جهاز أبوظبي للمحاسبة
ABU DHABI ACCOUNTABILITY AUTHORITY

ADAA IFRS Digest

IFRS news, updates from ADAA, IASB, IFAC & the Accounting Profession

November 2017

WHAT'S NEW THIS MONTH

ADAA's hot topics

CIPFA and IFAC launch public sector financial accountability index. The result: a world map of government accounting.
IPSAS news: Filling the gaps. ED 63 addresses Social Benefits.
KPMG IFRS 15 Revenue Supplement disclosure requirements.

IFAC calls for nominations for the IFAC Boards and Committees and the Independent Standards Setting Boards. Your opportunity to influence.

"For every complex problem there is an answer that is clear, simple, and wrong" Root cause analysis
Refresh your knowledge. Take the IFRS Foundation quiz.
ESMA publishes database of enforcement decisions. 21st extract includes enforcement actions on Joint Control.
Materiality definition clarification. FASB focus on a reasonable person.
Audit evidence. How much is enough?
And on the back page ***Identifying cash generating units*** an insight from ADAA's Ebrahim Al Shaikhali.

WHAT'S NEW FROM IFAC AND THE IASB (AND ESMA)

The IASB is located in Cannon Street, London

CIPFA and IFAC launch public sector financial accountability index to improve understanding of public sector accounting and budgeting, and stimulate public financial management (PFM) reforms. The output is a world map of financial reporting by central governments, which will be expanded over time to include state/provincial and local government. Map here.

IPSAS news. IPSAS filling the gaps. ED 63 addresses Social Benefits. The ED clarifies accounting for: social benefits, social risks, and universally accessible services. It also updates the accounting of delivery of retirement, unemployment, and disability benefits. Recognition is based on an obligating event, or optionally on an insurance based approach. The ED requires five-year projected cash flow disclosure, which will be challenging. ED here

IFAC calls for nominations for the IFAC Boards and Committees and the Independent Standards Setting Boards. Your opportunity to influence international auditing and financial reporting standards. Nominate here.

"For every complex problem there is an answer that is clear, simple, and wrong" *If firms cannot tell us what went wrong then we're left with two conclusions, either there is cover-up in place or, worse still, the firm still doesn't know why it went wrong."* Root cause analysis from IFAC Global knowledge gateway.

Refresh your knowledge. Take the IFRS Foundation quiz.

ESMA publishes database of enforcement decisions.

- Power to block is not power to control. Power requires unilateral ability to make decisions to direct the relevant activities.
- Qualified consent or veto power of strategic decisions over relevant activities, ESMA concludes, is joint control. www.esma.pdf

WHAT'S NEW FROM THE ACCOUNTING PROFESSION

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

KPMG IFRS 15 Revenue Supplement. The Supplement complements the illustrative financial statements and focuses on the disclosure requirements of IFRS 15.

Disclosures should contain both quantitative and qualitative information, which includes disaggregation of revenue, contract balances, performance obligations and assets recognized to obtain or fulfill a contract as well as significant judgements in the application of the standard.

IFRS 15 offers a range of transition options including:

- Retrospectively to each prior period presented in accordance with IAS 8 subject to certain expedients.
- Retaining prior period figures as reported under the previous standards with the cumulative effect of applying IFRS 15 recognized at the date of initial application as an adjustment to the opening balance of equity.

Read more here.

Materiality definition clarification. FASB's new definition: *"The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances the magnitude of the item is such that it is probable that the judgement of a reasonable person relying on the report would have been changed or influenced by the inclusion or correction of the item."* More here.

Audit Evidence. Collecting sufficient, relevant, reliable audit evidence is enough. Sufficient is a measure of quantity. Evidence to support one item can sometimes be sufficient e.g. a test of a computer control, a bank loan confirmation. Relevant is a measure of quality. It is not enough just to gather evidence that *proves*, evidence that *disproves* must also be sort. If disproving evidence is found it must be investigated and assessed. Appropriate is another measure of quality assessed by considering relevance and reliability.
Knowing when audit evidence is enough, is a matter of professional judgement. This is not some woolly concept. IAS provides audit procedures and thresholds for evidence gathered. Problems arise, not with interpretations of accounting standards, but with the quality of audit evidence gathered to support the interpretation.
Details here.

