, are only seldom viewed as key audit matters by the auditors. Risks with respect to the reliability and continuity of IT are included in six key audit matters, but many other reported risks are hardly recognized as key audit matters: finance and treasury (twice), compliance with laws and regulations (one time), continuity of production and delivery (zero), and talent/human capital (zero).

This discrepancy between the risks that companies deem to be most important and the key audit matters of auditors are striking. The focus of key audit matters on balance sheet items results in an underexposure of the potential influence of risks on the audit. For example, reliability and continuity of IT (reported 44 times) and compliance with laws and regulations (reported 42 times) are viewed as important risks but are hardly reflected in key audit matters. In general, this holds for issues related to internal control of the audited companies. This is remarkable, since it may be expected that particularly for these companies (44 of the largest listed companies) the examination of the internal control would be an important element of the often strongly system-oriented audit approach. An example of an auditor's report in which the auditor does explicitly pay attention to internal control in his key audit matters is the auditor's report of PostNL (best practice 6).

Best practice 6 – PostNL Annual report 2015, p. 151 (PwC)

Key audit matter	**How our audit addressed the matter**
Mitigation of internal control deficiencies	
During 2015 PostNL has spent a considerable amount of time in the strengthening of the IT control framework. Execution of strategic IT projects at the same time reduced the execution power to remediate existing control deficiencies in the area of change management, segregation of duty conflicts and logical access security relating to the financial system and certain underlying operating systems. Furthermore in Germany the Postcon organisation faced capacity constraints as a result of a reorganisation. This resulted in insufficient attention to internal controls in 2015 especially in the area of revenue. These internal control deficiencies increased the risk of misstatements in financial reporting. Management and Internal Audit performed additional procedures to mitigate the risk.	Our audit procedures included evaluating and testing the additional procedures management put in place to remediate the related risks and the work performed by Internal Audit. In addition we performed additional substantive testing, comprising of, amongst others, assessing whether access rights had not been inappropriately used, validation of transactions processed in areas where segregation of duties conflicts existed, additional testing of revenue transactions, and reconciliation between operational and financial data.

Finally, we would like to focus on a best practice in which the relationship between the key audit matters reported by the auditor and the important estimates reported by the company are explicitly shown. In the auditor's report of the financial statements of Unilever, there is an explicit reference to the notes of the financial statements and the report of the audit committee (best practice 7). There is also a statement on the communication of the key audit matters with the audit committee. In the audit committee report there is also attention for the most important issues regarding the financial statements (which are similar to the auditor's key audit matters) and there is an explicit statement regarding the fact that the auditor and the audit committee are united regarding the most important issues. This relationship between the reports of the audit committee and the auditor is caused by the legal provisions in the UK which state that the audit committee should report on the most important discussion points with the auditor. A comparable active dialogue between audit committee and the auditor in The Netherlands is included in the proposals of the Monitoring Commissie Corporate Governance (2016).

Best practice 7 – Unilever Annual report and accounts 2015 (KPMG)

Report of the audit committee (p. 60)

Particular attention was paid to the following significant issues in relation to the financial statements:

- revenue recognition – estimation of discounts, incentives on sales made during the year, refer to note 2 on page 96;
- direct tax provisions and contingencies, refer to note 6 on pages 106 to 108; and
- indirect tax provisions and contingencies, refer to note 19 on page 129

The external auditors have agreed the list of significant issues discussed by the Audit Committee

Auditor's report (pp. 85 and further)

Key audit matters:

- Revenue recognition
- Indirect tax provisions and contingencies
- Direct tax provisions and contingencies

(…….)

In arriving at our audit opinion above on the Financial Statements the risks of material misstatement that had the greatest effect on our audit (key audit matters) were as set out below and are unchanged from 2014.

These are the matters that, in our professional judgement, had the greatest effect on: the overall audit strategy; the allocation of resources in our audit; and directing the efforts of the engagement team. We have communicated these matters to the Audit Committee. Our audit procedures relating to these matters were designed in the context and solely for the purposes of our audit of the Financial Statements as a whole, and in forming our opinion thereon, and we do not express discrete opinions on these matters.

