جهاز أبوظبي للمحاسبة
ABU DHABI ACCOUNTABILITY AUTHORITY

ADAA IFRS DIGEST

IFRS news from ADAA, IASB, and the Accounting Profession

December 2019

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NEWS THIS MONTH

> **Selecting and Applying Accounting Policies.** IFRS Foundation Guide.

> **IAS 12 Income Taxes.** A 40-year old standard in a fast changing tax environment.

> **Developments in Audit 2019.** FRC report.

> **Exploring the IESBA Code.** An in-depth look at the Int. Code of Ethics for Professional Accountants.

> **2020 – Opportunities and challenges.** IASB's upcoming consultations.

> **UK Corporate Governance Code.** Comparing to the US.

> **Determining accounting estimates and related disclosures.** IAASB's management briefing.

IN DEPTH

> **FRC Thematic Review on IFRS 15 'Revenue from contracts with customers'** insight from ADAA's Hasina Al Adawi.

NEWS IN DETAIL

> Selecting and Applying Accounting Policies. This guide will help companies determine their accounting policies when preparing IFRS financial statements. IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' specifies the requirements for selecting and applying accounting policies. In the absence of an IFRS Standard that specifically applies to a transaction, management uses its judgement in developing and applying an accounting policy that results in information that is reliable and relevant to an investor's economic decision-making needs.

> IAS 12 Income Taxes. PWC's IFRS talk (link) discusses IAS 12 as it celebrates its 40th birthday against a backdrop of major economies overhauling their tax systems on regular basis. The talk also touches upon the recently issued IFRIC 23 'Uncertainty over Income Tax Treatment' and the clarification it provides in relation to taking into consideration the expectations of tax authorities.

> Developments in Audit 2019. The FRC's report covers the quality review inspections of the seven largest audit firms over the past year and highlights the following:

- Audit quality is not consistently reaching the necessary high standards expected.
- The biggest seven firms failed to meet the FRC's 2019 inspections target for FTSE 350 entities.
- Insufficient challenge of management remains the dominant finding, but worrying shortcomings also seen in routine audit procedures.
- Work over the "front half" of annual reports inconsistent and not always in line with Auditing Standards.

Read the 2019 FRC report or an ICAEW summary here.

> Exploring the IESBA Code. This 12-month series takes an in-depth look at the International Code of Ethics for Professional Accountants. Each installment of the series will highlight key aspects of the Code in a manner that is relatable, with special focus placed on the recent revisions to the Code. The first installment of the Exploring the IESBA Code deals with the five Fundamental Principles of ethics which establish the standard of behavior expected of all professional accountants - a standard which enable accountants to uphold their responsibility to act in the public interest. To read and download this and future installments, visit the IFAC website.

> 2020 – Opportunities and challenges. Chair of the IASB Hans Hoogervorst delivered the opening speech at the World Standard-setters Conference, highlighting important upcoming consultations from the Board:

- Exposure draft by the end of 2019 on Primary Financial Statements that focuses on providing better structure and content in IFRS financial statements. This has 3 main parts: subtotals in the income statement (including operating profit), management performance measures, and improving disaggregation.
- A discussion paper by February 2020 covering goodwill and impairment.
- Exposure draft for rate-regulated activities in the first half of 2020.
- A revised Management Commentary Practice Statement and proposals for Business Combinations under Common Control. Read more, here.

> UK Corporate Governance Code. The US approach to internal control attestation raises questions about whether existing board responsibilities under the UK Corporate Governance Code is sufficient guidance for boards to execute their responsibilities. Deloitte's publication discusses the limitations of the Code and considers the differences between UK and US requirements. Useful recommendations set out in the publication will assist boards to meet their responsibilities and establish a framework of prudent and effective controls.

> Considerations for management when determining accounting estimates and related disclosures. The IAASB has prepared an Audit Client Briefing (based on a CPA Canada briefing) to make senior finance staff aware of matters to consider in preparing for the auditor's requests pertaining to ISA 540 (Revised) 'Auditing Accounting Estimates and Related Disclosures'.

This Briefing provides an overview of:

- Management's responsibilities in determining when accounting estimates are needed;
- Management's responsibilities regarding the main components of an estimation process; and
- The impact on management because of changes to the auditor's responsibilities, including broad questions auditors are likely to ask those involved in the detailed aspects of the estimation process.

FRC Thematic Review on IFRS 15 'Revenue from contracts with customers' insight from ADAA's Hasina Al Adawi

> Introduction

IFRS 15 came into effect on 1 January 2018. It introduces a single principles based five-step model to account for revenue. IFRS 15 has more extensive disclosure requirements than previous revenue standards both qualitatively and quantitatively. This article summarises the key findings from the FRC's Thematic Review of IFRS 15, covering company disclosures in the first year of application which was published in October 2019. The FRC assessed the comprehensiveness and quality of revenue disclosures against IFRS 15 requirements to evaluate whether there was sufficient information provided to enable a user to understand the impact of adopting IFRS 15.

> Scope

The FRC reviewed a total of 25 annual reports applying IFRS 15 for the first time. The sample targeted the industries that the FRC expect the implementation of IFRS 15 to have the most significant impact: Software & Computer Services, Construction, Aerospace & Defence, Telecoms, Pharmaceuticals & Biotechnology, Support services, Travel & Leisure and Others (including media, utilities and real estate).

