



ADAA IFRS digest

IFRS news, updates from ADAA, IASB and the Accounting Profession

March 2017

WHAT'S NEW THIS MONTH

ADAA's
hot topics

Non-GAAP measures. Rose tinted spectacles, or valuable insight. Non-GAAP measures are on the IASB's radar.

The rise of bitcoin. A cryptocurrency is a virtual currency.

Going concern. Management go first. The US Auditing Standards Board (ASB) issues a new standard.

When confidence is high, money flows in. When confidence is low, it drains out. Hans Hoogervorst tells Saudi Arabia.

IFRS 16 leases - oil and gas industries. When is a lease not a lease - when it is a service contract.

And on the back page **IFIAR Annual Inspection Findings survey** – an insight from ADAA's Mahmoud Shahin.

WHAT'S NEW FROM THE IASB?

The IASB
is located
in Cannon
Street,
London

Non-GAAP measures. Rose tinted spectacles, or valuable insight. Non-GAAP measures are on the IASB's radar in a project titled Primary Financial Statements. Used and sometimes abused, IASB member Gary Kabureck drills into the topic: "Properly used, non-GAAP measures are extremely valuable. For example, they can enhance financial analysis by isolating the effects of items that do not promote an understanding of historical or future trends of earnings or cash flows. At the other extreme, unfortunately sometimes non-GAAP reporting is used to ignore inconvenient charges or to perfume the pig, thereby giving non-GAAP reporting a bad name". There are significant problems to overcome:

- EBIT is not used by Banks because to them the cost of finance is an operating expense. An industry solution won't work because some banking entities also do other things.
- Underlying earnings requires removal of non-recurring items. Big companies incur litigation costs. Usually these are small. What if a big case comes along, size matters but not in accounting. Property companies split rentals from valuation movements to differentiate between capital and profit.
- Core/non-core another problematic area. Activities with associates and JVs can very easily be both. More [here](#).

When confidence is high, money flows in. When confidence is low, it drains out. Hans Hoogervorst tells Saudi Arabia. Hans visited KSA to attend the inaugural Accounting and Auditing conference celebrating 25 years of Saudi regulator SOCPA. In his speech [Trust, accountants and the economy](#) Hans says:

- IFRS brings transparency by enhancing international comparability enabling informed economic decisions.
- IFRS strengthens accountability by reducing the information gap between entities and those who have entrusted their money to them. "They help those on the outside hold those on the inside to account."
- IFRS contributes to economic efficiency by helping investors to better identify opportunity and risks, in a specific country and across the world.
- IFRS lowers cost of capital. "This goes back to trust and confidence."

The silver anniversary of SOCPA coincides with companies now reporting using IFRS sends a clear signal to the world Saudi Arabia welcomes foreign direct investment.

Want to know more about what's on at the IASB [IASB-Work-Plan](#)

WHAT'S NEW FROM THE ACCOUNTING PROFESSION?

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

The Rise of Bitcoin. A cryptocurrency is a virtual currency used to pay for goods and service that exists in a digital form, a common example known as 'bitcoin.' Recent debates on disclosing and explaining the accounting and measurement basis of cryptocurrency, with possible suggestions such as an intangible asset measured at fair value. Further reading [PWC](#).

Going concern. Management go first. The US Auditing Standards Board (ASB) issues a new standard (SAS). SAS were not aligned with International Standards on Auditing (ISA) because the FASB was developing an accounting standard on going concern, which it now has and auditing standards now align too. Crucial is management must conclude first. Evidence must be obtained and if financial support is required from a third party it must be obtained from management written evidence or confirmed directly. More [here](#).

IFRS 16 leases - oil and gas industries. When is a lease not a lease - when it is a service contract. IFRS 16 contains a practical expedient to continue to account for leases under IFRS 16 agreements that were determined to be leases under IAS 17. The problem is entities who had structured agreements to achieve operating lease accounting do not like the answer. It gears up the balance sheet and back loads profit recognition.

In order to keep the operating lease accounting the agreement needs to be a service contract.

There is very little economic difference in substance between a service contract and an operating lease. Neither is executory, both require the use of assets the service provider owns (or leases) and can freely substitute at their behest.

If operating leases do become service contracts the legal profession will have defeated the objective of the IASB with the new standard and contrived a disclosure position worse than under IAS 17. EY publication [here](#). ADAA technical briefing paper [here](#).



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IFIAR Annual Inspection Findings Survey – an insight from ADAA’s Mahmoud Shahin

About IFIAR

International Forum of Independent Audit Regulators (IFIAR) comprises audit regulators: ADAA, PCAOB, UK FRC etc. from fifty-two jurisdictions in Africa, Americas, Asia-Pacific, Europe, and the Middle East. IFIAR’s official observers are the Basel Committee on Banking Supervision, the European Commission, the Financial Stability Board, the International Association of Insurance Supervisors, the International Organization of Securities Commissions, the Public Interest Oversight Board and the World Bank. So there are some serious regulators and finance providers interested in what we do. More information here www.ifiar.org.

