جهاز أبوظبي للمحاسبة
ABU DHABI ACCOUNTABILITY AUTHORITY

ADAA digest

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

January 2018

WHAT'S NEW THIS MONTH

ADAA's hot topics

Corporate Governance is an essential ingredient for success.
IFRS Taxonomy Update for IFRS 17. Leading to extra cost and time.
KPMG Illustrative Disclosures for Investment Funds. Key guidance on investment financials.
KPMG IFRS Health check.
Issues related to year ending 31 December 2017. Prepare to amend.
Accounting for revenue and non-exchange expenses. Will IPSAS follow IFRS?
IFAC rumbled Monitoring Group Consultation.
IFRS 16. Rough tide ahead.

And on the back page ***A sorry start to the year*** an insight from ADAA's Steven Ralls

WHAT'S NEW FROM IFAC AND THE IASB

The IASB is located in Cannon Street, London

Corporate Governance is an essential ingredient for success. IFAC says Focus on performance, don't forget conformance. Good governance principles operate inside a framework comprising two dimensions.

1) Forward looking addressing risks of non-conformance, and
2) Backward looking to ensure risk assessment, control mitigation and outcome evaluation procedures are in place and fit for purposes. More here.

IFRS Taxonomy 2017, Update for IFRS 17. Though not effective for 3 years, insurance companies are wide-awake for IFRS 17. Expected to add significant costs because of extra actuarial information it will require.

Accounting for revenue and non-exchange expenses. With the IFRS change of revenue standard, the International Public Sector Accounting Standards Board (IPSASB) issues a webinar on preliminary views on revenue and non-exchange expenses.

IFAC rumbled Monitoring Group Consultation on 'Strengthening the governance and oversight of the International Audit-related standard setting Boards in the Public Interest.' It sounds boring, accountants are boring, but someone is not happy. IOSCO, Basel Committee, European Commission, World Bank, issued a paper on splitting up IFAC. IFAC isn't happy, read the IFAC-Views-and-Reactions.pdf It is quite a paper, there is a lot of emotion in there. In one sense they have a point, why change if it works? I guess because it doesn't, does it? If listed entities are suddenly becoming insolvent something is wrong. More here.

WHAT'S NEW FROM THE ACCOUNTING PROFESSION

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

KPMG Illustrative Disclosures for Investment Funds. The guide illustrates examples of two different funds in two appendices. Appendix I disclosures for an investment fund that is an investment entity and measures its subsidiaries at fair value through profit or loss (FVTPL) and this fund is outside the scope of IFRS 8 Operating Segments.
Appendix II illustrates disclosures for a multiple-segment fund that falls in the scope of IFRS 8. Details here.
KPMG IFRS Health check. ***KPMG IFRS Health Check.html*** It's a health check.
Issues related to year ending 31 December 2017. In this special edition, Deloitte sets out financial reporting issues as a result of areas of regulatory focus, economic environment or change in accounting standards.
The publication focuses on possible effects of new accounting standard IFRS 15 and IFRS 9 and the reporting of non-GAAP alternative measures. Click here to read more.

Accounting for joint arrangements in the power and utilities sector. EY looks at some of the challenges of applying IFRS 10 and 11. The relevant activities over which power is exercised are the current activities. They are not residual activities, because by definition residual activities do not have a material effect on return. IFRS 10 refers to power to influence return. Joint arrangements.pdf Practical matters.pdf

IFRS 16. The impact of the new lease standard "IFRS 16" is impacting all entities, including shipping and the transportation industry. A study by PwC Global Lease Capitalization predicts a median increase of Debt by 24% and a median increase of EBITDA by 20% in the industry. Most of the challenges of the new standard will be borne by the lessees not the lessors. Due to the existence of many shipping arrangement, each will have to be assessed differently, for example:

- Bareboat contracts meet the new definition of a lease because the lessee has control over the use of a specific ship.
- Time contracts and pool arrangements contain both a lease (the right to use a specific ship) and service components (operation and maintenance by the owner of the ship).
- Voyage contracts are service contracts and thus do not meet the new definition of a lease.
- Contracts of affreightment are unlikely to meet the definition of a lease, since they have characteristics indicating that they are contracts for the provision of a service rather than the use of an identified asset.

However, judgment is required to separate lease and non-lease components of a contract. Most contracts do not and some decide not to apply the separation, keeping in mind the lease obligation and the significance of the non-lease components. Leading to challenges such as the identification of events that are out of the control of the lessee leading to reassessment of the lease accounting. Further reading here.

ADAA IFRS digest

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

January 2018

A sorry start to the year – an insight from ADAA's Steve Ralls

Only a few weeks in to 2018 and January has provided a nasty surprise.
In the UK Carillion was put into compulsory liquidation. Not administration or receivership where time is available to find a buyer of the whole or constituent parts. But directly into liquidation.
This is serious because Carillion was in some respects an extension of the public sector building schools, hospitals, prisons and highways and operating them through what is known as Private Finance Initiative (PFI) contracts. We have similar arrangements in Abu Dhabi, so if we were thinking of a financial examination what would we look at? Print off Carillion's: Annual report 31 December 2016 and let's look through.

