STAFF PAPER

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Project	**Revenue recognition**		
Paper topic	Transition, effective date and early application		

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Purpose of this paper

1. The objectives of this paper are to:
   (a) consider possible improvements to the requirements for (i) transition and (ii) early adoption in the November 2011 Exposure Draft, *Revenue from Contracts with Customers* ('2011 ED'); and
   (b) set the effective date of the new standard.

Summary of staff recommendations

2. The staff recommend the Boards:
   (a) retain the requirement in the 2011 ED that an entity apply the revenue standard retrospectively in accordance with Topic 250 *Accounting Changes and Error Corrections* (under U.S. GAAP), or IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (under IFRS);
   (b) expand the practical expedient in paragraph 133(a)/C3(a) of the 2011 ED to allow entities to apply the standard as follows:

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(i) an entity should apply the revenue standard to all contracts in existence[1] as of the start of the annual reporting period beginning on or after the effective date (ie the current year) and to all contracts entered into after that date;

(ii) the entity should recognize the cumulative effect of initially applying the revenue standard as an adjustment to the opening balance of retained earnings for the current year; and

(iii) for the current year, an entity should disclose how all of the financial statement line items of the current year have been affected as a result of applying the revenue standard rather than legacy revenue guidance;

(c) assuming that the revenue standard is issued in the first half of 2013, set an effective date for annual reporting periods beginning on or after 1 January 2017;

(d) affirm the FASB's proposal to prohibit early application; and

(e) affirm the IASB's proposal to permit early application.

Structure of this paper

3. The remainder of this paper is structured as follows:

(a) 2011 ED (paragraphs 4 – 6)

(b) General feedback (paragraph 7)

(c) Transition method (paragraphs 8 – 47)

(i) Feedback (paragraphs 8 – 11)

(ii) Staff analysis (paragraphs 12 – 41)

(iii) Staff recommendation (paragraphs 42 – 47)

[1] a contract in existence at the start of the annual reporting period beginning on or after the effective date is one for which the entity has not fully satisfied its obligations as determined under the entity's legacy revenue accounting policies

(d) Effective date (paragraphs 48 – 53)

(i) Staff analysis and recommendation (paragraphs 51 – 53)

(e) Early application (paragraphs 54 – 55)

(i) Staff analysis and recommendation (paragraph 55)

(f) Appendix A: Summary of proposed changes

(g) Appendix B: 2011 ED's initial application practical expedients

(h) Appendix C: Illustration of the four transition alternatives

(i) Appendix D: Topic 250's disclosure requirements for a change in accounting principle

2011 ED

4. The 2011 ED proposed that entities apply the proposed revenue model retrospectively (paragraph 132/C2 of the 2011 ED) in accordance with the requirements on accounting changes and error corrections in Topic 250 or IAS 8. The 2011 ED also includes four practical expedients intended to ease the burden of retrospective application (these practical expedients are included in **Appendix B**). The staff note that the practical expedient in paragraph 133(c)/C3(c) of the 2011 ED, which relates to the evaluation of onerous performance obligations before the date of initial application, is no longer applicable because the Boards decided to remove the requirement to evaluate whether a performance obligation is onerous.

5. In the 2011 ED, the Boards indicated the expected effective date of the proposals by noting that it would be "set to ensure that the start of the earliest comparative period for an entity required to present two comparative annual periods (in addition to the current annual period) would be a few months after the standard is issued" (paragraph BC334 of the 2011 ED). Consequently, based on the project timelines at the time of publishing the 2011 ED, the

effective date was not expected to be earlier than for annual reporting periods beginning on or after 1 January 2015 (paragraph 131/C1 of the 2011 ED).

6. In terms of early application, the FASB proposed in the 2011 ED to prohibit early application, while the IASB proposed to permit early application (paragraph 131/C1 of the 2011 ED).

General feedback

7. While the Boards did not ask a question about the proposed transition method, effective date or early application, almost a third of all comment letter respondents remarked on one or more aspects of these proposals. A high-level summary of feedback received on the proposed transition method can be found in the January 2013 agenda paper 7E/166E, *Update on outreach regarding disclosure and transition proposals*. As indicated therein, transition was a critical topic discussed at the four disclosure and transition workshops. The feedback indicated general disagreement between users and preparers regarding the appropriate transition method for applying the revenue requirements. In addition, a number of preparers requested additional time to prepare for transition and, therefore, requested a delayed effective date. More specific feedback on and staff analysis of the Boards' proposals for transition method, effective date and early application is provided in the sections below.

Transition method

Feedback

8. Users generally stressed the importance of retrospective application because trend information is critical to their analysis, and retrospective application would, in their view, be the only transition method that would maintain trend information. Some users suggested that a later effective date would be preferable to other transition methods that would not provide trend information. Comparatively, preparers and auditors stressed that the cost of

applying the requirements retrospectively would be significant, primarily because a change in revenue will affect many other numbers in the financial statements as well as items that reference an entity's GAAP revenue (such as taxes, statutory reporting and financing arrangements).

