Project **Financial Statement Presentation**

Topic **Transition and effective date**

Introduction

1. At the 3 March 2010 joint board meeting, the staff will ask the boards to decide on the overall **transition** approach to be included in the financial statement presentation (FSP) exposure draft (the ED). Other than a possible sweep issues meeting, this will be the last deliberative board meeting prior to issuing the ED.

2. This paper includes several transition alternatives based on the feedback received at our recent meeting with the Joint International Group (JIG) and the Financial Institution Advisory group (FIAG). Because the boards will not be including specific effective dates in its exposure drafts, this paper does not propose a **specific effective** date for inclusion in the exposure draft. However, this paper does address whether **early adoption** should be permitted and whether first-time adopters of IFRSs (IASB only) should apply provisions in the ED.

3. This paper presumes that when adopting the new FSP standard, an entity that follows IFRSs will present three statements of financial position (because this is a restatement of prior periods) and two statements of comprehensive income, cash flows, and changes in equity, consistent with IAS 1. In Phase A, the FASB agreed to the comparative period requirements in IAS 1, thus the US GAAP requirement for comparative financial statements will be the same. (The SEC currently requires three statements of comprehensive income (income statements), cash flows, and changes in stockholders' equity and two statements

of financial position. The FASB staff has had preliminary discussions with the SEC staff about the difference between those requirements and the FASB's Phase A tentative decision.)

4. In addition, this paper presumes that the FSP standard would not be effective any sooner than 1 January 2013 (see paragraph 31).

Summary of staff recommendations

5. The staff recommend that in terms of **transition**:

   (a) an entity should be required to apply the financial statement presentation (FSP) standard following a retrospective application in phases approach. However, if the effective date will be three or more years after issuance (possibly because other Memorandum of Understanding [MoU] projects will be implemented first), then the staff recommend a full retrospective application.

   (b) *[for IASB only]* an exemption should be made to the transition requirements of IFRS 1 *First Time Adoption of International Financial Reporting Standards* for first-time adopters of IFRSs if the final standard requires something other than full retrospective application.

6. The staff recommend that in terms of **effective date**:

   (a) the exposure draft should give some indication of the proposed time between the issuance of the standard and its effective date and should include a question soliciting information about the amount of time needed to prepare for and implement the changes proposed.

   (b) early adoption should not be permitted.

   (c) early adoption should not be permitted for first-time adopters *[for IASB only]*.

Issue 1: Transitional provisions

7. The following paragraphs describe four transition approaches for the boards' consideration:

(a) full retrospective application

(b) retrospective application in phases

(c) prospective application

(d) limited retrospective application.

Full retrospective application

8. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires any change in an accounting policy that is required by a new IFRS to be treated retrospectively unless that new IFRS provides specific transitional provisions. Accounting Standards Codification (ASC) Topic 250 *Accounting Changes and Error Corrections* has similar requirements for a change in accounting principle.

9. Retrospective application would require an entity to apply the financial statement presentation requirements to previously issued financial statements. This would entail reclassifications, new groupings and disaggregation of comparative information presented and disclosed for each prior period as if the new presentation provisions had always been applied. Because the FSP ED does not address recognition or measurement, it will not require any adjustments to the opening balance of retained earnings.

10. Retrospective application of the FSP standard would ensure the comparability of financial statements with those of previous periods, thereby allowing users of financial statements to compare the financial statements of an entity to identify trends in its financial position, performance and cash flows for predictive purposes.

11. The implications of this approach for financial statement presentation are:

    (a) information may not be available to recast financial statements of prior periods, possibly requiring the use of numerous assumptions

    (b) it may be impractical to recreate the information needed for comparative purposes.

12. We understand that it would be impossible or at least cost prohibitive to require an entity to prepare a direct method statement of cash flows (SCF) for prior years because this information might not be available. Therefore, full

retrospective application might not be feasible for the FSP project. However, if enough time is given between issuance of the standard and its effective date, retrospective application should be a viable alternative even for a direct method SCF because an entity will be able to compile the cash flow data needed during the period in which the cash flows occur.

Retrospective application in phases

13. Under a retropsective application in phases approach, an entity would implement the presentation and disclosure requirements retrospectively so that comparative periods are presented in the same manner; however, an entity would not apply all of the new requirements at the same time. The FSP ED will include the following presentation and disclosure requirements:

    (a) alignment of information across the financial statements into defined sections, categories and subcategories

    (b) increased disaggregation by function, nature and measurement basis in the statements of financial position, comprehensive income and cash flows

    (c) analyses of changes in assets and liabilities in the notes to financial statements

    (d) disclosure of remeasurement information in the notes

    (e) presentation of a direct method SCF, an indirect reconciliation of operating income to operating cash flows and recategorization of the items reported within the SCF

    (f) additional operating information for each reportable segment in the segment note (FASB only).

