IASB/FASB Meeting
Week commencing 13 June 2011

IASB Agenda reference **4A**

FASB Agenda reference **147A**

Staff Paper

Project	**Revenue from contracts with customers**
Topic	**Transition requirements**

Objective of this paper

1. This paper addresses the transition requirements for the new revenue recognition standard. It does not address the related topics of effective date, early adoption or (for the IASB only) early adoption by first-time adopters of IFRSs.

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

3. The staff recommends that the boards:

   (a) affirm the proposal in the Exposure Draft that an entity should apply the revenue standard on a retrospective basis but grant the following reliefs to reduce the burden to preparers of transitioning to the new requirements:

      (i) not require restatement of contracts that begin and end in the same accounting period prior to the effective date

      (ii) allow the use of hindsight in estimating variable consideration

      (iii) not require recognition as assets of fulfilment and acquisition costs recognised as an expense in prior periods

      (iv) not require the onerous test to be performed in comparative periods but only at the effective date unless an onerous contract liability was recognised previously

(v) in the first year of application, not require disclosure for prior periods of the maturity analysis of remaining performance obligations

(b) permit full retrospective application (ie to not use any of the transition reliefs noted above)

(c) require additional transitional disclosures for those entities employing transition reliefs

(d) include additional guidance on impracticability.

Structure of the paper

4. The paper is organised as follows:

(a) background

(b) feedback received on the boards' proposals

(c) addressing respondents' concerns

(d) summary and staff recommendation

(e) impracticability

(f) transition disclosures

(g) private companies (FASB only)

(h) Appendix 1 Comment letter analyses

(i) Appendix 2 Costs associated with change

Background

5. In the exposure draft *Revenue from Contracts with Customers* the boards proposed that an entity should apply the new standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or ASC Topic 250 *Accounting Changes and Error Corrections* in the

FASB Accounting Standards Codification®. The boards believed retrospective application would provide users of financial statements with useful trend information because transactions would be measured and recognised consistently in the current and comparative periods presented in the first financial statements following the effective date. The boards thought it was particularly important for users to be able to understand trends in revenue, given its significance to the financial statements.

6. The boards noted that retrospective application could be burdensome, particularly for those entities with many long-term contracts. In addition they noted that it might be difficult to estimate stand-alone selling prices without using hindsight. However, the boards believed that some of these concerns would be addressed by:

   (a) IAS 8 and ASC Topic 250 both of which limit retrospective application if it is impracticable, and

   (b) allowing a long lead time between issuance of the standard and its effective date.

Feedback received on the boards' proposals

Feedback on the exposure draft

Feedback from respondents other than preparers

7. The boards received over 300 comment letters that included a response to Question 13 of the Exposure Draft concerning transition requirements.

8. Most of the users, regulators, standard-setters and some accounting firms agreed with the boards' proposals.

> CRUF participants feel strongly that the new standard should be applied retrospectively. Prospective application would severely impair analysts' ability to perform comparative analysis and would render the revenue numbers prepared under the new standard practically meaningless until there is at least one comparable period. [CL 965]

9. Those who agreed observed that under the proposals:

    (a) trend information about revenue would be preserved,

    (b) financial information would be easy to understand, because all contracts would be accounted for identically in all periods.

10. However, some respondents (including the large accounting firms), while acknowledging that retrospective application would be desirable and would achieve the greatest level of comparability between entities, thought that some entities would find it very challenging to apply the new standard retrospectively. Therefore, some of these respondents encouraged the boards to modify the retrospective approach so that it would be more practical. Specific suggestions included:

    (a) lowering the 'impracticability' threshold for when an entity would not be required to restate a contract;

    (b) providing some guidance or examples to explain when retrospective application would be impracticable;

    (c) permitting the use of significant estimation in restating the accounting.

11. Many respondents also emphasised that if the boards specify retrospective application then the effective date must be set so as to allow sufficient time for the restatement work and to minimise the instances in which restatement would be impracticable.

