Joint IASB-FASB Meeting
February 16, 2010

IASB agenda reference	**5B**
FASB memo reference	**127B**

Project	**Revenue Recognition**
Topic	**Transition requirements**

Purpose

1. This paper addresses the proposed transition requirements for the new revenue recognition standard.

Summary of staff recommendations

2. The staff recommend that:

   (a) an entity should apply the new standard retrospectively, but not to those contracts completed prior to the effective date,

   (b) an entity should be permitted to apply the new standard on a full retrospective basis,

   (c) no transitional reliefs should be granted to supplement the existing guidance in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and FASB ASC Topic 250 *Accounting Changes and Error Corrections* (formerly FAS 154 *Accounting Changes and Error Corrections*) on impracticability,

   (d) transition disclosures should be required in accordance with IAS 8 and FASB ASC Topic 250, and

   (e) *[for IASB only]* no exemption should be made to the transition requirements of IFRS 1 *First Time Adoption of International Financial*

This paper has been prepared by the technical staff of the FASB and the IASCF for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of IFRSs or U.S. GAAP do not purport to be acceptable or unacceptable application of IFRSs or U.S. GAAP.

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Reporting Standards for first-time adopters of IFRSs in respect of the proposed standard.

Structure of the paper

3. The paper is organised as follows:
   (a) alternative transition methods
   (b) potential transition reliefs
   (c) transition disclosures
   (d) potential exemption for first-time adopters of IFRSs (IASB only).
4. Agenda paper 5C / Memo 127C discusses effective date. Throughout these papers, the effective date is the beginning of the period in which an entity first applies the new standard.

Alternative transition methods

5. The staff think that there are three principal transition methods for the Boards to consider:
   (a) retrospective application,
   (b) limited retrospective application, and
   (c) prospective application.

Retrospective application

6. With this method, in the first financial statements following the effective date, an entity would apply the new standard to:
   (a) all contracts in existence at the start of the earliest period presented in those financial statements as if the new standard had always been applied to those contracts, and
   (b) all contracts entered into after the start of the earliest period presented.

7. The FASB permitted, but did not require this method as an option for entities adopting FASB ASC Subtopic 605-25 *Revenue Arrangements with Multiple Deliverables* (EITF 08-1).

8. The advantages of this method are:

   (a) Comparative amounts are prepared on the same basis as amounts in the current period. This provides consistent trend information, which is important for users' models and also in understanding the effect of the change in accounting requirements.

   (b) It is consistent with the default approach for accounting for a change in accounting policy in IAS 8 and FASB ASC Topic 250.

9. The disadvantages of this method are:

   (a) An entity needs to restate the accounting for all contracts prior to the effective date. That could be burdensome because of the large number of contracts, especially if there is a lack of data about those contracts (although IAS 8 and FASB ASC Topic 250 do not require restatement if it is impracticable).

   (b) It might be difficult for an entity to make estimates as of earlier dates (eg in accounting for uncertain consideration, estimating standalone selling prices at contract inception). This difficulty would be reduced if there is a long period between issuance of the standard and its effective date.

Limited retrospective application

10. With this method, in the first financial statements following the effective date, an entity would apply the new standard to:

    (a) all contracts existing at the start of the current period, and

    (b) all contracts entered into after the start of that period.

Comparative amounts would not be restated. The cumulative effect of applying the new standard would be recognised as an adjustment to the opening balance of retained earnings for the current period.

11. The FASB required this approach for FASB ASC Subtopic 944-605 (formerly FAS 163 *Accounting for Financial Guarantee Contracts*).

12. The advantages of this method are:

    (a) An entity does not need to restate the accounting for contracts that have ended before the start of the current period.

    (b) An entity needs to make fewer estimates as of earlier dates than are needed for the retrospective method.

    (c) An entity needs only to determine the cumulative revenue it would have recognised at the start of the current period and does not need to allocate that revenue to different prior periods.

    (d) Comparability is achieved more quickly than with the prospective method.

