

A Work Project, presented as part of the requirements for the Award of a Master's degree in  
Management from the Nova School of Business and Economics.

DETERMINANTS OF KEY AUDIT MATTERS DISCLOSURE: A COMPARATIVE  
STUDY OF BANKING AND INSURANCE SECTORS IN PORTUGAL, THE UNITED  
KINGDOM AND THE NETHERLANDS

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06/01/2025

## Abstract

This study examines determinants of Key Audit Matters (KAMs) disclosure in audit reports from 84 companies in the banking and insurance sectors in Portugal, the United Kingdom, and the Netherlands. Using a mixed-method approach, the research highlights that Big 4 auditors disclose more KAMs, influenced by fees, entity size, and complexity, while profitability and indebtedness show weaker effects. Regional and sectoral variations also shape KAM reporting. Results underscore KAMs' role in enhancing audit transparency and stakeholder trust. This work was supported by Fundação para a Ciência e a Tecnologia and projects funded by POR Lisboa and POR Norte. Special thanks to my advisor and my parents for their guidance and unwavering support.

Keywords: Audit, Key audit matters, ISA 701, Europe

This work used infrastructure and resources funded by Fundação para a Ciência e a Tecnologia (UID/ECO/00124/2013, UID/ECO/00124/2019 and Social Sciences DataLab, Project 22209), POR Lisboa (LISBOA-01-0145-FEDER-007722 and Social Sciences DataLab, Project 22209) and POR Norte (Social Sciences DataLab, Project 22209).

## **Abbreviations**

KAM – Key Audit Matters

Big 4 auditors – KPMG, Deloitte, PwC and E&Y

ISA 701 - Communicating key audit matters in the independent auditor's report

PwC – PriceWaterhouseCoopers

ISA - International Standards on Auditing

IAASB - International Auditing and Assurance Standards Board

ISA 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

ISA 700 - Forming an opinion and reporting on financial statements

ISA 706 – Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report

ISA 570 – Going Concern

FRC - Financial Reporting Council

## **Literature Review**

Auditing is defined as an examination of the financial statements, including balance sheet, income statement, cash-flow statement, statement of changes in equity and notes comprising a summary of significant accounting policies and other explanatory notes, of an organization by an auditor (PwC, 2015). Auditing is also defined by its purpose, with the main objective being increasing the degree of confidence of user of financial information. In most used auditing standards, this opinion focuses on whether the financial statements are fairly presented, in all material respects, or give a true and fair view in accordance with the applicable financial reporting framework. An audit conducted in accordance with the International Standards on Auditing (ISA) and relevant ethical requirements enables the auditor to form an opinion (ISA 200) (International Audit and Assurance Standards Board – IAASB 2012). Additionally, auditing is pivotal for a company, as it allows and ensure that readers of financial information are provided with financial statements that are free of material misstatements.

As the world is constantly changing at a fast pace, consequently, so is the business world, hence entities need to be competitive and on top of its industries providing reliable information to the stakeholders. However, as all our interactions happen in the society, one feels the need to regulate behaviours and attitudes for all to allow for consistency on information provided. Therefore, in the business world, professionals should apply ethics when carrying on a decision, as do auditors (Manuel Cerqueira Lopes 2017). After the eruption of scandals related with unethical behaviours, auditors needed to reinforce, show, and maintain an ethical behaviour throughout an audit, leading to the revision of ethical codes, such as the International Ethics Standards Board of Accountants (IESBA), to serve as model for all codes of ethics companies create and apply (IFAC 2019). When performing an audit, the auditor is expected to perform his duty complying with ethical standards and without being influenced by external sources that could compromise the quality of the audit (Satava, David, Cam Caldwell and Linda Richards 2006).

Furthermore, as mentioned in previous paragraphs, after carefully analysing the financial statements, notes, movements and transactions carried out and transmitted by a company, the auditor prepares an independent audit report, that includes an opinion on the financial statements of the audited entity that states if those financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework (ISA 200.3) (IAASB 2012).

The independent auditor's report follows a structure defined in ISA 700 which include a title, to whom the report is addressed, the auditor's opinion (if the financial statements as a whole, are free of material misstatements), that can be unqualified opinion, qualified opinion, adverse opinion or disclaimer of opinion, the basis for the opinion, going concern (if applicable), key audit matters (if applicable), responsibilities of the auditor (including scope) and responsibilities of the management of the entity, the name of the engagement partner and the

signature of the engagement partner (IAASB 2015). If the auditor wants to draw the reader's attention towards any significant matter, an emphasis of matter paragraph (refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements) and/or other matter paragraph (refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report) should be included (ISA 706) (IAASB 2015).

Although this is a structure audit reports are presented in most countries (those who use as a basis the ISAs), this structure is the consequence of users of financial statements having asked auditors to provide more entity-specific and relevant information in their auditor's reports based on their audits, as users of financial statements considered auditor's reports could have more informative (Church, Davis, and McCracken 2008; Mock et al. 2012; IAASB 2015).

Therefore, the content of the audit reports was reviewed. In January of 2015, a new ISA and revised ISAs were issued by IAASB, effective for audits of financial statements for periods ending on or after 15th of December of 2016. As a result, auditor's reports changed to contain more information and being more transparent to users of financial information. One of the most important and significant change was the introduction of key audit matters (Baur, n.d) - ISA 701 – Communicating Key Audit Matters in the Independent Auditor's Report, applicable for audits of financial statements of listed entities and in circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. ISA 701 also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report (IFAC 2017). The standard is intended to address both the auditor's judgement as to what should be communicated in the auditor's report and the form and content of that communication. The aim of communicating key audit matters is to improve the information included in the

auditor's report, providing greater transparency about the audit that has been carried out. Hence, as Pinto and Morais (2018) point out, the purpose of the revised audit report content was to reduce information gaps between users and auditors, improving auditors' communication by adding more information (Church, Davis, and McCracken 2008). Pinto and Morais (2018) identifies two gaps, an expectation gap and an information gap. The former is defined as difference between what the user expects from the auditor and financial statements audit and the reality of an audit while the latter is the gap between information users believe is necessary to make informed decisions and what is available to them. For instance, some countries were pioneers in including more information in audit report structure. In the United Kingdom, in June of 2013, the Financial Reporting Council's (FRC) revised ISA 700 (UK and Ireland) introducing significant changes to the auditor's report for audits conducted in the United Kingdom and Ireland. This standard aligns closely with the ISA while tailoring and adding certain requirements to the local context.

The revision in 2013 was to make auditor reports more informative, transparent, and tailored to the needs of users of financial statements, by introducing the disclosure of KAMs, materiality applied (rationale behind it) and audit scope (addressing specific risk in focus areas, to provide clarity on the areas auditors devoted the most effort and resources). By requiring disclosure of significant risks, materiality levels, and audit scoping, the FRC aimed to improve the usefulness of the report for investors and other stakeholders, aligned with the broader trend of fostering increased accountability and trust in the audit process (Financial Reporting Council 2013).

The Netherlands was also a frontrunner in adopting KAMs and other information in auditor report. Dutch auditors began voluntarily to include KAMs in their auditor reports before it became mandatory. The formal requirement was established with the adoption of ISA 701, effective for audits of financial statements for periods ending on or after 15th December 2016.

As in the UK, the disclosure of materiality, as well as how it was determined, became mandatory alongside the adoption of ISA 701.

The FRC made further updates to reflect changes in corporate governance and additional reporting requirements under other regulations (Financial Reporting Council 2022).

Joining users desire for more informative audit reports was the continuous work of accounting professionals, regulators, governments, among others to maintain the quality of audit reports following the eruption of financial scandals in earlier years of the 21st century. The focus was to improve audit quality while providing more information for users of financial statements and simultaneously reducing information gaps (Bédard, Gonthier-Besacier, and Schatt 2014). Pinto and Morais (2018) emphasizes that previous studies produced mixed results regarding changes to audit report and reduction of expectation gap. However, evidence support that more information in the audit report reduces information gap (Litjens, van Buuren, and Vergoossen 2015).

ISA 701 defines Key Audit Matters as the matters, that in the auditor's professional judgement, were of the most significance during the audit of the financial statements of the current period and are selected from matters communicated with those charged with governance. In other words, auditors shall determine, from matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit (KPMG 2019).

The introduction of this section was to add value to the auditor's report through greater transparency, highlighting the matters that required special attention from the auditor. In this section, the auditor must describe the most significant risks of material misstatement identified, including the identified risks of material misstatement due to fraud, referring, where relevant, to the respective disclosures included in the financial statements, summarize the response to the

risks of material misstatement assessed and finally, if relevant, mention key observations that may have arisen in relation to these risks. When elaborating this section, the auditor should consider areas of higher assessed risk of material misstatement, or significant risks, significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as high estimation uncertainty and, effect on the audit of significant events or transactions that occurred during the period. (ISA 701) (IAASB 2015).

When describing the KAMs identified, the auditor should mention the reason why the matter was considered relevant and the respective treatment in the audit. KAMs are the responsibility of the auditor and are intended for the users of the financial information, both to help them understand those matters which were the most important in the current year's audit and to help them understand the entity and the areas of significant judgment of the management in the financial statements. In this way, KAMs have a direct impact on shareholders, financiers and investors, boards of directors and other interested parties (IFAC 2017; EY 2015; KPMG 2019; Velte and Issa 2019).

Although what was consider before regarding the reason for the changes, in accordance with International Federation of Accountant (IFAC), the introduction of KAM in audit reports did not arise as an answer to fails identified during an audit, but to increase transparency and provide additional information about financial and operational questions subjected to an audit (IFAC 2017). Overall, the disclosure of KAMs helps to reduce asymmetries of information and influence decisions taken by investors (Pinto and Morais 2018).

Venturini et al. (2022) argue that financial analysts give greater credibility to KAMs on accounting aspects, compared to KAMs related to the entity (management uncertainties). For this reason, it is believed that the greater the informative value of the content of KAMs, the

better the quality of this information and, consequently, contributes to reducing informational asymmetry.

Overall, KAMs enhance communicative value of an audit report by providing deeper information about the audit to users of financial information to understand the professional judgement of the auditor, the areas of critical management judgement and assumptions in audited financial statements and encourage further engagement between management and auditors by using information provided in KAMs (Rautiainen, Saastamoinen, and Pajunen 2021; Rousseau and Zehms 2020; KPMG 2019).

However, some drawbacks related with KAMs can be identified, such as inconsistencies with different countries reporting varying numbers of KAMs, for instance, the UK tends to report more KAMs than others (ACCA nd). Lacking a consensus as what is defined as a correct number of KAMs to report and as it depends on auditor's professional judgement, is important to determine factors influencing auditor's behaviour (Pinto and Morais 2018). Also, reporting many KAMs could confuse readers of financial information and impact the quality of the report and hampering identification of most critical issues (EY 2015; Li et al. 2016). KAMs are not substitutes of preparer's view reported in the financial statements, even though it is more concise and credible than other disclosures (KPMG 2019, Christensen, Glover, and Wolfe 2014). Despite the fact it might appear relevant, or the auditor spent a large portion of his efforts in an area, it does not mean immediately that these are key audit matters (Pinto and Morais 2018; Al Lawati and Hussainey 2022; Gold and Heilmann 2019; ACCA, n.d.).

Although some pitfalls can come from communicating KAMs, most studies point that its introductions brought more positive impact to audit reports than drawbacks (Li 2017; Li 2020; Li, Hay, and Lau 2018; Gold et al. 2020).

**Auditor:**

There exist an innumerable number of audit companies, although the ones leaders in the auditing market are the ones known as "Big 4" - Deloitte, KPMG, Ernst & Young (EY) and PricewaterhouseCoopers (PwC). Many authors consider that Big 4 provide better quality audits (Francis and Yu 2009; Krishnan 2003) due to continuous investment in human and technological resources, allowing the realization of a more efficient and effective audit, thus, the larger the size of company performing the audit, one expects to see a higher the quality of the audit performed (Che, Hope, and Langli 2016). Studies also concurred Big 4 do not compromise independence (Lawrence, Minutti-Meza, and Zhang 2011), implying Big 4 have a higher capacity to withstand pressure from clients and identify non-compliance (Lai 2013; Ferreira and Morais 2020). Ferreira and Morais (2020) concludes that an audit performed by a Big 4 will result in more KAMs communicated, as it is how auditors communicate relevant matters to users of financial information. Although, Ecim, Maroun, and Duboisée (2023) argue that the differences in KAMs disclosed by Big 4 and non-Big 4 companies are not very significant.

H<sub>1</sub>: Type of auditor positively influences the number of KAMs

**Fees:**

Setting audit fees depends on various factors as professional ethics, the size and complexity of the companies audited, auditor, and number of hours required to carry out all the audit procedures.

On the one hand, Pinto and Morais (2018) found that higher client risks and higher audit fees resulted in greater numbers of KAM received by the firms. Choi, Cho, and Park (2019) indicated companies paying higher fees tend to show more KAMs, highlighting a positive relationship between KAM level and fees. On the other hand, Bédard, Gonthier-Besacier, and

Schatt 2014, Ferreira and Morais (2020); Almulla & Bradbury (2018); Gutierrez et al. (2018) and Reid et al. (2019) in the UK found that audit fees did not increase much because of reporting more KAMs, justified the results that additional efforts required to disclose more KAMs are insignificant, and audit firms bear no extra fees.

H<sub>2</sub>: Audit fees negatively impact the number of KAMs

### **Profitability:**

Profitability associates with future viability (Ferreira and Morais 2020), reducing most profitable companies changes of non-compliance and conflicts between entity and auditor (Bellovary, Giacomino, and Akers 2007). Auditors tend to report fewer KAMs for more profitable entities, as they perceive less necessity to highlight significant issues, concurred by Asbahr and Ruhnke (2019), as auditors are less likely to communicate aggressive accounting estimates as KAMs when dealing with profitable firms, suggesting a higher profitability level can influence the auditor's judgment and reporting behaviour.

H<sub>3</sub>: Negative impact between company's profitability and number of KAMs.

### **Indebtedness:**

Expected that companies presenting a higher level of debt present a higher level of financial risk. Chen and Walter (1996) emphasize that companies with higher levels of debt pose greater financial risks, needing more detailed and rigorous audit procedures. Similarly, Ireland (2003) and McKinsey & Company (2023) highlighted that companies reporting financial losses are inherently riskier, prompting auditors to undertake more comprehensive analyses to address concerns such as asset impairments, covenant breaches, and the firm's ability to continue as a going concern.

Entities with high levels of debt or sustained losses are more likely to face going concern uncertainties – the risk that they may not be able to continue their operations for the foreseeable future, making its ability to continue as a going concern becomes a critical issue, introducing significant risk into the audit. In these situations, auditors should perform enhanced procedures which involves assessing the adequacy of management’s going concern assumptions, scrutinize cash flow forecasts, debt repayment schedules, and financing options, and gather additional evidence, including reviewing contingency plans (ISA 570) (IAASB 2015). If substantial doubt exists about the company’s ability to continue, auditors may include an Emphasis of Matter paragraph or issue a qualified or adverse opinion if the disclosures are inadequate (ISA 705) (IAASB 2015). The need for increased audit effort in high-risk situations, such as those involving high debt or liquidity problems, aligns with the concept of KAMs. A going concern issue often qualifies as a KAM, as it represents a significant audit risk requiring substantial auditor attention. However, as Ferreira and Morais (2020) noted, not all high-risk areas lead to additional KAMs. This may be due to the professional judgment of auditors, as some risks may already be sufficiently addressed in financial statement disclosures without the need for KAMs, or because some risks, like going concern issues, may overlap with other significant matters such as debt restructuring or liquidity management, resulting in fewer KAMs being reported. Thus, while financial risks like high indebtedness or losses are commonly associated with increased audit work, they do not always directly translate into more KAMs, as the determination depends on the specific circumstances of the audit and the judgment of the auditor.

H<sub>4</sub>: The level of indebtedness positively impacts the number of KAMs reported.

**Size:**

An entity which presents a higher degree of complexity, which can vary due to human resources, economic and industry structure, is subjected to a more meticulous work performed

by its auditors. Thus, the higher the degree of complexity of an entity the more rigorous and exigent auditor's work will be, and bigger will be the pressure auditors might have to include more KAMs to ensure their independence and reduce audit risk (ÖZCAN 2021).

Pinto and Morais (2018) shown the higher the size and complexity of the audit client, will positively impact the number of KAMs reported, as the audit risk is also influenced by complexity of the client, and several relevant matters that cannot go unnoticed by the auditor, supported by other studies (Ferreira and Morais 2020, Suttipun and Swatdikun, 2021; Velte, 2019; Lennox, Schmidt, and Thompson 2022).

H<sub>5</sub>: Firm size and complexity positively influence the number of KAMs reported.

## **Methodology**

When consider the methodology to apply, one considers two types of methodologies.

Quantitative methodology focusing on measuring and testing numerical data. Qualitative methodology focusing on opinions, behaviours and experiences of people. An application of both methodologies, known as mixed-method methodology uses characteristics of both during the study. Therefore, the methodology best suited for this study will be an application of both methodologies, as the quantitative will be used to analyse data extracted from the companies' annual reports including the independent auditor's report and the qualitative will be justified when used to analyse and compilation of KAMs auditors reported in reports.