9. In addition to implementation cost concerns, some preparers raised other concerns about applying the requirements retrospectively. For instance, it could be challenging to identify and analyze contracts that are fully satisfied under legacy revenue guidance but not yet fully satisfied under the proposed revenue model (ie completed contracts) because the entity may have discontinued tracking the contract when it had fully performed in accordance with legacy accounting guidance. Also, because the proposed revenue model may, in some cases, result in a change in the timing of when revenue is recognized, it may mean that:

   (a) revenue recognized in a prior year might be reported again in a current reporting period, such as when contracts that had qualified for continuous recognition under legacy revenue guidance are recognizable at a point in time after the effective date under the proposed revenue model; and

   (b) unearned revenue balances (based on legacy revenue guidance) at the date of application of the revenue standard may never be reported in a current reporting period if the revenue standard would require the revenue to be recognized in a previous (comparative) period or even in retained earnings. As explained by one respondent:

   > . . . with earlier revenue recognition under the provisions of the ED combined with a retrospective transition requirement, a significant amount of Microsoft's unearned revenue will never appear as revenue, net income or earnings per share in any periods presented to our financial statement users. Given the numerous mentions in the ED that revenue is a crucial number to users of financial statements, we fail to see how this result of retrospective transition will provide more useful information. (CL #67 Microsoft).

10. In light of these concerns, many preparers requested the Boards consider the following requests if retrospective application is affirmed:

(a) expand or add practical expedients and/or clarify some aspects of retrospective application (eg clarify how to measure reasonably assured amounts retrospectively);

(b) coordinate with securities regulators (eg the Securities and Exchange Commission) to reduce the number of comparative years to be restated in regulatory filings; and

(c) for IFRS reporters, include an exemption from IAS 8 paragraph 28(f)'s requirement to disclose the effect, if applicable, of initial application of a standard (ie of the revenue standard) on each financial statement line item for the *current* period. Respondents expressed concern that without an exemption, this disclosure requirement would result in an entity being required to continue providing revenue information under legacy revenue guidance in the first year of application (which would involve maintaining the related systems and processes) with limited perceived benefit.

11. Many respondents who disagreed with retrospective application suggested alternative methods. A discussion of commonly suggested alternatives is contained in the January 2013 agenda paper 7E/166E and include:

(a) prospective application whereby the revenue standard would be applied only to new or materially modified contracts;

(b) optional prospective or retrospective application; and

(c) retrospective application whereby the revenue standard would be applied only to contracts (i) where changes are anticipated to be significant, (ii) when it is practicable, or (iii) that are uncompleted as of the date of initial application (ie contracts completed before the date of initial application would not be restated).

Staff analysis

12. Given the feedback above, the staff think that there are four viable alternatives for the transition requirements of the proposed revenue model. Those alternatives are as follows:

    Alternative A – retrospective application as proposed in the 2011 ED with optional practical expedients;

    Alternative B – retrospective application as proposed in the 2011 ED with *enhanced* optional practical expedients;

    Alternative C – retrospective application as proposed in the 2011 ED with *enhanced* optional practical expedients AND modified presentation; and

    Alternative D – optional prospective application.

13. For purposes of this analysis, the following terms apply:

    (a) *date of initial application*: the start of the reporting period in which an entity first applies the revenue standard. This date may differ from the effective date for an entity that does not have a calendar year-end. For example, if the revenue standard becomes effective for annual reporting periods beginning on or after 1 January 2017, and an entity has a year-end of 30 June, the date of initial application is 1 July 2017, regardless of the number of comparative periods presented.

    (b) *completed contracts*: contracts for which the entity has fully performed its obligations as of the date of initial application of the revenue standard, as determined under the legacy revenue guidance.

    (c) *existing contracts*: contracts that were entered into before the date of initial application but for which the entity has not fully satisfied its

obligations as of the date of initial application, as determined under legacy revenue guidance.

(d) *new contracts:* contracts that are entered into after the date of initial application.

Alternative A: Retrospective application as proposed in the 2011 ED

14. As mentioned above, the 2011 ED requires an entity to apply the proposed revenue model retrospectively and permits entities to apply one or more of the following practical expedients:

    (a) no restatement of contracts that begin and end within the same annual reporting period;

    (b) use of the transaction price at the date of contract completion for contracts completed before the date of initial application and that have variable consideration; and

    (c) relief from disclosures related to remaining performance obligations.

15. An implication of the 2011 ED proposals is that all contracts (ie completed, existing and new contracts) would need to be analyzed to determine how they should be accounted for under the revenue standard for all periods presented (except for completed contracts that began and ended within the same annual period if an entity elected to apply the proposed practical expedient in paragraph 133(a)/C3(a) of the 2011 ED). The period-specific effects of the revenue standard on each contract would be presented in the respective prior period.

16. In accordance with Section 250-10-45, *Accounting Changes and Error Corrections, Other Presentation Matters*, and IAS 8, retrospective application requires that the cumulative effect of any change in applying a new accounting standard to periods prior to those presented be reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented. An offsetting adjustment, if any, is made to the opening balance of retained earnings (or other appropriate components of equity or net assets in

the statement of financial position) for that period. Retrospective application, however, is subject to an impracticability provision. Also, as mentioned above, the 2011 ED proposed (in paragraph 133/C3) some practical expedients that entities can elect to apply to ease the burden of retrospective application.