Feedback from preparers

12. Some preparers also supported the proposals. For example a respondent writing on behalf of a consortium of European constructors, summarised the view of many supporters of retrospective application:

> We agree with the boards' proposals, which will provide greater comparability and consistency between entities and between the results of an individual entity over time. The benefits to users will outweigh any additional costs to preparers and difficulties arising from the retrospective application of judgemental criteria. [CL 572]

13. However, the majority of preparers disagreed with the boards' proposals, with that disagreement being more pronounced in the US compared with the rest of the world.

> Our contract base is composed of thousands of contracts that often span for a period of several years … It would be extremely complex and time-consuming to recast these contracts to their inception, requiring the revision of quarterly estimates of profitability on a contract-by-contract basis over a multi-year period. Retroactive restatement would require contractors to track this population of contracts across a wide range of systems and manual records and true up the historical revenue recognition on these contracts for activity that predates the beginning of the retrospective period … We believe this would impose significant, unreasonable expense and require an excessive time commitment by our contract management and finance personnel with no meaningful benefit to investors. [CL 460]

14. Many of these respondents commented that retrospective application would be impracticable in a number of circumstances:

    (a) historical information may be inaccessible as it is retained in a wide-range of systems and manual records which change over time;

    (b) contracts may have started before the issuance of the standard and information to apply the requirements retrospectively may not have been collected or retained;

    (c) the information needed to estimate stand-alone selling prices of goods or services in a contract with many performance obligations may not exist, especially when that good or service was not sold separately;

    (d) entities make assumptions and estimates throughout a contract's life and it may not be possible to re-create the circumstances that apply historically without the use of hindsight.

15. A few respondents in the engineering and construction industries suggested that the requirements might be impracticable in so many instances that it might not be worth the boards specifying a fully retrospective transition approach. Others, however, were concerned that the 'every reasonable effort' threshold used for

assessing impracticability in IAS 8 and Topic 250 is so high that an entity can be required to restate contracts even when it is very difficult and burdensome to do so.

16. Some respondents questioned whether the benefit of the proposals, even if practicable, would justify the cost to preparers.

> Retrospective application of this guidance would be incredibly expensive and complex and we strongly question whether the benefit is justified by the cost [CL 489]
>
> Retrospective application may have a theoretical appeal in spite of its costs, but in our view the perceived benefits of this approach are modest. We believe that most financial statement users are more interested in understanding and predicting future revenues and cash flows and how the current period results compare to expectations. Under the proposed approach, three years of historical income statements would have to be restated, yet comparisons to more than one year would likely be stale. Further, the requisite restatement of quarterly data, even for expired contracts, provides an added layer of complexity with little incremental benefit. Accordingly, we believe that retrospective application is likely to produce only modest benefits that, in our view, do not outweigh the substantial costs of implementation. [CL 495]

17. Respondents also noted that applying the new standard prospectively only to new contracts entered into after the effective date would be unlikely to distort *trends* in revenue (ie whether an entity's revenues are increasing, decreasing or stable). Some also believed that retrospective application required such a long lead time that it would be better to apply the new standard in a more timely fashion, using an alternative methodology, even if comparability had to be reduced.

18. Respondents who disagreed with the proposals mainly suggested entities should:

    (a) be permitted or required to apply the new standard prospectively only to contracts entered into after the effective date (ie to not require any restatement of contracts), and

    (b) provide additional disclosure for the transition period.

Feedback on the cross-project consultation process

19. The IASB's Request for Views (RFV) on *Effective Dates and Transition Methods* (RFV) and the FASB's Discussion Paper (DP) *Effective Dates and Transition Methods* (DP) both requested feedback on the suitability of the transition method proposed in individual exposure drafts. Ninety respondents to the DP specifically addressed the revenue proposals as did forty respondents to the RFV.

20. Responses to these consultation documents showed the same pattern of reported preferences as the responses to the Exposure Draft ie US respondents prefer prospective application. Half of the respondents to the FASB's DP supported prospective application compared with a third who supported retrospective application. The remainder recommended the use of either application method as a free choice by the preparer.

21. Respondents to the IASB's RFV generally agreed with the boards' proposals with only a minority, principally in Asia and Australia, suggesting prospective application.