The sample consists of annual reports including the independent auditor's report of 84 companies from three different countries (Portugal, the United Kingdom and the Netherlands) from two different sectors of activity (banking and insurance) from 2023. The banking sector includes 50 companies, while the insurance sector includes 34 companies. More specifically, Portugal includes 22 banks and 20 insurance companies, the United Kingdom includes 14 banks and 10 insurance companies, and the Netherlands includes 14 banks and 4 insurance

companies.

Reasons behind the determination of which countries to consider were due to Portugal being the country of development of this study, and both UK and the Netherlands being pioneers in the report of KAMs in auditor reports before introduction of ISA 701.

Based on the previous literature review, to achieve the objective of evaluating the determinants of KAM disclosure and testing the relationship between audit firm, auditor fees, profitability and company leverage with the number of KAMs reported, the following model was developed:

$$KAM_i = \beta_0 + \beta_1 AUD + \beta_2 FEES + \beta_3 PROF + \beta_4 IND + \beta_5 SIZ + \varepsilon_i \text{ (Equation 1)}$$

Where  $\beta_0, \beta_1, \beta_2, \beta_3, \beta_4, \beta_5$  are the coefficients of the model and  $\varepsilon_i$  represents the residuals for the model, this is, the degree of error.

The auditor and fees charged for the performance of all services, total assets and total liabilities, net income for the year, the number of KAMs reported and its description were extracted from the annual report. From the data which composes the sample, the following variables for the model were set:

- Dependent variable: number of KAMs auditors reported in the annual reports (KAM)
- Independent variables:
  - Auditor (AUD): equal to 1 if the entity is audited by a Big 4, otherwise equal to 0
  - Fees (FEES): Fees charged by auditors. For this variable, the natural logarithm was applied.
  - Profitability (PROF): Ratio between an entity net income and total assets
  - Indebtedness/Leverage (IND): Ratio between an entity total liabilities and total assets
  - Size (SIZ): Entity's total assets were used to consider entity size. For this variable, the natural logarithm of the observations was used in the sample.

Table 1 -Variables Description, shows all variables, its names, description and expected signal.

Variables Description			
Variable	Name of variable	Description	Expected signal
<b>Dependent Variable</b>			
Key Audit Matters	KAM	Number of KAMs disclosure per report	
<b>Independent Variable</b>			
Auditor	AUD	Dummy variable, equal to 1 if audited by a Big 4 0 otherwise	+
Fees	FEES	Natural logarithm of fees charged by auditors	-
Profitability	PROF	Ratio between net income and total assets by entity	-
Indebtedness	IND	Ratio between an entity's total liabilities and total assets	+
Size	SIZ	Natural logarithm of entity's total assets	+

Table 1 – Variables Description

To make it easier to systematise the information gathered, the KAMs analysed have been compiled into different categories.

The independent auditor’s reports were analysed, extracting the number and description of each KAM. One notices that each auditor chooses his own title to disclose the matter to reflect on similar topics. For example, in the insurance sector, when talking about the first application of IFRS 17 in January 2023, E&Y disclosed it as “Initial application of IFRS 17, which establishes principles applicable to the recognition, measurement, presentation, and disclosure of insurance contracts” while PwC disclosed it as “First application of IFRS 17 - Insurance Contracts and IFRS 9 - Financial Instruments on January 1, 2023”. Therefore, to facilitate the interpretation of KAMs analysed, and systematise the information, it was compiled into different categories:

- 1) Impairment of loans and advances to customers
- 2) Deferred Tax Assets
- 3) Fair value measurement of financial instruments
- 4) Pensions, employee benefits and post-employment obligations
- 5) Insurance contracts – Implementation of IFRS 17
- 6) Contingent Liabilities, Provisions, and Legal/Regulatory Matters
- 7) Valuation of Real Estate and Non-Current Assets Held for Sale

- 8) Goodwill and Intangible assets impairment
- 9) IT systems, reliability, and continuity of controls
- 10) Revenue Recognition (Including Effective Interest Rate Method)
- 11) Complex Investments and Other Financial Instruments
- 12) Other Specific Financial Reporting Concerns

Table 2 – KAMs category, illustrates the number of KAMs reported for each category and respective percentage. The categories with the highest number of KAMs reported are Impairment of Loans and Advances to Customers (17,91%), Insurance contracts – Implementation of IFRS 17 (13,01%) and Fair Value Measurement of Financial Instruments (11,57%).

The quantity of KAMs related with impairment of loans and advances to customers is mainly justified by the nature of the loans, assessment of credit risk, regulatory and economic condition changes while fair value is justified by complexity of valuation, market volatility and economic uncertainty.

KAMs Category

Category of KAMs	KAMs	%
Impairment of Loans and Advances to Customers	48	17,91%
Insurance contracts - Implementation of IFRS 17	35	13,06%
Fair Value Measurement of Financial Instruments	31	11,57%
Pensions, Employee Benefits, and Post-Employment Obligations	28	10,45%
Contingent Liabilities, Provisions and Legal/Regulatory Matters	21	7,84%
Other specific financial reporting Concerns	20	7,46%
Complex Investments and Other Financial Instruments	19	7,09%
IT systems, reliability, and continuity of controls	18	6,72%
Deferred Tax Assets	16	5,97%
Valuation of Real Estate and Non-Current Assets Held for Sale	14	5,22%
Goodwill and Intangible assets Impairment	10	3,73%
Revenue Recognition	8	2,99%
	268	100,00%

*Table 2 – Number of KAMs reported by category*

From the above analysis the sector with more KAMs reported is “Banks” with 147 KAMs while “Insurance” reported 121 KAMs. Subsequently, as Table 3 illustrates, Portugal was the

country where most reports were analysed and the Netherlands with less reports. As expected, for the sample as whole as Portugal is the country with more entities considered, had more KAMs than the others. Although the sample is composed mostly of Portuguese entities, when analysing the three countries, one can see from Table 3- KAMs- sector + country, that in the UK and in the Netherlands the Insurance sector disclosure per report, on average 4 KAMs while in Portugal the same sector disclosure per report, on average, 3 KAMs.

Regarding the banking sector, in the UK banks disclosure per report, on average 4 KAMs and in Portugal and the Netherlands banks disclosure per report, on average, 3 KAMs.

KAMs- sector + country

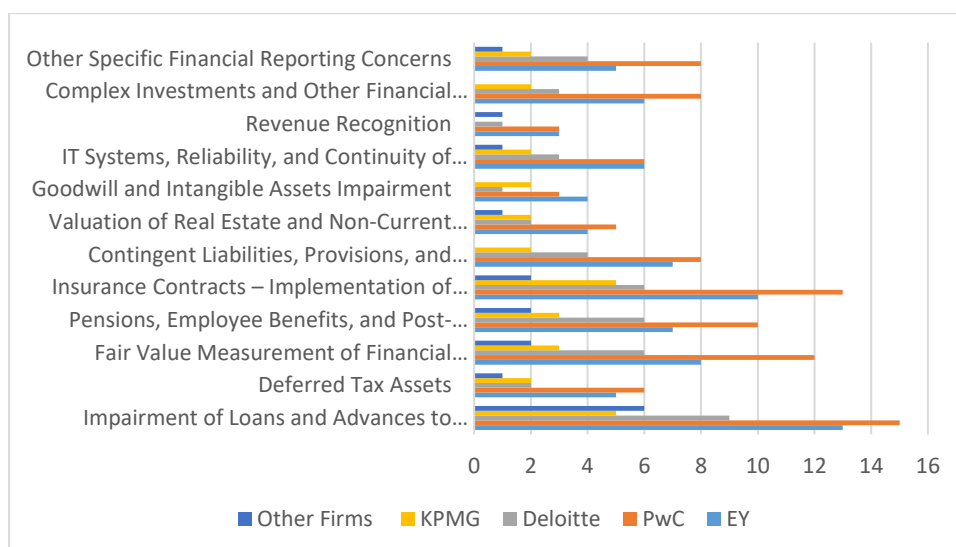
Country	Sector	Reports	KAMs	Average KAMs
Portugal	Bank	22	59	3
	Insurance	20	63	3
Total		42	122	3
United Kingdom	Bank	14	52	4
	Insurance	10	43	4
Total		24	95	4
Netherlands	Bank	14	36	3
	Insurance	4	15	4
Total		18	51	3
<b>Total per industry</b>				
Bank		50	147	
Insurance		34	121	

*Table 3 – Total KAMs per sector and country*

More precisely, Graph 1 and Table 4 – KAMs by auditor, shows the number of reports, KAMs reported, average KAM per report and KAMs reported by auditor by each category.

From the Big 4, PwC has the highest number of KAMs disclosed per report (3,45), followed by EY (3,44), KPMG (3,3) and finally Deloitte (2,73), in line with the number of reports issued. Among the non-Big 4, Mazars stands out with an average of 2,25 KAMs per report.

As Graph 1 illustrates, when organised into the 12 categories, one can see the category with more KAMs disclosure, concurred by Table 2 – KAMs category, and the disclosure of categories by auditors.



Graph 1- Number of KAMs reported by category

KAMs by auditor

Auditor	Reports	nr KAMs	KAM per report
Deloitte	11	30	2,73
EY	25	86	3,44
PwC	29	100	3,45
KPMG	10	33	3,30
Mazars	4	9	2,25
Others	5	10	2,00

Table 4- KAMs reported by auditor

## Results and discussion

The proposed model will analyse whether the independent variables resulting from the hypotheses raised during the methodology influence the number of KAMs reported in an audit report.

As mentioned before, the dependent variable will be KAMs, and independent variables will be the auditor (dummy variable), the auditor fees (ln of fees agreed upon), profitability (Return on Assets ratio-ROA), indebtedness (financial leverage ratio) and size (ln of companies' total assets).

Using Excel data analytics to perform a linear regression to determine if the overall model is relevant or not, one can analyse the model F-test or p-value. Moreover, from Table 5 - Regression statistics and Table 6 – Regression statistics, one can assess the overall significance of the model proposed. For a value of F=6,14 and a p-value smaller than 0.001 for any significance level (1%, 5% or 10%), one concludes that the model  $KAM_i = \beta_0 + \beta_1AUD + \beta_2FEES + \beta_3PROF + \beta_4IND + \beta_5SIZ + \varepsilon_i$  (Equation 1) is significant.

Regression Statistics

**Overall Model Test**

<b>Model</b>	<b>R</b>	<b>R<sup>2</sup></b>	<b>F</b>	<b>df1</b>	<b>df2</b>	<b>p-value</b>
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*Table 5- Regression statistics*

Regression Statistics

<i>Regression Statistics</i>	
Multiple R	0,5315
R Square	0,2825
Adjusted R Square	0,2365
Standard Error	1,4192
Observations	84

*Table 6 - Regression statistics*

Additionally, considering the regression statistics one finds that the correlation between dependent and independent variables is of 0,531, indicating a positive correlation. However, when considering the R<sup>2</sup>, also called coefficient of determination, which explains how well the independent variables account for the variability in the dependent variable, one understands that the independent variable only explain 28,2% of the variability of the dependent variable, suggesting that while there is some predictive power, the model leaves a significant portion (71,8%) of the variance unexplained, indicating room for improvement or the influence of unaccounted factors. Considering the initial model, which increases when a new variable is added, regardless of relevance to explain the dependent variable, the adjusted R<sup>2</sup>, a refinement of R<sup>2</sup>, accounts for the complexity of the model by penalizing the inclusion of variables that do not improve the model significantly. Moreover, adjusting for the number of variables, the model explains roughly 23,65% of the variability, showing a slight decrease from the R-squared, implying some variables included in the model do not contribute significantly to explain the number of KAMs reported. This decrease suggests that some predictors may not significantly contribute to the model.

Considering the value of the adjusted  $R^2$  (0,2365) for the proposed model, one concludes that some or all independent variables might not contribute significantly to explain the dependent variable, this is, number of KAMs reported in an auditor report. To conclude if an independent variable is statistically significant, one performs a linear regression on the sample and data collected to understand if the independent variables are statistically significant or not. It can be done by defining a threshold – significance level in this case of 0,1- and see if the p-value is inferior or superior to the significance level set. From Table 7- Linear Regression statistics, one sees the coefficients, standard errors, and p-value for all variables. As the orange highlight illustrates, for a significance level of 10%, as p-value  $>0,1$  the variables Profitability (0,68), Indebtedness (0,75) and Size (0,15) are not statistically significant, this is, this variables are not relevant in influencing the number of KAMs reported, while Auditor and Fees are statistically significant with p-values of 0,08 and 0,004 respectively, implying it might influence why specific KAMs are reported.

Linear Regression Statistics

	Coefficients	Standard Error	tStat	P-value
Intercept	-1,42967	1,172009	-1,21985	0,226199
AUD	0,927518	0,527715	1,757613	0,082737
FEES	0,18444	0,063729	2,894138	0,004928
PROF	-1,98601	4,798205	-0,41391	0,680079
IND	0,354118	1,139317	0,310816	0,756769
SIZ	0,05909	0,041514	1,423362	0,158619

Table 7 – Linear regression statistics

Analysing all variables on an individual level, one can conclude that about auditor type, Big 4 firms consistently reported a higher number of KAMs per report compared to non-Big 4 firms, reinforcing the hypothesis that resource availability significantly influences the audit process PwC leads in both the number of reports issued that were included in the sample and the average KAMs disclosed per report, as seen in Table 4-KAMs by auditor. This finding highlights the aim of Big 4 auditors in maintaining high-quality audits that are both rigorous and transparent. Big 4 dominance also aligns with prior studies emphasizing its capacity to withstand client pressure and ensure audit independence. The findings further suggest that clients audited by these firms receive a more complex support as investment and knowledge

areas in a Big 4 go simply beyond auditing, while the relationship between audit fees and KAMs reported is nuanced. While higher fees are associated with increased auditor effort and possibly more KAMs, the study found that disclosing additional KAMs might not significantly inflate audit costs. This suggests that fee variations may stem from other factors, such as client complexity or risk, rather than simply the quantity of KAMs disclosed.

On one hand, from the linear regression one discovered that for any significance level chosen, profitability is not a statistically significant variable, therefore, for the purposes of this study, will not be a variable that influences KAMs, which suggest that profitability will not have a negative or positive impact on KAM disclosure. On the other hand, regarding indebtedness levels from the data collected, one can see mixed results. Some companies with higher and lower debt levels exhibited more KAM in the audit report than the remaining sample. This trend stresses the statistical finding that indebtedness will not be statistically significant to influence KAMs disclosure in audit reports.

Regarding the entity size and complexity, assuming a similar audit process for all entities, independently of its size, one found that larger entities disclose more KAM. The results support the hypothesis that complexity—arising from intricate organizational structures or diverse operations—drives auditors to identify and report more areas of significant judgment or risk. The positive correlation between size and KAMs is consistent across industries and regions.

As mentioned before, the data collected to perform this study is composed of information from two industry sectors (Banking and Insurance) from three different countries (Portugal, Netherlands and United Kingdom), prompting different findings for the two industries and geographies considered.

The banking industry reported a higher number of KAMs compared to insurance. Banks face unique challenges such as credit risk, regulatory scrutiny, and financial instrument valuation,

which inherently demand more extensive audit focus. In contrast, insurance firms, while complex, may present fewer issues requiring emphasis in auditor reports. On a geographical level, Portugal was the country with more KAMs in all data considered, as most of the companies analysed for the sample are Portuguese, however, United Kingdom auditors were the ones disclosing the highest average number of KAMs per report (4), reflecting that although the three countries use the same accounting norms (ISAs), additional requirements in specific geographies influence the audit process. Consequently, the inclusion of materiality and audit scope and going concern assumption, in the United Kingdom and the Netherlands, influence decisions the auditor took.

The distribution of KAMs across the 12 different categories provides additional insights into the categories most reported and the reasons behind its inclusion (Impairment of loans and advances (17.91%), insurance contracts under IFRS 17 (13.06%), and fair value measurement of financial instruments (11.57%) and the comprehensive coverage across all categories by Big 4 auditors, with PwC in the lead, illustrating the importance of expertise in addressing sector-specific and client-specific risks.

Despite positive findings, this study is subjected to limitations as the data collected is from three different countries and two different industries, therefore the number and description of KAMs is only from types of KAMs reported in these sectors. Hence, other industry sectors will report different types of KAMs which could enrich the sample and provide additional indications if other industries with entities with different sizes and complexities, will better explain impact of its numbers in disclosure of KAMs.

Without including in the sample previous years reports it is not possible to conclude if a specific KAM is reported every year because of entity's nature or because of something happening in the year of the report (example: IFRS 17 implementation). For instance, legislation that limits the number of years an audit firm can audit a listed entity or a Public

Interest Entity in the three countries is not the same. While the introduction of the new auditor might introduce a different audit process one expects KAMs report to continue to follow a similar trend.

Additionally, as it does not exist a consensus about a “correct” number of KAMs to disclosure, as mentioned throughout the text, the number of KAMs disclosure depends on the auditor experience and professional judgement. Therefore, some entities in some countries might disclose 5 or 6 KAMs while others might disclose one or two KAMs per independent auditor report. One expects that the same industries in different countries will present similar KAMs (example of “Insurance contracts – Implementation of IFRS 17” for the Insurance industry form the sample). However, as mentioned before, as the disclosure of KAMs will depend on auditors’ professional judgement and experience, in some countries entities in the same industry might present similar KAMs and unique KAMs the auditor identified as necessary to include.

