



ADAA digest

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

May 2018

WHAT'S NEW THIS MONTH

ADAA's
hot topics

A tool for audit committees. Preparing for the new leases accounting standard.

How auditors can help fight corruption in local government. Auditors (internal & external, financial & non-financial) enhance quality and transparency of government financial management with support, and robust challenge.

A recap on IFRS 9 for investments. Refresher for 2018 audits.

Law No (1) of 2017 Concerning the Financial System of the Government of Abu Dhabi. And IFRS 15.

IESBA code of ethics complete makeover. Any change?

And on the back page **COSO and the three lines of defense**, an insight from ADAA's Fatema Lari.

WHAT'S NEW FROM IFAC AND THE IASB

The IASB
is located
in Cannon
Street,
London

A tool for audit committees. We may only be in May of 2018 but 2019 can't come fast enough for some. Why? It's 1994 all over again. IAS 17 introduced substance over form into leasing and the lawyers went bananas. Literally. Overnight leases were on the balance sheet. Hurrah. But the lawyers boxed clever and a structure that looked like a finance lease, operated like a finance lease and quacked like a finance lease...suddenly became an operating lease, and off the balance sheet it went! Why? Because one man's perception of risks and rewards of ownership, differs from another. It's taken 25 years and this time the IASB has been smart. They have deleted the concept of operating leases for the lessee. IAS 8 requires an entity to report known impacts of new standards, or state the entity doesn't know. So most entities in 2016, 2017, and still, in 2018 are reporting they don't know. Which is a failure of good corporate reporting.

The Centre for Audit Quality, an organization sponsored by the AICPA, published a tool for Audit Committees to help guide them through the implementation. Asking questions such as: What are the key judgements? Do those making them have the appropriate knowledge and resources? What is the impact on systems and controls? It would be a shame to not get it right this time. More [here](#).

A recap on IFRS 9 for investments. In her paper, the IASB Vice Chair Sue Lloyd discusses:

- IFRS 9 on long-term investment.
- Reporting value changes in P&L provides better information of value creation over time.
- Recycling can provide a confusing presentation of performance.
- Debt investments are different.
- Prohibiting recycling avoids complexity related to impairment.
- Developing a new impairment model for equity investments is not easy.
- Prevalence of AFS equity investments applying IAS 39. Full paper [here](#)

WHAT'S NEW FROM THE ACCOUNTING PROFESSION

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

How auditors can help fight corruption in local government. According to the OECD, local and regional government entities manage 40% of public spending and 59% of public investment. Bringing government closer to consumers has many benefits as long as local institutions are strong and subject to robust oversight. Auditors enhance quality and transparency of government financial management with support, and robust challenge.

The CEO of the IIA outlined 9 risk areas: Geography. Hiring & employment procedures. Political finance contributions. The giving and receiving of gifts to and from politicians and officials. Entertainment. Information technology. Procurement procedures. (Especially for infrastructure projects). Senior Management, the higher up an official, the higher the risk. The OECD reported 10-30% of the investment may be lost in a publicly funded construction project due to mismanagement and corruption.

To guard against requires "strong legislative and regulatory bodies and managers, bureaucrats and public servants who set the right ethical tone and are prepared to hold people to account." Read the full article [here](#).

Law No (1) of 2017 Concerning the Financial System of the Government of Abu Dhabi. And IFRS 15. Article 36 of the Law requires issuance of half yearly financial statements. With regards to applying IFRS 15; IAS 34 'Interim Financial Reporting' requires disclosure of the recognition or reversal of an impairment loss from assets arising from contracts with customers, as an additional example of the events and transactions for which disclosures would be required. Whether IAS 34 applies to you or does not, if Law No (1) does you will be reporting on IFRS 15 in July this year. See [PWC IFRS news](#).