22. Many respondents to the IASB's RFV expressed concern that some transactions could have the characteristics of both a lease and a contract with customer and for that reason the draft IFRSs should require the same application method for both. The application method proposed in the Exposure Draft *Leases* is discussed in paragraph 36.

Cost benefits of application method

23. Respondents to both the Exposure Draft and the cross-project consultation expressed concerns at the cost associated with retrospective application and requested the boards consider the cost/benefits of their proposals.

24. While the costs of retrospective application are generally higher for preparers than those associated with prospective application, so are the perceived benefits for users. Users and regulators overwhelmingly support retrospective application. If retrospective application were not required, there would be a cost

to users in analysing financial reports prepared in accordance with prospective application. Because of the range of factors involved in assessing the perceived benefits to users compared with the estimated costs to preparers, it is impossible to quantify the relative cost/benefit of either application method.

25. The staff have discussed the costs associated with changes to accounting requirements, however, with system providers, users and preparers and reviewed the results of the cross-project public consultation on the types of cost associated with changing accounting requirements. These findings are summarised in Appendix 2.

Addressing respondents' concerns

26. In the light of feedback received, the staff thinks that the boards should explore whether the transition proposals in the Exposure Draft could be modified to reduce the burden on preparers. The boards need to be sensitive to the concerns expressed by preparers, for instance:

> Of all the proposals under the new rules, the one that we find the most daunting is the requirement to retrospectively adopt these rules. [CL 46]

Would a long lead time address respondents' concerns?

27. Some respondents agreed with the boards that a long lead time would reduce some of the challenges of retrospective application if the effective date is set so that the start of the earliest typical comparative period is after the issuance of the standard. That is because the entity would be able to collect the necessary information for retrospective application contemporaneously. However, the staff notes:

    (a) some contracts in existence at the effective date could predate the issuance of the standard. To apply the standard retrospectively an entity could have to retrace the contract to its inception.

    (b) although a long lead time might reduce the need to invoke impracticability exceptions in IAS 8/Topic 250, particularly for shorter contracts, it might require dual bookkeeping which could be burdensome and costly for preparers.

> For many financial statement preparers, particularly those with numerous, large and complex multiple-element arrangements and those with construction or other long-term contracts, the retrospective application of the proposed guidance would require preparers to track such contracts under dual accounting guidance for the period to be applied retrospectively. The costs to track and report under dual principles for extended periods of time would be prohibitive. [CL 408]

28. Therefore, the staff do not think that a long lead time by itself addresses respondents' concerns.

Do the changes to the Exposure Draft reduce the burden of retrospective application?

29. The staff thinks that some of the boards' tentative decisions will have eased the burden of retrospective application because in some cases they have (a) clarified and modified the proposals in the Exposure Draft so that they are closer to current guidance or (b) have reduced complexity.

30. In particular, many construction-type contracts are likely to consist of a single performance obligation rather than many performance obligations. Respondents who objected to retrospective application were concerned that the Exposure Draft would require identification of many separate performance obligations in such contracts, and therefore may now find retrospective transition of the new standard is less burdensome than they thought. For instance,

> … concerns [about the cost and complexity of retrospective application] will be largely mitigated if the final standard acknowledges that an integrated customer service contract is the appropriate level at which to define a performance obligation, and that control [CL 530]

31. Many respondents in the US construction sector also interpreted the boards' proposals as prohibiting percentage of completion (POC). The boards' redeliberations have confirmed that POC may be a suitable method to depict the

transfer of goods and services to the customer when that transfer takes place continuously.

32. In addition, the boards' redeliberations on warranties, licences and measuring the transaction price (time value of money, uncertain consideration and collectibility) will have all reduced the expected degree of change to existing accounting practice.

33. Nonetheless, although the new standard will often result in a similar accounting to current practice, all entities will have to evaluate the effects of the standard on their contracts and many will have to modify their accounting as a result. For instance, although the requirements for warranties are similar to current requirements they are different and for some entities will result in different accounting. The boards should therefore not underestimate the extent of changes that will result from the new standard.