The proposed regression model leaves unexplained the variability in KAMs, indicating that other factors besides the ones included may play a crucial role in explaining the disclosure of KAMs.

### **Recommendations for future research**

To provide a more robust analysis in understanding why KAMs are reported and the factors that influence KAMs reported by auditors, future research about this topic might include in future analysis a data set from other regions besides the ones considered with different regulatory environments to understand if exists or not global patterns and or differences in KAMs disclosure. Additionally, the sample may also include data from other sectors beside banks and insurance companies. Moreover, analysing more years would also enrich the study as it helps understand if KAM reporting evolves with regulatory changes and economic conditions.

It was mentioned as a limitation auditor rotation. For a future research, one can analyse if the legal requirements, for instance in the European Union and United Kingdom, among other geographies, responsible for auditor rotation will generate a change in the disclosure of Key Audit Matters.

Taking as a basis for future research this study and previous studies done in this topic, future research could explore how fee structures relate to audit quality beyond KAM disclosures.

Given the expansion of multinational companies, research could focus on the feasibility and challenges of standardizing KAM disclosures across jurisdictions. This could involve assessing how varying national regulations affects the content and format of KAMs.

As artificial intelligence (AI) is becoming more prevalent in more services, future research could explore the impact of AI in audit procedures. This is, as AI will allow a massive treatment of information and an enhanced potential for data analysis, how AI introduction can change or influence the nature of auditor judgement and the ethical implications the introduction of AI in decisions taken by an auditor, this is, if the introduction of AI in an auditor work might be a source of conflict with auditor ethics. ESG (Environmental, Social, Governance) practices have become more relevant, natural disasters and pandemics have revealed that the financial sustainability of companies is closely linked to environmental and social sustainability. Furthermore, in the year of 2024, in the European Union it become mandatory for public interest entities a report regarding non-financial information, the Corporate Sustainability Disclosure Directive – CSRD. The CSRD Directive introduces the concept of dual materiality analysis, capturing materiality from the perspective of the financial impact on the entity and the impact on the environment and society (PricewaterhouseCoopers, n.d.). This new report illustrates a shift in the traditional business idea that only financial indicators matter, showing the growing importance of non-financial topics in decision making together with financial matters. Moreover, with an increasing

demand for more transparency in this area, future research could examine how sustainability decisions undertaken by an entity prove to be relevant when applied to business decisions. Lastly, the introduction of mandatory KAMs for other entities besides PIEs. In the European Union, KAMs disclosure is mandatory for public interest entities, however, future research could introduce the idea that, for example, at local level, i.e. in different countries, local groups that present relevant numbers, in addition to public interest entities, could also be subject to KAMs. Therefore, extending the KAM requirement to other companies, in addition to being listed, should also ponder the size of the entities.

In short, to extend to entities of relevant size, to have KAMs apply to PIEs and entities that pass a defined size threshold.

## **Conclusion**

The introduction of Key Audit Matters (KAMs) has significantly enhanced the transparency and informativeness of audit reports. This study demonstrates that factors such as auditor type, fees, profitability, indebtedness, and entity size might influence KAM disclosures.

The findings from the linear regression analysis validate some hypotheses, challenge others, and uncover areas requiring further exploration, aligning with the multifaceted nature of audit reporting.

The hypothesis that Big 4 auditors positively influence the number of KAMs disclosed is substantiated. As a statistically significant variable, results reveal that companies audited by Big 4 tend to present more KAMs in their audit reports. Studies by Ferreira and Morais (2020) and Cruz et al (2018) found similar results.

Contrary to the hypothesis that higher audit fees negatively correlate with the number of KAMs, the study reveals a positive relationship. Opposite to studies where one found that fees negatively impact KAMs disclosure (Ferreira and Morais 2020). For Pinto and Morais (2019) fees negatively impact KAM disclosure because of the auditor decision to disclose a KAM

could be a choice between maintaining its reputation and maintaining a certain level of return.

Reynolds and Francis (2000) study could disprove this hypothesis, as they concluded that economic factors could encourage auditors to agree with the clients' decisions in terms of financial reports solely to keep them as clients.

Profitability, indebtedness and size were not statistically significant variables, implying these variables do not influence the disclosure of KAM. Therefore, these three variables are not determining factors in the disclosure of KAMs.

The regression model, while statistically significant, explains only 24% of the variability in KAM disclosures. This modest explanatory power underscores the complexity of auditor judgment, which incorporates both measurable factors and qualitative considerations not captured in the model. For example, auditors' professional discretion, client-specific dynamics, among others likely play a critical role in shaping KAM disclosures.

Despite these insights, the study highlights limitations in explaining the variability in KAM reporting, suggesting opportunities for future research. By exploring additional determinants and expanding the scope of analysis, future studies can provide a deeper understanding of KAM disclosures and their role in bridging information gaps between auditors and stakeholders.

In conclusion, KAMs have proven to be a pivotal information in transforming audit reports for its users to contain more information that is useful to users of financial statements to take their decisions.

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## Appendix

### Appendix 1 – Portuguese entities used from banking and insurance sector and number of

#### Key Audit Matters disclosure per audit report

Entity	Country	Sector	Auditor	KAMs
Caixa Geral de Depósitos (CGD)	Portugal	Bank	EY	3
Millennium BCP	Portugal	Bank	Deloitte	5
Novo Banco	Portugal	Bank	EY	4
Santander	Portugal	Bank	PwC	4
BPI	Portugal	Bank	PwC	4
Montepio	Portugal	Bank	PwC	6
Crédito agrícola	Portugal	Bank	PwC	6
ActivoBank	Portugal	Bank	Deloitte	1
Banco CTT	Portugal	Bank	EY	2
Credibom	Portugal	Bank	Mazars	2
Haitong Bank, SA	Portugal	Bank	PwC	2
Banco Atlântico Europa, SA	Portugal	Bank	Deloitte	1
BANCO BAI EUROPA,SA	Portugal	Bank	EY	1
Banco BIC Português, SA	Portugal	Bank	Deloitte	3
Banco de Investimento Global, SA	Portugal	Bank	PwC	2
Banco Finantia, SA	Portugal	Bank	EY	2
Banco Invest, SA	Portugal	Bank	KPMG	1
Banco LJ Carregosa, SA	Portugal	Bank	PwC	2
BANCO PRIMUS,SA	Portugal	Bank	Mazars	3
BEST BANCO ELECTRONICO DE SERVICIO TOTAL,SA	Portugal	Bank	EY	1
Bison Bank, S.A.	Portugal	Bank	PwC	2
BNI - BANCO DE NEGÓCIOS INTERNACIONAL (EUROPA), SA	Portugal	Bank	Mazars	2
ACP MOBILIDADE - SOCIEDADE DE SEGUROS DE ASSISTÊNCIA, SA	Portugal	Insurance	Ribeiro da Cunha & Associados	1
AEGON SANTANDER PORTUGAL NÃO VIDA - COMPANHIA DE SEGUROS, SA	Portugal	Insurance	PwC	3
AEGON SANTANDER PORTUGAL VIDA - COMPANHIA DE SEGUROS DE VIDA, SA	Portugal	Insurance	PwC	3
CARAVELA - COMPANHIA DE SEGUROS, SA	Portugal	Insurance	PwC	3
COMPANHIA DE SEGUROS ALLIANZ PORTUGAL, SA	Portugal	Insurance	PwC	4
COMPANHIA PORTUGUESA DE RESSEGUROS, SA	Portugal	Insurance	EY	3

FIDELIDADE - COMPANHIA DE SEGUROS, SA	Portugal	Insurance	EY	7
FIDELIDADE ASSISTÊNCIA - COMPANHIA DE SEGUROS, SA	Portugal	Insurance	EY	3
GamaLife-Companhia de Seguros de Vida, S.A	Portugal	Insurance	EY	5
Generali Seguros, SA	Portugal	Insurance	KPMG	4
Lusitania - Companhia de Seguros, SA	Portugal	Insurance	PwC	3
Lusitania Vida Companhia de Seguros,Sa	Portugal	Insurance	PwC	3
MUDUM - COMPANHIA DE SEGUROS, SA	Portugal	Insurance	PwC	2
MULTICARE - SEGUROS DE SAÚDE, SA	Portugal	Insurance	EY	3
MÚTUA DOS PESCADORES, MÚTUA DE SEGUROS, CRL	Portugal	Insurance	Oliveira, Reis & Associados , SROC, LDA	4
PLANICARE-COMPANHIA DE SEGUROS, S.A.	Portugal	Insurance	PwC	2
RNA Seguros, S.A.	Portugal	Insurance	Kreston Iberaudit	1
VIA DIRECTA - COMPANHIA DE SEGUROS, SA	Portugal	Insurance	EY	3
VICTORIA - SEGUROS, SA	Portugal	Insurance	Deloitte	1
ZURICH - COMPANHIA DE SEGUROS VIDA, SA	Portugal	Insurance	EY	5

**Appendix 2 – United Kingdom entities used from banking and insurance sector and number of Key Audit Matters disclosure per audit report**

<b>Entity</b>	<b>Country</b>	<b>Sector</b>	<b>Auditor</b>	<b>KAMs</b>
HSBC Holdings plc	UK	Bank	PwC	4
Lloyds Banking Group	UK	Bank	Deloitte	6
Royal Bank of Scotland Group - -> Nat west group	UK	Bank	EY	6
Nationwide Building Society	UK	Bank	EY	5
Virgin Money UK plc	UK	Bank	EY	2
Metro Bank plc	UK	Bank	PwC	2
Investec Bank Plc	UK	Bank	EY	4
The Co-operative Bank plc	UK	Bank	EY	5
Aldermore Bank Plc	UK	Bank	Deloitte	2
FCE Bank plc	UK	Bank	BDO	2
Paragon Bank Plc	UK	Bank	KPMG	5
Starling Bank Limited	UK	Bank	KPMG	2
AIB Group (UK) Plc	UK	Bank	PwC	4
Atom Bank Plc	UK	Bank	PwC	3
Aviva plc	UK	Insurance	PwC	10
Admiral Group	UK	Insurance	Deloitte	3
Phoenix Group Holdings plc	UK	Insurance	EY	6
Beazley plc	UK	Insurance	EY	3
Direct Line Group	UK	Insurance	Deloitte	4
RSA Insurance	UK	Insurance	KPMG	4
Legal & General Group	UK	Insurance	KPMG	3
Bupa	UK	Insurance	PwC	6
Ageas UK	UK	Insurance	BDO	2
AIG UK	UK	Insurance	Mazars	2

**Appendix 3 – Netherlands entities used from banking and insurance sector and number of Key Audit Matters disclosure per audit report**

<b>Entity</b>	<b>Country</b>	<b>Sector</b>	<b>Auditor</b>	<b>KAMs</b>
ABN Amro	Netherlands	Bank	EY	3
ING Group	Netherlands	Bank	KPMG	2
Rabobank	Netherlands	Bank	PwC	3
De Volksbank	Netherlands	Bank	EY	3
BNG Bank NV	Netherlands	Bank	PwC	3
Nationale-Nederlanden Bank NV	Netherlands	Bank	KPMG	2
NIBC Bank NV	Netherlands	Bank	EY	2
Nederlandse Waterschapsbank NV	Netherlands	Bank	EY	3
Van Lanschot Kempen	Netherlands	Bank	PwC	4
Triodos Bank N,V,	Netherlands	Bank	PwC	3
DHB Bank N.V.	Netherlands	Bank	Deloitte	2
Knab	Netherlands	Bank	PwC	2
Anadolubank Nederland N.V.	Netherlands	Bank	Deloitte	2
GarantiBank International NV	Netherlands	Bank	EY	2
NN Group	Netherlands	Insurance	KPMG	4
AEGON	Netherlands	Insurance	PwC	2
ASR Nederland N.V.	Netherlands	Insurance	KPMG	6
Akzo Nobel Assurantie N.V.	Netherlands	Insurance	PwC	3

**Appendix 4 – Key Audit Matters disclosure by a Bank, Novo Banco in Portugal and respective independent auditor report**

<b>KAM 1</b>	Impairment for loans and advances to customers
<b>KAM 2</b>	Measurement of real estate obtained through credit for foreclosure
<b>KAM 3</b>	Disclosure of contingent liabilities
<b>KAM 4</b>	Responsibilities with pensions

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ANNUAL  
REPORT  
2023

**novobanco**





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### Statutory and Auditor’s Report

#### REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

##### Opinion

We have audited the accompanying consolidated financial statements of Novo Banco S.A. (the Group), which comprise the Consolidated Balance Sheet as at 31 December 2023 (showing a total of 43,500,790 thousand euros and a total equity of 4,422,428 thousand euros, including a net profit for the year of 743,088 thousand euros), and the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity and the Consolidated Cash Flow Statement for the year then ended, and notes to the consolidated financial statements, including material accounting policy information.

In our opinion, the accompanying consolidated financial statements give a true and fair view, in all material respects, of the consolidated financial position of Novo Banco, S.A. as at 31 December 2023, and of its financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as endorsed by the European Union.

##### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs) and other technical and ethical standards and guidelines as issued by the Institute of Statutory Auditors. Our responsibilities under those standards are further described in the “Auditor’s responsibilities for the audit of the consolidated financial statements” section below. We are independent of the entities comprising the Group in accordance with the law and we have fulfilled other ethical requirements in accordance with the Institute of Statutory Auditors’ code of ethics.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

##### Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The key audit matters in the current year audit are the following:

1. Impairment for loans and advances to customers

Description of the most significant assessed risks of material misstatement	Summary of our response to the most significant assessed risks of material misstatement
The caption Loans and advances to customers includes an accumulated impairment amount of 954,525 thousand euros (“K€”), with an impairment loss of 109,389 K€ recorded in the period on Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss. The details of the impairment for loans and advances to customers, the related accounting policies, methodologies, definitions and assumptions are disclosed in the	Our audit approach included, amongst others, the execution of the following procedures: <ul style="list-style-type: none"> <li>▶ obtaining the understanding, evaluating the design and testing the operational effectiveness of the existing internal control procedures in the process of quantification of impairment losses for loans and advances to customers;</li> <li>▶ performing analytical procedures on the evolution of the balance of the impairment for loans and advances to customers, comparing it with last year and with the</li> </ul>

Sociedade Anónima - Capital Social 1.340.000 euros - Inscrição n.º 7711 na Ordem dos Revisores Oficiais de Contas - Inscrição N.º 20161480 na Comissão do Mercado de Valores Mobiliários  
 Contribuinte N.º 505 988 283 - C. R. Comercial de Lisboa sob o mesmo número  
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Description of the most significant assessed risks of material misstatement	Summary of our response to the most significant assessed risks of material misstatement
<p>notes to the consolidated financial statements (Notes 7.12, 8.1, 19, 22.3 and 42.3).</p> <p>In order to calculate this estimate on the impairment loss of the loans and advances to customers, management made judgments such as the business model assessment, the evaluation of significant increase in credit risk, the classification as default, the definition of groups of financial assets with similar credit risk characteristics and the use of models and assumptions. For relevant exposures on an individual approach, the impairment is determined based on the judgment from Group specialists on the evaluation of credit risk.</p> <p>In addition to the complexity of the models, its use requires the treatment of a significant volume of data, which raises issues on its quality and availability.</p> <p>Given the degree of subjectivity and complexity involved, especially in a rapidly changing macroeconomic environment, the use of alternative approaches, models or assumptions may have a material impact on the value of the estimated impairment, which makes we consider this topic as key auditing matter.</p>	<p>expectations considering the changes in the loan portfolio;</p> <ul style="list-style-type: none"> <li>• selecting a sample of customers individually assessed for impairment to evaluate the assumptions used by management in quantifying impairment. This analysis included the information containing business models, the financial situation of the debtors and the collateral appraisal reports. Inquiring of Group experts in order to obtain an understanding of the recovery strategy defined and the assumptions used;</li> <li>• analyzing the documents formalizing the relevant sale operations of loans and advances to customers and assessed the impact in the financial statements;</li> <li>• obtaining the understanding and evaluating the design of the model used to calculate the expected loss, testing the calculation, comparing the information used in the model with the source information, through the reconciliations prepared by the Group staff, evaluating the assumptions used to fill gaps in data, comparing the parameters used with the results of the estimation models and comparing the results with the values in the financial statements;</li> <li>• evaluating the reasonableness of the parameters used in the calculation of impairment, highlighting the following procedures:             <ol style="list-style-type: none"> <li>i) understanding the methodology formalized and adopted by management and comparing with the one effectively used;</li> <li>ii) evaluating the changes to models used by the Group to determine the parameters used in the impairment calculation;</li> <li>iii) testing, for the Group credit portfolio, of the application of the rules to measure the significant increase in credit risk, and on a sample basis, the assessment of such classification;</li> <li>iv) inquiries to management's experts responsible for models and inspection of reports from internal audit and regulators; and</li> <li>v) analyzing the work of the validation area and internal audit on the collective assessment models;</li> </ol> </li> <li>• reading the minutes of the Credit Impairment Committee, Broad Credit Impairment Committee and Credit Risk Monitoring Group; and</li> <li>• analyzing the disclosures included in the explanatory notes to the consolidated financial statements, based on the requirements of international financial reporting standards and accounting records.</li> </ul>