IESBA code of ethics complete makeover. Any change? It is 46 pages longer at 200 pages. The fundamental principles of: Integrity. Objectivity. Professional competence and due care. Confidentiality. Professional behavior. Remain the same. The recognition of a distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Remain the same. The difference is in clarification, increased application guidance, and easier to apply. Will it change anything? No because people are the same. That said, the new application material on professional skepticism and professional judgement make it easier to identify when the Professional Accountant in Public Practice (PAPP) or in Business (PPIB) has crossed a line. <http://www.ifac.org/publications-resources/final-pronouncement-restructured-code>

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COSO and the three lines of defence –an insight from ADAA’s Fatema Lari



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It is very likely by now you are familiar with the COSO cube (did we mention it’s in ISA 315 too). If not, you are behind the curve. You may have a project team currently documenting and testing (auditing) your responses (organization structure, people, processes, systems) to the five COSO principles. If not, you should have soon. If you think when you have done COSO you are done. You are mistaken. COSO outlines components, principles and factors to effectively

manage risks through the implementation of internal controls. However, it is silent on who. Who is quite important. Because although mechanical equipment fails through design or metal fatigue, and computers get bugs. It is people who are the source. In July 2015 the Institute of Internal Auditors (IIA) published a research paper commissioned by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) entitled “[Leveraging COSO across the three lines of defence](#)”

and usually are of high expertise in the areas of risk management, compliance, fraud, and finance. They are the quality inspectors, the Reassures, in legal, compliance, information security, health and safety. They provide ongoing, real time monitoring and confirmation of operational decisions being optimal, and legal, and in line with standards. This line reports to senior management, but also require a degree of independence such as reporting to a risk committee so their outputs are not controlled by the first line.

What to avoid?

- Absence of coordination.
- Non value adding operations done for documentation purpose only.
- Dealing with first line’s role
- Limited use of data and technology

Third line: Internal audit

Internal audit is a means of oversight of the board and senior management’s performance.

The role has been misunderstood to be one over the whole of an internal control framework, when it actually is the final link in the chain of an internal control system.

The IIA defines internal auditing as an “*independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and assess the effectiveness of risk management, control and governance processes.*”

Internal Audit is the final resort for risk and control management. This role is about communicating assurance on the effectiveness (or otherwise) of the risk management internal control system framework as implemented by the first two lines to both the board and senior management. Internal Audit must be independent and objective, appropriately focused and resourced.

What to avoid?

- Forgetting their purpose and trying to be the second line.
- Forgetting their requirement to be independent and aligning with management.
- Not providing appropriate, relevant, tools and resources.

Final thoughts

The whole organization is responsible in some way for the system of internal control.

However, a system of internal control is just one way to achieve an entity’s objectives.

The board of directors could choose a different system or a different way.

However, what is true from history, from Maxwell through Enron and Worldcom, and unfortunately others in the future. Tone from the top, and management override, have a huge part to play.

manage risks through the implementation of internal controls. However, it is silent on who. Who is quite important. Because although mechanical equipment fails through design or metal fatigue, and computers get bugs. It is people who are the source. In July 2015 the Institute of Internal Auditors (IIA) published a research paper commissioned by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) entitled “[Leveraging COSO across the three lines of defence](#)”

The three lines of defence are:

- 1) Own and manage risk and control.
- 2) Monitor risk and control in support of management.
- 3) Provide independence assurance to the Board.

First line of defence: Operational management

The business and process owners whose activities create and/or manage the risks that lead to success or failure of achieving the entity’s objectives are the first line of defence. They are identifiers, assessors, and managers of risk and control activities aligned with the strategy and risk appetite.

A formula 1 team builds a new race car every year. It develops the current race car during the year. Toro Rosso swapped engine suppliers to Honda last year. McLaren to Renault. Mercedes and Ferrari make their own. Who makes the decision to switch finite resources from in year development to next year’s development? Who makes the decision to switch engine suppliers or develop engines in house? What knock on effects do those decisions have on maintenance, tooling, fuel, sponsors? Have you noticed it is ‘Aston Martin Red Bull’ this year?

Individuals in the first line of defence have significant responsibilities in COSO related to the principles of Risk Assessment, Control Activities and Information and communication.

What to avoid?

- Lack of accountability for decision making.
- Ambiguous understanding of function’s role, authority and responsibility.
- Wrong tone from the top can encourage wrong risk taking.

Second line: Internal monitoring and oversight functions

This line is not less important than core operations, but should always come in support of the core operation, and should not at any stage replace it. These functions ensure risk and control are effectively managed by the first line,

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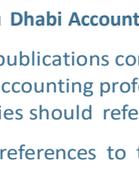
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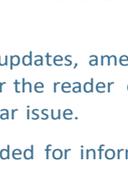
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