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ABU DHABI ACCOUNTABILITY AUTHORITY

ADAA IFRS digest

IFRS news, updates from ADAA, IASB and the Accounting Profession — **July 2017**

WHAT'S NEW THIS MONTH

ADAA's hot topics

Traditional financial reporting no longer meets the needs of business. IFAC and ACCA opinion.
Public contracts need to be public! To be transparent.
Law number (1) of 2017 Concerning the Financial System of the Government of Abu Dhabi. Effective for all 2017 reporting by ADAA Subject Entities.
IFRS 15 expectations on 2017 interims. Time for more.
Grant Thornton IFRS news. Round up from GT.
Rate Regulated activities. Is change coming and will you benefit?
Goodwill and impairment. Still more work to do.
Heritage assets. You will be surprised.
Extended auditor's reports. Will they make a difference?
People matter. Our biggest asset is our people.
New Insurance standard. Did the face of provisioning just change.
On the back page ***Materiality Matters*** - insight from ADAA's Ahmed Al Mazrouei.

WHAT'S NEW FROM IFAC AND THE IASB

The IASB is located in Cannon Street, London

Traditional financial reporting no longer meets the needs of business. Capital allocation and corporate behaviour require alignment to deliver goals of financial stability and sustainable development. IFRS and IPSAS cannot achieve this themselves. Which is why RPG 3 'Reporting Service Performance' was developed and why Listing Rules require MD&A to accompany historic financial statements. Integrated Reporting improves financial reporting. However, since announced in 2014 adoption has been slow. IFAC reports that ACCA sees momentum grow as value creation is understood in a wider sense. Adopt it or not, there is great value in the understanding survey results.

Public contracts need to be public. Public procurement is an important aspect in Public Financial Management (PFM) where government brings to reality the vision of budgets. According to the Center for Global Development, public contracting involves 15% of global GDP. Such big cash flows in the public sector need to be transparent and clearly disclosed. The irony is public contracts are not that public, which makes them inherently risky and vulnerable to corruption. Open contracts not only achieve transparency in government spending, but also more efficient spending, improved fiscal sustainability, and improved documentation addressing key user needs. More here.

Rate Regulated activities. The IASB considers a model that recognises assets and liabilities that reflect rights and obligations arising from a rate adjustment mechanism in a regulatory environment. This could be a significant change for Water and Electricity companies benefitting those in a cost plus regime and hurting those in a rate-capped regime. More in IASB Update June 2017.

Goodwill and impairment. It may be a next year project but change must be coming. There is a sense there are too many intangibles and impairments not being booked. The IASB looks to simplify the model and auto- amortise, more here.

Heritage assets. Do heritage items meet the definition of an asset? Can they be measured and recognized in the financial statements? The IPSASB aims to improve financial reporting for heritage in the public sector, by considering the type of information that should be reported about heritage items. More here

WHAT'S NEW FROM THE ACCOUNTING PROFESSION

And finally please turn the page for ADAA's monthly accounting insight…

Law number (1) of 2017 Concerning the Financial System of the Government of Abu Dhabi. Effective 2017 reporting by all Subject Entities: *"Every Government Entity, Institutions and Company shall prepare and issue half-yearly Financial Statements within a period not exceeding 30 days from the end of the half of the fiscal year and shall issue annual audited Financial Statements within a period not exceeding 90 days from the end of the fiscal year."* Copy delivered to the Department of Finance. More here, search in Arabic.

IFRS 15 expectations on 2017 interims. In 2016 only 1% provided quantitative disclosure and 3.3% qualitative disclosure, meaning, 96.7% of 2017 Fortune 500 IFRS preparers surveyed by EY failed to comply with IAS 8. More in EY IFRS developments issue 126.

Grant Thornton IFRS news. In this issue:

- IASB proposals on resolving disclosure issues.
- IASB proposed improvements on certain areas of IFRS 8 'Operating Segments'.
- IASB seeks to make targeted amendments to IFRS 9

Extended auditor's reports. Investors and Audit firms have different opinions regarding disclosure of performance materiality applied in the audit of financial statements. ISA (UK & Ire) requires an explanation of how the auditor applied the concept of materiality in planning and executing the audit. The FRC report illustrates results of audit firms and benchmarks used for audits of companies for the past two years.

People matter. "Our biggest asset is our people" has been a somewhat liberal platitude. Trotted out to make employees feel better. Not anymore. More and more entities are waking up to the idea of embedding social and human capital accounting, measuring its effects and bringing it forward into decision-making. "It is so important to monetise it as that drives decision-making" SSEs Group Sustainability Accountant. Read more in The Bruce Column.

