جهاز أبوظبي للمحاسبة
ABU DHABI ACCOUNTABILITY AUTHORITY

ADAA DIGEST

Accounting and Auditing News
February 2020

معاً نحمي المال العام
Together Safeguarding Public Funds

NEWS THIS MONTH

> **Classification of liabilities.** Amendments to IAS 1.

> **IAASB revises ISA 315.** A modern approach to assessing audit risk.

> **Alternative performance measures.** ESMA issues guidance.

> **Replacement of IAS 1.** The IASB has issued an Exposure Draft.

> **Evaluating audit quality.** FRC issues an update.

> **Climate related disclosures.** ICAEW webinar.

> **Closing out 2019.** Financial reporting tools.

> **Climate change.** BlackRock focuses on sustainable investing.

> **IFIAR observes 21% decrease in audits with inspection findings.** But more can be done.

> **Revisions to international independence standards.** IESBA Exposure Drafts.

> **IPSAS update.** Latest pronouncements from the IPSASB.

IN DEPTH

> **Brydon's Report on "Improving Audit Quality and Effectiveness"** insight from ADAA's Ghais Kadi.

NEWS IN DETAIL

> Classification of liabilities. The International Accounting Standards Board (IASB) has issued 'Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)'. These narrow-scope amendments to IAS 1 *Presentation of Financial Statements* clarify how to classify debt and other liabilities with an uncertain settlement date as current or non-current.

The amendments specify that the classification of liabilities as current or non-current should be based on rights that are in existence at the end of the reporting period. Management expectations about events after the balance sheet date, for example on whether a covenant will be breached, are not relevant.

The amendments do not change, existing requirements, and so are not expected to affect companies' financial statements significantly. The effective date is January 2022. Early application is permitted. Read more in the press release and EY's IFRS technical resources.

> IAASB revises ISA 315. Identifying and assessing the risks of material misstatement is fundamental to the audit. ISA 315 has been revised to require a more robust risk identification and assessment, thereby promoting better responses to the identified risks. The standard will be effective for periods beginning on or after December 15, 2021. We will go into more detail in a future technical article. Read more.

> Alternative performance measures. The European Securities and Markets Authority (ESMA) has published a report on EU issuers' use of Alternative Performance Measures (APMs) and their compliance with ESMA's Guidelines.

The report shows that there is significant room for improvement as only a minority of issuers comply with all principles of the Guidelines. ESMA calls on issuers to improve their disclosures regarding APMs. In particular, issuers should enhance their reconciliations, definitions and explanations in relation to all APMs used. ESMA highlights that ratios and subtotals included inside financial statements may also fall within the definition of an APM and thus should comply with the Guidelines.

The Report highlights that the use of APMs is widespread in all sectors and within all regulated documents. Significant diversity exists in the number and type of APMs used, as well as in their labels and definitions. The most commonly used APMs include: Earnings Before Interest & Tax (EBIT); Operating results; Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA); and Net-debt.

> Replacement of IAS 1. The IASB has issued an Exposure Draft 'General Presentation and Disclosures' which will eventually replace IAS 1 and amend other IFRS standards. The proposal aims to improve how information is communicated in the financial statements, with a focus on information about performance in the statement of profit or loss. The Board proposes to require companies to:

1. present new defined subtotals in the statement of profit or loss;

2. disaggregate information in a better way; and

3. disclose information about some performance measures defined by management ('non-GAAP' measures).

The deadline for comment is 30 June 2020.

> Evaluating audit quality. The Financial Reporting Council (FRC) has issued an update of its Practice Aid to assist audit committees in evaluating audit quality in their assessment of the effectiveness of the external audit process. The update takes account of developments since the first edition was issued in 2015. Link.

> Climate related disclosures. Climate change is one of the most significant risks faced by business today. The recommendations of the Task Force for Climate-related Financial Disclosures (TCFD) are the most widely supported and adopted framework for climate-related reporting. Find out more about the recommendations of the Task Force on Climate-related Financial Disclosures with this 60-minute live and interactive webinar from the ICAEW.

> Closing out 2019. Deloitte cover financial reporting issues that may be relevant for years ending on or after 31 December 2019 as a result of areas of regulatory focus, the current economic environment or changes in accounting standards. Illustrative 2019 financial statements can also be found here (PWC, EY, KPMG, BDO). Looking ahead, Grant Thornton offers an illustrative interim reporting requirements for June 2020 financial statements. Read more.

> Climate change. In its recent letter to clients and CEOs, BlackRock states that climate change has become a defining factor in companies' long-term prospects and has announced a number of initiatives to place sustainability at the centre of its investment approach. One area is improved disclosure for shareholders. Investors, along with regulators, insurers, and the public, need a clearer picture of how companies are managing sustainability-related questions. Each company's prospects for growth are inextricable from its ability to operate sustainably. Over time, companies that do not address sustainability risks will encounter growing scepticism from the markets, and in turn, a higher cost of capital.

