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ADAA IFRS DIGEST

IFRS news from ADAA, IASB, and the Accounting Profession

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معاً نحمي المال العام
Together Safeguarding Public Funds

WHAT'S NEW THIS MONTH

- > **Accounting for leases relating to a joint operation.** IFRIC decision discussed in relation to extractive industries.
- > **Authentic Integrated Reporting.** Insights into integrated reporting, the drive for authenticity.
- > **Extended External Reporting (EER).** Growing demand for such reports.
- > **Disclosures on the sources and uses of cash.** As requested by stakeholders.
- > **The future of Audit.** A more effective approach.
- > **Guidance on UAE Cabinet Decision No.31 of 2019.** The 'ESR' test approach.
- > And finally, October's article: **Audits of less complex entities:** insight from ADAA's Ghais Kadi.

NEWS IN DETAIL

> **Accounting for leases relating to a joint operation.** In March 2019 the IFRS Interpretations Committee (IFRIC) finalised a tentative agenda decision regarding lease arrangements in a joint operation under IFRS 16 Leases and IFRS 11 Joint Arrangements. IFRIC decided that a lead operator of a joint operation has primary responsibility for a lease, and should recognise 100% of the lease liability. This EY publication ([link](#)) explores and discusses this IFRIC decision which will have an impact on extractive industries where joint operations are common.

> **Authentic Integrated Reporting.** 'Insights into integrated reporting 3.0: The drive for authenticity' is ACCA's third annual study of the use of integrated reporting around the world. The report examines the reporting practices of organisations in the International Integrated Reporting Council's <IR> Business Network. It highlights the progress made towards integrated reporting over the past year, discusses the challenges that preparers face, and gives practical recommendations to guide more organisations on the path to integrated reporting. The report includes tips for authentic reporting involving the integrated report, the internal process, and the people in the organisation. [More here.](#)

> **Extended External Reporting (EER).** Listen [here](#) to IAASB member and Task Force Chair, Marek Grabowski, discuss the extended external reporting (EER) Consultation Paper that includes the first part of the draft guidance for practitioners applying International Standard on Assurance Engagements (ISAE) 3000 (Revised) 'Assurance Engagements Other than Audits or Reviews of Historical Financial Information', to EER assurance engagements. EER extends beyond the entity's financial statements and includes integrated reporting and sustainability reports.

The non-authoritative guidance will be an addition to ISAE 3000, addressing 10 challenges identified in a 2016 discussion paper. It will add a materiality process for such engagements, whether and how to use assertions, as well as elements in the report and their qualities. It will add preconditions to such engagements to facilitate application of the new guidance.

> **Disclosures on the sources and uses of cash.** A report from the Financial Reporting Council's Financial Reporting

Lab looks at disclosures on the sources and uses of cash. In 2019, the FRC ran a stakeholder survey. Feedback from investors suggest they want to know:

- How much cash is being generated from the operations of the business, both in the current period and future?
- Is generated cash likely to be sufficient to meet the company's strategic objective and, if not, where will the required cash come from?
- What is the company planning to do with the cash it generates, especially beyond servicing its current operations?
- Is management being effective and efficient in its use of cash?

Providing better disclosures to investors allows them to assess management's stewardship of a company's assets and supports their analysis of future expectations. The article focuses on disclosures that provide a clear description of the drivers and uses of cash, explains how companies generate cash and how it's linked to their strategies, working capital and risks. Additionally, it provides detail and examples on uses of cash both in the past and in the future. You can read the report [here](#).

> **The future of Audit.** Continuous evolution is needed in the audit and the profession to improve the quality of the audit. PWC's [publication](#) summarises the needs of investors, audit committee chairs, finance directors, journalists, politicians and academics to boost the audit effectiveness in the future. The publication also highlights PWC's perspective in response to the ideas given from the stakeholders and outlines the opportunities for change. Improving the audit alone will not be enough—a more fundamental review of the entire corporate reporting system will be required to ensure that stakeholders can have confidence in the information they need for decision making.

> **Guidance on UAE Cabinet Decision No.31 of 2019.**

The UAE Ministry of Finance has released ministerial Decision No. 215 providing guidance to implement Economic Substance Requirements ("ESR"). The ESR is issued in pursuant to the global standard set by the OECD to curb harmful tax practices. The [guidance](#) summarised by BDO, outlines requirements for any licensees that carry 'a relevant activity' from which it derives income in the UAE.

Audits of Less Complex Entities: insight from ADAA's Ghais Kadi.

As covered in September's Digest, the International Auditing and Assurance Standards Board (IAASB) has published a Discussion Paper called 'Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs'. The DP sets out the challenges that have been identified in using ISAs for non-complex audits, and possible actions to address these challenges.

"If it's not documented, it's not done" is the familiar mantra in audit. It can be argued that adhering to fully-fledged audit requirements such as the ISAs should always be required regardless of the complexity of the entity, as this ensures that all audits are done in a consistent manner and allows reviewers and regulators to assess each audit against the same set of standards. I.e. an audit is an audit.