17. The retrospective application approach with practical expedients as outlined in the 2011 ED has significant advantages but also significant costs. For users, this approach would be ideal as it would provide for comparability across all annual years presented and for all contracts; that is, it would preserve trend information which is critical for their analysis. The Boards acknowledged this and supported retrospective application under both exposure drafts for consistency and comparability reasons. As noted in the Basis for Conclusions paragraph BC326 in the 2011 ED, "Retrospective application would ensure that all contracts with customers are recognized and measured consistently both in the current period and in the comparative periods presented regardless of whether those contracts were entered into before or after the requirements became effective. Consequently, revenue recognized in the current period would be understandable and comparable because an entity would account for all of its contracts with customers on the same basis."

18. For preparers, the cost in time, effort and money would be high, as expressed in feedback received on both the 2010 and 2011 ED's. While many expressed appreciation for the practical expedients added in the 2011 ED, some did not believe that these practical expedients would sufficiently mitigate implementation costs of retrospective application (see the **Feedback** section above and the feedback summary from comment letters and outreach in agenda paper 7A/160A from May 2012).

19. One respondent, a global professional organization representing users, in response to hearing implementation cost concerns, believes that the cost of converting to a new revenue standard ('cost of change') has been confused with the cost of retrospective application. They believe that the cost of changing IT systems, performing contract reviews and evaluating the implications on other factors (eg taxes, statutory filings) is not incremental to

applying the revenue standard retrospectively. Instead, in their view, much of the cost of change will be borne by preparers irrespective of the transition method applied. Instead of moving away from retrospective application to address preparer and auditor concerns about such costs, this respondent believes that the Boards should set a delayed effective date, which could, for some companies "be equivalent in cost of a modified prospective method or an entirely prospective approach" (CL #358 CFA Institute), depending on the length of their contracts. This respondent reasons the following:

> Further we believe a deferred effective date has the effect of mitigating the cost by converting what many perceive as wasted efforts/costs in looking backward to a prospective consideration of changes. Moreover, a deferred effective date approach would permit preparers to implement the new standard over time. It also has the benefit of providing them with the ability to analyze the impact of the change and better communicate that impact to investors. We understand there is a cost of change, but the decision to create a new standard has already been made. We do not believe the costs of retrospective change are being computed properly and we encourage the Boards to be disciplined in their analysis. (CL #358 CFA Institute)

Alternative B: Retrospective as proposed in the 2011 ED with an enhanced practical expedient

20. This transition method is similar to the 2011 ED proposals, but provides additional implementation relief in the form of an enhanced practical expedient (see below), based on feedback received from many preparers. Many preparers requested that the Boards expand the practical expedients as follows:

    (a) broaden the practical expedient in paragraph 133(a)/C3(a) of the 2011 ED, which states that an entity need not restate contracts that begin and end within the same annual reporting period, to include all completed contracts. As the term 'completed contracts' is defined above, an entity would assess whether a contract is complete under legacy revenue guidance (paragraphs 22 – 27 below); and

(b) broaden the practical expedient in paragraph 133(d)/C3(d) of the 2011 ED, which states that an entity need not disclose in the comparative periods the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue, to include relief from disclosing information related to contract balances and assets recognized from the costs to obtain or fulfill a contract (paragraph 28 below).

21. Some respondents also suggested a practical expedient that would allow them to not restate contracts that would have been written differently had the revenue standard been in place when those contracts were negotiated; however, the staff did not think this was a viable alternative because it would introduce too much subjectivity into the assessment, and any existing agreement should be assessed based on its substance rather than its legal form.

Completed contracts: expanded practical expedient

22. Many respondents suggested expanding the practical expedient in paragraph 133(a)/C3(a) of the 2011 ED to include all completed contracts, irrespective of whether they begin and end within the same annual period. Several respondents also requested that the Boards clarify the term ‘completed contracts’ to mean that the entity has performed its obligations as determined under legacy revenue guidance (which is how the term has been defined above in paragraph 13). Respondents explained that expanding the practical expedient is necessary to ease the burden of retrospective application because without this amendment, in theory, entities would be required to consider every contract ever entered into in order to ensure that applying the revenue standard to that contract would not require a change to the periods presented.

23. Expansion of the practical expedient would mean that the proposals on the time value of money, uninstalled materials in paragraph 46 of the 2011 ED, and contract costs would not need to be applied to completed contracts, each of which had been raised as an implementation issue. Further, respondents

explained that they thought expansion of the practical expedient is necessary because the practical expedient as proposed is insufficient. In their view, this is because for some industries, very few contracts begin and end in the same fiscal year. Thus, an entity would still need to consider all contracts under the revenue standard, regardless of whether they had been completed in accordance with legacy revenue guidance prior to the date of initial application.

24. The staff think that there may be some entities in some industries that would want to apply the revenue model retrospectively. Consequently, the staff think that the proposed additional relief for completed contracts should be a practical expedient (as with the other reliefs in the 2011 ED). Therefore, entities wishing to restate completed contracts may do so. Meanwhile, entities that elect to apply the expanded practical expedient would still be required to disclose (a) if the practical expedient has been used, and (b) to the extent reasonably possible, a qualitative assessment of the estimated effect of applying the expedient (as required in paragraph 134/C4 of the 2011 ED).