13. The disadvantages of this method are:

    (a) Current period amounts are not prepared on the same basis as comparative amounts, which limits the usefulness of trend information.

    (b) Some consideration from some contracts would never appear on the face of a performance statement; some consideration would appear on the face of performance statements for two different periods. For instance, suppose the effect of the model would be to accelerate the pattern of revenue recognition on an entity's contracts. The entity would make a one-time cumulative adjustment to opening equity for the effect of the acceleration, but that amount would not appear on the face of a performance statement in any period presented.

Prospective application

14. With this method, an entity would apply the new standard to all contracts entered into on or after the effective date.

15. The FASB required this approach for FASB ASC Subtopic 605-25 (EITF 08-1 *Revenue Arrangements with Multiple Deliveries*), although the FASB permitted retrospective application.

16. The advantages of this method are:

    (a) It is simple to apply: an entity does not need to restate the accounting on any contract.

    (b) It does not require an entity to make estimates as of earlier dates; all information required is readily available at the time.

17. The disadvantages of this method are:

    (a) Post-effective-date period amounts are not prepared on the same basis as pre-effective-date period amounts, thereby affecting trend information.

    (b) Amounts in the financial statements are not prepared on a consistent basis within the same accounting period. Contracts entered into before the effective date would be accounted for in accordance with existing standards, those entered into later in accordance with the new standard. If an entity has long-term contracts, the lack of comparability could persist for some years.

Staff analysis and recommendation

18. All users of financial statements place significant emphasis on revenue and revenue is a major input into both cash flow and profit modeling routinely used by investors.

19. The retrospective method best facilitates users' trend analyses as the financial information reported is comparable both between all reported periods and for all transactions within a reported period.

20. However, that method places a greater burden on preparers, in particular when having to restate contracts that have already been completed. That burden may not be justified on a cost-benefits basis.

21. The EITF considered similar arguments when developing FASB ASC 605-25 (EITF 08-1). This guidance resulted in significant changes to the basis of recognising revenue, albeit probably not as extensive as those currently proposed. The EITF decided on prospective application to avoid burdening preparers unduly.

22. While acknowledging the difficulties which full retrospective application presents, the staff think that prospective application as proposed in paragraphs 14-17 above would not provide sufficient comparability for users of financial statements. The mixed basis of accounting for old and new contracts within the same period would persist until the last pre-effective-date contract was completed. Consequently, the staff do not recommend prospective application.

23. The staff think an application method is required which delivers comparability of reported information quickly without resulting in the need for excessive restatement by preparers. Limited retrospective application, described in paragraphs 10-13, provides a better balance between comparability and ease of transition. From the date of transition all contracts, old and new, are accounted for in accordance with the new standard, based on a contract asset or liability as at that date.

24. In order to recognise that opening position, however, the staff think the entity would in practice need to restate contracts from inception to both identify the performance obligations in the contract and then to allocate the transaction price to those performance obligations. In the absence of this restatement, the staff believe it would be too difficult to allocate the transaction price reliably to the remaining performance obligations of part completed contracts.

25. In a model based on a transaction price allocated at inception, a significant level of restatement is likely to be required to implement the model proposed using any form of limited retrospective application.

26. The staff recommend that retrospective application be required, therefore, but only for those contracts still in existence at a mandated date.

    (a) That date could be anytime after publication of the final standard, but would be most useful if it were immediately before the effective date.

    (b) No 'closed' contracts would need to be restated under this method.

    (c) The restatement effect of applying the new standard to continuing contracts would result in an adjustment to the opening equity of the period in which the change is made, ensuring that all revenue recognised after the effective date is presented on a consistent basis.

27. The staff also think, however, that some entities might conclude that the benefits of fully comparative figures outweigh any costs of restatement. This is likely to be the case where users place such emphasis on trend analyses of revenue that they demand restated figures.

28. To fulfil this need the staff recommend that full retrospective application should also be permitted.

Potential transition reliefs

29. If the boards agree with the staff's recommendation and either limited or full retrospective application is applied, an entity will have to restate some (or all) contracts. For many contracts this will present few practical problems (eg short term contracts, single-element contracts).