14. Using this approach, the standard would indicate which of the above:

    (a) would be applied at the first effective date (eg two–three years after the standard is issued)

    (b) would be applied after the first effective date (eg one year later)

    (c) would be applied at the latest effective date (that is, when all of the requirements need to be applied) (eg two years after first effective date).

15. The main advantages of this approach are that:

(a) it allows for a long implementation period for preparers of financial statements to gather information for retrospective purposes

(b) it gradually introduces the new presentation and disclosure requirements, thus preparers and users can adjust to the changes in phases

(c) it involves fewer assumptions as of earlier dates than a full retrospective approach.

16. The main disadvantage of this approach is that what was developed as a presentation model will be implemented in phases, which may limit the usefulness of the resulting information until the complete model is implemented.

17. In addition, the staff will need to develop interim guidance if the sections, categories and new definitions are implemented before the direct method SCF is implemented. That is because those definitions will need to be used for an entity's indirect SCF during the transition period. This will result in some cash flow line items being presented in different categories than they currently are under IAS 7 and ASC Topic 230 *Statement of Cash Flows*. There may be other areas where similar guidance will be needed.

Prospective application

18. Using a prospective approach, the current year financial statements would be prepared using the new FSP standard, but the prior period(s) would not. Thus, this approach would involve no costs related to recasting or creating prior year information. However, since we envision that an entity would present one set of financial statements for the current year and another set for the prior year, there would be no "side-by-side" information on any statement except perhaps the statement of changes in equity.

19. Having different presentation for similar items in current and previous periods might result in a user of the financial statements:

(a) misinterpreting what may appear to be similar subtotals and

(b) not being able relate amounts in the current period to amounts in the previous period(s) because the current period amounts will be reclassified, disaggregated and grouped in an entirely different manner.

For example, capital expenditures are currently presented as investing cash flows; however, under the FSP standard they will be presented in the operating category. This will result in operating cash flow amounts that are not comparable.

Limited retrospective application

20. Under a limited retrospective approach, an entity would apply most of the new presentation standard retrospectively to the previous period(s). The remaining aspects of the standard would be applied prospectively. The staff think that the only aspect of the FSP standard that should be applied prospectively under this approach is presentation of a direct method SCF. In other words, all aspects of the presentation model would be applied to current and prior periods except the direct method requirement.

21. In the year of adoption, an entity would present a direct method SCF for the current year. The "indirect method" SCF presented for the previous period would be similar to the current period direct method SCF because it would incorporate the new sections and categories; however, the operating category of the SCF would be presented indirectly (that is, operating income would be reconciled to operating cash flows). In essence, the operating cash flow information presented for the previous period would be the same as the indirect reconciliation of operating income to operating cash flows presented in the notes for the current period.

22. The benefit to this approach is that effective date for the standard could be one year earlier because direct operating cash flow information would not be required for the previous period(s), but subtotals and cash flow information in the other sections and categories would be comparable.

Staff analysis and recommendation

23. The staff prefer a retrospective approach over a prospective approach because retrospective application provides comparability for all reported periods. In addition, it is consistent with the transition approach for most other projects (per IAS 8 and Topic 250).

24. However, for many entities a full retrospective approach may have some practical problems, as information for previous periods might not be readily available or may involve using assumptions. At the recent JIG/FIAG meeting, members expressed concern with implementing a direct method SCF for previous periods. Members did not express concerns with retrospective application of other presentation and disclosure requirements. Some mentioned that the analyses of changes of assets and liabilities would be easy to implement as analyses of changes for relevant items are already provided in the financial statements.

25. Therefore, the staff think that either the limited retrospective approach described in paragraphs 20–22 or the retrospective application in phases approach described in paragraphs 13–17, will provide comparability in the financial statements and give preparers some relief as they would not have to implement all of the changes in the same year. The staff also think that a full retrospective approach could be used if preparers are given enough time to implement the FSP standard.

26. If the boards support a limited retrospective approach, then the staff recommend that a statement of cash flows prepared using a direct method should be the only exception to retrospective application.

27. If the boards support a retrospective application in phases, then the staff recommend that it be implemented as follows:

    (a) *Changes that could be applied at the first effective date (eg two to three years after the issuance date):* alignment across financial statements, disaggregation on SFP, remeasurement information and, for the current period only, analyses of changes.