25. Proponents of expanding the practical expedient in paragraph 133(a)/C3(a) of the 2011 ED believe that it addresses the major concerns raised by respondents. They also note that the expanded practical expedient will not apply to existing contracts. Accordingly, if an existing contract would still require performance by the entity in the year of initial application under an entity's legacy revenue guidance, the entire contract would be reassessed under the revenue standard. Advocates think that this application approach strikes a balance between providing additional implementation relief and preserving the intent of retrospective application because they think that the expanded expedient would not be used by entities for which its application would significantly impair comparability. This logic is consistent with the Boards' decision in the 2011 ED to introduce the practical expedient in paragraph 133(a)/C3(a), even though this expedient has the potential to create incomparability in interim financial statements:

> A consequence of this relief is that revenue reported in interim periods before and after the effective date would not necessarily be accounted for on a comparable basis. The boards expect that an entity would not use this relief if it operates in an industry in which comparability across interim reporting is particularly important to users of financial statements.

26. For example, an entity may prefer to apply the revenue standard retrospectively if, for example, they have:

    (a) existing deferred revenue balances as of the date of initial application, and for which application of the revenue standard would require point in time revenue recognition in a *prior (comparative)* period. While an entity would be required to restate the related existing contracts, they may decide to restate completed contracts as well such that prior (comparative) periods do not appear to have 'double' revenue recognition; and

    (b) completed contracts recognized over time under legacy revenue guidance but which would be recognized as of a point in time *after* the date of initial application. An entity may decide to restate completed contracts such that their current period does not appear to have 'double' revenue recognition, because this inflated revenue will not continue into the future.

27. Opponents of expanding the practical expedient highlight that it has the potential to impair comparability because it would result in revenue being recognized in comparative periods under both legacy revenue guidance for completed contracts and the revenue standard for existing contracts. This would mean that revenue reported in annual periods before and after the effective date may not necessarily be comparable, which was acknowledged by the Boards as a disadvantage of the practical expedient proposed in paragraph 133(a)/C3(a) of the 2011 ED for *interim* reporting.

Disclosure relief: expanded practical expedient

28. A few respondents also requested expansion of the disclosure relief provided in paragraph 133(d)/C3(d) of the 2011 ED for periods presented before the date of initial application. The primary requests were for relief from disclosing (a) the reconciliation of contract balances disclosure in paragraph 117 of the 2011 ED, and (b) the reconciliation of cost asset balances in paragraph 128 of the 2011 ED. The staff note the disclosure proposals are evaluated separately in agenda papers 7A-D/167A-D. The staff think that the holistic assessment of disclosures and the staff recommendations adequately address the above mentioned disclosure relief request related to transition.

Alternative C: Retrospective as proposed in the 2011 ED with an enhanced practical expedient AND modified presentation

29. This approach would require an entity to apply the revenue standard retrospectively, with an enhanced practical expedient outlined above for completed contracts. However, for entities that choose to apply the expanded practical expedient, this approach would prohibit an entity from restating the comparative periods in its financial statements so that, unlike Alternative B, prior periods do not reflect mixed revenue recognition methodologies (ie completed contracts being presented under legacy revenue guidance while existing contracts are presented under the revenue standard). Instead, entities would be required to present prior periods prepared under legacy revenue guidance and the current period prepared under the revenue standard. This alternative would also require disclosure of all line items of the current period prepared under legacy revenue guidance (ie guidance in place immediately before adoption of the revenue standard). That presentation is depicted in the following table:

Cumulative effect adjustment
as of 1 Jan 2015
(date of initial application)

	20X5[2] **Revenue standard** **[financial statements]**	**20X4** **Legacy revenue guidance** **[financial statements]**	**20X5** **Legacy revenue guidance** **[footnote disclosure]**
Service revenue	XXX	XXX	XXX
Product revenue	XXX	XXX	XXX
Total revenue	**XXX**	**XXX**	**XXX**
Cost of sales	XXX	XXX	XXX
Gross profit	**XXX**	**XXX**	**XXX**

30. A consequence of presenting the comparative years under the legacy revenue accounting policies is that any cumulative adjustment to retained earnings, as a result of applying the revenue standard to existing contracts, would be presented *as of the date of initial application* (as opposed to as of the beginning of the first period presented, which would be required under Alternative A).

31. Thus, instead of restating prior periods, this alternative requires disclosure of all *current* year line items under legacy guidance.

32. Supporters of Alternative C suggest that this modified presentation is the only way (other than retaining retrospective application as proposed in the 2011 ED) to overcome the inconsistencies in prior periods that would otherwise occur when an entity applies the expanded practical expedient to not restate completed contracts. Furthermore, this approach has the benefit of further easing the burden of retrospective application by saving time, effort and money of not restating prior years in the financial statements (particularly audit and review costs).

33. Proponents also believe that enhanced disclosure of the current year under legacy revenue guidance would (a) provide users with trend information that is

[2] 20X5 is the first annual reporting period after the effective date.

comparable, and (b) enable users to compare significant changes in the balances in the current year under legacy revenue guidance and the revenue standard to understand where the major changes in applying the revenue standard arise. They note that while advance disclosure of recently issued accounting standards is already required for both U.S. GAAP and IFRS reporters by the SEC and IAS 8, respectively, those requirements do not provide for disclosure of affected line items amounts. Instead, the advance disclosure requirements relate to discussion of the anticipated impact of adopting a new standard, if known or reasonably estimable. Finally, supporters highlight the positive reception from some users of a similar approach discussed with users and preparers at the disclosure and transition workshops.

34. Opponents argue that this approach would:

(a) not eliminate the possibility of double-counting revenue or of unearned revenue never being recognized;

(b) still require preparers to examine all existing contracts under the revenue standard to determine any adjustment that is required as of the date of initial application; and

(c) not provide trend information based on the revenue standard in the year of initial application.