30. For other contracts, transition will be difficult. This is especially true where the entity is required to make estimations, as at an earlier date. In the model proposed, these estimates could be of several types:

    (a) Estimates of the amount of total contract consideration (uncertain consideration, time value of money, noncash consideration).

    (b) Estimates of the basis for the allocation of that contract consideration to performance obligations (ie selling prices for goods or services that are not sold separately and for which an entity previously did not have to make such estimates).

(c) Estimates of the amounts of performance obligations satisfied for part completed contracts.

31. The use of estimates has always created difficulty when any standard is applied retrospectively. For that reason, the Boards have already issued guidance on 'impracticability' in IAS 8 and FASB ASC Subtopic 250-10 (see Appendix A).

32. That guidance specifies the circumstances under which the estimations required for retrospective application cannot be made and also warns against the use of hindsight when applying a new accounting policy.

33. The staff, therefore, think that the guidance provided by IAS 8 and FASB ASC Subtopic 250-10 is adequate and that no additional transitional relief should be granted.

34. Transition will also be easier, and any difficulty in estimation will be reduced, if the Boards specify an effective date that is significantly later than the publication date of the standard. This is the subject of Agenda Paper 5C, Memo 127C.

Transition disclosures

35. The staff's recommendation of limited retrospective application means that entities would in **all** periods presented apply the new model to contracts which continue after the effective date, but in the comparative periods would apply the old models to contracts completed before the effective date. The effect of the initial application of the new standard must be made clear in the financial statements.

36. In the staff view, the existing disclosure requirements of IAS 8 and FASB ASC Subtopic 250-10 (see Appendix B) would allow a user to compare the current period with previous periods and to evaluate adequately the effect of the new standard on revenue recognised in current and comparative periods. The staff do not recommend any additional disclosure requirements, therefore.

Question 1
The staff recommend that: (a) an entity should apply the new standard retrospectively, but not to those contracts completed prior to the effective date; (b) an entity should be permitted to apply the new standard on a full retrospective basis; (c) no transitional reliefs should be granted to supplement the existing guidance in IAS 8 and FASB ASC Topic 250 on impracticability; (d) transition disclosures should be required in accordance with IAS 8 and FASB ASC Topic 250. Do the boards agree?

Potential exemption for first-time adopters of IFRSs (IASB only)

37. The staff considered whether additional guidance should be given to first-time adopters of IFRSs in respect of the limited retrospective application method recommended by the staff. The recommended application method acknowledges the burden which full retrospective application places on preparers and relieves that burden for contracts which are completed before the effective date. IAS 8 provides further guidance when the application method proposed is impracticable.

38. The impracticability requirements of IAS 8 do not apply to first-time adopters. The staff considered whether first-time adopters, who adopt IFRSs close to the issuance date of the standard, would be disadvantaged compared with those who adopt IFRSs at a later date or those who already report in accordance with IFRSs and can rely on the impracticability guidance of IAS 8.

39. The staff concluded no exemption is required for first-time adopters:

    (a) IFRS 1 requires the retrospective application of other IFRSs.

(b) BC10 of that standard records the Board's decision that it is important to achieve comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date. Compared with this, achieving comparability between first-time adopters and entities that already apply IFRSs is a secondary objective.

(c) In Agenda Paper 5C / Memo 127C, the staff recommend that early adoption of the standard be permitted and recommend that an exemption be granted for first-time adopters of IFRSs if the board do not approve that recommendation. That will allow first-time adopters to avoid a two-stage transition to IFRSs for revenue recognition if they have sufficient contract information prior to the effective date.

Question 2
The staff recommend that no exemption should be made to the transition requirements of IFRS 1 for first-time adopters of IFRSs in respect of the proposed standard. Does the IASB agree?