Why not specify a prospective transition approach?

34. The most frequently suggested alternative transition approach was to allow entities to apply the new standard to all new (or substantively modified) contracts entered into on or after the effective date. Entities would continue to apply existing standards to all contracts existing at the effective date. Many noted that the FASB permitted this approach when introducing the changes to accounting for arrangements with multiple deliverables in FASB ASC Subtopic 605-25 (entities were also permitted to use retrospective application).

35. This transition approach would:

    (a) be simple to apply as an entity does not need to restate the accounting on any contract. It therefore removes all of the practicability issues noted above in paragraph 14;

    (b) generally be less costly and disruptive than retrospective application;

    (c) allow the boards to specify an earlier effective date than would be required for retrospective application.

36. Alternatively, the boards could require the approach proposed in the leases exposure draft. With this transition method both new and existing contracts would be accounted for prospectively from the effective date. An entity would determine and recognise the contract asset or liability at the effective date as if it had always applied the new standard but would not restate prior periods.

37. The staff acknowledge that permitting the approach described in paragraph 34 would address many of the concerns expressed by preparers to the proposals in the Exposure Draft. However, the staff do not think this approach is satisfactory primarily because there would be inconsistent accounting for contracts with customers *after* the effective date. Not only would pre-effective-date comparatives be reported on a different basis from post-effective-date amounts, but within each subsequent period any pre-effective-date contracts would be reported on a different basis from post-effective-date contracts.

38. The approach described in paragraph 36, on the other hand, would achieve comparability of accounting after the effective date, but revenue recognised after the effective date would not be comparable with amounts recognised in prior periods. This approach would also pose some of the same challenges as a retrospective transition approach, although it would not require consideration of contracts that finished before the effective date.

39. Either of these approaches would reduce comparability within an entity's financial statements and between entities, and thus impair the usefulness of the financial information.

Suggested ways to modify the proposed retrospective transition approach

40. The staff have identified seven possible transition reliefs below that could reduce the burden on preparers. Some of these reliefs reduce the comparability of revenues in the comparative periods. However, unlike the prospective approach described in paragraph 34 they do ensure that revenues are reported on a comparable basis within the entity and between entities after the effective date.

	Relief	**Comments**
	Reliefs that affect the number of contracts that would require restatement	
1	Do not require restatement of contracts that started and finished in the same annual period	This would avoid an entity having to restate all of its completed contracts. Although revenue reported in *interim* periods before and after the effective date would not necessarily be accounted for on a comparable basis, revenue in annual periods would be.
2	Do not require restatement of contracts that finished before the effective date	This would avoid an entity having to restate contracts that ended in the comparative periods. Only contracts that are active at the effective date would require restatement. Some entities were particularly troubled by having to open up and restate contracts that ended in the comparative periods. However, this relief would affect the comparability of revenues between reporting periods before and after the effective date. Some contracts in the comparative periods would be accounted for under existing guidance and others under the new standard.
	Reliefs that would simplify how an entity restates contracts with customers	
3	Do not require an entity to reallocate the transaction price if the remaining separate performance obligations at the beginning of the earliest comparative period under the new standard are determined to be the same as under existing guidance.	Even though the entity may have identified the same separate performance obligations at the beginning of the earliest comparative period under the new standard as it had under existing guidance, the entity may have allocated the transaction price to those performance obligations on a different basis under existing guidance from that under the new standard. In particular, the entity may have used a residual technique. In such cases, even if practicable, it may be unduly costly and burdensome to determine what the allocation would be under the new standard. The Boards could provide relief for entities by permitting entities to carry forward into the new standard the amounts allocated to the remaining performance obligations under existing guidance.
4	Allow the use of	Full retrospective application of the standard