Alternative D: Optional prospective application

35. This approach would provide entities with an option of applying the revenue standard prospectively. This would mean that only new contracts or those that are materially modified on or after the date of initial application would be accounted for under the revenue standard. Completed and existing contracts (to the extent they are not materially modified) would be accounted for based on legacy revenue guidance. The staff think that the following indicators could be used by entities to determine if a contract has been materially modified:

(a) an increase or decrease in the total arrangement consideration that is more than insignificant;

(b) a significant change in the contracted promises (eg modifying or removing existing performance obligations that are more than insignificant to the contract); and

(c) a significant change in the period of the arrangement (ie extending or shortening the original contracted term that does not result from the unilateral exercise of an option held by either party) that does not constitute a new contract.

36. Because prospective application would be optional, an entity could apply the revenue standard retrospectively. Accordingly, the staff suggest that this alternative also include the practical expedients as proposed in the 2011 ED. Those practical expedients would ease the burden of retrospective application, if elected, without sacrificing comparability.

37. A number of preparers suggested this alternative because they think that it is appropriate for entities to apply the requirements either prospectively or retrospectively based on their business and the needs of their users. Many also highlighted that an optional transition method was used in Updates 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*, and 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements—a consensus of the FASB Emerging Issues Task Force*. Some entities who applied those Updates prospectively, indicated that they did not receive specific questions from their analysts.

38. Additionally, a few preparers indicated that prospective application should be permitted because with retrospective application, there could be no practical expedient that could reduce or eliminate the expansion of a significant amount of time and expense to update internal policies, update controls and system modifications and perform reviews and audits of prior (comparative) periods. Adding to the cost of retrospective application is the implicit requirement for entities to maintain dual reporting systems for long-term contracts and contracts that include multiple elements under legacy revenue guidance and

under the revenue standard. Dual reporting contains its own set of complexities including reconciliations between systems, dual internal control processes, additional audit procedures, and maintenance of the systems. To this point, the following is a representative comment from a national accounting standard setter:

> . . . They [some constituents] also argue that restatements regarding revenue recognition would be impracticable because retrospective application of the new standard for revenue recognition, which would be a fundamental change to the operations of entities, would force entities to duplicate their management of a wide range of activities and their preparation of enormous volume of data, given that the criteria for recognizing revenue constitutes the foundation of corporate management. Therefore, they suggest that the criterion in paragraph C3(a) that "the contracts that begin and end within the same annual reporting period" should be deleted and that, for the performance obligations satisfied over a period across the date of initial application, continuing application of the existing standards should be allowed by not requiring restatements. (CL #188, Accounting Standards Board of Japan)

39. Many also explained that, in their view, prospective application would have the following benefits:

    (a) reduced implementation costs because existing and completed contracts would continue to be accounted for under legacy revenue guidance;

    (b) revenue that was deferred under legacy revenue guidance could be recognized in future periods as those contracts are completed;

    (c) reduced audit, tax and statutory filing costs because prior year restatement would not be required; and

    (d) for U.S. GAAP reporters, reduced presentation costs because they would not be required to restate five years of audited information for the purposes of the SEC's requirement to disclose Selected Financial Data under Part II, Item 6 of Form 10-K.

40. Opponents of permitting prospective application argue that:

(a) permitting prospective application would not provide consistent revenue recognition treatment for existing contracts and new contracts, thus impairing comparability and would not provide useful trend information to users until existing contracts have been fully satisfied after the date of initial application;

(b) unless an entity elects to apply the revenue standard retrospectively, they could incur significant costs of maintaining two accounting systems for contracts that are accounted for under the revenue standard and legacy revenue guidance, until all existing contracts have been completed. For entities with long-term contracts, maintaining dual systems may span decades, which could be a significant impediment; and

(c) the Boards would need to define the terms 'new contracts' and 'materially modified contracts', which had caused significant challenges in interpretation for entities applying Updates 2009-13 and 2009-14.

41. Additionally, one respondent remarked the following about prospective application and introducing optionality in a transition approach:

> An entirely prospective method mixes old and new recognition and measurement guidance and creates decision-useless information and because of this is unacceptable. Further, a modified prospective approach provides no historical trends that investors can use to assess performance. Some suggest an approach similar to that followed under the adoption of EITF 08-01 [Update 2009-13] be followed. Our view is that those disclosures were not useful. (CL #358 CFA Institute)

Staff recommendation

42. A comparative summary of key differences of the four alternative transition methods is as follows:

Alternative	Transition method	Would the revenue standard be applied to *completed contracts*?	Would the revenue standard be applied to *existing contracts*?	Comparative periods restated?
A	*Retrospective: 2011 ED*	Yes	Yes	All presented
B	*Retrospective: enhanced practical expedient*	No	Yes	All presented
C	*Retrospective: enhanced practical expedient AND modified presentation*	No	Yes	None
D	*Optional prospective*	No	No (unless materially modified after the date of initial application)	None

For an illustration of the effect of the four alternatives on prior year and current year financial statements, see **Appendix C**.