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2. Measurement of real estate obtained through credit foreclosure

Description of the most significant assessed risks of material misstatement	Summary of our response to the most significant assessed risks of material misstatement
<p>The captions Investment properties and Other assets, include real estate assets of 393,795 K€ and 66,312 K€, respectively. The accounting policies and the details of these assets are disclosed in the notes to the financial statements (notes 7.14, 7.15, 8.6, 26, 29 and 40).</p> <p>As disclosed in note 7.14 to the consolidated financial statements, the Other assets include real estate that were essentially obtained by credit foreclosure and for which the Group has implemented a plan pursuant to its sale. These real estate assets are valued at the lower of net book value and the fair value less cost to sell.</p> <p>The notes to the consolidated financial statements (note 26) disclose the detail and the movement of investment properties, which are held by investment funds and which are rented to third parties for obtaining income or held to generate capital gains. The real estate assets in this category are valued at fair value which is calculated by experts registered at CMVM contracted by the management.</p> <p>The fair value results from an estimation process by the management that relies on judgments and assumptions and is embodied in an evaluation carried out by contracted experts. The assumptions considered include the best use that can be given to the asset, what could be considered as a comparable transaction or the potential yield that can be obtained.</p> <p>As the use of different valuation techniques or assumptions could lead to different estimates of fair value, with a potential material impact in the consolidated financial statements, we consider this topic as a key audit matter.</p>	<p>Our audit approach included, amongst others, the execution of the following procedures:</p> <ul style="list-style-type: none"> <li>▶ performing analytical procedures on the value of the assets included in the Investment properties and Other assets, compared with last year and with the expectation formed, which include the understanding of the variations that have occurred and identification of changes in the assumptions and methodologies;</li> <li>▶ for a sample of real estate assets, testing the reasonableness of the methodologies and assumptions used by management's external experts registered in CMVM. For these assets, inspection of the eventual promissory sale contracts and the certificate of land register;</li> <li>▶ For the more significant real estate transactions:                         <ul style="list-style-type: none"> <li>▶ inspecting the real estate sale contracts;</li> <li>▶ analyzing the Group internal documentation on the assessment of conflicts of interest and of the competitive sale process;</li> <li>▶ for the real estate assets in the scope of the contingent capital agreement, analyzing the Resolution Fund approvals; and</li> <li>▶ testing the derecognition of the assets and the calculation of gains or losses recorded;</li> </ul> </li> <li>▶ inquiries to the management experts on the assumptions used for a sample of assets and read the minutes of the executive board;</li> <li>▶ Inquiring the management about potential sale operations and, when applicable, examining the offers received on the assets and comparing with the fair value calculated by the management; and</li> <li>▶ analyzing the disclosures included in the explanatory notes to the consolidated financial statements, based on the requirements of international financial reporting standards and accounting records.</li> </ul>

3. Disclosure of contingent liabilities

Description of the most significant assessed risks of material misstatement	Summary of our response to the most significant assessed risks of material misstatement
<p>The notes to the consolidated financial statements disclose the contingent liabilities (Note 36) that may represent a possible obligation to the Group resulting from past</p>	<p>Our audit approach included, amongst others, the execution of the following procedures:</p>



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Description of the most significant assessed risks of material misstatement	Summary of our response to the most significant assessed risks of material misstatement
<p>events. The occurrence of these obligations is dependent on one or more future events that are not entirely under the control of the Group. The accounting policies for the recognition of provision or disclosure of contingent liabilities are described in note 7.24 and the main estimates and assumptions in note 8.5. The main contingent liabilities arise from various situations, most notably:</p> <ul style="list-style-type: none"> <li>■ notwithstanding the clarifications and existing neutralization guarantees, potential adjustments that may occur to "excluded liabilities" payable by Banco Espírito Santo, S.A. ("BES") and that have not been transferred to the Group;</li> <li>■ the existence of litigation resulting from the resolution measure applied to BES, which, in spite of existing guarantees, may lead to effects or impacts in the Group which not possible to determine or quantify;</li> <li>■ existing lawsuits following the closing of the sale and purchase agreement of the Group and the setting up of the contingent capital mechanism, signed between the Resolution Fund and Lone Star;</li> <li>■ the Group participates in the Resolution Fund, which, as a result of the measures implemented in the past, presents uncertainties related to ongoing litigation and the risk of a possible insufficiency of resources to ensure compliance with its responsibilities. Management expects that the Group will not be required to make special contributions or any other kind of extraordinary contributions to fund resolution measures applied to the BES and Banif, as well as the contingent capital mechanism and the indemnities mechanism.</li> </ul> <p>There are, also, divergent views between the Group and the Resolution Fund regarding the amount requested to this Fund that the Group considers due in accordance with the contingent capital agreement.</p> <p>The risk assessment and the assumptions are matters of judgment by the Management of the Group which requires complex analysis using internal and external legal experts. Given the relevance of these contingencies for the Group, we consider this topic as a key audit matter.</p>	<ul style="list-style-type: none"> <li>■ reading the minutes of the management bodies of the Group, the correspondence with regulators and with the Resolution Fund;</li> <li>■ analyzing the responses to external confirmations from external legal experts of the Group and inquiries to the management and to the legal experts on the contingent liabilities of the Group;</li> <li>■ inspecting the documentation of the Resolution Fund, in particular the annual report of 2022 and the public communications from the Resolution Fund; and</li> <li>■ analyzing the disclosures contained in the consolidated financial statements, based on the requirements of international financial reporting standards and in the accounting records.</li> </ul>



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4. Responsibilities with pensions

Description of the most significant assessed risks of material misstatement	Summary of our response to the most significant assessed risks of material misstatement
<p>The responsibilities with pensions amount to 1,596,810 K€, with a total of 103,329 K€ recognizes in the other comprehensive income as an actuarial loss resulting from the update of the actuarial assumptions.</p> <p>The accounting policies for the recognition of responsibilities with pensions are disclosed in the notes do the financial statements (Notes 7.23, 8.4 and 16).</p> <p>The discount rate used in the calculation of the responsibilities with pensions is derived based on market yields of high quality corporate bonds, in the currency on which the liabilities will be settled, with a maturity similar to the responsibilities within the pension plan.</p> <p>Estimating the responsibilities with pensions requires the use of actuarial assumptions, which if different from the ones used by Management, could result in a materially different amount. For this reason, we consider this topic as a key audit matter.</p>	<p>Our audit approach included, amongst others, the execution of the following procedures:</p> <ul style="list-style-type: none"> <li>• Inspection of the actuarial note as of December 31, 2023 prepared by the independent actuary contracted by the Management;</li> <li>• inquiries of the key personnel of the Bank and with the independent actuary in order to understand the assumptions used;</li> <li>• assessment of the assumptions used as of December 31, 2023, in particular the discount rate, with the assistance of our internal actuarial specialists; and</li> <li>• analyzing the disclosures contained in the financial statements, based on the requirements of international financial reporting standards and in the accounting records.</li> </ul>

Responsibilities of management and the supervisory board for the consolidated financial statements

Management is responsible for:

- the preparation of consolidated financial statements that presents a true and fair view of the Group's financial position, financial performance and cash flows in accordance with International Financial Reporting Standards as endorsed by the European Union;
- the preparation of the Management Report, the Corporate Governance Report and the Non-financial statement in accordance with the laws and regulations;
- designing and maintaining an appropriate internal control system to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
- the adoption of accounting policies and principles appropriate in the circumstances; and
- assessing the Group's ability to continue as a going concern, and disclosing, as applicable, matters related to going concern that may cast significant doubt on the Group's ability to continue as a going concern.

The supervisory body is responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.



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As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- ▶ identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- ▶ obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control;
- ▶ evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- ▶ conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern;
- ▶ evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- ▶ obtain sufficient and appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion;
- ▶ communicate with those charged with governance, including the supervisory body, regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit;
- ▶ from the matters communicated with those charged with governance, including the supervisory body, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter; and
- ▶ we also provide the supervisory body with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the measures we took to eliminate those matters or the related safeguards we applied.

Our responsibility also includes the verification of the consistency of the Management Report with the consolidated financial statements, and the verifications under nr. 4 and nr. 5 of article 451 of the Commercial Companies Code regarding corporate governance, as well as verifying that the Non-financial statement was presented.



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## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

### On the Management Report

Pursuant to article 451, nr. 3, paragraph e) of the Commercial Companies Code, it is our opinion that the Management Report was prepared in accordance with the applicable legal and regulatory requirements and the information contained therein is consistent with the audited consolidated financial statements and, having regard to our knowledge and assessment over the Group, we have not identified any material misstatement.

As mentioned in article 451, Nr. 7 of the Commercial Companies Code, this opinion is not applicable to the Non-financial statement included in the Management Report.

### On the Corporate Governance Report

Pursuant to article 451, nr. 4 of the Commercial Companies Code, in our opinion, the "Corporate Governance" chapter included in the Management Report includes the information required to the Group to provide as per article 29-H of the Securities Code, and we have not identified material misstatements on the information provided therein in compliance with paragraphs c), d), f), h), i) and m) of nr.1 of the said article.

### On the Non-financial statement

Pursuant to article 451, nr. 6 of the Commercial Companies Code, we inform that the Group prepared the Sustainability Report separated from the Management Report, which includes the Non-financial statement, as required in article 66-B of the Commercial Companies Code, being the same disclosed together with Management Report.

### On additional items set out in article 10 of the Regulation (EU) nr. 537/2014

Pursuant to article 10 of the Regulation (EU) nr. 537/2014 of the European Parliament and of the Council, of 16 April 2014, and in addition to the key audit matters mentioned above, we also report the following:

- ▶ We were appointed as auditors of Novo Banco, S.A. (Group's Parent Entity) for the first time in the shareholders' general meeting held on 21 December 2017 for a mandate from 2018 to 2020. We were reappointed in the shareholders' general meeting held on 22 October 2020 for a second mandate from 2021 to 2024;
- ▶ Management has confirmed that they are not aware of any fraud or suspicion of fraud having occurred that has a material effect on the financial statements. In planning and executing our audit in accordance with ISAs we maintained professional skepticism and we designed audit procedures to respond to the possibility of material misstatement in the consolidated financial statements due to fraud. As a result of our work we have not identified any material misstatement to the consolidated financial statements due to fraud;
- ▶ We confirm that our audit opinion is consistent with the additional report that we have prepared and delivered to the supervisory body of the Group on this date; and
- ▶ We declare that we have not provided any prohibited services as described in article 5 of the Regulation (EU) nr. 537/2014 of the European Parliament and of the Council, of 16 April 2014, and we have remained independent of the Group in conducting the audit.

### European Single Electronic Format (ESEF)

The accompanying consolidated financial statements of Novo Banco, S.A. for the year ended 31 December 2023 must comply with the applicable requirements set out in the Commission Delegated Regulation (EU) 2019/815 of 17 December 2018 (ESEF Regulation).

Management is responsible for preparing and disclosing the annual report in accordance with the ESEF Regulation.

Our responsibility is to obtain reasonable assurance about whether the consolidated financial statements, included in the annual report, are presented in accordance with the requirements set out in the ESEF Regulation.



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Our procedures considered the OROC Technical Application Guide (GAT 20) on report in ESEF and included, among others:

- gaining understanding of the financial reporting process, including the submission of the annual report in valid XHTML format; and
- the identification and evaluation of the risks of material distortion associated with the marking-up of the information of the financial statements, in XBRL format using iXBRL technology. This evaluation was based on the understanding of the process implemented by the Group to mark-up the information.

In our opinion, the accompanying consolidated financial statements included in the annual report are presented, in all material respects, in accordance with the requirements set out in the ESEF Regulation.

Lisbon, March 5, 2024

Ernst & Young Audit & Associados – SROC, S.A.  
Sociedade de Revisores Oficiais de Contas  
Represented by:

*(Signed)*

Antonio Filipe Dias da Fonseca Brás - ROC nr. 1661  
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**Appendix 5 – Key Audit Matters disclosure by a Bank, Novo Banco in Portugal and respective independent auditor report**

<b>KAM 1</b>	Credit impairment provisions
<b>KAM 2</b>	Valuation of the deferred tax asset relating to the Bank's future profitability
<b>KAM 3</b>	Completeness and valuation of conduct risk provisions
<b>KAM 4</b>	Valuation of the defined benefit pension scheme surplus in the Britannia pension scheme
<b>KAM 5</b>	Risk of fraud in the recognition of income using the Effective Interest Rate ("EIR") Method

# The Co-operative Bank

2023 Annual Report and Accounts

The **co-operative** bank

Ethical then, now and **always**



**Opinion**

In our opinion:

- the financial statements of The Co-operative Bank p.l.c (the “Bank Company”) and its subsidiaries (together the “Bank”) give a true and fair view of the state of the Bank’s and of the Bank Company’s affairs as at 31 December 2023 and of the Bank’s profit for the year then ended;
- the Bank financial statements have been properly prepared in accordance with UK adopted international accounting standards;
- the Bank Company financial statements have been properly prepared in accordance with UK adopted international accounting standards as applied in accordance with section 408 of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements (as defined in the table below) of the Bank Company and the Bank for the year ended 31 December 2023, which comprise:

<b>Bank</b>	<b>Bank Company</b>
Consolidated balance sheet as at 31 December 2023	Balance sheet as at 31 December 2023
Consolidated income statement for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Statement of cashflows for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 26 to the Bank Company financial statements (except for the columns marked as “unaudited” in Note 30 of the Group and Bank financial statements, which are referenced in Note 22 of the Bank Company financial statements), including material accounting policy information, including those disclosed within the explanatory information on pages 281 to 290
Consolidated statement of cash flows for the year then ended	
Related notes 1 to 36 to the financial statements, (except for the columns marked as “unaudited” in Note 30), including material accounting policy information, including those disclosed within the explanatory information on pages 281 to 290	
Tables within the Directors’ Report on remuneration to the shareholder identified as “audited” on pages 107 to 110 and information in the risk management section of the Business Review, identified as “audited” on pages 126 to 156	

The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards and as regards to the Bank Company financial statements, as applied in accordance with section 408 of the Companies Act 2006.

**Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (“ISAs (UK)”) and applicable law. Our responsibilities under those standards are further described in the Auditor’s responsibilities for the audit of the financial statements section of our report. We are independent of the Bank and Bank Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC’s Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Conclusions relating to going concern**

In auditing the financial statements, we have concluded that the Directors’ use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the Directors’ assessment of the Bank and Bank Company’s ability to continue to adopt the going concern basis of accounting included the following procedures:

- We confirmed our understanding of the Directors' going concern assessment process, including the Financial Statement Close Process, and the process by which the Financial Plan is created and approved. We engaged with Management early to ensure all key factors that we considered to be material were considered in the Bank's going concern assessment.
- We obtained Management's Board approved Financial Plan covering the period of Management's going concern assessment to 30 June 2025. Management has modelled stress scenarios to the financial plans to incorporate unexpected changes to the forecasted profitability and liquidity.
- We evaluated the relevance and reliability of the underlying data used in the financial plan which supports the going concern assessment, and tested assumptions to third party evidence, where appropriate.
- Using our understanding of the business, we evaluated the approach adopted by the Directors in assessing going concern, including considering plausible alternative downside scenarios, and concluded that the approach adopted was reasonable.
- We used our internal valuation specialists to test the mathematical accuracy of the financial forecasting models used to develop the Financial Plan.
- We reconciled the Bank's capital and liquidity position to its regulatory reporting returns and challenged the assumptions within the Bank's capital and liquidity forecasts over the going concern period, considering the Bank's current position and availability of additional capital and liquidity should it be required. We also evaluated the Bank's ability to replace maturing debt instruments over the going concern period to manage capital and buffer requirements. We challenged the Bank's ability to refinance £996m of TFSME funding over the going concern period through customer deposit growth and liquidity wholesale actions and considered the Bank's ability to make TFSME repayments under stressed scenarios.
- We evaluated Management's plans for future actions within the control of the Bank and Bank Company to maintain a surplus to binding regulatory requirements over the going concern period in order to determine if such actions are feasible in the current circumstances.
- We evaluated Management's assumptions by performing independent stress testing to determine whether a reasonable alternative stressed scenario, or combination of scenarios, would result in a breach of binding regulatory requirements.
- We considered Management's assessment of the impact on the going concern assessment of entering into exclusivity discussions with Coventry Building Society (as describe within accounting policies on page 193). We note that these discussions are currently at a preliminary stage and there is no guarantee that these discussions will result in any potential transaction.
- We considered whether the disclosures (as described within accounting policies on page 193 of the Group and Bank Consolidated Financial Statements) sufficiently and appropriately reflect the events relating to the uncertainties identified in the going concern assessment, and Management's plans in response to these.

### **Our key observations**

Our evaluation of the Directors' going concern assessment covers the period to 30 June 2025.

The Bank retains headroom to its binding liquidity and capital requirements over the going concern period and we therefore do not consider that these requirements give rise to a material uncertainty.

We have concluded that the Bank's forecasts and expected outcome over the going concern period are reasonable.

### **Conclusion**

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Bank and Bank Company's ability to continue as a going concern for the period to 30 June 2025.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Bank or Bank Company's ability to continue as a going concern.