	hindsight in estimating variable consideration	would require an entity to determine the estimates it would have made as at each of the reporting dates in the comparative periods. If the boards allow a long lead time, this may not be impracticable, however it increases the complexity and costs of retrospective restatement. The Boards could reduce that complexity by allowing an entity to restate a contract with the benefit of hindsight. For instance, if an entity knows that on a contract it ultimately obtained a performance bonus, it could reflect that information throughout the comparative periods (rather than determining a probability-weighted or most likely estimate of the transaction price at each reporting date and assessing whether revenue is reasonably assured). If the contract has not completed as at the effective date, the entity could restate that contract using assessments about uncertain consideration on the basis of facts and circumstances at the effective date.
	Reliefs that would simplify retrospective application of other aspects of the new standard	
5	Do not require recognition of an asset from the costs of acquiring or fulfilling a contract if the entity had previously recognised those costs as expenses.	Under existing guidance, entities may have recognised acquisition or some fulfilment costs as expenses as incurred. Even if not impracticable, it may be unduly costly and burdensome for an entity to evaluate whether these costs would have been eligible for capitalisation under the new standard. Because this change in requirements for costs would not affect revenue, the Boards could provide relief from retrospective restatement for costs of acquiring or fulfilling a contract.
6	If an entity has not previously recognised a liability for an onerous contract, allow the entity to test whether the contract is onerous at the effective date only, rather	Under existing guidance an entity may not have recognised a liability for an onerous contract that would be required under the new standard. Even if not impracticable, it may be unduly costly and burdensome for an entity to evaluate whether a contract would have been onerous at each reporting date in the

	than at each reporting date in the comparative periods.	comparative periods.
7	Do not require disclosure for prior periods of the maturity analysis of remaining performance obligations.	This would avoid an entity having to prepare disclosures as at the end of the comparative reporting periods. This disclosure is most useful being reported as at the comparative reporting date itself, and not as at the effective date, and could be burdensome to prepare.

Summary and staff recommendation

41. The staff are persuaded by the arguments that retrospective application is desirable to ensure comparability of revenue recognised in all reported periods.

42. However, the staff are aware of the burdensome nature of retrospective application for some entities. With that burden in mind, the staff have considered the potential reliefs identified above.

Reliefs affecting the number of contracts restated

43. One suggested relief was not to require the restatement of contracts that began and ended in the same prior accounting period. The assessment of timing of contract inception and end would need to be made in accordance with the new standard. Even so, this would be a significant reduction of the burden placed on those entities that have a large number of short-term contracts. The staff were concerned, however, that revenue recognised would not be comparable on an interim reporting basis. Some think that interim results, and the revenue growth trends shown quarter-by-quarter, have equal significance to investors as do full-year results. However, most think that the burden this removes and the assurance that revenue would be reported on a comparable basis in the annual financial statements justifies this relief.

44. The relief proposed to remove completed contracts from the restatement process caused the staff concern:

(a) Although reducing the number of contracts requiring restatement would provide some relief, that relief might be limited, depending on the entity's typical contract length and date of contract inception.

(b) The staff also think that a major burden of retrospective restatement is setting up the processes required to collect and evaluate the prior years' information and to identify any contracts subject to the proposed relief. Once that process is complete, a reduction in the volume of contracts restated is of limited benefit

(c) Most importantly, however, the staff think that exempting a defined population of contracts from retrospective application reduces the comparability of reported figures. For that reason the staff do not recommend excluding completed contracts from the restatement process.

Reliefs that simplify the restatement process

45. Two reliefs are proposed that would simplify the restatement process itself.

46. The first would not require an entity to reallocate the transaction price if the remaining separate performance obligations identified at the beginning of the earliest comparative period are the same under both the new standard and existing guidance.This relief would be particularly likely to apply to contracts in the software industry when the same separate performance obligations may be identified but Subtopic 985-605-25 prohibited allocation based on estimated stand-alone selling prices. The staff do not recommend this relief. Although the timing of recognition would be comparable, the amount of revenue recognised would not, and comparability of reported revenues would be reduced.

47. On the other hand, the restatement process could be simplified by allowing the use of hindsight in estimating variable consideration. The objective of the standard is to recognise revenue at the amount that the entity expects to be entitled to receive. This relief would reduce the amount of information an entity needs to collect contemporaneously through the transition period. The entity

would not need to determine the transaction price at each period end or assess at the end of each comparative reporting whether cumulative revenue is reasonably assured. The staff recommend this relief.