43. The staff recommend Alternative C. That is, the staff recommend:

(a) retaining the 2011 ED's requirement that an entity apply the revenue standard retrospectively in accordance with Topic 250 (under US GAAP), or IAS 8 (under IFRS); and

(b) expanding the practical expedient in paragraph 133(a)/C3(a) of the 2011 ED such that:

(i) an entity applies the revenue standard to all new and existing contracts;

(ii) the entity recognizes the cumulative effect of initially applying the revenue standard as an adjustment to the opening balance of retained earnings for the current year; and

(iii) for the current year, an entity discloses how all of the financial statement line items of the current year have been affected as a result of applying the revenue standard rather than the legacy revenue guidance.

44. The staff think that Alternative C is the most appropriate alternative because it both maintains the importance of trend information for users, explains the changes as a result of applying the revenue standard and addresses the most significant concerns raised by preparers.

45. The staff think that a move away from the 2011 ED's version of retrospective application, which requires prior year restatement for all contracts, is supported by (a) the positive reception by users and preparers at the workshops for additional implementation relief, and (b) the significant implementation concerns raised by preparers about retrospective application even with the addition of the practical expedients proposed in the 2011 ED.

46. The staff note that the disclosure requirements under Alternative C would differ from some of the required disclosures in Topic 250, paragraphs 250-10-50-1 through 250-1-50-3 (these disclosure requirements are included in **Appendix D**) for U.S. GAAP reporters. Specifically, some of the disclosure requirements in those paragraphs would no longer apply or would need to be modified because of the required Alternative C disclosures. IAS 8 includes current period disclosure requirements consistent with Alternative C. The staff will review IAS 8 and Topic 250 in preparing the requirements.

47. Under Alternative C, entities would be required to disclose:

    (a) when/if they have elected to take the enhanced practical expedient in paragraph 133(a)/C3(a) of the 2011 ED (paragraph 42 of the 2011 ED);

    (b) to the extent reasonably possible, a qualitative assessment of the estimated effect of applying the practical expedient (paragraph 42 of the 2011 ED); and

    (c) all line items of the current period prepared under legacy revenue guidance.

Question 1 – Transition method

Do the Boards agree with the staff's recommendation of Alternative C, as detailed in paragraph 43 above?

Effective date

48. In addition to the feedback on the proposed method for transition, many respondents also commented on the proposed effective date. As noted above, the Boards indicated in the 2011 ED that the standard would not be effective sooner than for annual reporting periods beginning on or after 1 January 2015. Generally, respondents requested additional time to prepare for transition if the Boards decide that the revenue standard would be applied retrospectively. This is because entities would need time to prepare systems and gather information for contracts that may begin before the earliest comparative period. Those respondents explained that the effective date should be set after 1 January 2015. The majority of respondents also acknowledged the formula provided by the Boards to determine the effective date, however, requested that the effective date be set for at least three years after publication of the standard. This would allow for at least one year between the release of the revenue standard and the start of the earliest comparative period for entities required to present two comparative annual periods. Other respondents requested a longer time before the effective date which ranged from a minimum of three years to eight years.

49. A few respondents requested that the effective date be aligned with that of the leases standard because of the interdependency of the standards. They also believe that a common effective date would help constituents avoid inconsistencies when applying the standards and assist preparers and users in understanding the reasons behind any significant differences in the accounting models. Other respondents asked the Boards generally to consider the effective dates of other standards and the demands on resources when determining the effective date for the revenue standard.

50. The most common reasons provided for requesting a longer transition period if the Boards decide on retrospective application as proposed under the 2011 ED (ie without enhanced practical expedients and modified presentation) were:

    (a) significant financial reporting system modifications;

    (b) changes to processes and policies (including those related to financial controls) to address the changes in guidance;

    (c) some entities will need to capture information from the inception date of their contracts (ie it would be very costly for these entities to try and obtain the information that related to a comparative period as their contracts may span many years – sometimes decades). These entities are not only concerned about existing contracts but also those that may be in existence only for a few months into the earliest comparative period;

    (d) time required to gather prior period comparative data for long-term contracts and make new estimates related to past periods;

    (e) resources required to address the significant increase in disclosure requirements and time needed to review a large volume of transactions; and

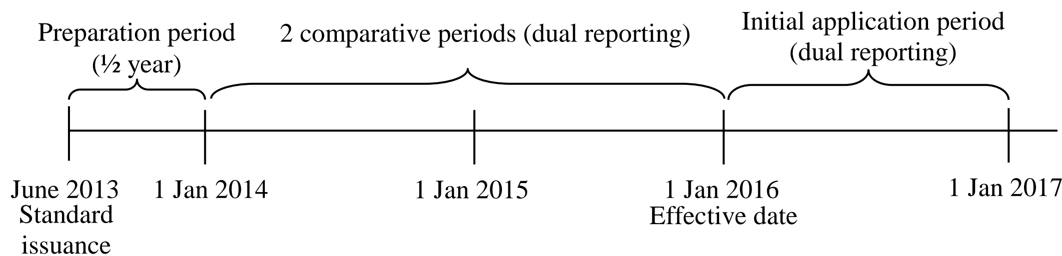
    (f) internal training.