Important progress improving disclosure has already been made - and many companies already do a good job of integrating and reporting on sustainability - but BlackRock notes we need to achieve more widespread and standardized adoption. BlackRock believes that the Sustainability Accounting Standards Board (SASB) provides a clear set of standards for reporting sustainability information across a wide range of issues, from labour practices to data privacy to business ethics. For evaluating and reporting climate-related risks, as well as the related governance issues that are essential to managing them, the Task Force on Climate-related Financial Disclosures (TCFD) provides a valuable framework.

> IFIAR observes 21% decrease in audits with inspection findings. The International Forum of Independent Audit Regulators (IFIAR) has announced the results of an initiative begun in 2015 to measure the frequency of inspection findings against a goal established by its Audit Quality Working Group (AQWG). In 2015, in response to a persistently high rate of audits inspected with findings, the AQWG and the largest global audit firm networks (the "GPPC networks") set a goal to reduce by at least 25% over a four-year period the rate of listed PIE audits inspected by the AQWG members that had one or more findings. The 2019 data indicates that the GPPC networks collectively achieved a 21% reduction over four years in the frequency of audits inspected with findings, resulting in 31% of inspected audits with findings.

Whilst the decrease is encouraging, the failure to reach the target highlights the GPPC networks need to maintain focus on further improving audit quality and ensuring consistent execution of high quality audits, and to continue to identify and implement initiatives to further improve audit quality.

> Revisions to international independence standards

In January, the International Ethics Standards Board for Accountants (IESBA) released two Exposure Drafts (EDs):

- Proposed Revisions to the Non-Assurance Services Provisions of the Code.
- Proposed Revisions to the Fee-Related Provisions of the Code.

The EDs are aimed at strengthening the non-assurance services (NAS) and the fee-related independence provisions of the International Code of Ethics for Professional Accountants (the Code).

Also in January, the IESBA released for public comment the Exposure Draft: 'Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers'. The proposed limited-scope revision to the Code dovetails with the International Auditing and Assurance Standards Board's (IAASB's) development of proposed International Standard on Quality Management (ISQM) 2, Engagement Quality Reviews.

> IPSAS update. In December, the IPSASB held its fourth meeting of 2019 in Abu Dhabi. Among other things in a busy session, the IPSASB approved ED 70, 'Revenue with Performance Obligations' based on IFRS 15 expanded to apply to binding arrangements which are not necessarily contractual. ED 70 also has a broadened scope with a greater emphasis on the transfer of goods or services to third-party beneficiaries. The IPSASB also approved ED 71, 'Revenue without Performance Obligations'. ED 71 addresses revenue that arises from binding arrangements with present obligations which are not performance obligations, and revenue not related to binding arrangements. The IPSASB also approved ED 72 'Transfer Expenses'. Transfer expenses are transactions where an entity transfers resources to another party without directly receiving anything in return. IPSASB also revisited the objective and scope for the Leases project where they intended to decide on an approach in March 2020. Link.

In January, the IPSASB published Improvements to IPSAS, 2019. This comprises of minor improvements to IPSAS through a collection of amendments which are unrelated in order to address issues raised by stakeholders.

Also in January, the IPSASB issued 'Collective and Individual Services' (Amendments to IPSAS 19), which addresses a wide range of significant government expenditures that directly impact the lives of citizens globally. This guidance complements IPSAS 42 *Social Benefits* by providing requirements for accounting for collective services (such as defence at national-levels and street lighting at sub-national levels) and individual services (such as healthcare and education). *Collective and Individual Services* requires that an expense is recognized at the point of service delivery.

Brydon's Report on "Improving Audit Quality and Effectiveness" insight from ADAA's Ghais Kadi.

A review on the quality and effectiveness of audit in the UK was concluded in December 2019. The review was led by Sir Donald Brydon at the request of the UK government in response to recent corporate failures such as Carillion and Patisserie Valerie.

This review, along with two others issued earlier in 2018/2019 on the audit market and the FRC by the UK's Competition and Markets Authority and Sir John Kingman respectively, form a strong triangular foundation for any attempt at reforming the statutory audit market in the next decade. The recommendations, if put into action, can be expected to have a substantial impact on the audit market, initially in the UK and subsequently in wider regions if other jurisdictions follow suit.

The main objective of the review was to make audit more informative to its users and it started from the premise that the current audit quality and effectiveness is being questioned by a wide spectrum of stakeholders.

The recommendations touch on various aspects of corporate governance such as corporate directors and audit committees; the main focus of this article will be those recommendations that are closely related to the external audit process.

> Redefining Audit and Creation of an Independent Profession

One of the overarching recommendations is to redefine audit and its purpose as follows: *"The purpose of an audit is to help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements.* "The report calls for transitioning audit into an independent profession with its own body of knowledge (including technological education), qualification requirements and continuous professional development.

This stems from the fact the skill set needed for professionals in audit functions is different than those that carry out accounting roles. This is to be supplemented by the introduction of "Principles of Corporate Auditing" which would include a statement that "auditors act in the public interest and have regard to the interests of the users of their report beyond solely those of shareholders".

