Topic **Effective dates and transition Preliminary staff feedback**

Purpose

1. The IASB expects to complete this year a number of major projects that will improve financial reporting. The Board therefore published a document in October 2010 requesting views on the overall time and effort that will be needed to adapt to the new IFRSs and views on when those IFRSs should become effective. The Board will use the information it learns from the responses to develop an implementation plan for the new IFRSs that helps interested parties to manage the pace and cost of change. The comment letter period ended on 31 January 2011.

2. This paper gives a **preliminary overview** of the comments received to date. The staff are still reviewing the comment letters to provide the Board with a more detailed comment letter summary for discussion in March 2011.

3. The US-based Financial Accounting Standards Board (FASB) also published a discussion paper inviting comments on similar issues raised in the *Request for Views*. This paper only discusses the comments received by the IASB or those sent to the IASB and FASB on a joint basis. It does not incorporate FASB-only comments. We anticipate that the Board and the FASB will discuss the results of their consultations at a joint meeting in March 2011.

Which IFRSs are affected?

4. The projects that are subject to the *Request for Views* are:

This paper has been prepared for discussion at a public meeting of the IFRS Advisory Council of the IASB.

The views expressed in this paper are those of the authors.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretation Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

(a) Fair value measurement;

(b) Financial instruments (IFRS 9);

(c) Revenue from contracts with customers;

(d) Insurance contracts

(e) Leases;

(f) Revenue recognition

(g) Post-employment benefits—defined benefit plans: proposed amendment to IAS 19; and

(h) Presentation of items other comprehensive income—proposed amendments to IAS 1.

5. In addition, the Board noted that comments received from the *Request for Views* will help when it considers the effective dates and transition methods for other projects such as financial statement presentation and financial instruments with the characteristics of equity. However, after the *Request for Views* was published the Board modified its work plan. Work on the financial statement presentation and financial instruments with characteristics of equity projects is not expected to resume until late 2011. The status of these projects will also be considered as part of the Board's consultation on its agenda.

Overview of comments received

6. As of 11 February 2011, the Board had received 141 comment letters.

7. The Board received comment letters from different types of respondents—eg preparers, standard-setters, industry groups, regulators and auditors. Unfortunately, there was a limited response from user groups. The staff are undertaking additional outreach to seek views from users, such as reaching out to the IASB's Analysts Representatives Group (ARG).

8. The Board also received comments from different jurisdictions including developing and developed nations, and from those that have been applying IFRSs for some time, those that have recently adopted IFRSs and others that will adopt IFRSs in the future. Their responses, based on their background and experience, will assist the Board in making decisions with respect to the effective dates and transition methods for the projects that are the subject of the *Request for Views*.

9. Nearly every respondent welcomed and commended the boards for taking an overall view to considering the effective date and transition application because of the scale and significance of the changes anticipated.

10. Many respondents also noted that for many projects the final requirements remain uncertain and that they were providing their comments based on the proposals in the exposure drafts.

Preparation required to apply the new IFRSs

11. In the *Request for Views*, the Board asked which of the proposed new IFRSs is likely to require more time to learn about, train personnel for, plan for and implement or otherwise adapt for (whether they are a preparer, auditor, standard-setter or user), the type of costs they would expect to incur in planning for and adapting to the new requirements, and the primary drivers of those costs.

12. In addition, the Board also asked whether stakeholders agreed with the transition methods as proposed for each project, when considered in the context of a broad implementation plan covering all the new requirements.

13. The Board proposed the following transition methods for the following projects:

Project	Transition method
Consolidation	Limited retrospective
Fair value measurement	Prospective
Financial instruments (IFRS 9)	Retrospective[1]
Insurance contracts	Limited retrospective
Joint arrangements	Limited retrospective
Leases	Limited retrospective
Post-employment benefits—Defined benefit plans	Retrospective
Presentation of items of other comprehensive income	Retrospective
Revenue from contracts with customers	Retrospective

Note:

(a) Retrospective application is the default approach required by IFRSs. Retrospective application means an entity would implement the new requirements as if it had always been required, re-presenting comparative information on the new basis of reporting. However the Board, in making decisions about transition methods, strives to balance the benefits of inter-period comparability with the cost and practicability of retrospective application.

