Staff Paper

Project: **Revenue from Contracts with Customers**

Topic: **Effective date and early application**

Objective of this paper

1. This paper addresses the following issues for the new revenue recognition standard:

   (a) effective date,

   (b) early application, and

   (c) first-time adoption of IFRSs (IASB only).

2. Throughout this paper, the effective date is the beginning of the period in which an entity first applies the new standard.

3. This paper does not address effective date or early application for nonpublic companies (FASB only). Those topics will be discussed in a separate paper after the FASB has deliberated the transition method for nonpublic companies.

Effective date

4. The staff recommends that in the forthcoming exposure draft the boards:

   (a) specify that the effective date of the standard will not be earlier than annual reporting periods beginning on or after 1 January 2015; and

   (b) explain that they will re-evaluate the effective date before issuing the final standard in the light of the transition and effective date interdependencies of the major joint projects.

Early application

5. The staff recommends that the boards:

   (a) permit early application of the standard, and

   (b) require entities that apply the standard early to disclose that fact.

First-time adoption of IFRSs (IASB only)

6. The staff recommends that the IASB:

   (a) permit early application of the standard by first-time adopters of IFRSs, even if early application of the standard is prohibited for entities that already use IFRSs

   (b) amend IFRS 1 *First-time Adoption of International Financial Reporting Standards* to grant first-time adopters of IFRSs the same transitional reliefs as those granted to entities that already use IFRSs.

Structure of the paper

7. The paper is organised as follows:

   (a) effective date

   (b) early application

   (c) first-time adoption of IFRSs (IASB only).

Effective date

8. The 2010 revenue exposure draft did not specify an effective date.

Cross-project discussions

9. In their discussions in March 2011 on cross-project effective dates and transition methods, the boards acknowledged that constituents will require some time to evaluate and plan their individual implementation and transition processes. The

boards indicated they will allow a long lead time between issuing the final standards and the effective date to enable constituents to:

(a) develop and test systems and processes

(b) train their staff

(c) educate investors.

Systems changes and dual processing

10. The staff have consulted with systems providers and preparers. That consultation is summarised in Agenda Paper 10A / 6 'Summary of Additional Outreach'. The feedback received on the time needed to develop, test and implement any system changes required varies between 1 and 10 years. The time required is most often given as two to three years. Some also commented there might be limitations on the availability of both consultancy and system development resources and suggested inadequate availability of these resources could result in extending the implementation time required. In some jurisdictions this lead-time is further extended, where it is believed that local practice would require dual processing during the comparative periods. These factors suggest a significant lead-time will be required.

Transition method

11. In June 2011, the boards reaffirmed their decision in the 2010 revenue exposure draft that an entity should apply that proposed standard on a retrospective basis. However, to ease the burden of applying the proposed standard in the first year of application, the boards tentatively decided to grant four specific transitional reliefs.

12. Retrospective application would require a detailed analysis of contract data and a knowledge of circumstances at contract inception. The boards' discussions in June 2011 of transition methods relating to revenue indicated that the best way of ensuring this happens is to issue the standard before the beginning of the first

required comparative period. This would substantially reduce the risk that hindsight is used in the restatement process.

13. Issuing the standard before the beginning of the first comparative period would not prevent entities with contracts that pre-dated issuance having to restate their contracts using estimates based on facts and circumstances prior to issuance, but it would lessen the burden on those entities with mid-length and shorter contracts.

Number of comparative periods

14. Although IAS 1 *Presentation of Financial Statements* requires only one comparative period to be presented, SEC registrants are required to present two comparative periods. The staff believe, therefore, that two comparative periods should be anticipated as a minimum.

15. If the boards decide that all presented periods must commence after issuing the standard and the boards plan to issue the standard in the second half of 2012, the earliest possible effective date would be for annual reporting periods beginning on or after 1 January 2015, if two comparative periods are required.

16. This is illustrated in the diagram below:

H2 2012	31 Dec 2012	31 Dec 2013	31 Dec 2014	31 Dec 2015
Issuance	Comparative 2	Comparative 1	Reported year 1	

17. This timing would be consistent with the boards indicating in their joint meeting in March 2011 that the effective dates of the major joint projects would not be before financial periods beginning on or after 1 January 2015.