**Overview of our audit approach**

Audit scope	<ul style="list-style-type: none"> <li>• We performed an audit of the complete financial information of the Bank and the Bank Company</li> </ul>
Key audit matters	<ul style="list-style-type: none"> <li>• Credit impairment provisions</li> <li>• Valuation of the deferred tax asset relating to the Bank’s future profitability</li> <li>• Completeness and valuation of conduct risk provisions</li> <li>• Valuation of the defined benefit pension scheme surplus in the Britannia pension scheme</li> <li>• Risk of fraud in the recognition of income using the Effective Interest Rate (“EIR”) Method</li> </ul>
Materiality	<ul style="list-style-type: none"> <li>• Overall materiality for the Bank and the Bank Company of £12.0m which represents 0.9 % of Bank equity (2022: £13.0m representing 1.0 % of Bank equity).</li> </ul>

**An overview of the scope of the audit**

**Tailoring the scope**

The Bank is principally managed from one location in Manchester, with certain functions such as Treasury and some corporate activities operated from London. All audit work performed for the purposes of the audit was undertaken by the Bank audit team.

**Climate change**

Stakeholders are increasingly interested in how climate change will impact the Bank and the Bank Company. The Bank and Bank Company has determined that the most significant future impacts from climate change on their operations will be from physical and transition risks. These are explained on pages 43 to 54 in the required Task Force for Climate related Financial Disclosures. Within these disclosures the Bank also explains that climate change has been established as a “thematic risk” holistically across the Risk Management Framework and integrated through the Group’s principal risks, which are disclosed on pages 116 to 125. All of these disclosures form part of the “Other Information”, rather than the audited financial statements. Our procedures on these unaudited disclosures therefore consisted solely of considering whether they are materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appear to be materially misstated, in line with our responsibilities on “Other Information”.

In planning and performing our audit we assessed the potential impacts of climate change on the Bank’s and Bank Company’s business to determine whether they had a material impact on the financial statements.

The Bank and Bank Company have explained in Note 1.2 within the Basis of Preparation how they have reflected the impact of climate change in their financial statements. Note 1.2 explains that where forward-looking information is relied on in preparing the financial statements, the Bank and Bank Company have given due consideration, where appropriate and quantifiable, to potential future impacts of climate-related risk. The Bank recognises that governmental and societal responses to climate change risks are still developing and thus their ultimate impacts on the Bank and the Bank Company are inherently uncertain and cannot be fully known. In Note 2.2.1.c to the financial statements supplementary narrative explanations of the impact of reasonably possible changes in key assumptions and estimates related to climate risk have been provided and significant judgements and estimates relating to climate change have been described.

Our audit effort in considering the impact of climate change on the financial statements was focused on evaluating management’s assessment of the impact of climate risk, physical and transition, their climate commitments, the effects of material climate risks disclosed on pages 43 to 54 and the significant judgements and estimates disclosed in Note 2 and whether these have been appropriately reflected the financial statements, following the requirements of UK adopted international accounting standards. As part of this evaluation, we performed our own risk assessment, supported by our climate change internal specialists, to determine the risks of material misstatement in the financial statements from climate change which needed to be considered in our audit.

We also challenged the Directors’ considerations of climate change risks in their assessment of going concern and associated disclosures. Where considerations of climate change were relevant to our assessment of going concern, these are described above.

Based on our work we have considered the impact of climate change on the financial statements to principally impact the Credit Impairment Provisions key audit matter. Details of our procedures and findings are included in our Credit Impairment Provisions key audit matter below.

**Key audit matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk
<p><b>Credit impairment provisions</b></p> <p><i>Please refer to the Audit Committee Report (page 82); Accounting policies (page 286); and Note 14 of the Bank Consolidated Financial Statements (page 208).</i></p> <p>At 31 December 2023, the Bank reported total gross loans and advances to customers of £20,354.3m (2022: £20,962.2m) and credit impairment provisions of £37.4m (2022: £40.3m).</p> <p>The determination of expected credit losses (“ECL”) continues to be highly subjective and judgemental. Key judgements and estimates in respect of the timing and measurement of ECL include:</p> <ul style="list-style-type: none"> <li>- The appropriateness of staging criteria selected by the Bank to determine whether a significant increase in credit risk (“SICR”) has arisen;</li> <li>- Accounting interpretations and modelling assumptions used to build the models that calculate the ECL;</li> <li>- Inputs and assumptions used to estimate the impact of non-linearity arising from the Bank’s use of multiple economic scenarios including appropriate weightings for the various scenarios;</li> <li>- Completeness and valuation of Post Model Adjustments (“PMAs”) and the adequacy of PMA disclosures in the financial statements; and</li> <li>- Measurement of individually assessed provisions.</li> </ul> <p>We also considered potential consequences of climate change as an emerging risk to the Bank loan portfolio and assessed the impact of this on the Bank’s ECL provision.</p> <p>In line with the prior year the level of judgement and estimation remains elevated as a result of the impact of higher inflation and interest rates on the cost of living.</p>	<p>We understood and evaluated the design effectiveness of key controls over the impairment process and tested the operating effectiveness of the controls which we intended to rely on covering the reconciliation of model data and the determination of arrears status.</p> <p>We assessed the reasonableness of the methodology for determining the SICR criteria and independently tested the staging allocation by reperforming this across the entirety of the secured and unsecured portfolios and a risk based sample of the corporate loan portfolio, with reference to the Bank’s SICR thresholds and cure periods. We also performed sensitivity analysis including stage escalations for sectors or exposures with higher risk characteristics, this included those properties on flood plains or locations which are most likely to be economically impacted by changes in industry trends as a result of the increased focus on climate risk.</p> <p>With the support of EY credit risk modelling specialists, we performed a model inherent risk assessment of all models used to generate ECL. Based on this risk assessment we tailored our procedures and reviewed the underlying model methodology including model design review, model implementation and validation testing, sensitivity analysis, benchmarking and the recalculation of the Probability of Default, Loss Given Default, and Exposure at Default.</p> <p>We performed testing over the integrity of the key data elements used in developing and validating the Bank’s ECL models and assumptions. We challenged the completeness of these data elements and then tested the data within the models back to source evidence. We also tested other information used by the Bank to calculate the provision, such as collateral valuations.</p> <p>With the support of EY economist specialists, we assessed the base case and the four alternative economic scenarios. We performed this assessment by challenging probability weightings and comparing to other scenarios from external sources, as well as EY internally developed forecasts. We assessed whether forecasted macro-economic variables including GDP, unemployment, interest rates, and indexation applied to collateral valuations, were appropriate. Having determined the appropriateness of the economic forecasts and associated probability weightings, we assessed the reasonableness of the extent of non-linearity arising from the Bank’s model outputs.</p> <p>Alongside EY credit risk modelling specialists, we performed sensitivity analysis over the underlying macro-economic factors included within the ECL models to assess how they would perform in a more volatile economic environment, and evaluated the resulting impact on ECL.</p>

Risk	Our response to the risk
	<p>In conjunction with EY credit risk modelling specialists, we assessed whether the inventory of PMAs used by the Bank was complete. In performing this evaluation, we considered the impact of external factors, including the higher inflation and interest rates and the consequent impact on cost of living, climate change, geopolitical tensions and other emerging risks. In addition, we considered the findings from our model design and implementation reviews and the Bank’s lack of historic loss data on the secured portfolio. We critically analysed new PMAs created in the year and reviewed the continued justification for existing PMAs where relevant.</p> <p>We tested the material PMAs by assessing the appropriateness of the Bank’s methodologies, validating data inputs and independently recalculating the PMAs, which included an assessment of the underlying calculation methodology. For the more significant PMAs we developed alternative assumptions to form an independent range of the quantum of each PMA, which we compared to the PMA recorded by the Bank.</p> <p>For a sample of higher risk individually assessed corporate provision cases, and also certain Stage 2 corporate cases where the Bank includes a PMA to reflect risks not captured by the underlying models, we obtained an understanding of the latest developments in the borrower’s situation and the factors impacting the measurement of provisions.</p> <p>With the support of EY valuation specialists, we independently assessed the underlying collateral used in the Bank’s cash flow calculations. In each case we tested key data inputs and considered alternative scenarios in challenging the Bank’s estimate.</p> <p>We assessed the adequacy and appropriateness of disclosures made within the financial statements, including the disclosures provided in relation to PMAs.</p> <p>In line with the requirements of ISA 540 (Revised) – Auditing Accounting Estimates and Related Disclosures, we performed a stand back analysis to assess the overall adequacy of the ECL coverage and approach. In completing this analysis, we considered the nature and credit quality of the overall loan books, used data analytic tools to highlight risk areas in the loan portfolios, performed benchmarking across similar institutions considering both staging percentages and provision coverage, assessed the impact of the cost of living crisis on individual and company exposures and behaviours and evaluated the overall reasonableness of economic recovery assumptions.</p>
<p><b>Key observations communicated to the Audit Committee</b></p>	
<p>We communicated that we are satisfied the Bank’s ECL provisions were reasonably estimated and materially in compliance with IFRS 9.</p> <p>We highlighted to the Committee that there remains increased uncertainty in determining forecast losses due to the prevailing uncertain economic environment.</p> <p>We highlighted to the Audit Committee that although we observed model deficiencies, the resulting ECL was reasonable after incorporating appropriate Post Model Adjustments, which in aggregate we considered to be reasonably estimated.</p> <p>We considered the multiple economic scenarios, and associated weightings, incorporated in the IFRS 9 models to be materially appropriate.</p>	

Risk	Our response to the risk
<p><b>Valuation of the deferred tax asset relating to the Bank’s future profitability</b></p> <p><i>Please refer to the Audit Committee Report (page 82); Accounting policies (page 289); and Note 28 of the Bank Consolidated Financial Statements (page 217).</i></p> <p>As the Bank continues to be profitable, with forecasts suggesting that this will be maintained, it has continued to recognise a £197.5m (2022: £120.6m) deferred tax asset to reflect the extent that the Bank’s historic losses could be utilised against future anticipated taxable profits and has also recognised £36.4m (2022: £46.8m) of deferred tax assets in respect of capital allowances on fixed assets on the same basis.</p> <p>Judgement therefore exists relating to the likelihood that the Bank will achieve its forecast results and generate sufficient taxable profits against which losses can be utilised, which is based on estimates of future profitability that are inherently uncertain as they are sensitive to future economic, market and other conditions which are difficult to predict. Key estimates which underpin these forecasts include:</p> <ul style="list-style-type: none"> <li>- Revenue and cost forecasts;</li> <li>- Macroeconomic and model assumptions;</li> <li>- Duration and reliability of forecasts used especially in the outer years.</li> </ul> <p>The recognition of deferred tax also considers the interpretation of changes to applicable tax rates and laws.</p> <p>Relative to the prior year the risk of material error remains elevated given the continuing higher inflation and interest rate environment and general uncertainty in respect of future economic forecasts.</p>	<p>We considered the length of the forecasts that it would be appropriate to use in calculating the deferred tax asset, with reference to the Bank’s historic performance and levels of forecasting accuracy. We also benchmarked the period used by the Bank against that used by peer organisations.</p> <p>We critically assessed the forecast assumptions which underpin the deferred tax asset calculation and tested these for consistency with assumptions used throughout the Bank’s financial reporting process. This included ensuring consistency with the economic forecasts used in the ECL assessment.</p> <p>We developed an alternative range of assumptions to apply to the Bank’s profit forecasts. These assumptions were determined using external market information, considering the Bank’s historical forecasting accuracy and assessing the achievability of future revenue growth and cost reduction plans. Applying these alternative assumptions to the Bank’s forecasts enabled us to calculate an independent range against which we assessed the Bank’s forecasts.</p> <p>With the support of EY taxation specialists, we assessed the valuation of the deferred tax asset against the applicable tax rates and laws.</p> <p>In conjunction with our EY modelling specialists, we assessed the clerical accuracy of calculations impacted by key model assumptions within the Bank’s forecasting model. We also utilised the support of our tax audit team to develop an independent tax model to assess the model used by the Bank to calculate the deferred tax asset.</p> <p>In line with the requirements of ISA 540 (Revised) – Auditing Accounting Estimates and Related Disclosures, we performed a stand back analysis to assess the overall reasonableness of the deferred tax asset recognised by the Bank. In completing this analysis, we considered the Bank’s performance in 2023, track record of profitability established in the past three years and the likelihood that sufficient future profits will be generated against which historic losses can be used, and assessed the impact of reasonable alternative assumptions on the Bank’s profit forecasts.</p> <p>We assessed the appropriateness of the related disclosures in the 2023 Annual Report and Accounts, including the assumptions used and the associated sensitivities.</p>
<p><b>Key observations communicated to the Audit Committee</b></p>	
<p>We reported the outcome of the EY independently determined ranges, including our assessment of outer year sustainable earnings, and concluded that the Bank’s deferred tax asset was at the top end of our reasonable range. In addition, we considered the anticipated period of recovery for the deferred tax asset and found that to be reasonable.</p> <p>We also concluded in conjunction with our EY taxation specialists that the deferred tax asset was materially calculated in line with applicable tax rates and laws.</p>	

Risk	Our response to the risk
<p><b>Valuation of the provision raised to redress closed book Standard Variable Rate (SVR) customers</b></p> <p><i>Please refer to the Audit Committee Report (page 82); Accounting policies (page 290); and Note 26 of the Bank Consolidated Financial Statements (page 216).</i></p> <p>At 31 December 2023, the Bank reported provisions of £60.6m (2022: £33.2m). This includes £29.4m (2022: £1.1m) for conduct/legal matters.</p> <p>In November 2023, the Bank received two final decisions from the Financial Ombudsman Service that partially upheld complaints brought by customers regarding historical changes to the Standard Variable Rate (SVR) within a closed book of mortgages acquired by the Bank as part of its merger with the Britannia Building Society in 2009.</p> <p>Following these decisions, the Bank decided to pro-actively redress these complainants, and other closed book SVR customers, and raised a provision of £28.9m for the associated cost.</p> <p>Key areas of judgement in calculating the Bank's expected redress in relation to this matter are:</p> <ul style="list-style-type: none"> <li>- The period over which redress should be calculated;</li> <li>- The entities whose customers are in scope for redress, and the customer populations that should be included;</li> <li>- The extrapolation of the expected outcome from a sample of redress calculations over the entire population.</li> </ul> <p>As a result of the increased judgement and estimation uncertainty arising from the Bank's decision to pro-actively redress closed book SVR customers and the associated disclosure requirements we consider the risk to have increased and this to be a Key Audit Matter for 2023.</p>	<p>In conjunction with EY conduct risk specialists, we assessed the appropriateness of the Bank's judgement of the period over which the proactive redress to closed book SVR customers is calculated. This assessment was made with reference to the FCA's Dispute Resolution: Complaints Sourcebook (DISP) and correspondence between the Bank and its regulators.</p> <p>We challenged the Bank on the coverage of the proposed remediation, and the extent to which this included subsidiaries of the Bank Company with similar characteristics. We also challenged whether the redress should include only those customers who have complained, or all known customers who had a similar mortgage over the redress period.</p> <p>With the support of our conduct risk and forensic accounting specialists, we assessed the reasonableness of the provision estimate, and the Bank's extrapolation of the expected outcome from a sample of redress calculations to form an expectation of total redress. As part of this assessment, we calculated the redress that would be paid for a sample of impacted customers and compared this to the Bank's provision estimate.</p> <p>We also considered whether the matter was appropriately disclosed in the Annual Report and Accounts.</p>
<p><b>Key observations communicated to the Audit Committee</b></p>	
<p>We highlighted that the redress period used by the Bank in the provision calculation was reasonable based on the redress terms outlined in the Financial Ombudsman Services' ruling and the Group's correspondence with the Financial Conduct Authority, and that the population of customers included in the provision estimate was appropriate.</p> <p>We concluded to the Audit Committee that the Bank's approach to estimating future redress costs resulted in a provision that was reasonably estimated and the matter was appropriately disclosed in the Financial Statements.</p>	