(b) Limited retrospective method: the Board may provide some exceptions to which the entities need to revise previously issued financial information.

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[1] The exposure draft of Phase 3 of IFRS 9 had not yet to been published when the *Request for Views* was published. Phase 3 proposed a prospective transition method. Phases 1 and 2 adopted a retrospective transition method.

(c) Prospective method: entities will apply the new IFRSs only to transactions and events after the effective date.

Impact of new IFRSs on respondents

14. Some new IFRSs could have pervasive changes for all types of entities. Projects such as leases and revenue recognition will require new data to be analysed and could require a number of adjustments: eg leases because of the right-of-use model proposed in the leases project compared with the existing IAS 17 *Leases*, which has two types of leases, and revenue recognition where there are proposals for new requirements for distinct performance obligations and control transfers.

15. Some projects will likely have a higher impact on particular industries. For example some respondents noted that the requirements in IFRS 9 will have a higher impact on financial institutions—the requirements on classification and measurement changes will require entities to review potentially high volumes of financial assets and to apply new classification criteria. Similarly, for insurance entities, the proposed replacement of IFRS 4 *Insurance Contracts*, if implemented, would require them to assemble the data necessary to apply the building block approach and to implement system changes.

16. Many respondents noted that projects such as post-employment benefits, presentation of items of other comprehensive income, consolidation and joint arrangements would have a low to medium impact on them.

17. The fair value measurement project received mixed reaction on the impact that it would have on respondents. Entities that use fair value measurements often, eg financial services or investment properties entities, noted that this project will have a higher impact because they will need to review their accounting policies and models to ensure that they meet the requirements in the new IFRS. Other entities noted that this project will have a lower impact on them because many of their assets are accounted on a cost basis.

Costs to learn, train, plan for and implement

18. The Board asked respondents (whether they are preparers, auditors, industry groups, standard-setters, users or regulators) what types of costs they expect to incur to comply with the new IFRSs, and the relative significance of each cost component.

19. Many respondents asserted that applying the new IFRSs would require a major effort and, for some industries such as finance or telecommunications companies, the costs in applying those IFRSs would be similar to those of adopting IFRSs for the first time. Consequently, many respondents encouraged the Board to provide a stable platform of standards.

20. Generally, the main types of costs that respondents expect to incur are:

    (a) Understanding new requirements to train personnel.

    (b) Changing processes (eg internal controls and IT systems). Entities might either have to adapt existing systems or purchase new IT systems to comply with new requirements for recognition, measurement and disclosure. Some respondents asserted that the leases project and revenue recognition project would require them to purchase new systems to comply with the new requirements.

    (c) Updating contracts and transactions, for example to update banking covenants to reflect the new requirements. For example, capitalising all operating leases would mean higher liabilities and affect some financial ratios.

    (d) Use of external experts such as consultants or contractors because their existing pool of employees may not have the expertise to implement some of the new requirements.

    (e) Communication to external users and other key stakeholders (eg regulators) to explain the impact of the new standards on financial results and how it affects key performance indicators.

(f) For preparers, additional audit costs because some of the projects (eg leases and financial instrument projects) proposed entities to use more estimates or management judgement, which may require additional audit activities.

Effects of new IFRSs on broader financial reporting systems

21. Furthermore, respondents noted the effects on the broader financial reporting system arising from the proposed new IFRSs:

    (a) Any legislative or regulatory requirement that is underpinned by an accounting concept (eg profit) will be the most likely to be affected by changes to accounting standards.

        (i) Financial service and insurance regulations: entities in banking and insurance will face regulatory implications from Basel requirements and Solvency II requirements that could be significant.