    (b) *Changes that could be applied after the first effective date (eg, one year later):* analyses of changes (if comparative period to be presented), disaggregation by function/nature in the SCI, additional segment information [FASB only].

(c) *Changes that could be applied at the latest effective date (that is, when all of the requirements need to be applied) (eg two years after first effective date):* a SCF using the direct method.

28. If the boards select full retrospective application, the staff presume that the effective date would be set at a later date than it would be under a limited retrospective or a retrospective application in phases approach because entities will need time to prepare a direct-method SCF for two years (or possibly three years for US public entities).

29. Based on that presumption, the staff's first preference is retrospective application in phases because the benefits of the presentation model will be realized sooner. Our second preference is a limited retrospective approach. Our preference for those two approaches relates solely to applying the new standard as soon as practicable. Thus, if the effective date will be three or more years after the FSP standard is finalized (possibly because other MoU standards will be implemented first), then the staff prefer a full retrospective transition approach.

30. Because the boards are not addressing the effective date, making a specific recommendation is difficult. The following questions should assist the boards in reaching a decision without deciding on an effective date.

Questions for the boards on transition

1. Do the boards prefer that an entity adopt all aspects of the FSP model at the same time, thereby eliminating a retrospective application in phases approach?

2. Do the boards have any interest in a limited retrospective approach (that is, allow or require an entity to present a SCF using the direct method only for the current period)?

3. Do the boards prefer a full retrospective approach to transition? If so, then that will be the transition approach included in the ED. If not, we will address questions 4 and/or 5.

> 4. If the boards support a retrospective application in phases approach (question 1), is the staging recommended by the staff in paragraph 27 acceptable? If not, which of the presentation and disclosure requirements in paragraph 13 should be:
>   a) applied at the first effective date (two to three years after the issuance date)?
>   (b) applied after the first effective date?
>   (c) applied at the latest effective date?
>
> 5. If the boards support a limited retrospective approach (question 2) should any other presentation and/or disclosure requirement besides providing a direct method SCF be applied prospectively?

Issue 2: Effective date

31. The staff understand that the boards will be addressing the effective date of all MoU projects in a separate exposure draft and that a mandatory effective date for the FSP standard would be no earlier than 1 January 2013. "When will the final standard be effective?" is a common question we receive from constituents. Therefore, the staff think that the exposure draft should give some indication of the proposed lead time between issuance of the standard and its effective date. That is, whether we think the final standard will be effective close to January 2013 or a number of years later.

32. The staff think that if a full retrospective application transition approach is used, the effective date should be four years after the standard is issued so that an entity has enough time to present a SCF using the direct method (for both the current and previous period). An additional year may be needed for US companies that are listed with the SEC (as they may need to present a statement of cash flows for two previous periods).

33. In addition, the staff recommend that the exposure draft include a question soliciting information about the amount of time needed to prepare for and implement the various changes proposed.

Questions for the boards on effective date
6. Do the boards agree that the exposure draft should give some indication of the proposed lead time between the issuance of the standard and its effective date? (a) If so, should the lead time be a minimum of four years after the issuance date if full retrospective application is required? (b) What should the lead time be if full retrospective application is not required?
7. Do the boards agree that the exposure draft should include a question soliciting information about the amount of time needed to prepare for and implement the changes proposed?

Issue 3: Should any exemption be provided for first-time adopters of IFRSs (IASB only)

34. The staff recommend that the transition approach the IASB agrees to for the FSP standard should be used for first-time adopters of IFRSs. For example, if the FSP standard includes a retrospective application in phases approach, first-time adopters should also use a phased approach even though IFRS 1 requires full retrospective application.

Question for the IASB on first-time adopters
8. The staff recommend that the transition requirements for the FSP standard should apply to first-time adopters of IFRSs. That is, there should be an exemption to the full retrospective application requirements in IFRS 1. **Does the IASB agree?**

Issue 4: Should early adoption be permitted?

35. The standards produced by the boards are intended to improve the quality of financial reporting. The objective of the FSP standard is to ensure comparability both with an entity's financial statements of previous periods and with the financial statements of other entities. Therefore, the staff recommend that early adoption of the FSP standard should **not** be permitted, regardless of the transition approach used. If the boards disagree, the staff think that at a minimum, all entities should align their financial statements (implement the section and category requirements) in the same year; the same would apply for

the presentation of the SCF using a direct method as described in the new standard.

Questions for boards on early adoption
9. The staff recommend that: (a) early adoption should not be permitted. **Do the boards agree with the staff recommendation?** (b) early adoption should not permitted for first time adopters of IFRS. **Does the IASB agree with the staff recommendation?**