Subsequent re-evaluation of the effective date

18. Although it will be useful to constituents to give some indications in the forthcoming revenue recognition exposure draft about the likely effective date of the final standard, the staff think the boards will need to re-evaluate the effective date before issuing the final standard.

(a) The boards have not yet decided whether the four major joint projects will have linked or unlinked sequential effective dates or a single effective date. Whatever decision is made in this regard, many respondents have suggested the effective date of the forthcoming leases standard should be the same as the revenue standard. In addition, the transition method applied to each standard will affect the decision-making process for that standard's effective date and one may require a shorter lead time than another.

(b) Progress on the major joint projects will need to be monitored to ensure that any transition and effective date interdependencies are properly considered in determining the effective date of each standard.

19. When the boards re-evaluate the effective date of the final standard, there will be some increased flexibility in the effective dates because both the FASB and the IASB can require effective dates for annual reporting periods beginning either 1 January or 1 July.

Staff summary and recommendation

20. The staff believe that if the forthcoming revenue recognition exposure draft indicates that the effective date will not be before annual reporting periods beginning on or after 1 January 2015 this would provide useful information to enable constituents to develop implementation plans in a timely manner. In the staff's view, any of the factors referred to in paragraph 18 in a subsequent re-evaluation of effective date by the boards would extend the effective date and not reduce it, and would, therefore, be consistent with that recommendation.

21. The staff also recommend that the boards state in the forthcoming exposure draft that they will re-evaluate the effective date before a final standard is issued in the light of the factors noted in paragraph 18.

Question 1
Do the boards agree with the staff recommendation that the forthcoming revenue recognition exposure draft should: (a) state that the effective date of the proposed standard will not be earlier than annual reporting periods beginning on or after 1 January, 2015; and (b) explain that the boards will re-evaluate the effective date before issuing the final standard.

Early application

22. The boards have consulted on early application through a number of activities:

    (a) the IASB's *Request for Views on Effective Dates and Transition Methods* (the 'RFV')

    (b) the FASB's *Discussion Paper Effective Dates and Transition Methods* (the 'DP')

    (c) the boards' joint investor outreach questionnaire.

23. The results of that consultation are detailed in Agenda papers 10A / 6 'Summary of Additional Outreach' and Agenda Paper 10B / 7 'Early Application and Early Adoption'.

24. The majority of respondents to both the RFV and DP stated that early application should be permitted:

    (a) The proposed standards are an improvement to financial reporting and this more relevant information should be available to users as soon as possible. Early application would ensure any current reporting problems could be remedied sooner. For example, the interpretative diversity seen when applying IFRIC 15 *Agreements for the Construction of Real Estate* in some jurisdictions could be resolved at an early stage.

(b) The flexibility of choosing its own transition timetable allows an entity to implement the new standard in the most cost effective way. It also allows the entity to reduce implementation costs by combining transition changes with other internal changes to processes and systems. Furthermore, it allows the entity to construct a schedule that reflects the availability of both internal and external consultancy and IT resources.

(c) Early application by some preparers is a significant benefit to the financial reporting community as a whole as it helps identify practice and transition issues at an early stage. Subsequent application by the majority of preparers is easier and less disruptive as the early-applying preparers, auditors and system providers have already resolved any practical problems that arise.

25. For these reasons agenda paper 10B / 7 recommends that the boards permit early application of standards generally but that this policy should be assessed further for each separate standard.

26. The main disadvantage of permitting early application is the loss of comparability between reporting entities and the resulting reduction in usefulness of the financial statements to users. Due to this loss of comparability the FASB indicated a preference in the 2010 revenue exposure draft to prohibit entities applying the standard early (paragraph BC238).

27. In order to assess the effect of early application on users, the boards included a question on this subject in their recent investors' questionnaire. Responses to the question whether early application should be permitted were evenly split. Half the respondents believe that early application should be permitted for all the new standards, to reflect the improvement to reporting at the earliest possible time. Slightly fewer than half the respondents did not believe early application should be permitted due to the reduced comparability of financial statements.