        (ii) Taxation: the number of differences between IFRSs and local taxation requirements may increase, so entities will have to maintain more financial records to comply both with IFRSs and with taxation requirements.

        (iii) For auditors, the impact of the consolidations and leases project could affect auditors' independence requirements in some jurisdictions[2].

    (b) Some auditor respondents expressed concern about auditors' abilities to audit some of the proposed accounting requirements because the judgemental nature of some of the proposed requirements may lead to a lower level of auditable evidence to support management's judgment.

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[2] CL83 stated: 'Current US SEC independence rules permit auditing firms to enter into a leasing arrangement with a US SEC registrant audit client if the lease is an operating lease and certain other conditions are met. The elimination of the distinction between operating and capital/finance leases may mean that auditors of US foreign private issuers would have to change their leasing arrangements to remain independent within the US SEC rules, or that the independence requirements in this area may need to be revisited. Other jurisdictions may have similar requirements.'

For example the revenue recognition standard proposed using a probability-weighted average estimate to measure contingent payments.

Transition methods

22. For projects where the Board had not commenced redeliberations on the exposure drafts when the *Request for Views* comment period ended (eg leases, revenue recognition and insurance), many respondents either provided the comments from their previous comment letters or referred to those comments in their responses to the *Request for Views*. Consequently, for these projects, there was a consistent message given for individual projects and for the *Request for Views*.

23. Most respondents agreed with the Board that retrospective application should be the default approach required by IFRSs unless it is too costly, or impracticable (such as when the information needed for prior period is not available) or else that the Board should allow the use of hindsight to transition to new requirements.

24. A respondent noted that the 'impracticable' test in IAS 8 *Accounting Policies, Changes in Estimates and Errors* has become a high hurdle that auditors rarely or never accept has been passed. That respondent was concerned that, as a result of that current practice, entities would have to undertake a heroic effort and incur significant costs that will exceed the benefits of applying retrospective application, particularly for the new consolidation and revenue recognition standards.

25. Many respondents agreed with the Board's proposed transitional provisions for most of the projects that are subject to the *Request for Views*. This includes the fair value measurement project, where it is the only project for which the Board proposed prospective application.

26. Some respondents were concerned about the areas in which the Board proposed limited retrospective application. These respondents proposed that entities should be given an option to do retrospective application, rather than limited

retrospective application being mandatory. Such projects are leases, insurance contracts and transitional methods in IFRS 9 for financial assets. For example, a respondent stated:

> We strongly disagree with the proposed transitional requirements for the insurance project as discussed in our comment letter. … Setting the residual margin to zero on transition will result in mature and profitable life insurance businesses reporting little profit or less for several years until the business written after transition becomes a significant proportion of the portfolio. [CL47]

27. Some respondents question how it is possible for entities to apply the requirement in paragraph 30 (from which an extract is reproduced below) in IAS 8 relating to describing the expected effect of new IFRSs issued but not yet implemented. This is of particular concern if the Board were to mandate a sequential approach.

> When an entity has not applied a new IFRS that has been issued but is not yet effective, the entity shall disclose this fact and details of the possible impact of application of the new IFRS on the entity's financial statements.

They propose that entities should disclose information about the expected impact of applying the new IFRSs only in the year preceding application. Such disclosures inform markets about when to expect changes to the entity's financial statements.

Effective dates for new requirements

28. The Board asked respondents whether they preferred a single-date approach or a sequential approach. In addition, respondents were asked whether early application of the new IFRSs should be allowed. Views on these issues were split.

29. In addition, some respondents highlighted that the Board also considered the same effective date for other projects such as the financial statement presentation project for which the Board has not yet published an exposure draft and the replacement of IAS 37 *Provisions, Contingent Liabilities and*

Contingent Asset. The point was made that, if the Board decides on a single-date approach, the single effective date should also be applicable for other standards that will be issued after June 2011.

Why a single-date approach?

30. The reasons why some respondents supported a single-date approach are:

    (a) It will maintain comparability for all entities that apply IFRSs.