New Insurance standard. The old one grandfathered existing policies even if inconsistent in a group. The new one undoes all those. Results may be significantly impacted by the change. PWC IFRS News June.

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Materiality Matters – an insight from ADAA's Ahmed Al Mazrouei

Materiality appears 96 times in 16 of the IAASB's auditing standards. Materiality appears 26 times in 18 of the IASB's accounting standards. Materiality is material to the auditing and accounting profession. **Materiality is so material there is a whole ISA on it.**

Audit standard ISA 320.2 requires the auditor to set materiality based on *"consideration of the common financial needs of users as a group. The possible effects of misstatements on specific individual users, whose needs may vary widely is not considered."*

If you are an analyst comparing competitor inventory levels, or a potential creditor considering the impact of debt factoring and leverage on whether to extend credit terms, or a customer purchasing a service package, you should not conclude the auditor will have assessed your needs in setting materiality. They may have but they may not have.

It's not all bad though the IASB comes to the rescue with the IFRS Conceptual Framework *"the objective of general purpose financial reporting is to provide financial information that is useful to investors, lenders and other creditors in making decisions about providing resources to the entity."* Which is good because investing is about valuation and dividends and lending is about getting your money back with interest.

Therefore if you are an investor, lender or other creditor your needs will have been considered by the auditor and you may conclude the auditor will pay close attention to matters such as impairments, intangibles, depreciation, amortization and cash flows in setting materiality.

Actually no, you cannot.

The audit opinion states: *"In our opinion, the accompanying financial statements present fairly in all material respects…"*

This means a line item, a disclosure note or even a primary statement might be materially wrong but because the opinion is on the financial statements as a whole then providing the error does not influence the economic decisions of users, made on the basis of the financial statements, then it is not a problem.

ISA 320.4 *"The auditors' determination of materiality is a matter of professional judgement, and is affected by the auditor's perception"* of what the users needs are. What did the auditor perceive users' needs to be?

If you are deemed one of Those Charged With Governance (TCWG) then ISA 260 A13 reports materiality is one of those matters that <u>may</u> (and therefore may not but is mostly in practice) be communicated to you. Communication is a two way street so the Chair of the Audit Committee should expect a serious discussion with the auditor on how the level of materiality selected was chosen and what factors and needs of users, and who they are, were considered. If you have a government shareholder this should include the needs of government.

ISA 320. A2, states: *"In the case of a public sector entity, legislators and regulators are often the primary users of its financial statements. Furthermore, the financial statements may be used to make decisions other than economic decisions…The determination of materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) in an audit of the financial statements of a public sector entity is therefore influenced by law, regulation or other authority, and by the financial information needs of legislators and the public in relation to public sector programs."* Therefore, TCWG should ensure Government needs are considered by the auditor in setting materiality.

Materiality isn't just materiality though. There is Planning materiality, Performance materiality, Component materiality and the SUD.

Planning materiality

Is the amount determined by applying a percentage to a benchmark. Typically auditors use a percentage of an adjusted profit measure, Profit before tax or Revenue. Other benchmarks can be used however they are highly unusual outside of investment property and asset management activities.

Performance materiality

Is the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of any uncorrected and undetected errors exceeds materiality for the financial statements as a whole. It also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

Performance materiality is determined by applying a 'haircut' a percentage to Planning materiality. Percentages applied by audit firms range from 50 to 75%.

Performance materiality is about precision. It is a professional judgement based on the auditor's assessment of the risk that the audit does not detect errors. Performance materiality is the materiality to focus on. You should ask what haircut has been applied and why? Particularly with regard to your auditor's assessment of your internal control systems and unusual or one-off business activities during the year. In the UK FRC's survey (link on front page) two audit firms applied the maximum percentage (took advantage of the smallest haircut) in 100% of the audits reviewed. Indicating very little professional judgement or very little audit risk.

Component materiality

Is the amount prescribed by the Group Auditor to the Auditor of a Component (subsidiary, associate, joint venture) of the group that they should apply in the audit of the component. Amounts are less than Group Materiality and will be determined by the significance of the component's revenue, profit, assets, liabilities (either or all) to the reported group.

Statement of Unadjusted differences (SUD)

Auditors collate errors and unadjusted differences identified duting the audit to ensure they do not add up to an amount that is greater than materiality which would require an adjustment.

The UK FRC's survey is worth a read page 34 refers to the audit report for UBM which discloses that the auditor applied a lower performance materiality because UBM had implemented a new financial system and processes in the Americas and EMEA and made a significant acquisition during the year.

If your business has changed processes, changed procedures, changed people (acquisitions/disposals) did your auditor's assessment of materiality change?

When discussing materiality with your auditor, challenge them to evidence and justify the professional judgement they applied.

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