(…..)

For each risk noted above refer to related disclosure within the Report of the Audit Committee (page 60), accounting policies and financial disclosures within the notes to the Consolidated Financial Statements.

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4 Summary and conclusions

For decades, auditors have communicated their opinion on financial statements with standard wordings in the auditor's report. However, stakeholders expect more information from the auditor. The limited transparency regarding an auditor's actual activities has contributed to the dissatisfaction concerning the functioning of auditors. The Werkgroep Toekomst Accountantsberoep (2014) states that society has received too little information on what auditors actually do. Therefore, it cannot be expected that society bases her trust only on the standard auditor's report. The new auditor's report is an answer to the information need of stakeholders.

The key audit matters that are reported by the auditor cannot be viewed separately from the significant estimates that the management board must make when preparing the financial statements and when identifying the most important risks. It may be expected that these significant estimates and risks that are of influence on the financial statements, are also requesting attention of the auditor during the audit. In this article, we have studied to what extent the key audit matters in the new auditor's report match with the risks reported in the management report and with the significant accounting policies and estimates in the notes. We have examined the management reports, financial statements and auditor reports of 50 companies listed on the AEX- and Midkap-index, for the fiscal year 2015. The results from our study show that the key audit matters in the new auditor's report often match with the significant accounting policies and estimates identified by the management in the notes. The auditor has a strong focus on balance sheet items in the key audit matters, especially on tax positions and goodwill-impairment. Also revenue recognition is often mentioned as a key audit matter. Internal control and audit aspects are hardly mentioned as key audit matters. It is remarkable that pension and other provisions are often reported by companies as significant accounting policy/estimate, but that they are only reported by the auditor as a key audit matter in a limited number of cases. The relationship between the companies' reported significant estimates and the auditors' reported key audit matters are explicitly described by some auditors in the key audit matters.

In only ten percent of the cases, a risk that is reported in the management report is identified as a key audit matter in the new auditor's report. However, it should be noted that many of the reported key audit matters concerning the valuation of goodwill and other assets are related to the risks regarding external economic and political factors, consumer preferences, competition and other risks with respect to the strategy and the business model of a company. Risks related to the tax position often find their way into the auditors' key audit matters. Other risks that are often reported by companies are only seldom mentioned in the auditors' key audit matters. The risks reported in the management report, often concern a higher level of abstraction and are often distant from the often technical balance sheet items reported in the key audit matters in the new auditor's report. Possibly, this situation will change in the future as a result of the increasing stakeholder expectations and the increasing responsibility of the auditor regarding the reporting of material misstatements in the management report, starting in 2016.

Many companies view issues like reliability and continuity of IT and compliance with laws and regulations as risks, but they are hardly reported in the auditor's key audit matters. This generally holds for issues related to the internal control of audited companies. This is salient, since it may be expected that particularly for our examined companies, the examination of the internal control would be an important element of the often strongly system-oriented audit approach.

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Appendix 1. List of examined companies

	AEX		Midkap
1	Aalberts	26	Air France-KLM
2	ABN AMRO	27	Aperam
3	AEGON	28	Arcadis
4	Ahold	29	ASM Int.
5	Akzo Nobel	30	BAM Groep
6	Altice	31	BE Semiconductors.
7	Arcelor Mittal	32	Corbion
8	ASM Litho	33	Delta Lloyd
9	Boskalis	34	Eurocommerce Properties
10	DSM	35	Flow Traders
11	Gemalto	36	Fugro
12	Heineken	37	Galápagos
13	ING	38	GrandVision
14	KPN	39	IMCD
15	NN Group	40	Intertrust
16	Philips	41	NSI
17	Randstad	42	OCI
18	RD Shell-A	43	PostNL
19	RELX Group	44	Sligro
20	SBM Offshore	45	TKH Group
21	TNT Express	46	TomTom
22	Unibail	47	USG People
23	Unilever	48	VastNed Retail
24	Vopak	49	WDP(be)
25	Wolters Kluwer	50	Wereldhave