Staff analysis and recommendation

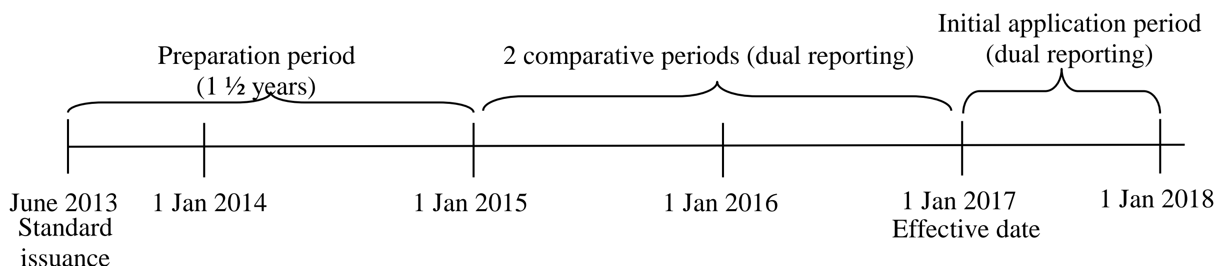
51. According to IAS 1, *Presentation of Financial Statements* paragraph 39, when an entity applies an accounting policy retrospectively, as a minimum, three statements of financial position and two of each of the other statements are required to be presented to provide comparative information. SEC registrants are required to present two comparative periods. Therefore, the staff think that two comparative periods should be anticipated as a minimum. Accordingly, assuming two year comparatives, an entity with a calendar year-end, and

issuance of the revenue standard in the first half of 2013, the following timelines depict two possible options for an effective date:

Effective date: 1 January 2016 – 2 ½ years transition period



Effective date: 1 January 2017 – 3 ½ years transition period



52. Given the feedback received, the staff recommend that the Boards allow for at least three years between the issuance date and effective date (ie the second timeline above) if the Boards reach a consensus on Alternative A, B or C. As such, assuming the revenue standard is issued in the first half of 2013, the effective date would be for annual periods beginning on or after 1 January 2017. If the Boards reach a consensus on Alternative D, then the staff recommend an effective date of 1 January 2016, given the ability for entities to significantly reduce implementation cost and time by applying the revenue standard prospectively (accordingly, only new and materially modified contracts would be subject to the revenue standard).

53. For Alternatives A, B and C, the staff think that allowing at least three years between issuance date and effective date would be appropriate because preparers indicated that retrospective application would require significant system and process changes (see **Feedback** section) and these systems would ideally need to be in place before the earliest comparative period begins. This

is because entities would need to gather information on those contracts that exist or are entered into before the effective date to adequately capture the information for retrospective application. Also, capturing revenue information under both legacy revenue guidance as well as under the revenue standard (ie dual reporting) would be required for the comparable periods. Several steps are required to put a system in place and this is typically a major project for preparers. The staff think that completing this process within six months will be costly and challenging. To this effect, the following is a comment reflective of dual reporting considerations noted by many preparers:

> Specifically, for our business whose revenue recognition policies include a combination of significant multiple element transactions and long-term contracts, retrospective application would likely require dual systems to track revenue during the period of transition. Inherent within the need for dual systems will be increased time spent reconciling between the systems, duplicative internal control processes, additional audit procedures and fees, as well as the costs of establishing, testing and maintaining the systems during the transition period." (CL #90 Tyco International, Inc.)

Question 2 – Effective date
Do the Boards agree with the staff's recommendation that, assuming the standard is issued in the first half of 2013, the effective date be for annual reporting periods beginning on or after 1 January 2017 if the Board decide on transition Alternative A, B or C, or, if the Boards decide on transition Alternative D, for annual reporting periods beginning on or after 1 January 2016?

Early application

54. Some respondents also commented on the FASB's proposal to preclude entities from applying the proposed revenue model early and/or on the IASB's proposal to allow entities to apply the guidance early. Mixed responses were received, with most supporting the ability to apply the guidance early. Those in favor of the FASB permitting early application commonly mention alignment

with IFRSs, which would be particularly helpful for multi-national companies' financial reporting processes, and would lower transition costs for new companies that would otherwise be required to apply current accounting policies for a relatively short period of time prior to applying the revenue standard. Opponents of either Board permitting early application note (a) the reduced comparability of financial information between entities, which, if coupled with a deferred effective date, would exist for an extended period of time, and (b) concern that only entities whose revenue would increase under the revenue standard would elect early adoption.

Staff analysis and recommendation

55. The staff do not propose modifying the early application proposal in either the FASB's or the IASB's 2011 ED. The staff observe that the Boards acknowledged there may be a reduction in comparability before the effective date if some entities choose to adopt early, however the IASB indicated that the revenue standard "would improve accounting for revenue" (paragraph BC335 of the 2011 ED) and "should resolve some pressing issues in practice arising from existing requirements" (paragraph BC335 of the 2011 ED). Furthermore, "The Boards observed that the IASB-only decision to permit early adoption should not result in differences after the effective date in the accounting of revenue between entities applying U.S. GAAP and those entities applying IFRSs that adopt the standard early, even for contracts that straddle the effective date."

Question 3 – Early application

(a) Does the **FASB** agree with the staff's recommendation that the Board affirm its consensus-for-exposure to not permit early application?

(b) Does the **IASB** agree with the staff's recommendation that the Board affirm its consensus-for-exposure that early application be permitted?

Appendix A: Summary of proposed changes

A1. The following table lists the proposed requirements from the exposure draft that relate to the guidance on transition and effective date, and identifies what might change as a result of the staff recommendations in this paper.