Appendix A Impracticability guidance

FASB ASC Section 250-10-45

250-10-45-9 It shall be deemed impracticable to apply the effects of a change in accounting principle retrospectively only if any of the following conditions exist:

a. After making every reasonable effort to do so, the entity is unable to apply the requirement.

b. Retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated.

c. Retrospective application requires significant estimates of amounts, and it is impossible to distinguish objectively information about those estimates that both:

> 1. Provides evidence of circumstances that existed on the date(s) at which those amounts would be recognized, measured, or disclosed under retrospective application
>
> 2. Would have been available when the financial statements for that prior period were issued.

250-10-45-10 This Subtopic requires a determination of whether information currently available to develop significant estimates would have been available when the affected transactions or events would have been recognized in the financial statements. However, it is not necessary to maintain documentation from the time that an affected transaction or event would have been recognized to determine whether information to develop the estimates would have been available at that time.

IAS 8 paragraphs 50 – 53

50 In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 51–53, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

51 It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for

estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

52 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

(b) would have been available when the financial statements for that prior period were authorised for issue

from other information. For some types of estimates (eg an estimate of fair value not based on an observable price or observable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in measuring financial assets previously classified as held-to-maturity investments in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*, it does not change their basis of measurement for that period if management decided later not to hold them to maturity. In addition, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with IAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Appendix B Disclosure requirements of IAS 8 and ASC 250

IAS 8 paragraphs 28-31

28 When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the IFRS;

(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

(c) the nature of the change in accounting policy;

(d) when applicable, a description of the transitional provisions;

(e) when applicable, the transitional provisions that might have an effect on future periods;

(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;

(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(h) if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

29 When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 applies to the entity, for basic and diluted earnings per share;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

30 When an entity has not applied a new IFRS that has been issued but is not yet effective, the entity shall disclose:

(a) this fact; and

(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity's financial statements in the period of initial application.

31 In complying with paragraph 30, an entity considers disclosing:

(a) the title of the new IFRS;

(b) the nature of the impending change or changes in accounting policy;

(c) the date by which application of the IFRS is required;

(d) the date as at which it plans to apply the IFRS initially; and

(e) either:

(i) a discussion of the impact that initial application of the IFRS is expected to have on the entity's financial statements; or

(ii) if that impact is not known or reasonably estimable, a statement to that effect.

ASC 250-10-50 Disclosure

General Note: The Disclosure Section provides guidance regarding the disclosure in the notes to financial statements. In some cases, disclosure may relate to disclosure on the face of the financial statements.

General

> Accounting Changes

> > Change in Accounting Principle

250-10-50-1 An entity shall disclose all of the following in the fiscal period in which a change in accounting principle is made:

a. The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.

b. The method of applying the change, including all of the following:

1. A description of the prior-period information that has been retrospectively adjusted, if any.

2. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required.

3. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

4. If retrospective application to all prior periods is impracticable, disclosure of the reasons therefore, and a description of the alternative method used to report the change (see paragraphs 250-10-45-5 through 45-7).

c. If indirect effects of a change in accounting principle are recognized both of the following shall be disclosed:

1. A description of the indirect effects of a change in accounting principle, including the amounts that have been recognized in the current period, and the related per-share amounts, if applicable

2. Unless impracticable, the amount of the total recognized indirect effects of the accounting change and the related per-share amounts, if applicable, that are attributable to each prior period presented. Compliance with this disclosure requirement is practicable unless an entity cannot comply with it after making every reasonable effort to do so.

Financial statements of subsequent periods need not repeat the disclosures required by this paragraph. If a change in accounting principle has no material effect in the period of change but is reasonably certain to have a material effect in later periods, the disclosures required by (a) shall be provided whenever the financial statements of the period of change are presented.

250-10-50-2 An entity that issues interim financial statements shall provide the required disclosures in the financial statements of both the interim period of the change and the annual period of the change.

250-10-50-3 In the fiscal year in which a new accounting principle is adopted, financial information reported for interim periods after the date of adoption shall disclose the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), and related per-share amounts, if applicable, for those post-change interim periods.