Reliefs that do not affect the restatement of revenue

48. Finally, two reliefs are recommended by the staff because they do not affect the restatement of revenue itself:

    (a) If acquisition or fulfilment costs have previously been recognised as an expense the entity should not be required to recognise them as an asset. This will provide relief in those cases when cost data has not been retained in sufficient detail to decide whether costs would be eligible for recognition as an asset or when it is burdensome to make this evaluation.

    (b) If an entity has not previously recognised a liability for an onerous contract, an entity does not need to evaluate whether a contract would have been onerous at each reporting date in the comparative periods. This relief removes the requirement to recreate estimated costs to completion of unsatisfied performance obligations in comparative periods. The staff recommend that this test is applied, however, as at the effective date when the required information will be available and comparability with subsequent review processes can be assured.

Disclosure

49. The staff recommend that the maturity analysis of the remaining performance obligations is not required for prior periods in the first year of application. This analysis as at the end of the comparative reporting period would not be useful at the effective date and would be burdensome to prepare.

Staff recommendation to require modified retrospective application

50. The staff recommend that the boards require retrospective application, modified to include those reliefs recommended above. This requirement will ensure comparability of reported revenues but still provide some relief to preparers.

Allow full retrospective transition

51. If the boards modify the full retrospective transition method proposed in the Exposure Draft to include the recommended reliefs, the staff think that some entities might conclude that the benefits of fully comparative figures (subject to any impracticability limitations) 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 fully restated figures or where internal review processes rely on full comparability of reported amounts.

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

Question 1
Do the boards agree with the staff recommendation to affirm the proposed requirement in the Exposure Draft that an entity apply the revenue standard on a retrospective basis subject to the following reliefs to reduce the burden to preparers of transitioning to the new requirements: (i) not require restatement of contracts that begin and end within the same prior accounting period to be restated (ii) allow the use of hindsight in estimating variable consideration (iii) not require recognition as assets of fulfilment and acquisition costs recognised as an expense in prior periods (iv) not require the onerous test to be performed in comparative periods but only at the effective date unless an onerous contract liability was recognised previously (v) in the first year of application not require disclosure for prior periods of the maturity analyses of remaining performance obligations

Question 2
Do the boards agree with the staff recommendation that full retrospective application should be permitted?

Impracticability

53. Many respondents expressed concern that retrospective application would be impracticable in some situations. Respondents identified long-term contracts, contracts with multiple performance obligations and those contracts for which estimation may not be possible without applying hindsight as likely to present particular practical problems when applied retrospectively.

54. These respondents suggested the boards should include specific guidance on what characteristics would indicate that it would be impracticable to apply the new standard retrospectively.

55. Some of the reliefs described in the table above would address some concerns about impracticability. In addition allowing a long lead time between issuance of the standard and its effective date would also address some of the concerns because entities would be able to collect the necessary data and make the necessary contemporaneous judgements. Nonetheless, in some cases retrospective application of the new standard might be impracticable. The staff thinks that those cases are likely tobe limited to contracts that have all the following characteristics:

- that started before issuance of standard,
- that contain more than one performance obligation, and
- for which entity does not have the necessary contemporaneous information to allocate the transaction price.

Question 3
Do the boards agree with the staff recommendation to include additional guidance in the standard to indicate when the impracticability exceptions of IAS 8 and Topic 250 should apply?

Transition disclosures

56. In the staff's view, the existing disclosure requirements of IAS 8 and Subtopic 250-10 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.

57. If, however, the boards decide to grant preparers any of the transition reliefs proposed above the staff recommend further disclosures be required:

    (a) to state which reliefs have been employed by the entity, and

    (b) a qualitative assessment of the likely effect of applying those reliefs.

Question 4
Do the boards agree with the staff recommendation that the existing disclosure requirements of IAS 8 and Subtopic 250-10 should be supplemented by the additional transition disclosures in paragraph 57 for those entities employing transition reliefs?

