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ABU DHABI ACCOUNTABILITY AUTHORITY

ADAA digest

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

March 2018

WHAT'S NEW THIS MONTH

ADAA's hot topics

Interpretations Committee open items. Tentative Agenda Decisions for real estate developers.

Will your auditor soon be a robot? With Cambridge Analytica and Facebook in the news EY's Forensic Data Analytics survey results requires examining.

IASB Update. Business combinations and Rate-regulated activities creeping up the agenda.

SEC issues interpretive guidance on cybersecurity. Clearer and more robust disclosures by public companies.

VAT Is Here. And it is a good thing.

And on the back page ***Audit Quality Review -*** an insight from ADAA's Steven Ralls

WHAT'S NEW FROM IFAC AND THE IASB

The IASB is located in Cannon Street, London

Interpretations Committee open items. Tentative Agenda Decisions. We don't normally do this but these four decisions are key and you have the opportunity to comment.

- Presentation of interest revenue for particular financial instruments.
- Revenue recognition in a real estate contract.
- Revenue recognition in a real estate contract including the transfer of land.

One performance obligation or two performance obligations? And when to recognise profit? A surprising answer.

- Right to payment for performance completed to date.

When a customer breaks a contract and the constructing entity has the right to recover lost profits and costs of resale from the original customer, it does not meet the IFRS 15.35(c) requirement of payment for performance to date. Developers take heed! IC project page here.

IASB Update. Business combinations under common control are currently scoped out of IFRS 3. IASB tentatively decides to use the acquisition method in IFRS 3 as the starting point. Not surprising really. IFRS 14 Regulatory deferral accounts only applies to first time adopters. Issued 2014 it enabled Canada (mainly) to adopt IFRS. The IASB said it was not a fan of industry specific standards however with IFRS 6, 9, 14, 16 (lessors) and 17 is that not the path it is on? Rate-regulated activities accounting appears to cater for both cost plus and rate capped regulatory regimes. The unit of account is the individual timing difference that create incremental rights and obligations arising from the regulatory agreement. The present right – to charge a rate increased by an amount as a result of an event, meets the asset definition in the IFRS Framework. The present regulatory obligation - to provide goods or services at a rate reduced by an amount as a result of past events, meets the definition of a liability. Is this storing impairment problems for cost plus regimes and smoothing opportunities for rate capped? More here.

WHAT'S NEW FROM THE ACCOUNTING PROFESSION

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

Will your auditor soon be a robot? Billions wiped off Facebook's market value last week as the 'theft' data storm gathers pace. Know your customer procedures are a legal requirement for banks. Knowing as much about your customers as possible is a commercial or social necessity for other entities to effectively target consumers with customized products and services. Technology creates new opportunities to gather more and more data. As it does so it creates more risks.

May 2018 new UAE law governing General Data Protection Regulations apply. The Facebook Cambridge Analytica story perfectly evidences the new risks entities face.

If you have a data leak, it is an event, the settlement of which, might be expected to result in an outflow of economic benefits. It is a liability. If the amount to settle cannot be measured reliably, it is a contingent liability.

Forensic data analytics combined with artificial intelligence, machine learning and automation increases risks of legal, compliance and fraud. It is a difficult read from EY but worth it. Forensic data analytics survey here.

SEC issues interpretive guidance on cybersecurity. The increasing number and severity of cybersecurity incidents has led the Securities and Exchange Commission (SEC) to issue interpretive guidance to promote clearer and more robust disclosures by public companies in relation to their cybersecurity risks and incidents The new guidance clarifies that the SEC expects companies to disclose cybersecurity risks and incidents that are material to investors, including financial, legal, or reputational consequences. More here

VAT Is Here. And it is a good thing. A surprising observation you might consider as a supplier or a consumer. VAT is a revenue tax. From 1 January 2018 IFRS 15 applies. Prior to that IAS 18 applied. Some entities applied IFRS 15 early primarily to bring forward revenue recognition. Does early adoption of IFRS 15 have VAT implications? We suggest you ask the auditors.

So why is VAT a good thing? Two reasons:

1) It will reduce the temptation to bring forward revenue recognition – because VAT will be payable. VAT assists in deferring fraud.
2) The quality of infrastructure and therefore the ability of potential investors to operate effectively in the target country, is of greater importance than low tax rates. VAT facilitates government spending on infrastructure. Read more from the ICAEW here.

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Audit Quality Review UK FRC Snapshots - an insight from ADAA's Steven Ralls

Quite a lot of acronyms but we accountants like that.

