



ADAA IFRS digest

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

May 2017

WHAT'S NEW THIS MONTH

ADAA's hot topics

The importance of standing back. The IAASB raises the bar!

EY IFRS Developments. Principles of disclosure.

PWC IFRS News. Leases IFRS 16, Revenue IFRS 15 and IFRIC Rejections Supplement IAS 34.

Where governance is strong. The role played by professional accountants in tackling corruption is amplified.

Quality control. A webcast: 'Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment'.

Who or what is the Chief Operating Decision maker? IASB clarifies.

Where IFRS goes IPSAS follows. Time for a role reversal?

Deloitte Closing out 2016. Topical issues reporting on 2016.

KPMG Lease definition. The new on/off balance sheet test.

And on the back page **The new audit report-Key audit Matters (KAM)**
An insight from ADAA's Mahmoud Shahin.

WHAT'S NEW FROM THE IASB?

The IASB is located in Cannon Street, London

The importance of standing back. The IAASB raises the bar! Auditing is different to accounting. Both are about doing the right thing but auditing is about determining when enough is enough. By definition when the IAASB revises an auditing standard, it is because the previously thought enough was not enough! Which means the Auditing Profession recognize insufficient and/or inappropriate audit work is completed on 'Accounting Estimates and Related Disclosures.' The IAASB is revising ISA 540 because its stakeholders asked it to. One of those is IFIAR of which ADAA is a member. The project started with a focus on the implementation of IFRS 9 (the expected loss model) and quickly widened to apply to all entities' key management estimates and judgements. The ISA focuses on key provisions to enhance the auditor's application of, yes you guessed it, the old chestnut - professional skepticism. Revision to the standard includes:

- Enhanced risk assessment requirements providing a better basis for identifying and assessing the risks of material misstatement related to accounting estimates.
- More granular requirements to obtain audit evidence when inherent risk is not low.

- Requirements to 'stand back and evaluate the evidence including corroborating and contradictory evidence. Link [here](#).

Quality control. A webcast: 'Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment'. The key areas were:

- Clarification on IT audit role and benefits.
- Providing examples of internal controls relevant to the audit.
- Assess inherent risk and control risk separately.
- The importance of enabling data analytics.
- The role and attributes of the Engagement Quality Control Reviewer. Listen [here](#)

Who or what is the Chief Operating Decision maker? One area the IASB seeks to clarify amending IFRS 8. Link [here](#).

Where IFRS goes IPSAS follows. Time for a role reversal? IFRS 3 does not always work for public sector entities. IPSAS 40 allows:

1. Acquisition method when one entity gains control over another.
2. Merger method when neither party gains control. Link [here](#).

WHAT'S NEW FROM THE ACCOUNTING PROFESSION?

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

EY IFRS Developments. Principles of disclosure. In an attempt to enhance communication in financial reporting the IASB has made better communication in financial reporting a central theme for 2017 to 2021. The disclosure initiative aims to address how the effectiveness of disclosures can improve. Running alongside the initiative are projects on: clarifying and applying materiality, the general characteristics of materiality and guidance on making judgements about materiality when presenting and disclosing information in financial statements. Link [here](#).

PWC IFRS News. Leases IFRS 16, Revenue IFRS 15 and IFRIC Rejections Supplement IAS 34. The requirement to produce quarterly financial statements brings IAS 34 into play. The question is how much disclosure is required in your interims? The answer is surprisingly more than you thought. Link [here](#).

Where governance is strong. The role played by professional accountants in tackling corruption is amplified. Link [here](#).

Deloitte Closing out 2016. Topical issues reporting on 2016.

- Foreign currency impacts. Sterling assets and liabilities are going to be less. Watch provisions and recoverability.
- Commodity prices remained low hitting impairment reviews, valuation of assets and derivative fair values. Link [here](#).

KPMG Lease definition. The new on/off balance sheet test. We have labored on the new standards in the Digest for which we do not apologise. Some are calling it the accounting equivalent of voting for Brexit or Trump. Some are in denial and report they do not know. It is time to deal with the implications of IFRS 16. There is one key test in the new standard = who has control. Who has the right to direct the use of the asset? Does the customer obtain substantially all of the economic benefits? A customer takes a new car on a three-year lease. After three years, the residual is 40% of the new car price. Did the customer receive substantially all of the economic benefits? Yes for three years only the customer drove the car. The residual is a red herring. [New KPMG publication here](#).



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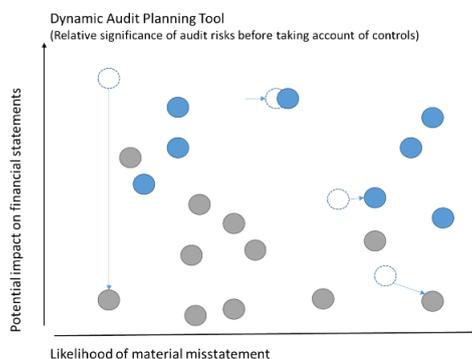
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The new audit report-Key audit Matters (KAM) an insight from ADAA's Mahmoud Shahin

Huge change this year to the audit report for listed entities. Will it make a difference? In 2001, the audit report fitted on a page ([RWE 2001](#)). In 2005 after the IAASB's revisions, it still fitted on a page ([RR 2008](#)). Now it does not, example [RR 2016](#).