FASB Board only – nonpublic entities

58. This section of the paper was prepared by the team of FASB staff that focuses on the financial reporting of private entities and not for profit entities.

59. The majority of preparers and auditors of nonpublic entity financial statements shared many of the same concerns raised by preparers and auditors of public entity financial statements. The majority of these constituents state that they do not support applying the proposed revenue recognition guidance retrospectively

because it would not be operational or practical in many cases and the costs to comply would be significant.

60. Most lenders to nonpublic entities have stated that they require a minimum of two years of comparable financial information because they need this input for their lending assessment models and in making credit decisions. However, some of these lenders indicated that they would be willing to accept a prospective application of the proposed requirements because of cost-benefit concerns (a) if the effect on comparability was not significant or (b) if upon request, management directly provides them with comparable unaudited financial information. Other users have added that retrospective application may have little benefit to other types of users of nonpublic entity financial statements relative to the costs that may be incurred.

61. Some nonpublic entity constituents suggest that the concerns about applying retrospective application can be mitigated by providing nonpublic entities with an extended implementation period such as two to three years beyond the effective date for public companies.

> ...retrospective application of the new standard would be operational only if a long implementation period is provided. [CL 972]

The Private Company Financial Reporting Committee supported this suggestion because while its preparers and auditors strongly favour the prospective method of transition, it recognizes the importance of the lender's needs in evaluating cost-benefit considerations for private company financial statements. Other nonpublic entity constituents suggest that nonpublic entities should be given the option to apply the proposed standards on either a prospective or a retrospective basis.

62. The staff recommends that nonpublic entities be provided a practicability exception for the requirement to apply the retrospective method of transition as proposed in the ED by allowing those entities the option to apply the proposed standard on a prospective basis. This approach would provide nonpublic entities with the flexibility to select the transition method that is most appropriate for their circumstances. Under this approach, a nonpublic entity would apply the

proposed standard on a retrospective basis if its primary type of user(s) requires it. However, preparers would also have the option to apply the proposed standard to all active contracts on a prospective basis (ie as described in paragraph 36 of this memo), which would better address cost-benefit concerns. Given that the volume and type of users of nonpublic entity financial statements are significant differentiating factors between nonpublic and public companies, the staff believes that this option can provide significant benefits in circumstances where an entity's primary user(s) informs a preparer that it will accept the prospective method of transition.

63. If the boards agree with the staff recommendation to grant the transitional reliefs proposed under the modified retrospective method along with the inclusion of additional guidance on impracticability, the staff believes that the nonpublic entity exception recommended in paragraph 62 may not be necessary. Depending on the boards' decisions reached about the proposed transitional reliefs and impracticability guidance, the staff may perform additional outreach with nonpublic entity constituents and will report its final recommendations to the FASB Board at a subsequent meeting.

Appendix 1 A Comment letter analysis

A1. The boards received 330 comment letters which included a response to Question 13 of the revenue recognition exposure draft:

Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?
Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

A2. Of those 330 responses, 33 contained no reference to the application method and were concerned only with effective date.

Geographical analysis

A3. The remaining 297 responses are analysed below by geographical area, split between US respondents and the rest of the world:

	Retrospective	Prospective	Either	Other	Total
US—number	22	42	44	35	143
—percentage	15	29	31	25	100
Rest of World —number	96	24	15	19	154
—percentage	62	16	10	12	100
Total	**118**	**66**	**59**	**54**	**297**
Percentage	**40**	**22**	**20**	**18**	**100**

A4. The responses differed markedly by geographical area. In the United States, prospective application was preferred. Elsewhere retrospective application received strong support, although many expressed concerns about the practicability of its application.

Industry analysis

A5. The 297 responses were also analysed to identify the preferred application method of individual industries where this could be determined. The detailed analysis is included as Appendix 1 B.

A6. This analysis show that some categories of respondents show a clear preference for one application method over any other:

(a) The respondents that generally support retrospective application include accountants and auditors, financial services, government agencies, regulators, academics, fellow standard-setters, trade development confederations and users.

(b) Those industries that prefer prospective application include engineering, utilities, biotech and US construction.