AQR (AUDIT QUALITY REVIEW), UK (UNITED KINGDOM), FRC (FINANCIAL REPORTING COUNCIL). Your audit is coming to a close, it is time for the Audit Committee to assess the quality of the financial reporting process. What should you look for?

These snapshots taken from UK FRC's AQR's provide a brief insight into the assessment of the quality of audit work, policies and procedures supporting audit quality at firms which audit PIEs (PUBLIC INTEREST ENTITIES). Each year they publish their findings. https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports. We chose just one but the themes seem common to all. Our observations in red.

Good practices identified

- Interaction of the audit team with both audit firms and management's specialists, including robust reporting by firm's specialists to audit teams in areas of judgement. Vital in areas such as: tax, pensions, property valuations, unlisted investments, purchase price allocations.
- Extent of group auditor involvement in, and evaluation of, component auditor's work, including improved communications and exchange of audit information (partly due to new software). The audit of consolidated financial statements is not an adding up exercise.
- Improvement in the testing of IT and other controls to conclude on whether they were operating effectively. Effective application of ISA 315 and 330 in particular for ITGC. These are not substantive only audits.

Key findings requiring actions and the firm's response

- In relation to the assessment of goodwill and other assets for impairment, there was insufficient challenge of whether management's cash flow forecasts appropriately reflected the expected timing and duration of important contracts and whether short term growth rates could be achieved. The AQR is not saying the VIU (VALUE IN USE) model is wrong, but it could be. If the assumptions are wrong the answer is...
- In relation to the valuations of investments, there was insufficient evidence of challenge of whether management had the appropriate information to support the more subjective valuation of certain investments. Level 2 and 3 valuations require great care.

Firm's actions

- 2017 RCA (ROOT CAUSE ANALYSIS) indicates teams did not always appreciate what was required in order to convey the level of challenge and rigour they had applied. We also concluded that in some cases, teams did not step back to consider the completeness of their evidence and whether it would enable an experienced auditor, having no prior connection with the audit, to understand the full extent of the work carried out. 2016 training included training on applying and evidencing professional skepticism in the audit of valuations and impairment assessments. We will incorporate into our 2017 training further emphasis on this areas reflecting the results of our RCA. This will include training on the rigour required when challenging estimates and assumptions.

The firm's RCA indicates it is a documentation problem, i.e. 'convey' and 'completeness.' However, the training response indicates it is an audit procedure i.e. 'Professional skepticism' and 'rigour.'

What should Audit Committees expect?

Continue to improve the quality of written communications with Audit Committees on significant findings

Insufficient detail was reported to Audit Committees on certain significant findings:

- Did not include the impact of management's assumptions for certain contracts on the goodwill impairment assessment and the recognition of deferred tax assets. It is critical Audit Committee discuss the impact a small and big change in management's assumptions could have.
- Reproducing the risks section of the auditor's report in the written communications to the Audit Committee was not an appropriate substitute for reporting the auditor's findings on the significant risks. ISA 701 requires KEY AUDIT MATTERS (KAMs) to be selected from the significant matters discussed with the Audit Committee, not to equalize those matters. Does the KAM disclose the level of detail required for an Audit Committee to conclude management's judgement is appropriate?
- Insufficient detail was provided to the Audit Committee on the rationale for, and effect of, valuing investments using assumptions that were more conservative that those used for similar third parties. Faithful representation requires neutrality, which means free from bias. IFRS 13 Fair Value Measurement and IAS 36 Impairment contain requirements to use entity's own data bench marked against market participant's data. There are very few situations where this cannot be done.

Make enhancements to staff appraisal process

Staff performance appraisals, including assessment against relevant objectives, are important to ensure that individuals understand how they contribute to achieving high audit quality and other strategic priorities set by the firm. The firm should improve the effectiveness of its staff appraisal process by:

- Strengthening the link between the assessment of audit quality and overall performance for staff. In the sample of staff appraisals we reviewed, audit quality did not appear to have a direct impact on the appraisal process. This could be improved by taking account of the results of internal and external quality reviews on staff performance and having a clearer linkage between the overall appraisal rating, the achievement of quality objectives and remuneration.
- A significant number of staff had not completed their objectives three months after the firm's deadline and, in the sample we reviewed, a number of audit quality objectives set by staff were either too brief or not specific.
- We identified that key information was not always included on staff appraisal forms, such as comments from appraisers, a detailed self-assessment and relevant references to adverse internal and external inspection quality ratings.

Until AI (ARTIFICIAL INTELLIGENCE) takes over, audits will include humans. Humans are preprogrammed to maximise their return from the efforts they expend. As a friendly CEO once said: *"If you measure the wrong things you will get the wrong answer. What you measure gets done. What you don't measure doesn't."*

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