This proposal comes against a backdrop of a similar shift globally, evident by the recent statement by the Business Roundtable in US - whose members are CEOs of major U.S. companies - that corporations should commit to meeting the needs of all stakeholders, not only shareholders.

> Bridging the Expectation Gap

The report argues that given the increasing use of estimates and judgements in modern day accounting, replacing the term "true and fair" with "present fairly" would allow users to better understand the degree of assurance the auditor is providing in the audit opinion.

> Professional Scepticism or Suspicion?

The report calls for complementing the existing concept of professional scepticism with a new concept of professional suspicion that is needed for auditors who have to assess trustworthiness as part of their work, as opposed to accountants for which, suspicion may not be as essential.

> Fraud Detection: Whose Responsibility is it?

Due to ambiguity of the role of auditors in relation to fraud, and the increasing demand from investors in favour of expanding the scope of the audit to include detecting fraud, the report recommends an amendment to ISA (UK) 240 *"to make clear that it is the obligation of an auditor to endeavour to detect material fraud in all reasonable ways"*. This would require that *"training in both forensic accounting and fraud awareness, be part of the formal qualification and continuous learning process to practice as a financial statements auditor"*.

In addition, two new reporting duties regarding fraud are among the recommendations:

1. On directors to set out the actions they have taken each year to prevent and detect material fraud; and
2. On the auditor to state in their report how they have assured the directors' statement on material fraud, and what additional steps they have taken to assess the effectiveness of the relevant controls and to detect any such fraud.

> From Going Concern to Business Resilience

The report also recommends that the directors of the company publish a statement on the resilience of the business, divided into three sections, covering the short term (similar to the current going concern concept), the medium term and risks to resilience in the long term.

The auditors would then need to report to the Board *"if they have encountered any information in the course of their audit which leads to an anxiety about the resilience of the business not reflected in the Resilience Statement"*.

> Stakeholders Say on "What to be Audited"

With regards to the annual audit strategy, the current practice is for auditors to present their plan to the Audit Committee at the beginning of each audit cycle, arguably a one-sided approach, most of the time.
Two recommendations revolve around giving the opportunity to wider stakeholders:

A- Shareholders, to propose - perhaps during AGMs - matters they wish to be covered by the auditors.
B- Employees to share with directors their views regarding the scope of various audit activities.

> AMPs and KPIs

Alternative performance measures (sometimes referred to as non-GAAP measures) have been on the rise recently. Their increasing inclusion in annual reports may lead users to believe that these measures have been verified as a result of not knowing that the auditor's opinion is only on the financial statements and not on the full annual report.

To reduce this risk, one of the recommendations is that these measures (along with KPIs that are used for calculating executive remuneration) should be subject to audit. The report goes further to recommend expanding the scope of audit to cover areas beyond the annual report such as investor presentations (as opposed to the current concept of 'Other Information' that confines the audit scope to the report within which the main financial statements are issued).

> More Transparency in the Audit Report

One of the challenges laid down in Brydon's review was for contributors to provide views on 'models for published auditor reporting that may provide more meaningful insight and narrative'. Extended audit reports were introduced in 2014, but do they go far enough in informing stakeholders of the judgements made by management and areas of uncertainty?

A set of recommendations deal with the potential inclusion of further information from various areas of the audit process. The following are a few examples:

1- Auditors to explain in the audit report any use of sampling techniques.

2- Auditors to disclose the hours spent on each audit by each grade within the audit team.

3- Auditors should be free to include original information, materially useful to a wide range of users, at the AGM.

> Transparency through More Corporate Disclosure

Since audit interacts with many participants such as management, non-executive directors, standard setters, regulators, and users of the accounts, the report includes various other sections to deal with these aspects separately.

The following non-exhaustive list gives a flavour of some of the recommendations that are aimed at restoring and enhancing public trust, not only in external auditors, but also in company directors and audit committees in fulfilling their duties:

1 - The directors, in proposing a dividend, need to make a statement that the payment in no way threatens the existence of the company in the ensuing, say, two years and that this dividend is within known distributable reserves.
2 - Audit fees to be shown on the face of the profit and loss account.
3 - Audit committee minutes be published with a time-lag of 12-18 months and with approved redactions.

> Conclusion

Some would argue that the reform of the audit profession may have started in early 2000s with the Enron collapse and continued throughout the global financial crisis, however, with the continuing corporate failures two decades down the line and the commissioning of major reviews into the profession such as the CMA, Kingman and Brydon, it is fairly safe to forecast that audit, and certain aspects of corporate governance, are heading towards an inevitable period of overhaul in the decade to come.

ADAA DIGEST EDITORIAL TEAM

 Hasina Al Adawi **ADAA Digest Editor**	 Richard Wright (AASD@adaa.gov.ae) **Head of Accounting and Auditing Standards Desk**

- > Sara Al Ateeqi
- > Fatima Al Khyeli
- > Saada Al Menhali
- > Sara Al Sajwani
- > Salwa Al Seiari
- > Ghais Kadi
- > Fatema Lari