(c) Permitting either retrospective or prospective application as a free choice by the preparer, is the preferred method for the air and defence, automotive, information technology, software and manufacturing industries.

A7. The remaining sectors showed no clear preference. Construction outside of the US, telecommunications, media, transport, pharmaceuticals and professional services all showed a divided range of views.

Appendix 1B - Analysis of preferred application method by industry

	Retro	Prospect	Either	Not retro	Other	Total
Accounting profession	30	8	6	1	6	51
Financial services	12	2	2	2	3	21
Government	4					4
Individuals & academic	9	2		2		13
Regulators	3	1				4
Standard-setters	13	3		1	1	18
Trade dev org	8	1	3	1	1	14
Users	5			1		6
Majority retro	**84**	**17**	**11**	**8**	**11**	**131**
Construction ROW	4	5	1	2	1	13
Media	1	2		1	1	5
Pharma	2	3	1	1		7
Professional services	2		3	1	2	8
Telcos	9	3	5	3		20
Transport	3	1		2		6
Range of views	**21**	**14**	**10**	**10**	**4**	**59**
Biotech		3	1			4
Construction US	1	8		4	2	15
Engineering	2	5	1			8
Power & utility	1	3	1			5
Majority prospective	**4**	**19**	**3**	**4**	**2**	**32**
Air & Defence	2	1	8			11
Auto		1	2			3
Info tech	3	5	19	2	1	30
Manufacturing		1	6	1	1	9
Majority either	**5**	**8**	**35**	**3**	**2**	**53**
	114	**58**	**59**	**25**	**19**	**275**
Other sectors	**4**	**8**	**0**	**6**	**4**	**22**
Total	**118**	**66**	**59**	**31**	**23**	**297**

Appendix 2 Costs associated with change

Cross-project public consultations

A8. The boards' DP and RFV on transition had asked respondents what types of costs they would expect to incur in planning for and adapting to the new requirements.

A9. These types of costs have been ranked for the 104 respondents to the RFV who replied to this question:

Activity	Number	%
Training personnel	88	82
Changing IT systems	82	77
Changing processes	69	64
Educating investors	57	53
Understanding requirements	47	44
Updating transactions	34	32

A10. Respondents to the DP reported similar types of costs.

Effect of application method on costs

A11. Some of these costs will be incurred regardless of the application method employed. Training personnel, educating investors and understanding the requirements will be required whatever method is used.

A12. On the other hand, some cost drivers will be affected by the method required. In general terms, retrospective application has higher one-off costs such as audit and other advisor's fees and internal costs associated with collecting and processing historic information. Proponents of prospective application also believe there are further costs associated with retrospective application due to the greater length of time required between publication and effective date. They believe that the additional internal costs of accounting under the existing basis while also collecting and in some cases processing data in order to restate contracts during this interim period will be burdensome.

System costs

A13. System providers believe that running duplicate systems is a significant source of additional cost.

A14. For this reason the staff think that retrospective application will have lower systems costs than prospective application, if the entity has a number of long term contracts. If prospective application is used for long term contracts, the entity will be required to run two sets of systems and processes concurrently until the oldest pre-effective-date contract has been completed. Running multiple systems increases costs for licences and hardware costs and introduces the risk of confusion or breakdown in controls.

Adjustment level

A15. The level at which restatements are effected will also affect costs. Some respondents believed that restatements would need to take place transaction-by-transaction. Those respondents believe that retrospective application would require all accounting transactions in the restated accounting periods to be reprocessed individually on the entity's new accounting systems. Some even assumed that sales invoices would need to be re-issued, any required credit notes raised, and that sales tax or VAT returns would need to be re-filed to the extent that any amounts had changed as a result of the restatement process. For this reason, many respondents believed that duplicate processing would take place for a number of years. Others thought that restatement adjustments would need to be calculated contract-by-contract, rather than on a portfolio basis.

A16. In the staff's view, neither approach is a requirement of retrospective application. The reporting entity should be able to estimate the effect of the accounting change on individual contracts or populations of contracts and reflect these accounting changes at a nominal ledger level by aggregated journals