> Key Findings

Transition to IFRS 15 and impact

IFRS 15 allows 2 methods of transition: apply IFRS 15 in full to prior periods (full retrospective) or retain prior period figures as reported under the previous standards (modified retrospective). Of the 25 companies, 13 chose the modified retrospective, 10 chose the full retrospective and two companies said IFRS 15 had no impact. Surprisingly 60% said the impact of adopting IFRS 15 was not material. In 20% of cases, revenue was deferred, and in 16% revenue was brought forward. In 4% of cases cost were deferred. Where the impact of adopting IFRS 15 was reported as not being material, the FRC considered whether significant judgements made in reaching this conclusion had been adequately disclosed and whether the accounting policies and disclosures reflected the new requirements.

Good practice observed:

- Disclosure of the transition method adopted.
- Explanation of the transition adjustment by category of impact (e.g. principal/agent, timing of recognition).
- Where the modified retrospective method was adopted:

- Disclosure of current year results under previous IFRS, in addition to those presented under IFRS 15, providing users with useful trend information.

- Clarification that revenue was determined under IFRS 15 in the current period and previous IFRS in the prior period which impacts the comparability of information.

Areas for improvement:

- Quantification of the transition adjustment to retained earnings disaggregated by categories of impact and by financial statement line item.
- Disclose the impact on the comparative period's earnings per share for companies that adopted the full retrospective method.
- Disclose the previous accounting policy if adopting the modified retrospective approach.

Accounting policies

There is scope to improve explanations of accounting policies for revenue recognition such as the specific nature of performance obligations and when they are satisfied, including whether a company is acting as agent in providing any goods and services. Some entities provided generic descriptions of the five-step model without tailoring to their particular circumstances or continued to use boiler-plate descriptions and terminology from previous IFRS.

Other findings:

- It should be clear what revenue policies are applied to the different business segments which are described in the strategic report and in the segmental note. For some companies it was not readily apparent how these related.
- References to contract variations and claims were confusing. It was sometimes unclear whether the issue was about variable consideration enforceable under the existing terms of the contract or was related to contract modifications.
- The extent of disclosures about variable consideration was disappointing.
- Significant judgements made in assessing whether estimates of variable consideration should be constrained should also be disclosed.
- Companies could have provided clearer explanations, with justification, for the accounting for licenses.
- Many companies disclosed specific policies tailored to their individual circumstances, however it was not always

clear exactly how the specific policies complied with the accounting requirements of IFRS 15.

Judgements about the amount and timing of revenue

Significant judgements made in applying IFRS 15 that affect the amount and timing of revenue recognition should be clearly explained and company specific. The main issues identified were:

- Disclosure of all judgements rather than those having a significant effect on the amount and timing of revenue recognised.
- Some descriptions lacked clarity about the specific judgements made.
- The omission of disclosures by companies in industries where there are expected to be significant judgements.
- Few companies explained why the method used to recognise revenue over time provided a faithful depiction of the transfer of goods or services.
- Where the judgements involved estimation uncertainty quantitative disclosure, such as sensitivities or ranges of potential outcomes, was not always provided.

Revenue Disaggregation

Disaggregated revenue disclosures to be consistent with information provided outside of the financial statements. This includes information in the strategic report, such as the business model and divisional reviews, investor presentations and any other analysis of revenue used to assess performance or allocate resource.

Contract balances

Most companies clearly disclosed the opening and closing balances for receivables, contract assets and contract liabilities from contracts with customers either in the primary statements or the notes. Areas for improvement:

- Better explanations needed for the difference between contract assets and trade receivables enabling users to understand the different risks.
- Also for how the timing of satisfaction of performance obligations relates to the typical timing of payment and the effect that those factors have on the contract asset and contract liability balances.
- The extent of disclosures explaining significant changes in the contract asset and contract liability balances varied.
- few companies reviewed disclosed revenue recognised in the period from performance obligations satisfied, or partially satisfied, in previous periods.

Contract costs

Under IFRS 15, the incremental costs of obtaining a contract must be recognised as an asset if the entity expects to recover those costs and certain criteria are met. Some accounts made no reference to the costs of obtaining and fulfilling revenue contracts which might be material given the companies' activities, such as those involved in longer term contracts.

Accounting policies could be further enhanced by describing when capitalisation occurs in practice. In relation to costs to fulfil a contract (e.g. set-up or mobilisation costs) good disclosures explained the nature of the different costs. They also clarified that costs were first assessed to see if they were within the scope of other standards and, if not, only recognised when they met the three criteria required by IFRS 15 for capitalisation.

Missing disclosure requirements relating to assets recognised from the costs to obtain or fulfil a contract with a customer:

- The amortisation method applied and the amount of amortisation and any impairment losses recognised in the period.
- The closing balances by main category of asset (for example, commissions, set-up costs).

Other issues

- IFRS 15 requires disclosure of the amount of the transaction price allocated to performance obligations that were unsatisfied or partially unsatisfied at the end of the period ('backlog') and an indication of when that revenue is expected to be recognised. Some companies did not provide the required information when it appeared to be relevant and possibly material.
- Only one company referred to breakage (customers' unexercised rights).
- IFRS 15 requires entities to assess contract assets for impairment in accordance with IFRS 9 'Financial Instruments'. For some companies there was no evidence that contract assets, in addition to trade receivables, had been assessed for impairment.

> Final thoughts

The implementation of IFRS 15 was a significant challenge and change for many companies, following a period of relative stability in terms of financial reporting requirements. The best disclosures gave information over and above that required by the standard, providing users with a clear understanding of the impact of IFRS 15. However, boiler plate accounting policies still persist, even under IFRS 15.

IFRS DIGEST TEAM

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

> Sara Al Ateeqi	> Dawood Al Hammadi	> Saada Al Menhali
> Faisal Al Kathiri	> Fatima Al Khyeli	> Sara Al Sajwani
> Salwa Al Seiari	> Ghais Kadi	> Fatema Lari

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