    (b) Because of the interrelationships and interdependencies between standards (eg *Financial Instruments* and *Insurance Contracts* and the fair value measurement project):

        (i) Many entities would have to adopt standards covering a number of large topics (eg revenue recognition, leases, financial instrument, insurance contracts) at the same time.

        (ii) A single effective date would minimise asset/liability mismatches. For example, the insurance contracts project focuses on the liability side and entities will have to apply the requirements in IFRS 9 for the asset side.

    (c) It achieves economies of scale and minimises disruption: the impact upon financial statements will occur only once. Combining the work to carry out each project implementation allows the alignment of processes and achieves synergies in the use of resources. Furthermore, users do not need to change their models so often, helping them to predict and evaluate entities based on old and new IFRSs applied.

    (d) Avoids conflicting scope of standards issued. For example, guidance on financial guarantees will be moved from IAS 39 *Financial Instruments: Recognition and Measurement* to the new insurance contracts standard.

    (e) A single date with an appropriate lead time would allow preparers to plan all changes, including system changes, as one project. It would

allow preparers to educate staff and investors on the changes resulting from new IFRSs in a more effective way.

31. Respondents favouring a single date proposed an effective date that ranged from 1 January 2014 to 1 January 2016. Most respondents preferred an effective date no earlier than 1 January 2015 because it will allow preparers three years to implement the new or updated IFRSs.

Why a sequential approach?

32. The reasons why some respondents supported a sequential approach are:

    (a) It would allow preparers, particularly for those entities with fewer resources to manage their resources better. Making all the changes as one project could be an excessive burden and costs may be significantly higher if they need to take on additional resources to deal with all the changes at once. Entities will be able to spread the burden of transition over a longer period and avoid facing a major peak in using resources in a single reporting period.

    (b) This will help to reduce the need to engage external assistance to implement a large number of changes.

    (c) It allows for improved financial reporting to start to reach the market as soon as is practicable.

    (d) Many of the proposed standards deal with different areas of accounting (eg the OCI project vs leases), so these respondents do not expect significant economies of scale by adopting the standards on the same date.

    (e) Based on recent experience: a jurisdiction recently introduced series of standards sequentially (although in a 5-10 year implementation period) and respondents from this jurisdiction noted that the implementation was generally smooth.

Should early application be allowed?

33. As noted above, views on whether early application should be allowed were split.

34. Some respondents noted that permitting early application may not necessarily mean that large numbers of entities would choose to early adopt. Many would choose to use as much time as possible to prepare for application.

35. Respondents who supported early application did so because:

    (a) It would give preparers the option to provide users with information that is more relevant and more faithfully represented earlier. Some question why preparers should be applying what might be regarded as obsolete IFRSs over several reporting periods if they have the resources to apply updated IFRSs earlier.

    (b) Early application by some would help other entities to identify unanticipated transitional issues that the IASB could address before the mandatory effective date. It would also help others to benefit from the lessons learnt from the experiences of early application.

    (c) Entities, such as those that intend to go for an initial public offering (IPO), may find it preferable to apply the new requirements early because of economies of scale or the availability of resources, associated with the other reporting changes that such entities may be making for the purposes of the IPO.

36. Respondents who supported early application of IFRSs proposed two approaches on early application:

    (a) Allow entities to choose which IFRSs they would prefer to apply early. This is because they may be in a better position to set out their own road map to apply the new IFRSs. However, some noted that if the mandatory effective date of a new standard was, eg three years after the standards are issued, there would be three years of non-comparable information with other entities.

(b) Restrict the standards to be applied early to defined groups of standards. For example:

(i) the Board could restrict early application to groups of standards that are interrelated, in order to be efficient and effective. For example, entities could be required to adopt the revenue recognition and leases standards together in order to ensure that lessors report all income based on the new requirements.