Proposals from the 2011 Exposure Draft	Anticipated change?
FASB 2011 ED 131. An entity shall apply this proposed guidance for annual reporting periods beginning on or after XXX, XX, 201X. (The Boards have not yet decided on the effective date of this proposed guidance. However, the Boards have decided that the standard would not be effective sooner than for annual reporting periods beginning on or after January 1, 2015. The effective date for nonpublic entities will be a minimum of one year after the effective date for public entities.) Earlier application is not permitted. *IASB 2011 ED* C1. An entity shall apply this [draft] IFRS for annual reporting periods beginning on or after XX XXX 201X. [The boards have not yet decided on the effective date of this [draft] IFRS. However, the boards have decided that the standard would not be effective sooner than for annual reporting periods beginning on or after 1 January 2015.] Earlier application is permitted. If an entity applies this [draft] IFRS earlier, it shall disclose that fact.	The staff recommend a change in paragraphs 53 and 55 of this paper. Specifically, the staff recommend an effective date of at least three years following the issuance date of the revenue standard. The staff do not recommend a change to the early adoption provision of either the FASB 2011 ED or the IASB 2011 ED.
FASB 2011 ED 132. An entity shall apply this proposed guidance retrospectively by applying the requirements on accounting changes in paragraphs 250-10-45-5 through 45-10, subject to the expedients specified in paragraph 133. In the period of adoption, an entity shall provide the disclosures required in paragraphs 250-10-50-1 through 50-3. *IASB 2011 ED* C2. An entity shall apply this [draft] IFRS retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, subject to the expedients specified in paragraph C3.	The staff recommend a change in paragraph 43 of this paper. Specifically, the staff recommend that an entity apply the revenue standard retrospectively with enhanced optional practical expedients and modified presentation.

133. [paragraph C3 of the IASB 2011 ED] An entity may use one or more of the following practical expedients when applying this proposed guidance. For the purposes of the expedients, the date of initial application is the start of the reporting period in which an entity first applies the proposed guidance. (a) For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period. (b) For contracts completed before the date of initial application and that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods. (c) An entity need not evaluate whether a performance obligation is onerous before the date of initial application unless an onerous contract liability was recognized previously for that contract in accordance with the requirements that were effective before the date of initial application. If an entity recognizes an onerous contract liability at the date of initial application, the entity shall recognize a corresponding adjustment to the opening balance of retained earnings for that period. (d) For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue (as specified in paragraph 119).	The staff recommend a change in paragraph 43 of this paper. Specifically, the staff recommend expanding the practical expedient in paragraph 133(a)/C3(a) of the 2011 ED to apply to completed contracts (as defined in this staff paper).
134. [paragraph C4 of the IASB 2011 ED] For any of the practical expedients in paragraph 133 that an entity uses, the entity shall apply that expedient consistently to all reporting periods presented. In addition, the entity shall disclose the following information: (a) The expedients that have been used (b) To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.	No material change is anticipated.

Appendix B: 2011 ED's initial application practical expedients

B1. The 2011 ED's transition and effective date guidance provides the following practical expedients in paragraph 133/C3:

> An entity may use one or more of the following practical expedients when applying this proposed guidance. For the purposes of the expedients, the date of initial application is the start of the reporting period in which an entity first applies the proposed guidance.
>
> (a) For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period.
>
> (b) For contracts completed before the date of initial application and that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
>
> (c) An entity need not evaluate whether a performance obligation is onerous before the date of initial application unless an onerous contract liability was recognized previously for that contract in accordance with the requirements that were effective before the date of initial application. If an entity recognizes an onerous contract liability at the date of initial application, the entity shall recognize a corresponding adjustment to the opening balance of retained earnings for that period.
>
> (d) For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue.

Appendix C: Illustration of the four transition alternatives

Financial statements as presented in the initial year of adoption

Key:
Contract A - completed contract (exists in both PY1 and PY2)
Contract B - existing contract (exists in CY, PY1 and PY2)
Contract C - new contract (exists in CY)

[green box] Existing US GAAP / IFRS applied to all contracts presented in this period
[red dashed box] New revenue standard applied to all contracts presented in this period
[red filled box] New revenue standard applied to some contracts and existing GAAP / IFRS applied to others presented in this period

	PY2	PY1	CY	CY footnotes	NOTES:
contracts existing during the period	A, B	A, B	B, C		
Alternative A - 2011 ED retrospective	A & B restated to new standard	A & B restated to new standard	B & C on new standard	n/a	All contracts on new standard in all years presented
Alternative B - retrospective; completed contracts not restated	A not restated, B restated	A not restated, B restated	B & C on new method	n/a	CY all contracts on new standard, PY mixed (some on existing GAAP/IFRS and some on new standard)
Alternative C - retrospective; completed contracts and existing contracts not restated in PY	A&B not restated	A&B not restated	B & C on new standard; and footnote	B&C footnote under existing GAAP/IFRS	CY all contracts on new stanard (with footnote disclosure of CY applying existing GAAP/IFRS), PY all contracts on existing GAAP/IFRS
Alternative D - prospective	A&B not restated	A&B not restated	B not restated, C on new standard	n/a	CY mixed (some on existing GAAP/IFRS and some on new standard), PY all contracts on existing GAAP/IFRS

Appendix D: Topic 250's disclosure requirements for a change in accounting principle

D1. Topic 250, *Accounting Changes and Error Corrections*, provides the following disclosure requirements for a change in accounting principle in Section 250-10-50:

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

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

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

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

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

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

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

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

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

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

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

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

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