Report on 2016 Survey of Inspection Findings March 3, 2017

“IFIAR’s annual Inspection Findings Survey shows a general decline in inspection finding rates; however, the high rates of findings continue to be of concern to IFIAR. The Survey notes similarities in the nature and extent of findings compared to the previous year. Overall, the results continue to show a lack of consistency in the execution of high quality audits and point to the continued need to address firm-wide systems of quality control, including in the critical area of auditor independence. IFIAR will continue its dialogue with the six largest network firms and its consideration of standard setting in the area of firm quality controls.”

All IFIAR Members are asked to respond to IFIAR’s Surveys of inspection findings. The Surveys solicit data on Members’ findings from inspections of:

1. Audits of listed public interest entities (PIEs)
2. Audits of systemically important financial institutions (SIFIs) including global systemically important banks G-SIFIs; and
3. Audit firms’ quality control systems.

Audits of listed PIEs

Inspection Theme	2016	2015	2014	2013	2012
Internal controls testing	278	173	178	156	117
Accounting estimates, including fair value measurement	258	*	*	*	*
Fair value measurement	*	158	205	217	169
Audit of allowance for loan losses and loan impairments	*	45	46	55	43
Audit sampling	109	**	**	**	**
Revenue Recognition	105	116	114	104	86
Substantive analytical procedures	65	50	79	55	75
Adequacy of financial statement presentation and disclosure	53	85	101	120	109
Group Audits	53	70	75	89	75
Risk Assessment	51	131	49	59	**
Inventory Procedures	43	86	69	76	57
Fraud Procedures	35	46	54	65	**
Use of Experts and Supervision	27	35	54	42	41
Adequacy of review and supervision	22	49	55	58	115
Engagement Quality Control review	20	39	53	78	116
Audit Report	18	15	**	**	**
Related Party Transactions	12	17	40	28	44
Going Concern	12	5	24	24	25
Audit Committee Communications	10	10	14	34	**
Total	1,171	1,130	1,210	1,260	1,072

*During 2012-2015, IFIAR collected data separately for findings related to “Audit of Allowance for Loan Losses and Loan Impairments” and “Fair Value Measurement”. Data collected and reported in previous Survey reports for these two themes is included in this table. Beginning in 2016, IFIAR combined these themes as “Accounting Estimates, including Fair Value Measurement”.

** Data for this theme was not collected during the Survey year. Prior to 2016, Members generally reported Audit Sampling findings under other themes (e.g., Revenue Recognition or Inventory).

Audits of SIFIs

Inspection Theme	2016	2015	2014	2013	2012
Internal controls testing	10	37	36	39	33
Use of Experts and Specialists	6	22	9	8	**
Audit Methodology, including Programs and Tools	5	7	11	1	9
Audit of allowance for loan losses and loan impairments	3	31	21	42	15
Valuation of investment and securities	3	22	42	26	32
Insufficient Challenge and Testing of Management’s Judgments and Assessments	3	20	13	21	12
Testing of customer deposits and loans	3	7	6	3	10
Substantive analytical procedures	3	2	6	12	**
Fraud Procedures	3	2	5	7	**
Adequacy of Financial Statement Presentation and Disclosure	2	6	7	9	4
Audit report	2	0	**	**	**
Audit of Insurance Contract Liabilities	2	**	**	**	**
Group Audit	1	6	4	8	2
Risk Assessment	0	22	4	10	**
Audit Committee Communications	0	1	2	2	**
Total	46	185	166	188	117

**Data for this theme was not collected during the Survey year.

Audits of Firms’ Quality Control

Inspection Theme	2016	2015	2014	2013	2012
Engagement Performance	202	222	377	380	261
Monitoring	81	63	74	93	77
Human Resources	76	77	111	146	166
Independence and ethical requirements	72	73	109	104	130
Client risk assessment acceptance and continuance	48	52	53	78	100
Leadership responsibilities for quality within the firm	18	21	45	43	33
Total	497	508	769	844	767

Let us call a spade a spade and not a manual dirt extraction tool. A finding is a failure. It is no accident failure in firm’s quality control procedures result in failure in firm’s audit procedures and the outcome is accounting errors are not found.

Regulators report a 60% increase in failures in the audit of managements system of internal control. Specifically manual controls.

People operate manual controls. This means the people management entrust to ensure management information is correct, that underpins the management judgements they take, has not been subject to a thorough and rigorous audit. Which is what all audit proposals promise. Not only did the auditor not do, they also did not deliver.

Management apply manual controls to accounting estimates, and discounted cash flows to support fair value measurement and loan loss assessments and in going concern judgements.

Unsurprisingly the biggest failure in accounting estimates and fair value measurement is in the auditor’s failure to assess the reasonableness of assumptions including contrary and inconsistent evidence where applicable.

Perhaps things will be different in 2017. We will see. What is true is if you do the same thing you get the same outcome.

2017 is time for change. IFIAR’s Summary Report accessible [here](#)



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