Risk	Our response to the risk
<p><b>Valuation of the defined benefit pension scheme surplus in the Britannia pension scheme</b></p> <p>Please refer to the Audit Committee Report (page 82); Accounting policies (page 289); and Note 29 of the Bank Consolidated Financial Statements (page 218).</p> <p>At 31 December 2023, the Bank reported a net retirement benefit asset of £148.5m (2022: £159.7m), of which £130.3m (2022: £142.9m) relates to the Britannia pension scheme. The Britannia pension scheme consisted of assets of £556.3m (2022: £557.4m) and liabilities of £426.0m (2022: £414.5m).</p> <p>The valuation of the liabilities the pension scheme is subject to the following significant assumptions and is performed by an external firm of pension actuaries:</p> <ul style="list-style-type: none"> <li>- Discount rate;</li> <li>- Inflation;</li> <li>- Revaluation of deferred pensions; and</li> <li>- Mortality.</li> </ul> <p>The Britannia scheme also contains an element of Level 3 illiquid investment funds that are harder to value, which increases the risk of incorrect valuation.</p> <p>The overall audit risk of material misstatement has reduced compared to the prior year and now only focusses on the Britannia pension scheme as a result of the completion of the “buy-in” transaction for the Pace pension scheme, concluded in the prior year.</p>	<p>With the support of EY pension actuaries, we considered the appropriateness of the assumptions supporting the valuation of the scheme liabilities through the development of an independent range of reasonable assumptions against which to assess those used by the Bank and its external actuarial experts.</p> <p>We assessed the impact on pension liabilities of changes in financial, demographic and longevity assumptions and whether these were in line with our expectations. We also tested the completeness and accuracy of member data on which these assumptions are based.</p> <p>Alongside EY valuation specialists, we challenged the appropriateness of the Bank’s asset valuation methodology, including the judgements made in determining significant assumptions used in the valuation of illiquid Level 3 pension assets, through assessing asset valuation statements and pricing policies.</p> <p>We assessed the recognition of the pension scheme surplus against the requirements of IFRIC 14.</p> <p>We assessed the adequacy of the pension disclosures made, and their compliance with the accounting standards including the appropriateness of the key assumptions and sensitivities disclosed.</p>
<p><b>Key observations communicated to the Audit Committee</b></p>	
<p>We highlighted to the Audit Committee that the defined benefit pension scheme surplus is reasonably estimated and recognised in accordance with both IAS 19 and IFRIC 14.</p> <p>We communicated that there is subjectivity in the valuation of the scheme liabilities due to the use of significant assumptions in calculating the balance. We were satisfied that on an overall basis, the assumptions made by the Bank were within a reasonable range.</p> <p>We also noted that the asset pools invested in by the scheme contained an element of Level 3 illiquid funds. We are satisfied that the Bank’s methods for valuing these assets, and the valuations themselves, were materially appropriate.</p>	

Risk	Our response to the risk
<p><b>Risk of fraud in the recognition of income using the effective interest rate method</b></p> <p><i>Please refer to the Audit Committee Report (page 82) and Accounting policies (page 286) of the Bank Consolidated Financial Statements.</i></p> <p>The Bank records interest income on its mortgage portfolio under the effective interest rate ('EIR') method.</p> <p>The EIR method of revenue recognition spreads the income statement recognition of income and expense cash flows that are, in substance, integral to the overall yield of the financial instrument over its modelled life. The method involves Management judgement in both determining the initial EIR and recording the present value of adjustments arising in subsequent periods when cash flows are reforecast. As such, it represents a risk of fraud in revenue recognition through Management override of internal controls.</p> <p>The Bank's EIR models are most sensitive to changes in the behavioural life assumptions and future interest rate expectations that is inherently difficult to predict. Judgement is also applied in determining the nature of fees eligible to be deferred as a result of being integral to the yield of the products, and the change in this as a result of the in-housing of mortgage operations from Capita.</p> <p>The key assumptions particularly in relation to modelled forecast cash flows may be measured incorrectly due to the use of inaccurate or incomplete data, erroneous formulae or inappropriate assumptions.</p> <p>We consider the level of audit risk associated with the risk of fraud in the recognition of income using the effective interest rate method to have remained consistent with the prior year.</p>	<p>We understood and evaluated the design effectiveness of key controls over the EIR process.</p> <p>We developed an independent reasonable range against which we evaluated the key assumptions used by the Bank in the EIR models, being the behavioural lives of assets and the forecasting of standard variable rates to which mortgages revert following the conclusion of their fixed rate term.</p> <p>We assessed customer behavioural assumptions in the context of the Bank's own historic and recent experience and also established the consistency of forecast standard variable rates with market derived base rate forecasts and the Bank's expectations of future interest margins. We considered the cost of living crisis and high interest rate environment on customer behaviour.</p> <p>We tested the completeness, appropriateness and compliance with the requirements of the accounting standards of fees deferred and amortised in the EIR models by independently assessing the Bank's income streams and fees charged to determine whether they form an integral part of the effective yield and therefore should be included or omitted from the Bank's model. As part of this we considered the changes in the business including the in-housing of Capita's operations.</p> <p>We tested the completeness of data within the Bank's EIR models by selecting a sample of loans from the Bank's underlying source systems and checking these were included in the model. We tested the accuracy of the data within the models through agreement of the model data to the Bank's source systems and underlying customer documentation.</p> <p>We tested the clerical and methodical accuracy of the EIR calculations by recalculating the EIR balance for a sample of mortgages and agreeing this to the Bank's modelled output.</p>
<p><b>Key observations communicated to the Audit Committee</b></p>	
<p>We communicated that the approach to determining the EIR at 31 December 2023, was appropriate and reasonable in the context of current observable market behaviours and economic conditions. We concluded that although the resulting EIR asset was below the bottom of our independently determined reasonable range, we did not consider this difference to be material.</p>	

In the prior year, our auditor's report included a key audit matter in relation to going concern. In the current year, we did not consider this to be a key audit matter due to the Bank's continued profitability and the successful completion of two additional debt issuances in 2023 further increasing the Bank's headroom to binding regulatory capital requirements.

### **Our application of materiality**

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

### **Materiality**

*The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.*

We determined materiality for the Bank and Bank Company to be £12.0m (2022: £13.0m), which is 0.9% (2022: 1.0%) of the Bank's equity. The overall reduction in materiality was to reflect the net increase in risk from the sale activity associated with the Bank. We believe that the Bank's equity provides us with the most appropriate basis on which to set materiality, as we see this as a proxy for regulatory capital, which is a key focus for users of the financial statements given its importance to the Bank's solvency. We also considered that although the Bank has now been profitable for three consecutive years, it has not yet reached a normalised level of profit on which to base our materiality calculation.

### **Performance materiality**

*The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.*

On the basis of our risk assessments, history of error, and together with our assessment of the Bank's overall control environment, our judgement was that performance materiality was 75% (2022: 75%) of our planning materiality, namely £9.0m (2022: £9.8m).

### **Reporting threshold**

*An amount below which identified misstatements are considered as being clearly trivial.*

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.6m (2022: £0.7m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

### **Other Information**

The Other Information comprises the information included in the annual report set out on pages 1 to 156, other than the financial statements and our auditor's report thereon. The Directors are responsible for the Other Information contained within the annual report.

Our opinion on the financial statements does not cover the Other Information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of the Other Information, we are required to report that fact.

We have nothing to report in this regard.

### **Opinions on other matters prescribed by the Companies Act 2006**

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

### **Matters on which we are required to report by exception**

In the light of the knowledge and understanding of the Bank and the Bank Company and their environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report. We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Bank Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Bank Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

### **Responsibilities of Directors**

As explained more fully in the Statement of Directors' Responsibilities set out on page 100, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Bank's and Bank Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Bank or the Bank Company or to cease operations, or have no realistic alternative but to do so.

### **Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

### **Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud**

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the Bank and Management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and determined that the most significant are:
  - Companies Act 2006.
  - Financial Reporting Council ("FRC") rules and guidance.
  - Tax Legislation (governed by HM Revenue and Customs).
  - Financial Conduct Authority ("FCA") rules.
  - CRD IV (Basel III) and Prudential Regulation Authority ("PRA") rules.
- We understood how the Bank is complying with those frameworks by attending the Bank's Risk Committee and Audit Committee, reviewing relevant Board and management committee minutes and reports, holding discussions with the Bank's legal team and internal audit, amongst others. We inquired as to any known instances of non-compliance or suspected non-compliance with laws and regulations. We also reviewed the Bank's Complaints Management Policy and Whistleblowing Policy and reports.
- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur by holding discussions with senior management, those charged with governance, internal audit and the Audit Committee. We also utilised the support of EY forensics specialists in the performance of this risk assessment.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reports on the aforementioned legal and regulatory frameworks, including relevant reports prepared by internal audit, and performing our own analysis as required. We reviewed the correspondence exchanged between the Bank and its Regulators, and gained an understanding of any regulatory investigations and enforcement actions being undertaken. We also met with the Bank's Regulators at least annually in the performance of the audit. We focused our testing on key areas of risk and estimation, as referred to in the key audit matters section above.

- The Bank operates in the financial services industry, which is a highly regulated environment. As such, the Senior Statutory Auditor considered the experience and expertise of the engagement team, including auditor's specialists, to ensure the team had the appropriate competence and capabilities, and utilised the support of auditor's specialists as appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

### **Other matters we are required to address**

- We were appointed as auditors by the Bank at the AGM on 30 May 2014 to audit the financial statements for the year ending 31 December 2014 and subsequent financial periods. Our first engagement letter was signed on 17 July 2014. The period of total uninterrupted engagement including previous renewals and reappointments is ten years, covering the years ending 31 December 2014 to 31 December 2023.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Bank or the Bank Company and we remain independent of the Bank and the Bank Company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

### **Use of our report**

This report is made solely to the Bank Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank Company and the Bank Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

*Michael-John Albert (Senior Statutory Auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
London  
27 February 2024*

**Appendix 6 – Key Audit Matters disclosure by a Bank, Rabobank in the Netherlands and respective independent auditor report**

<b>KAM 1</b>	Impairment allowances on loans and advances to customers
<b>KAM 2</b>	Regulatory and client care exposures
<b>KAM 3</b>	Design and effectiveness of IT General Controls



# *Annual Report 2023*



## Independent auditor's report

To: the General Members' Council and the Supervisory Board of Coöperatieve Rabobank U.A.

### Report on the audit of the financial statements 2023

#### Our opinion

In our opinion:

- the consolidated financial statements of Coöperatieve Rabobank U.A. together with its subsidiaries ('the Group', 'Rabobank' or 'the Bank') give a true and fair view of the financial position of the Group as at 31 December 2023 and of its result and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union ('EU-IFRS') and with Part 9 of Book 2 of the Dutch Civil Code; and
- the company financial statements of Coöperatieve Rabobank U.A. ('the Company') give a true and fair view of the financial position of the Company as at 31 December 2023, and of its result for the year then ended in accordance with Part 9 of Book 2 of the Dutch Civil Code.

#### What we have audited

We have audited the accompanying financial statements 2023 of Coöperatieve Rabobank U.A., Amsterdam. The financial statements comprise the consolidated financial statements of the Group and the company financial statements.

The consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2023;
- the following statements for 2023: the consolidated statement of income, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows; and
- the notes to the financial statements, including material accounting policy information and other explanatory information.

The company financial statements comprise:

- the statement of financial position as at 31 December 2023;
- the statement of income for the year then ended; and
- the notes, comprising a summary of the accounting policies applied and other explanatory information.

The financial reporting framework applied in the preparation of the financial statements is EU-IFRS and the relevant provisions of Part 9 of Book 2 of the Dutch Civil Code for the consolidated financial statements and Part 9 of Book 2 of the Dutch Civil Code for the company financial statements.

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### The basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. We have further described our responsibilities under those standards in the section 'Our responsibilities for the audit of the financial statements' of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Independence

We are independent of Coöperatieve Rabobank U.A. in accordance with the European Union Regulation on specific requirements regarding statutory audit of public-interest entities, the 'Wet toezicht accountantsorganisaties' (Wta, Audit firms supervision act), the 'Verordening inzake de onafhankelijkheid van accountants bij assuranceopdrachten' (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore, we have complied with the 'Verordening gedrags- en beroepsregels accountants' (VGBA, Dutch Code of Ethics).

### Our audit approach

We designed our audit procedures with respect to the key audit matters, fraud and going concern, and the matters resulting from that, in the context of our audit of the financial statements as a whole and in forming our opinion thereon. The information in support of our opinion, such as our findings and observations related to individual key audit matters, the audit approach fraud risk and the audit approach going concern was addressed in this context, hence we do not provide a separate opinion or conclusion on these matters.

### Overview and context

Rabobank is an international bank operating on the basis of cooperative principles. Rabobank operates globally in 37 countries with a focus on universal banking in the Netherlands and food and agricultural financing in the Netherlands and abroad. Its operations include domestic retail banking, wholesale banking, international rural banking, leasing and real estate. As the Group comprises multiple components, we considered our group audit scope and approach as set out in the section 'The scope of our group audit'. We paid specific attention to the areas of focus driven by the operations of the Group, as set out below.

Rabobank continues to operate in a challenging environment due to increasing geopolitical tensions, historic interest rate hikes and a cooling economy. Furthermore, the Group is impacted by changes to customer preferences which require ongoing investments in digitisation and by high expectations from society towards compliance with laws and regulations. The reliability of information processing is significant to the Group's operational, regulatory and financial reporting processes and we have therefore identified the design and effectiveness of IT general controls as a key audit matter.

Furthermore, there is an industry risk that compliance areas have not or not sufficiently been identified and/or addressed by management that requires considerations for financial statement purposes. This includes considerations regarding the need for the recognition of a provision or a contingent liability disclosure on the future outcome of the ongoing criminal investigation in connection with the alleged violation of the Dutch Anti-Money Laundering and Anti-Terrorist

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Financing Act (*Wet ter voorkoming van witwassen en financiering van terrorisme, Wwft*) by Rabobank. On 7 December 2022 Rabobank was informed by the Dutch Public Prosecution Service that they consider Rabobank a suspect in connection with violation of the Wwft. The criminal investigation followed announcement of further punitive enforcement procedures following the instruction that was received from De Nederlandsche Bank N.V. ('DNB') on 23 December 2021 in which DNB determined that Rabobank did not meet the requirements of the Wwft.

We also identified matters relating to client care exposures, such as the industry wide discussion on the variable interest rates set in the past for certain consumer lending products, as an important matter in our audit. In this respect the Bank identified that it did not consistently adjust the interest rate of certain consumer lending products in accordance with the reference rate selected by Kifid. As a result of the above compliance and client care matters, we have identified regulatory and client care exposures as a key audit matter.

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where the Managing Board made important judgements, for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. In these considerations, we paid attention to, amongst others, the assumptions underlying the physical and transition risk related to climate change. In paragraph 'Judgements and Estimates' in note 2.1 of the financial statements, the Bank describes the areas of judgement in applying accounting policies and the key sources of estimation uncertainty. From the estimates and judgements mentioned in this paragraph, we considered the impairment allowances on loans and advances to customers as a key audit matter, given the significant estimation uncertainty in combination with the magnitude. The continuing economic uncertainty has heightened the impact of certain estimations and judgements made by the Group, specifically towards forward-looking assumptions applied to the probability of default and the associated macroeconomic scenarios across the Group's loan portfolio. We refer to the section on key audit matters for procedures performed on impairment allowances on loans and advances to customers.

Other areas of focus, including estimates, that were not considered to be key audit matters, were revenue recognition, management override of controls, the provisions taken for the five new cooperative initiatives to accelerate the energy and food system transitions (refer to paragraph 'Going concern' in note 2.1), fair value of financial instruments (more specifically certain level 2 and level 3 financial instruments including debit/credit valuation adjustments), hedge accounting, recoverability of goodwill and other intangible assets, valuation of Rabobank's associate Achmea B.V., valuation of certain equity investments, and litigation and other provisions. Our procedures include assessments of these accounting matters and the relevant disclosures in the financial statements in accordance with the financial reporting framework applied by the Bank. Though these are areas of focus in our audit, they were not the matters of most significance in the audit of the financial statements of the current period.

The Group assessed the possible effects of climate change on its financial position. These effects impact the financial statements mostly as one of the potential drivers of credit risk exposures of the Group, refer to note 4.3.9 of the financial statements. We discussed the Group's assessment and governance thereof with the Managing Board and evaluated the potential impact on the financial position including underlying assumptions and estimates applied in connection with the impairment allowances on loans and advances to customers.

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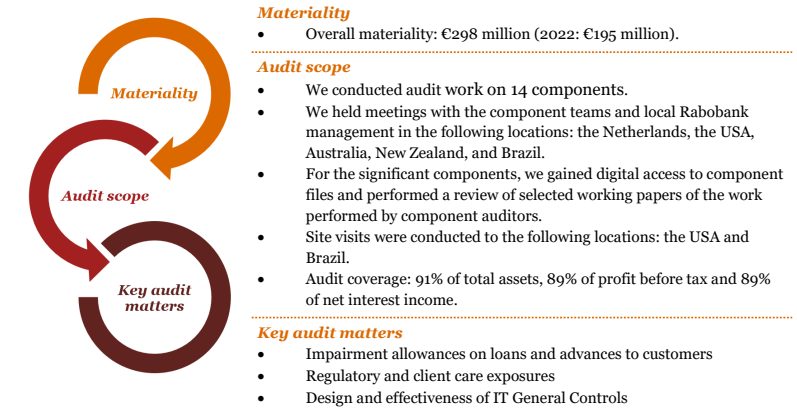
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The expected effects of climate change are not considered a separate key audit matter, but we took this into account as part of the key audit matter on impairment allowances on loans and advances to customers.

We ensured that the audit teams, both at group and at component levels, collectively contain the appropriate skills and competences which are needed for the audit of a bank. We included specialists and experts in the areas of IT, cyber security, taxation, forensics, valuation of financial instruments, real estate valuations, employee benefits, macroeconomic forecasting and hedge accounting in our team.

The outline of our audit approach was as follows:



#### Materiality

The scope of our audit was influenced by the application of materiality, which is further explained in the section 'Our responsibilities for the audit of the financial statements'.

Based on our professional judgement we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and to evaluate the effect of identified misstatements, both individually and in aggregate, on the financial statements as a whole and on our opinion.