So why more revisions. The revisions for 2016 aim to do what the revisions for 2005 aimed to do and did not, to close the expectation gap. The Public assume a clean audit opinion means all the numbers in the financial statements are fine. They are not. The financial statements as a whole are materially fine. Fine subject to the limitations of the auditor's work because it is not possible to test 100% every single transaction undertaken and balance reported. The revisions to ISA 700 requires the auditor to explain the audit work performed on the most significant judgements reported to the Audit Committee. [IAASB illustrative key audit matters](#). [IAASB new auditors report](#).

Will it make a difference? It is difficult to say until we have some experience of applying the revised standard. Fortunately, the English and the Dutch applied the standard a year early and reading [RR 2016](#), (from page 176) you will notice significant change.



KPMG provide a graphic for the risks identified and reported to the Audit Committee. From those reported, KPMG select the eight risks of material misstatement that had the greatest effect on their audit. These are the Key Audit Matters (KAMs):

- Disclosure of the effect on the trend in profit of items uneven in frequency or amount.
- Presentation of 'underlying profit.'
- Measurement of revenue and profit in Civil Aerospace business.
- Recoverability of intangible assets in Civil Aerospace business.
- Pressure on and incentives for management to hit revenue and profit targets.
- Basis of accounting for revenue and profit in Civil Aerospace business.
- Liabilities arising from customer financing arrangements.
- Bribery and corruption.

Eleven other identified risks reported to the Audit Committee are not considered to be KAMs. This distinction is important, not all risks are so impactful the auditor needs to disclose the work they undertook. The IAASB does not want the auditor to cut and paste boilerplate procedures lifted from auditing standards for every material transaction and account balance. The audit report is seven pages long we list some of the things that caught our eye.

- All of the KAMs affect Civil Aerospace Business, only half affect Military, why is this?
- The auditor says: "Our findings are the result of procedures undertaken in the context of and solely for the purpose of our statutory audit opinion on the financial statements as a whole and consequently are incidental to that opinion and we do not express discrete opinions on separate elements of the financial statements." ISA 701 does not change the limitations of an audit. ISA 701 gives greater insight to the audit work. The auditor is not saying there is no material error arising from this risk, merely from our audit procedures we didn't find any.
- "Our 2015 audit was reviewed by the Financial Reporting Council's Audit Quality Review team. The review findings noted limited areas for improvement." The UK FRC challenged the 2013 accounting for revenue risk sharing arrangements. The accounting restated. Why is the UK Regulator interested?
- Audit work on pressure to hit targets for measurement of revenue, profit and recoverability of intangible assets: "we challenged with a heightened awareness of the possibility of unconscious or systematic bias the basis for an increase in the estimated market size and share of the Trent 900 engine which offset the significant reduction in the recoverable amount of Trent 900 program assets arising from new technical issues on these engines, the response to which is forecast to be costly." It would be helpful to know how much forecasts of market size, share and cost increased in the DCF model to offset the impairment of intangible assets. Airbus reports there are currently 201 A380s flying and 107 on order. Assuming all A380s on order are built and require at least one full engine replacement in a lifetime and those flying require one replacement, is the market size 629 engines? How does the current actual market compare with the DCF model? The A380 introduced in 2005 competes with the B747 that is phasing out. Both are four engine aircraft. The new generation A330, 340, 350 and B777 and 787 are XWB two engine aircraft. Is the four engine XWB aircraft a thing of the past?
- Engines require maintenance, in the report it refers to linking or not of higher margin maintenance contracts with lower margin engine contracts. Some are linked as for the 700 some are not. The auditor response: "Re-evaluated appropriateness of the accounting bases...by reference to accounting standards and re-examining historical long-term aftermarket contracts. We considered whether the disclosure included in the financial statements enables shareholders to understand how the accounting policies represent the commercial substance of the Group's contracts with its customers. We made our own independent assessment, with reference to the relevant accounting standards, of the accounting basis that should be applied to each long-term aftermarket contract entered into during the year and compared this to the accounting basis applied by the Group...We found the Group has developed a framework for selecting the accounting bases, which is consistent with a balanced interpretation of accounting standards, and has applied this consistently. We found the disclosure was ample." Ample is a word my grandfather used – is ample enough?

A final thought

A UK FRC post-implementation review of 150 auditors' reports found the top five KAMs reported are: Impairment of assets. Tax. Goodwill impairment. Management override of controls. Fraud in revenue recognition. This list is almost the same as IFIAR reports of its top findings of audit deficiencies each year. Is ISA 701 a step forward or a step back?



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