However, for simple audits, or audits of less complex entities (LCEs) such adherence (and the documentation thereof) may prove to be burdensome, and unnecessary. Statistically, most audits globally are audits of smaller entities. Therefore, an alternative approach for auditing less complex entities is important for many stakeholders and may lead to more efficient, higher quality audits.

> What is a less complex entity?

The IAASB defines a less complex entity as one which typically possesses the following qualitative characteristics:

- A. Concentration of ownership and management in a small number of individuals (often a single individual - either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and
- B. One or more of the following:
 - i. Straightforward or uncomplicated transactions;
 - ii. Simple record-keeping;
 - iii. Few lines of business and few products within business lines;
 - iv. Few internal controls;
 - v. Few levels of management with responsibility for a broad range of controls; or
 - vi. Few personnel, many having a wide range of duties.

The IAASB clarifies that small does not necessarily mean less complex and vice versa. In other words, some smaller entities may be complex, and some larger ones may not. However, the vast majority of smaller entities will be less complex.

> Background

The following influences are driving changes to the environment in which auditors operate, especially is in the context of auditing LCEs:

Evolving business environment: Increasing complex structures and transactions. Advances in technology. More coordinated and focused regulators. Changing public expectations and increased scrutiny.

Changing financial and non-financial reporting: Laws and regulations are changing, including non-financial reporting. Financial reporting standards are continually evolving. Assurance needs related to non-financial reporting continue to evolve. Increasing requirements for estimates.

The IAASB note that these changes are taken into account when updating ISAs. However, for LCEs this may be problematic. In particular, the increases in the length and detail of the ISAs may:

- Prevent auditors from fully understanding what is required, specifically in the absence of implementation guidance.
- Change the auditors' mind-set from a principal based approach where professional judgement is key, towards a rule-based one.
- Lead to onerous documentation requirements in order to adhere to ISAs with no real value achieved.

All these factors can result in a reduction in overall audit quality as they affect how the auditor applies the ISAs.

In this context, the IAASB has already increased its focus on scalability and proportionality of standards, evidenced by two recent revision projects on ISA 540 and ISA 315. In ISA 315, new introductory paragraphs explain the various aspects of the standard in simpler language.

> Challenges related to applying ISAs in audits of LCEs

The IAASB recognises that there are unique challenges for applying ISAs in audits of LCEs.

The following are the current challenges that the IAASB deems to be within its control:

- *Language and basic approach*: the language in the standards is becoming more complex and difficult to comprehend. Too much “how” in the requirements. Too much detail which drives a compliance, rather than professional judgement, approach. Navigation of the standards is difficult.
- *Length*: ISAs are voluminous which makes them difficult to read and determine what needs to be done.
- *Documentation*: requirements throughout the standards becoming extensive and more onerous.
- *Lack of clarity*: unnecessary procedures are being performed and/or necessary procedures are not being performed.
- *Not enough guidance*: The specific considerations for smaller entities are not always helpful to understand scalability and proportionality. Insufficient material to aid effective application of standards.
- *Particularly problematic ISAs*: such as those related to risk assessment, fraud considerations, and estimates.

> Potential possible actions by the IAASB

The IAASB suggest three possible actions:

A. Revising the ISAs:

- Clarifying and simplifying requirements with appropriate application material.
- Setting out the basic requirements for all audits, then expanding where necessary for complex audits (building blocks approach).
- Introducing scalability and proportionality.
- Enhancing the considerations specific to LCEs.

These can be introduced in one substantial project, gradually on a rolling or phased basis, or through making targeted changes.

B. Developing separate auditing standard for audits of LCEs:

Based on the existing ISAs

- Mirroring the risk based approach of the ISAs but in a way that follows the work flow of an audit.

- Quality management principles at the engagement level.
- Allowing the auditor to use their professional judgment to focus on the objectives, i.e. more appropriately focused on being outcome based in the circumstances of the LCE and not including specific procedures.
- Aligning documentation requirements with ISA 230.

Based on a different framework (non-ISA)

- Requires the development of a supporting framework including relevant criteria.
- This option would require substantial efforts and resources and take longer to implement.

C. Developing guidance for auditors of LCEs or other related actions:

1. A “how to” guide when applying ISAs: a possible collaboration with IFAC may be an option as IFAC already has a guide of the same nature for audits of SMEs.
2. An Auditing Practice Note: this does not impose new requirements rather it provides assistance to auditors and covers specific areas where additional guidance may be needed.
3. Guidance for the application of specific areas within the ISAs or a particular ISA: for challenges previously identified in relation to audits of LCEs, e.g. a guide targeted at risk identification and assessment.
4. Implementation packs: these would include educational materials such as presentations and webinars to assist users in implementing revised and new ISAs.

> Final thoughts

Any of the three possible courses of action that result from the Discussion Paper will have major consequences for all stakeholders, not only audit practitioners. Whether we will see an introduction of a whole new set of standards for audits of LCEs or one of the other less substantial options, the change will be welcomed.

Although “If it’s not documented, it’s not done” will continue to be relevant, the extent of documentation required should reduce for audits of LCEs.

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