28. The long lead-time recommended between issuing the revenue recognition standard and its effective date increases the number of reporting periods during which comparability could be reduced by early application. On the other hand,

this long time period also indicates that there is a greater need than usual to permit early application to ensure anticipated improvements to financial reporting are made as soon as possible and are not delayed by the long lead-time.

Summary and staff recommendation

29. The revenue standard is intended to improve the quality of financial reporting. The stated objective of the revenue recognition project is to ensure comparability of reporting between capital markets and across all industries. In the staff's view, the wider comparability across industries and markets and the improvement to financial reporting outweigh any concerns about the lack of comparability produced by early application. In addition, it should be noted that the accounting for many types of transactions will not change from existing practice and so early application would not reduce comparability for those transactions. Early application will also resolve the current uncertainty in the application of IFRIC 15 in some regions. Therefore, the staff recommend that early application is permitted.

30. If the boards permit early application, in the staff's view the disclosure required in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and FASB ASC Topic 250 *Accounting Changes and Error Corrections* would provide adequate information about the effect of the change to accounting policies. No additional disclosure would be required for entities that opt for early application.

Question 2
Do the boards agree with the staff recommendation that: (a) early application should be permitted, and (b) entities that apply the standard early should disclose that fact.

First-time adoption of IFRSs (IASB only)

Early application for first-time adopters of IFRSs

31. If the boards prohibit early application of the new standard, however, the staff recommend the IASB reaffirm their proposal in the 2010 revenue exposure draft to permit early application in those cases where the entity adopts IFRSs after the date of issuance of the new revenue standard, but before its effective date (paragraph BC238). In those circumstances, the staff think it would be unduly burdensome to require the first-time adopter to apply IASs 11 and 18 at first-time adoption and then require the entity to apply the new revenue standard when that becomes effective.

Exemptions to disclosure requirements for first-time adopters

32. A few respondents to the 2010 revenue exposure draft suggested that some first-time adopters of IFRSs would be able to apply the standard prior to the effective date, but they would not have the systems in place at that time to provide all the disclosure required by the revenue standard. These respondents asked that first time adopters of IFRSs, who choose to apply the standard before the effective date, should be granted reliefs from the disclosure required in the revenue standard until the effective date, when they commented that they would have the appropriate systems in place to capture the required information. In particular, respondents requested an exemption from providing the reconciliation of contract balances (ie roll-forward) described in paragraph 75 of the 2010 revenue exposure draft.

33. The staff do not recommend that such exemptions be granted:

    (a) Disclosure provides valuable information about the amounts reported in the financial statements. If entities do not provide this information to users for the period between first applying the standard and the effective date, this will result in the loss of valuable information to users.

    (b) The disclosure required by the boards is derived directly from the accounting proposed in the standard. Therefore, the staff can see no reason why these first-time adopters cannot comply with the disclosure requirements proposed.

Transition reliefs for first-time adopters of IFRSs

34. IFRS 1, paragraph 9, states that transitional provisions in other IFRSs do not apply to first-time adopters of IFRSs unless the relief is specified in IFRS 1.

35. In June 2011 the boards tentatively decided to grant four transitional reliefs to retrospective application. These reliefs were that the entity:

    (a) should not be required to restate contracts that begin and end within the same annual reporting period

    (b) should be permitted to use hindsight in estimating variable consideration in the comparative reporting periods

    (c) should be required to perform the onerous test only at the effective date unless an onerous contract liability was recognized previously in a comparative period

    (d) should not be required to disclose the maturity analyses of remaining performance for prior periods.

36. The staff can see no reason why a first-time adopter should not also be able to apply one or more of the above reliefs. Therefore, the staff recommend that IFRS 1 is amended to grant these transitional reliefs to first-time adopters of IFRSs.

Question 3
Do the boards agree with the staff recommendation that: (a) first-time adopters of IFRSs should be permitted to apply the revenue recognition standard early, even if early application of the standard is prohibited for entities that already use IFRSs (b) IFRS 1 should be amended to grant first-time adopters of IFRSs the same transitional reliefs as those granted to entities that already use IFRSs.