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<b>Overall group materiality</b>	€298 million (2022: €195 million).
<b>Basis for determining materiality</b>	We used our professional judgement to determine overall materiality. As a basis for our judgement, we used 5% of profit before tax of the current period.
<b>Rationale for benchmark applied</b>	We used profit before tax as the primary benchmark, a generally accepted auditing practice, based on our analysis of the common information needs of the users of the financial statements. On this basis, we believe that <i>profit before tax</i> is an important metric for the financial performance of the Bank and is widely used within the industry. Furthermore, we utilised a 5% threshold, based on our professional judgement, noting it is within the range of commonly acceptable thresholds and the predominant threshold used for a bank with similar characteristics.
<b>Component materiality</b>	Based on our judgement, we allocate materiality to each component in our audit scope that is less than our overall group materiality. The range of materiality allocated across components was between €37 million and €160 million.

We also take misstatements and/or possible misstatements into account that, in our judgement, are material for qualitative reasons. Examples of areas that we focused on due to qualitative reasons are the accuracy of disclosures on impairment allowances on loans and advances to customers, fair value, recoverability of investments in associates, impairment of goodwill, regulatory exposures and the remuneration of the Supervisory Board and the Managing Board.

We agreed with the Supervisory Board that we would report to them any misstatement identified during our audit above €14.9 million (2022: €9.8 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

#### The scope of our group audit

Coöperatieve Rabobank U.A. is the parent company of a group of entities. The financial information of this group is included in the consolidated financial statements of Coöperatieve Rabobank U.A.

We tailored the scope of our audit to ensure that we, in aggregate, provide sufficient coverage of the financial statements for us to be able to give an opinion on the financial statements as a whole, taking into account the management structure of the Group, the nature of operations of its components, the accounting processes and controls, and the markets in which the components of the Group operate. In establishing the overall group audit strategy and plan, we determined the type of work required to be performed at component level by the group engagement team and by each component auditor.

In determining the scope of the group audit, we first assessed the components that are individually financially significant to the Group (i.e., significant components), namely Domestic Retail Banking Netherlands (not including Obvion and other associated entities), Wholesale and Rural in the Netherlands ('W&R') and De Lage Landen ('DLL'). These components were subject to audits of their complete financial information (full scope audit). To achieve appropriate audit coverage over the consolidated financial statements, we further selected eleven additional components for full scope audit, audit of certain specific account balances, or specified procedures.

In total, in performing these procedures, we achieved the following coverage on the financial line items:

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<b>Net interest income</b>	89%
<b>Total assets</b>	91%
<b>Profit before tax</b>	89%

None of the remaining components represented more than 2% of total group total assets, profit before tax or net interest income. For those remaining components we performed, among other things, analytical procedures to corroborate our assessment that there were no significant risks of material misstatements within those components.

Group components in the Netherlands include the significant components Domestic Retail Banking, W&R, DLL, but also include Property Development ('BPD'), Obvion, the Bank's equity investment in Achmea and some other smaller components (including group components). The group engagement team utilised the work of component teams for these entities. For components in the USA, Australia/New Zealand and Brazil, we used component auditors who are familiar with the local laws and regulations to perform the audit work. Except for Achmea B.V., all components in scope for group reporting are audited by PwC member firms.

Where component auditors performed the work, we determined the level of involvement we needed to have in their audit work to be able to conclude whether sufficient and appropriate audit evidence had been obtained as a basis for our opinion on the financial statements as a whole.

We issued instructions to the component audit teams in our audit scope. These instructions included amongst others our risk assessment, materiality and scope of the work. We explained to the component audit teams the structure of the Group, the main developments that are relevant for the component auditors, the risks identified, the materiality levels to be applied and our global audit approach. We were in active dialogue throughout the year with all component audit teams in scope for group reporting including upon the conclusion of their work. During these dialogues, we discussed the planning, risk assessment, significant accounting and audit issues identified by the component auditors, the reports of the component auditors, the findings of their procedures and other matters which could be of relevance for the consolidated financial statements. For the significant components, we gained access to component files and performed a review of selected working papers of the work performed by component auditors.

We conducted a series of meetings with local management along with component audit teams, some of which were physical site visits, in the Netherlands, Brazil, the USA and Australia/New Zealand. During these meetings, we discussed the strategy and financial performance of the local businesses, as well as the audit plan of the component auditors and execution thereof, significant audit risks and other relevant audit topics. The active dialogues, clear communication and effective use of technology have allowed us to direct and supervise the performance of our component teams.

The group engagement team performed the audit work on the group consolidation, IT general controls, central cost centre, financial statement disclosures, certain specific accounts in scope and a number of complex items such as impairment allowances on loans and advances to customers, hedge accounting, and certain other accounting matters, such as the valuation of investments in associates, the impact of the adoption of IFRS 17/9 on the accounting for Rabobank's associate Achmea BV, impairment assessment of the Bank's goodwill, income tax on the Dutch fiscal unity, regulatory matters and the legal provisions at the head office.

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Rabobank has an internal audit department (Audit Rabobank) that performs operational audits, compliance audits, IT audits, loan (valuation) audits and audits on internal control on financial reporting.

We considered, in the context of Dutch Standard 610 'Using the work of internal auditors', whether we could make use of the work of Audit Rabobank and we concluded that this was appropriate in the testing of design and operating effectiveness of certain controls (mainly relating to IT general controls, loan impairment provisioning, and a selection of controls in the Domestic Retail Banking domain), and procedures performed over individually assessed credit-impaired loans. To arrive at this conclusion, we evaluated the competence, objectivity as well as the systematic and disciplined approach applied by Audit Rabobank. Subsequently, we developed a detailed approach and model to make use of work of Audit Rabobank in our financial statement audit. We were substantially and independently involved in the higher risk areas and/or in areas or procedures that require significant judgement. During the audit process we worked closely with Audit Rabobank, had frequent status meetings and reviewed and reperformed some of their work which confirmed our initial assessment and reliance approach.

By performing the procedures outlined above at the components, combined with additional procedures exercised at group level, we have been able to obtain sufficient and appropriate audit evidence on the Group's financial information, to provide a basis for our opinion on the financial statements.

#### *Audit approach fraud risks*

We identified and assessed the risks of material misstatements of the financial statements due to fraud. During our audit we obtained an understanding of the Bank and its environment and the components of the internal control system. This included the Managing Board's risk assessment process, the Managing Board's process for responding to the risks of fraud and monitoring the internal control system and how the Supervisory Board exercised oversight, as well as the outcomes. We refer to note 4.7.1 'Operational Risk' of the financial statements on how the risk of fraud is managed and mitigated by the Bank.

As part of our process of identifying fraud risks, we evaluated fraud risk factors with respect to financial reporting fraud, misappropriation of assets and bribery and corruption. Together with our forensic specialists, we evaluated the risk of material misstatement due to fraud to the financial statements. We conducted interviews with members of the Managing Board and the Supervisory Board and others within the Bank, including the internal audit, legal and compliance departments, to obtain an understanding of the Bank's fraud risk assessment and of the processes for identifying and responding to the risks of fraud and the internal controls that the Managing Board has established to mitigate these risks. We asked members of the managing board, compliance department, component level management and the supervisory board whether they are aware of any actual or suspected fraud.

As described in the auditing standards, management override of controls and risk of fraud in revenue recognition are presumed risks of fraud. Inherently, management of a company is in a unique position to perpetrate fraud, because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

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We addressed this risk of management override of controls, including evaluating whether there was evidence of bias in management's estimates and judgements that may represent a risk of material misstatement due to fraud (we refer in this respect to the key audit matters 'impairment allowances on loans and advances to customers' and 'regulatory and client care exposures').

The audit procedures to respond to the assessed risks include, amongst others, evaluation of the design and the implementation of internal controls that intend to mitigate fraud risks (such as processing and review of journal entries), back testing of prior year's estimates, and procedures on unexpected journal entries with the support of data analytics. Furthermore, we paid attention to significant transactions outside the normal course of business. With regards to the risk of fraud in revenue recognition, based on our risk assessment procedures, we concluded that this risk is related to revenue recognition in areas that are more complex, non-systematic or manual in nature such as fee and commission income in the Wholesale and Rural segment and Domestic Retail Banking segment, property development income in the Property Development segment and the valuation of equity investments held by Rabo Corporate Investments. We instructed our component auditors to perform procedures over this risk, including evaluation of the design and implementation of relevant internal controls, and procedures over revenue recognition such as testing a sample of fees and commissions to ensure that the income recorded is accurate and had occurred, cut-off procedures to identify potential shifts in property development income, and the appropriateness of the valuation methodologies, inputs and assumptions applied in the valuation of equity investments. We incorporated elements of unpredictability in our audit. We also considered the outcome of our other audit procedures and evaluated whether any findings were indicative of fraud or non-compliance.

Finally, as part of our procedures we had dialogues throughout the year with the Rabobank Financial Crime Compliance ('FCC') team. The FCC team investigates, amongst others, reported internal integrity, whistleblowing and (internal and external) fraud matters. We assessed the process which the Bank has in place. This assessment included: assessing the skills of the investigators, the investigation approach and based on risk-based criteria, selecting a number of individual cases, and reviewing the documentation, conclusions, reporting and responses from the FCC team. We involved our forensic specialists in these procedures. This did not lead to indications of fraud that could potentially result in the financial statements being materially misstated.

#### *Audit approach to non-compliance with laws and regulations*

The objectives of our audit, with respect to non-compliance with laws and regulations are:

- to identify and assess the risk of material misstatement of the financial statements due to non-compliance with laws and regulations; and
- to obtain reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error when considering the applicable legal and regulatory framework.

In line with Dutch Standard 250 we made in our audit approach a distinction between those laws and regulations which:

- have a direct effect on the determination of material amounts and disclosures in the financial statements. For this category, we obtained amongst others audit evidence regarding compliance with the provision of those laws and regulations; and
- do not have a direct effect on the determination of material amounts and disclosures in the financial statements, but where compliance may be fundamental to the operating aspects of the business. Those include amongst others the Bank's ability to continue its business or to avoid material penalties.

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For this category, we performed specific audit procedures to identify non-compliance with those laws and regulations that may have a material effect on the financial statements, as described in the key audit matter: 'regulatory and client care exposures.'

The primary responsibility for the prevention and detection of non-compliance with laws and regulations lies with the Managing Board with the oversight of the Supervisory Board.

#### *Audit approach going concern*

As disclosed in paragraph 'Going concern' in note 2.1 to the financial statements, the Managing Board performed their assessment of the Group's ability to continue as a going concern for the foreseeable future and has not identified events or conditions that may cast significant doubt on the Group's ability to continue as a going concern (hereafter: going concern risks). Our procedures to evaluate management's going concern assessment include, amongst others:

- considering whether the Managing Board's going concern assessment includes all relevant information of which we are aware as a result of our audit.
- understanding and evaluating the Bank's medium-term planning and budget process (including the Group's funding plan), specifically for the next twelve months.
- understanding and evaluating the Group's financial position and stress testing of liquidity and regulatory capital requirements, including the severity of the stress scenarios that were applied.
- considering the results of our (other) risk assessment procedures and related activities performed to identify events or conditions that may cast significant doubt on the Group's ability to continue as a going concern.
- performing inquiries of the Managing Board as to their knowledge of going concern risks beyond the period of their assessment.
- reading and evaluating the adequacy of the disclosures in paragraph 'Going concern' in note 2.1 to the financial statements in relation to going concern.

Our procedures did not result in outcomes contrary to the Managing Board's assumptions and judgements used in the application of the going concern assumption.

#### *Key audit matters*

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters identified by our audit and that we discussed. In this section, we described the key audit matters and included a summary of the audit procedures we performed on those matters.

As compared to last year, there have been no changes in key audit matters. The key audit matters described below are mostly related to the nature of the Group and are therefore expected to occur every year.

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These are described in more detail in the individual key audit matters below.

<i>Key audit matter</i>	<i>Our audit work and observations</i>
<p><b><i>Impairment allowances on loans and advances to customers</i></b></p> <p>Refer to note 2.1 section 'Judgements and estimates', note 2.16 'Impairment allowances on financial assets and credit related contingent liabilities', note 4.3.4 'Impairment allowances on financial assets and credit related contingent liabilities' and note 11 'Loans and advances to customers'.</p> <p>In accordance with the requirements of IFRS 9, Rabobank calculated the impairment allowances on loans and advances to customers using a three-stage expected credit loss impairment model. Rabobank determined loan impairments in stage 1 and 2 on a modelled basis whereas the loan impairments in stage 3 are determined on either a modelled basis or on a specific loan-by-loan basis.</p> <p><b><i>Model based loan impairments</i></b></p> <p>For the model based loan impairments, Rabobank utilised point in time probability of default ('PD'), loss given default ('LGD') and exposures at default ('EAD') models for the majority of the loan portfolio. Three macroeconomic scenarios (consisting of a baseline, a baseline minus and a baseline plus scenario) were incorporated into these models and probability weighted in order to determine the expected credit losses. The estimation uncertainty due to economic impacts of uncertain geo-political and economic conditions in developing macroeconomic scenarios including the associated weightings given the range of potential economic outcome and suitability of models used, have led to a high degree of estimation uncertainty and required significant management judgement.</p> <p>To date, Rabobank's models do not (yet) specifically measure or quantify the impact of risk resulting from transitional or physical climate change impact into the credit risk provisions. Rabobank includes climate risk in the IFRS 9 assessment through:</p> <ul style="list-style-type: none"> <li>• determining impact of climate risk in individual client assessments;</li> <li>• determining sectors which are considered to be vulnerable to climate risk (all exposures in these sectors are moved to stage 2 to reflect the long-term challenging conditions and reflect the significant increase in credit risk ('SICR'));</li> </ul>	<p><b><i>Control design and operation effectiveness</i></b></p> <p>We evaluated the design and tested the operating effectiveness of key controls over:</p> <ul style="list-style-type: none"> <li>• the internal credit management process to assess the loan quality classification to identify impaired loans;</li> <li>• the assessment of the future cash flows and existence and valuation of collateral, based on the appropriate use of key parameters for the specific impairment allowance;</li> <li>• the methodology and controls applied in measuring and determining significant increase in credit risk;</li> <li>• the governance over development, validation, calibration and implementation of the PD, LGD and EAD impairment models; and</li> <li>• the review and approval process that management has in place for the outputs of the impairment models, and the top level adjustments that are applied to model outputs.</li> </ul> <p>The majority of these controls were designed and operated effectively. For certain controls, impact assessments were performed by management. Based on the testing of controls and assessments of impact analyses, we determined that it was appropriate to place reliance on the above controls for the purpose of our audit.</p> <p><b><i>Assessment of model-based impairment allowances</i></b></p> <p>We have tested management's process for model-based loan impairments. We (together with our internal model experts) have:</p> <ul style="list-style-type: none"> <li>• evaluated the reasonableness of PD and LGD model methodology;</li> <li>• assessed model validation reports prepared by Rabobank's model validation department;</li> <li>• together with our internal economist office, evaluated the reasonableness of management's inputs and assumptions used in the design of multiple future macroeconomic scenarios, the forecasted macroeconomic variables, the probability weights assigned to the scenarios including evaluation of the consistency of these assumptions with external market and industry data;</li> <li>• performed back testing procedures on key model parameters; and</li> </ul>

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#### Key audit matter

- a top level adjustment for climate and environmental risks reflecting both transition and physical risks in the mortgage and the corporate portfolio; and
- top level adjustments in specific regions in response to extreme climate conditions.

In case of data quality issues, or when unexpected external developments were not sufficiently covered by the outcome of the impairment models, adjustments were made (top level adjustments). This year, in addition to other adjustments, top level adjustments are recognised in relation to external conditions not captured in the IFRS 9 model including:

- an adjustment of €186 million to reflect the risk of second order effects of geopolitical tensions, high inflation combined with increasingly higher interest rates on the client's abilities to continue servicing and repaying their loans;
- an adjustment of €66 million for the elevated risk relating to interest only mortgages;
- an adjustment of €47 million related to the transition risks of the Dutch government's approach relating to nitrogen in the Netherlands; and
- an adjustment of €14 million related to climate and environmental risks in the mortgage and corporate portfolio.

#### Individually assessed credit-impaired loans

For credit-impaired loans that are assessed on an individual basis, the impairment allowance is based on the weighted average of the net present value of expected future cash flows (including forward looking information and the valuation of underlying collateral) in three different scenarios: a sustainable cure, an optimising scenario and a liquidation scenario.

#### Judgements and estimation uncertainty

The judgement and estimation uncertainty in the impairment allowance of loans and advances is primarily linked to the following aspects:

- determining significant increase in credit risk which is applied to transfer assets from stage 1 to stage 2;
- complex models such as the PD and LGD models that are used to estimate expected credit losses;

#### Our audit work and observations

- evaluated the reasonableness of the prepayment rate applied in the EAD calculations based on historical prepayments.

Based on the above we assessed the methodology in line with industry practice and the inputs to be reasonable.

Finally, we evaluated the top level adjustments as at 31 December 2023 by obtaining supporting evidence and evaluating alternative and contradictory information whether these adjustments were necessary to balance underlying model and data limitations. Specifically, for the top level adjustments recognised in relation to external conditions not captured in the IFRS 9 model, we have exercised professional scepticism in our audit given the significance and subjective nature of these top level adjustments. In doing so, we challenged management to consider multiple scenarios and information such as historical analysis and sensitivity analysis. Also, together with our internal economist office, we evaluated the reasonableness of management's assessment of vulnerable sectors, which includes climate risk sensitive sectors. We found the provided supporting evidence to be reasonable in the determination of the impairment allowances on loans and advances to customers. As part of our audit procedures, we considered the risk of management bias, for this estimation but also together with other estimations, and concluded that the resulting impairment allowances are not indicative of such bias.