The clutter test

The report is long split 50:50 between front and back. Management can say what they wish in the front half, the Auditor is responsible for ensuring what management says does not undermine the credibility of the IFRS financial statements in the back half (ISA 720).

Management influence on revenue and profit recognition

Page 38 is worth a look. *"The Group delivered revenue growth and improved underlying profit from operations coupled with good cash flow conversion."* Revenue growth of 600 million UK pounds is primarily in the construction sectors. These apply percentage of completion accounting. Revenue and profit recognition in percentage of completion accounting depends on a spreadsheet, with lots of management judgements of what the outturn of a project will be. Simplistically If activity is increased, spending increased, construction revenue goes up. However, risk moves from construction to collection. Four months after the 31 December financial statements were published, in the 30 June half year statement a contract receivables impairment of 600 million is booked.
Underlying profit increased 1.5 million. Did it? No adjustment was made for a (one off 2013 cited as the only other time page 132) 20 million license fee that was deemed not linked to supply contracts. It maybe, it may not but what are the payment terms? Is payment made over time or paid upfront? Net cash flow from operating activities flat at 73.3 million. As a rule of thumb, cash should equal profit plus depreciation. Anything different to this and you should question revenue recognition policies.
Carillion was a business of 5.2 billion in revenues that generated cash of only 73 million, a return of 1.4%. This is somewhat different to the 4.9% reported in 'alternative performance measures (APMs)' and somewhat different to the industry sector of 2%. The use of APMs is always controversial because why is an IFRS measure not enough?
As a result of just these few things we would expect to see on the audit file reference to heightened professional skepticism being applied. Was it?

What the auditor thinks is important

The audit opinion is the new one with Key Audit Matters (KAMs), KAMs are those the auditor deemed most significant in their reporting to those charged with governance (TCWG). They are not all those reported. The auditor reports just three:

1) ***Recognition of contract revenue, margin, related receivables & liabilities.*** (Basically the whole of the contracts business is a big risk!)

A business primarily based on long term contracts must operate tight internal controls over key performance indicators and service delivery and ensure its customers are in agreement with paying for performance to date (IFRS 15.35(c) satisfying service performance obligations is a little bit different from risks and rewards (IAS 11.22). The KAM lists the procedures completed in the contract reviews. Commentators in the press identify four significant projects: Aberdeen bypass, Msheireb in Doha, Hospitals in Birmingham and Liverpool. The audit procedures are those we would expect to see, including site visits and discussion with operations. There is nothing that has obviously not been done. Therefore either what was done, was not done well, or what happened could not have been foreseen.

2) Carrying value of goodwill.

IAS 36 requires an annual impairment assessment of goodwill and testing of goodwill at the level of a cash generating unit (CGU) which can be no bigger than that of an IFRS 8 defined operating segment. Carillion considers it has four operating segments and four CGUs. i.e. the operating segment is the CGU. This is unlikely given 100 or more separate legal entities and aggregation of goodwill from different acquisitions to test in the same segment is a known weakness in the accounting standard.
To assess the value of goodwill, Carillion measured Value in Use (VIU) at the Net Present Value of future earnings. This means goodwill was valued based on management's assessment of their own ability to win, extend and deliver contracts, primarily with customers in the UK Services sector. The segment reporting discloses the underlying operating profit of the sector is 182.7 million which equates to a six-year life, not unreasonable for the service sector.

3) Other revenue judgements (New risk)

Only 20 million in revenue terms but is 15% of group profit. The risk is whether to recognise revenue at a point in time or over time. Because the license was entered into at the same, or around the same time as other contracts with the same counter-party. The accounting treatment is a boost to profit whether it is correct requires a better understanding of the contracts, the length, and how or if they relate by understanding business development and organization structure.

***Where did it go wrong*?**

Maybe Carillion was unlucky. Four big construction projects going wrong is certainly bad luck. Maybe there was nothing that could be done earlier. Maybe the Chairman was correct in his 2016 statement that governance was strong, scrutiny applied to assessment of performance and risk management and control processes, and on constructively challenging the Executive Directors.
The evidence should be on the audit file, inside the minutes of meeting of the Board, and the Audit Committee, and in the risk register listing the risk of four contracts going wrong with an appropriate strategy to deal with it happening. One would expect to see separate project committee meeting minutes for all, management accounts and communications to and from customers.

What to learn from the collapse?

Red flags? Auditor for 19 years. No going concern disclosure. Pension deficit. Debt increasing. Trade debtors increasing. KAMs.
It cannot be under estimated the value Audit Committee and Auditors bring, by taking contra positions and examining audit evidence thoroughly.

جهاز أبوظبي للمحاسبة
ABU DHABI ACCOUNTABILITY AUTHORITY

ADAA IFRS digest

IFRS news, updates from ADAA, IASB and the Accounting Profession **January 2018**

Property of:

Abu Dhabi Accountability Authority Hamdan Street, Falcon Tower, Abu Dhabi, P.O. Box: 435 -
Phone: +971 2 639 2200 Fax: +971 2 633 4122
www.adaa.abudhabi.ae