(ii) the Board could restrict the standards to be applied early based on the time required to apply new IFRSs. For example, the Board could require the first group to be those standards that need less time to implement (eg the OCI project and post-employment benefits). Other standards, such as revenue recognition, leases, insurance and financial instruments, which may require entities to take a longer time to implement should be applied at a later date.

37. Some respondents noted that IFRS 9 *Financial Instruments* permits early application and that some jurisdictions and entities have applied the requirements in IFRS 9.

38. Some respondents proposed that the Board should consider providing similar effective dates requirements to those in IFRS 3 *Business Combinations* (revised in 2008) where entities were permitted to apply the new standard early only after a specified date.

39. Those who did not support allowing early application stated that:

(a) Allowing early application may affect comparability across entities. This may be acute if entities could 'pick and choose' which IFRSs to implement first.

(b) Not allowing early application would allow some entities in some jurisdictions time to translate IFRSs into their local language or to be

adopted into local law so that they could be implemented at the same time as other jurisdictions that apply IFRSs.

(c) Some regulators have a practice of prohibiting early application and requiring a regulated industry to adopt new standards at the mandatory effective date or at a specified earlier date.

Harmonisation with US GAAP

40. The Board asked whether respondents thought that the IASB and FASB should require the same effective dates and transitional methods for their comparable standards.

41. Many respondents noted that the IASB should place priority on consistency of proposed standards within the set of IFRSs and consider the cost and benefit for entities that apply IFRSs before considering the consistency between IFRSs and US GAAP. Their reasons are

(a) IFRSs and US GAAP have different starting points and the transition challenges would differ;

(b) US rules on comparative information differ from equivalent IFRS requirements; and

(c) the need for translation and for jurisdictional adoption procedures are not applicable in the US environment.

42. Some also believed that having different effective dates was not a significant concern provided that the standards are fully converged.

43. However, many respondents encouraged the IASB and the FASB to align the effective dates and transition methods under IFRSs and US GAAP because it would:

(a) improve comparability between the two;

(b) create a level playing field internationally; and

(c) minimise issues if the US adopts IFRSs.

44. Some also noted that some projects are jointly developed with the FASB, but are at different stages in development, eg financial instruments and insurance contracts. Respondents urged the boards to prioritise pursuing adequate convergence of standards and proposed the same effective dates for comparable standards.

First-time adopters of IFRSs

45. The Board asked if it should permit different application dates and early application requirements for first-time adopters of IFRSs. This is because different jurisdictions have adopted IFRSs at different times: a number of jurisdictions will be applying IFRSs for the first time, some jurisdictions would have been applying IFRSs for a number of years and others would have only recently adopted IFRSs.

46. The majority of those who responded on this issue stated that the Board should strive to minimise the extent to which a first-time adopter is forced to implement further changes to its accounting policies soon after adopting IFRSs. For example, an entity adopts IFRSs in 2013, but the Board mandates the effective date for all new projects to be 2015.

47. Some suggested that the mandatory effective dates for first-time adopters and those that are now applying IFRSs should be the same. However, others noted that this view may be good in theory, but they also noted that some jurisdictions that have not adopted IFRSs (eg some developing nations) may have more difficulties implementing the new requirements than do existing preparers in other jurisdictions. They encouraged the Board to provide additional and more flexible transitional arrangements so as not to deter these jurisdictions and entities from adopting IFRSs.

48. Many respondents who disagreed with allowing early application for existing IFRS preparers noted that the IASB should allow first-time adopters to early apply IFRSs out of cost/benefit considerations—these entities should not need to undertake a second substantial conversion soon after adoption. They think that

comparability concerns relating to early application is a less significant issue for entities in the year of first-time adoption. They also noted that if an entity elects to apply new IFRSs early when adopting IFRSs, there should not be a free choice on which new or revised IFRSs are applied early. Instead, they should apply IFRSs based on standards that are interdependent or integrated; eg revenue recognition and leases standards should be applied simultaneously.

49. Some respondents preferred that all entities (irrespective of whether they are first-time adopters) should apply the new requirements from the same date to improve comparability for all entities.