In response to the impact of risk resulting from climate change on credit risk, we evaluated both corroborative and contradictory information on whether climate related adjustments were necessary to balance underlying model and data limitations. For that purpose, we evaluated management's risk analysis of the potential impact of climate change on certain clients and sectors. Based on this assessment, certain clients were classified as vulnerable and certain sectors were classified as climate risk sensitive. Furthermore, we assessed how the Bank considers the impact of climate risk on counterparties through individual loan assessments. In addition, we performed inquiry with both management at group level and management in the main territories.

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#### Key audit matter

- determining the EAD which takes into account expected changes due to prepayments;
- determining the macroeconomic scenarios applied in the modelled loan impairments and associated probability weighting of these scenarios;
- determining the top level adjustments to the outcome of models due to external conditions not captured in the IFRS 9 model, such as the second order effects of the geo-political unrest, increased interest rates, inflation and increased costs base of clients as well as risks relating to nitrogen;
- estimation of the impact of transitional or physical climate related risks on the level of expected credit losses; and
- estimation of the expected future cash flows and the weighting of the three scenarios for credit-impaired loans and advances that are assessed on an individual basis.

Given the significance of the number of accounting policy choices, judgements taken by management, the complexity and the inherent limitations to the inputs required by the loan impairment models, this area is subject to a higher risk of material misstatement due to error or fraud. Therefore, we considered this a key audit matter in our audit.

#### Our audit work and observations

We also evaluated other information gathered from our audit procedures, such as the assessment of the top level adjustments relating to nitrogen and climate and environmental risks, and our assessment of client rating settings on certain client exposures.

#### Assessment of individually assessed credit-impaired loans

Considering the inherent estimation risk of individually credit-impaired loans, we selected appropriate samples and analysed the latest developments at the borrowers and considered whether the key judgements and significant estimates applied in the impairment allowance were acceptable for 31 December 2023. This included the following procedures:

- evaluating the reasonableness of the forecasted cash flows (including the use of forward-looking information) for each scenario by comparing them to historical performance of the customer and evidence (such as collateral values) to support forecasted cash flows;
- assessing the external collateral valuator's valuations that we challenge with an independent valuation performed by our valuation experts, for a sample of loans; and
- assessing management's analysis of the probability allocation of each individual scenario for each credit-impaired loan, corroborate with actual facts and circumstances.

Based on the above, we assessed the methodology and inputs to be in line with market and industry practice for the determination of the impairment allowances on loans and advances to customers.

Given the high estimation uncertainty, we gave specific and detailed attention as to whether the disclosures in the consolidated financial statements are adequate and in accordance with IFRS-EU. We found the disclosures to be appropriate in this context.

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### Regulatory and client care exposures

Refer to note 4.9 'Legal and Arbitration Proceedings'.

#### Developments in emerging compliance areas

We identified that the risk of non-compliance with laws and regulations on the one hand relates to laws and regulations which have an indirect impact on the financial statements, such as Anti-Money Laundering and Anti-Terrorist Financing Act ('Wwft') (inclusive regulations on Anti-Money Laundering ('AML') in other territories relevant for Rabobank), Counter Terrorist Financing ('CTF') and sanctions, Know Your Customer ('KYC'), Market Abuse Regulation, Markets in Financial Instruments Directive II (MiFID II – including transaction reporting), the General Data Protection Regulation ('GDPR'), the Capital Requirements Regulations ('CRR') and Capital Requirements Directive IV ('CRD IV').

On the other hand, the risk of non-compliance with laws and regulations may also have a direct effect on the financial statements. In this respect, Rabobank disclosed the following matters in note 4.9 'Legal and Arbitration Proceedings':

- following the instruction that was received from DNB on 23 December 2021 (in which DNB determined that Rabobank did not meet the requirements of the Wwft) Rabobank was informed by the Dutch Public Prosecution Service, on 7 December 2022, that they consider Rabobank a suspect in a criminal investigation in connection with violation of the Wwft. Rabobank disclosed that currently it is too early to determine the timeframe or potential outcome of the ongoing investigation and that the nature and materiality of subsequent fines, penalties or other related actions cannot be reliably estimated either other than stating these have the potential to be significant. Throughout 2023, Rabobank further strengthened its detection and prevention activities in Financial Economic Crime (FEC), and has continued to invest in training all staff, particularly employees working in FEC utilising €138 million of the provision established at year end 2022, leaving €8 million at December 31, 2023;
- as announced by the European Commission by means of a press release on 22 November 2023, the Commission fined Rabobank €26.6 million in connection with certain historic communications

We obtained an understanding of the significant laws and regulations that are relevant to the Bank's operations and how the Bank is instituting and operating appropriate systems of internal control to comply with those laws and regulations.

#### Specific audit procedures to identify non-compliance with those laws and regulations that may have a material effect on the financial statements.

We had dialogues with members of the Managing Board, the compliance officer and chief legal officer on a regular basis to understand emerging and potential regulatory exposures. We challenged management's view on these regulatory exposures based upon our knowledge and experience of emerging industry trends and the regulatory environment.

To identify potential regulatory investigations that could lead to the need for potential new provisions or disclosures in the financial statements, we read the Bank's relevant correspondence with its key regulators being the Autoriteit Financiële Markten ('AFM'), the DNB, the Federal Reserve Bank ('FRB') and the European Central Bank ('ECB'). Also, we met on a bilateral basis with the joint supervisory team of DNB and ECB during the year.

We read the minutes of the Managing Board and the Supervisory Board meetings and attended all Risk and Audit Committee meetings throughout the year up to the signing date of our auditor's report. We held regular bilateral meetings with the chairs of the Supervisory Board, Audit Committee and Risk Committee.

We inquired with the Bank's internal compliance department to understand the risk position of each new and ongoing regulatory investigations and reviewed reports and assessments of the Bank's internal audit department relating to compliance with laws and regulations.

From our audit work, we noted that there are specific programs in place that aim to improve AML and KYC processes throughout the Group, and the remediation plan to address the shortcomings in the Netherlands in particular. These programs are also connected to the regulatory investigations related to AML and KYC in the Netherlands (including the remediation plan on the shortcomings on compliance with the Wwft) and the USA. We obtained an understanding of the

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### Key audit matter

between a small number of individuals at Deutsche Bank and Rabobank, which the Commission has concluded breached EU competition law. The bank has lodged an appeal against the Commission's decision before the EU General Court. The fine has been provided for as a payable on Rabobank's balance sheet as at 31 December 2023;

- the Bank concluded in 2021 that it did not consistently adjust the interest rate of certain consumer credit products in accordance with the reference rate selected by Kifid.

Therefore, Rabobank included a provision of €301 million in the financial statements at year end 2022 to compensate part of its clients with certain consumer credit products with a variable interest rates of which €56 million is remaining as at 31 December 2023; and

- the AFM conducted an investigation into a number of files relating to consumer mortgage loans and decided to impose an administrative fine of €12 million, which is paid by the bank. Rabobank filed an objection against the decision with the AFM.

#### Management judgement

The recognition and measurement of provisions and the disclosure of contingent liabilities require considerable management judgement around the future outcome of further punitive actions, client care and regulatory investigations.

Given the inherent uncertainty and the judgemental nature, we determined the provisions and disclosures on contingent liabilities due to non-compliance with laws and regulations to be of particular importance to our audit, since this area is subject to a higher risk of material misstatement due to error or fraud including to what extent there is evidence of management bias. Therefore, we determined this to be a key audit matter in our audit.

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### Our audit work and observations

progress on the remediation plan through reading of progress reports, inquiry of the program owners, Managing Board, Audit Committee, reading correspondence with AFM, DNB, Federal Reserve and ECB related to these matters and discussed the outcomes of audits performed by the Bank's internal audit department with respect to AML and KYC.

Furthermore, we held meetings with the Bank's internal and external legal counsel in connection with the status of the investigation by the Dutch Prosecution Service and read correspondence with the Dutch Prosecution Services office.

We have performed audit procedures to assess the accuracy and completeness of the following provisions and how these provisions unwind, including validating key assumptions and source data:

- The provision to cover for the incremental cost to resolve the backlog files in client due diligence and transaction monitoring;
- The provision in connection with client compensation for certain consumer credit products with a variable interest rate.

We have also assessed to what extent there was evidence of bias by management in determining these provisions. Based on these procedures we found these provisions to be within an acceptable range.

We read the formal correspondence from the EC and the AFM on their respective fines given to Rabobank.

Finally, we assessed the disclosures that were made in highlighting the uncertainties and exposures of contingent liabilities due to non-compliance with laws and regulations. When doing so, we paid specific attention to the disclosure on the further punitive action in response to the instruction received from DNB (including the status of the investigation by the Dutch Public Prosecution Service), the disclosure in connection with the fine following the antitrust proceedings by the EC and the disclosure on application of the variable interest rate conditions for certain products included in note 4.9 'Legal and Arbitration Proceedings' of the financial statements. We found the disclosures to be appropriate in this context.



#### Key audit matter

##### Design and effectiveness of IT General Controls

The Bank's operations and financial reporting systems are heavily dependent on IT systems, including automated accounting procedures and IT dependent manual controls. The Information Technology General Controls (ITGCs) over IT systems include:

- the framework of governance over IT systems;
- controls over program development and changes;
- controls over access to programs, data and IT operations; and
- governance over generic and privileged user accounts.

ITGCs assist to determine the continued reliability of information generated by applications and ensure automated applications operate effectively in a consistent manner. Effective ITGCs are conditional for reliance on automated controls in the Bank's operations, and in our audit approach. Deficiencies in ITGCs could have a pervasive impact across the Bank's internal control framework and may provide opportunities to commit fraud.

The Bank has a number of long-term strategic regulatory and transformation projects, with important IT-components to continue to meet the high reporting standards and expectations from stakeholders relating to operating effectiveness, efficiency and data quality. The reliability of information processing is significant to the Group's operational, regulatory and financial reporting processes and we have therefore identified the design and effectiveness of IT general controls as a key audit matter.

#### Our audit work and observations

Our procedures included evaluating and testing the design and operating effectiveness of certain controls over the continued integrity of the IT systems that are relevant to financial reporting, focusing on:

- entity level controls over information technology in the IT organisation, including IT governance, IT risk management and cybersecurity management;
- management of access to programs and data, including user access to the network, access to and authorisations within applications and privileged access rights to applications, databases and operating systems. As the Bank uses automated tools to manage access rights, we have evaluated the appropriate use of these tools and tested the correct operation of these tools;
- governance over the strategic IT transformation projects and assessment of the impact on our 2023 audit;
- management of changes to applications and IT infrastructure, including the change management process and the implementation of changes in the production systems using automated deployment mechanisms;
- computer operations, including monitoring of batch processing, back-up and disaster recovery testing and incident management; and
- management of cybersecurity, through understanding of Rabobank's approach to enhancing cybersecurity and evaluating the status of the implementation in certain critical areas.

We focused on the ITGCs to the extent relevant for the purpose of our audit of the financial statements. Most of these controls operated effectively. After identifying deficiencies in certain controls, particularly those concerning identify and access management, management took remedial actions. Subsequent testing, including verification of these remedial actions, led us to conclude that we could rely on these controls for our audit purposes.

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### Report on the other information included in the annual report

The annual report contains other information. This includes all information in the annual report in addition to the financial statements and our auditor's report thereon.

Based on the procedures performed as set out below, we conclude that the other information:

- is consistent with the financial statements and does not contain material misstatements; and
- contains all the information regarding the directors' report and the other information that is required by Part 9 of Book 2 and regarding the remuneration report required by the sections 2:135b and 2:145 subsection 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and the understanding obtained in our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements.

By performing our procedures, we comply with the requirements of Part 9 of Book 2 and section 2:135b subsection 7 of the Dutch Civil Code and the Dutch Standard 720. The scope of such procedures was substantially less than the scope of those procedures performed in our audit of the financial statements.

The Managing Board is responsible for the preparation of the other information, including the directors' report and the other information in accordance with Part 9 of Book 2 of the Dutch Civil Code. The Managing Board and the Supervisory Board are responsible for ensuring that the remuneration report is drawn up and published in accordance with sections 2:135b and 2:145 subsection 2 of the Dutch Civil Code.

### Report on other legal and regulatory requirements and ESEF

#### Our appointment

We were appointed as auditors of Coöperatieve Rabobank U.A. on 18 June 2015 by the Supervisory Board. This followed the passing of a resolution by the shareholders at the annual general meeting held on 18 June 2015. Our appointment has been renewed annually by shareholders and now represents a total period of uninterrupted engagement of 8 years.

#### European Single Electronic Format (ESEF)

Coöperatieve Rabobank U.A. has prepared the annual report in ESEF. The requirements for this are set out in the Delegated Regulation (EU) 2019/815 with regard to regulatory technical standards on the specification of a single electronic reporting format (hereinafter: the RTS on ESEF).

In our opinion, the annual report prepared in XHTML format, including the marked-up consolidated financial statements, as included in the reporting package by Coöperatieve Rabobank U.A., complies in all material respects with the RTS on ESEF.

Management is responsible for preparing the annual report, including the financial statements in accordance with the RTS on ESEF, whereby management combines the various components into a single reporting package.

Our responsibility is to obtain reasonable assurance for our opinion whether the annual report in this reporting package complies with the RTS on ESEF.

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We performed our examination in accordance with Dutch law, including Dutch Standard 3950N 'Assuranceopdrachten inzake het voldoen aan de criteria voor het opstellen van een digitaal verantwoordingsdocument' (assurance engagements relating to compliance with criteria for digital reporting).

Our examination included amongst others:

- Obtaining an understanding of the entity's financial reporting process, including the preparation of the reporting package.
- Identifying and assessing the risks that the annual report does not comply in all material respects with the RTS on ESEF and designing and performing further assurance procedures responsive to those risks to provide a basis for our opinion, including:
  - obtaining the reporting package and performing validations to determine whether the reporting package containing the Inline XBRL instance document and the XBRL extension taxonomy files have been prepared in accordance with the technical specifications as included in the RTS on ESEF;
  - examining the information related to the consolidated financial statements in the reporting package to determine whether all required mark-ups have been applied and whether these are in accordance with the RTS on ESEF.

#### **No prohibited non-audit services**

To the best of our knowledge and belief, we have not provided prohibited non-audit services as referred to in article 5(1) of the European Regulation on specific requirements regarding statutory audit of public-interest entities.

#### **Services rendered**

The services, in addition to the audit, that we have provided to the Bank and its controlled entities, for the period to which our statutory audit relates, are disclosed in note 48 'Cost of external independent auditor' to the financial statements.

#### **Responsibilities for the financial statements and the audit**

##### **Responsibilities of the Managing Board and the Supervisory Board for the financial statements**

The Managing Board is responsible for:

- the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code; and for
- such internal control as the Managing Board determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Managing Board is responsible for assessing the Bank's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Managing Board should prepare the financial statements using the going-concern basis of accounting unless the Managing Board either intends to liquidate the Bank or to cease operations or has no realistic alternative but to do so. The Managing Board should disclose in the financial statements any event and circumstances that may cast significant doubt on the Bank's ability to continue as a going concern.

The Supervisory Board is responsible for overseeing the Bank's financial reporting process.

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#### **Our responsibilities for the audit of the financial statements**

Our responsibility is to plan and perform an audit engagement in a manner that allows us to obtain sufficient and appropriate audit evidence to provide a basis for our opinion. Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error and to issue an auditor's report that includes our opinion. Reasonable assurance is a high but not absolute level of assurance, and is not a guarantee that an audit conducted in accordance with the Dutch Standards on Auditing will always detect a material misstatement when it exists. Misstatements may arise due to fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

A more detailed description of our responsibilities is set out in the appendix to our report.

Amsterdam, 1 March 2024  
PricewaterhouseCoopers Accountants N.V.

Original has been signed by J.M. de Jonge RA

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### **Appendix to our auditor's report on the financial statements 2023 of Coöperatieve Rabobank U.A.**

In addition to what is included in our auditor's report, we have further set out in this appendix our responsibilities for the audit of the financial statements and explained what an audit involves.

#### **The auditor's responsibilities for the audit of the financial statements**

We have exercised professional judgement and have maintained professional scepticism throughout the audit in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit consisted, among other things of the following:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the intentional override of internal control.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Managing Board.
- Concluding on the appropriateness of the Managing Board's use of the going-concern basis of accounting, and based on the audit evidence obtained, concluding whether a material uncertainty exists related to events and/or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report and are made in the context of our opinion on the financial statements as a whole. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Considering our ultimate responsibility for the opinion on the consolidated financial statements, we are responsible for the direction, supervision and performance of the group audit. In this context, we have determined the nature and extent of the audit procedures for components of the Group to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole. Determining factors are the geographic structure of the Group, the significance and/or risk profile of group entities or activities, the accounting processes and controls, and the industry in which the Group operates. On this basis, we selected group entities for which an audit or review of financial information or specific balances was considered necessary.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit. In this respect, we also issue an additional report to the audit committee in accordance with article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

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We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related actions taken to eliminate threats or safeguards applied.

From the matters communicated with the Supervisory Board, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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