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Identifying cash generating units – an insight from ADAA's Ebrahim Al Sheikhali

IAS 36 requires an impairment test if there is any indication of impairment or if an intangible asset has an indefinite useful life or the asset is goodwill. The premise is to ensure that assets are carried on the balance sheet at no more than their recoverable amount. IAS 36 defines recoverable amount as the higher of fair value less costs to sell and value in use.
Assets may be tested for impairment individually however most intangible assets do not produce cash inflows by themselves, this is why IAS 36 requires the identification of Cash Generating Units (CGUs).

So what exactly is a CGU and how should entities identify them?

IAS 36 defines a CGU as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. IAS 36 prescribes guidelines for identifying CGUs but guidelines can be interpreted and applied in differing ways. It is not uncommon to find competitors within the same industry identifying CGUs in a dissimilar manner. In practice defining a CGU may have an endless amount of parameters. It may be different departments within the same company, different entities within a conglomerate, groups of property, plant and equipment, geographical areas or separate lines of business.
It is important to note the requirements of IAS 36 state no single CGU may be larger than a single operating segment as defined by IFRS 8. An operating segment is defined to be a component of an entity:

- That engages in business activities that generate revenues and incur expenses (including business activities with other components within the same entity).
- Whose operating results are regularly reviewed by the entity's chief operating decision maker (may be a group of people) to make decisions about resources to be allocated to the segment and assess its performance.
- For which discrete financial information is available

The last two points of the definition are points some entities overlook. An example of this is determining a subsidiary to be a single CGU when the subsidiary has several lines of business evaluated by the group board separately when considering performance.

Companies can also fall into the trap of determining CGUs at a level that is too large which defeats the objective of impairment testing because efficient high performing assets may mask inefficient or underperforming assets

Identifying CGUs is challenging to large businesses, especially ones that are closely integrated or that have units that sell their production internally.

IAS 36 addresses this issue by stating that an asset or group of assets should form a separate CGU if it could sell its output in an, "active market" as defined by IFRS 13 'Fair Value Measurement.' It is also important to note that IFRS 8 allows operating segments to be combined and aggregated into larger reportable operating segments if they meet certain criteria; however, the definition of a CGU to be used in IAS 36 is before the aggregation of more than one operating segment.

Testing assets for impairment individually vs. testing as part of a CGU.

When testing for impairment, entities must first consider assets individually. Meaning their recoverable amounts should be determined, however as mentioned above this may prove difficult because in many cases assets do not produce cash flows individually from other assets. If this is the case, then that asset cannot be tested for impairment individually but instead tested as a part of the CGU that it has been allocated to. The next step is to evaluate the CGUs recoverable amount. If the CGU's recoverable amount is not lower than its carrying amount then no impairment exists on a CGU level. The individual asset cannot be impaired even if its fair value less costs of disposal is less than its carrying amount. To provide a clarification of these requirements, the standard offers the following example:
"A mining entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine.
It is not possible to estimate the recoverable amount of the private railway because its value in use cannot be determined and is probably different from scrap value. Therefore, the entity estimates the recoverable amount of the cash-generating unit to which the private railway belongs, ie the mine as a whole."-IAS 36.67

Expanding on this example, what if the mining company decides to build a new private railway line and shifts its operations to using the new line exclusively. The result is that the original line is idle and has no use to the company (assuming switching back is not possible). The question that the company now faces is whether to impair the value of the original line. The answer lies in the fact that the asset no longer generates cash flows in conjunction with other assets. Furthermore, its fair value less costs of disposal can be estimated and is most probably its scrap value. Therefore, the asset should be impaired on an individual level.

While it is true that in practice some cases will not be as straightforward as the ones described entities still need to ensure that assets tested at a CGU level continue to meet the requirements set out in IAS 36 as business operations adapt and change with time. It is important to note that CGUs may not always change due to specific operational changes such as a divestment, a restructuring or an entry into a new market. The change can in fact occur over time gradually and therefore will not be so straightforward to identify.

In conclusion, identifying CGUs is important for testing impairment, allocating goodwill and even determining operating segments.

Difficulty in identifying CGUs and allocating goodwill and other assets to them will continue to pose challenges to entities across the board. Having large CGUs makes applying the standard more difficult. The basis of CGUs should be verified and challenged by auditors and management alike to minimize the possibility of having low performing assets masked by high value generating assets.

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