STAFF PAPER

Week of 18 March 2013

IASB Meeting

Project	**Revenue Recognition**		
Paper topic	Early application of the revenue standard		
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Purpose

1. This paper considers issues related to, and feedback received on, the IASB's tentative decision at the February 2013 board meeting to prohibit early application of the revenue standard. In particular, this paper considers how that tentative decision will affect the current practice issues related to IFRIC 15 *Agreements for the Construction of Real Estate*.

Implications for first-time adoption

2. This paper does not address transition issues related to IFRS 1 *First-time Adoption of International Financial Reporting Standards* including:
   (a) the date of application of the revenue standard for a first-time adopter of IFRSs, and
   (b) the appropriateness of the transition reliefs proposed in the 2011 Exposure Draft *Revenue from Contracts with Customers* ("the 2011 ED") for first-time adopters of IFRSs in the light of the IASB's February 2013 tentative decisions related to transition methods.
3. The staff think that it was clear that the IASB did not intend to preclude a first-time adopter of IFRSs from applying the revenue standard at its date of transition to IFRS, even if the end of its first IFRS reporting period precedes the effective

date of the revenue standard. However, the staff will address the issues related to IFRS 1 at a future board meeting.

Staff Recommendation

4. The staff recommend that the board revise their tentative decision at the February 2013 board meeting and instead permit early application of the revenue standard (as had been proposed in the 2011 ED).

Structure of the paper

5. The remainder of this paper is organised as follows:

   (a) Background and feedback (paragraphs 6-11)

   (b) The IFRIC 15 practice issue (paragraphs 12-16)

   (c) Staff analysis (paragraphs 18-30)

   (d) Staff recommendation (paragraph 31-33)

Background and feedback

6. At the February 2013 joint board meeting, the IASB and the FASB considered the related, but separate, issues of transition methods, effective date and early application (agenda paper 7E/167E). The boards tentatively decided to require the revenue standard to be applied either:

   (a) from the start of the earliest comparative period presented (ie retrospective application, which results in the prior periods being restated), or

   (b) from the start of the year of initial application (ie with cumulative effect of the change at the beginning of the year of initial application, no restatement of prior periods and additional disclosures in the year of initial application).

7. During the discussion about the effective date of 1 January 2017, the IASB decided that it would consider the issues of effective date and early application as

a package. This was because some board members considered that early application should be prohibited if the effective date of the revenue standard was extended to 2017 (ie because it would create a lack of comparability between entities for a longer period of time). Consequently, the IASB tentatively decided to:

(a) require an entity to apply the revenue standard for annual reporting periods beginning on or after 1 January 2017; and

(b) change its proposal in the 2011 ED and instead prohibit early application.

(The FASB also tentatively decided on an effective date of 1 January 2017 and affirmed their proposal in the 2011 ED to prohibit early application.)

8. The IASB's tentative decision to prohibit early application was unexpected, because the staff did not think that a decision to extend the effective date of the standard by one year should have a consequential effect on the decision of whether to permit early application of the revenue standard. In addition, as explained in the February 2013 agenda paper 7E/167E, respondent feedback had not highlighted any concerns with the IASB's proposal to permit early application. As a result, agenda paper 7E/167E did not provide a detailed analysis of whether the boards' rationale for the proposal was still valid, nor did it outline the implications of prohibiting early application.

9. After the February 2013 board meeting, the staff received feedback that highlighted the following concerns with the boards' tentative decision:

(a) the decision represents a departure from the IASB's usual policy of permitting early application and, furthermore, it is unclear whether this decision is intended to create a precedent that the IASB will apply to other standards.

(b) the decision will create difficulties in some jurisdictions that were intending to apply the revenue standard early in order to resolve some pressing issues in practice arising from existing IFRS requirements. Those jurisdictions explained that they were relying on the ability to apply the revenue standard early to address those issues, specifically in relation to the different views in the interpretation and application of IFRIC 15.

10. These issues were previously identified by the board and resulted in their decision to permit early application in the 2011 ED as explained in paragraph BC335. These issues were also considered by the board in July 2011 agenda paper 10C *Effective Date and Early Application*[1] as follows:

> “ (a) The proposed standards are an improvement to financial reporting and this more relevant information should be available to users as soon as possible. Early application would ensure any current reporting problems could be remedied sooner. For example, the interpretative diversity seen when applying IFRIC 15 *Agreements for the Construction of Real Estate* in some jurisdictions could be resolved at an early stage.
>
> (b) The flexibility of choosing its own transition timetable allows an entity to implement the new standard in the most cost effective way. It also allows the entity to reduce implementation costs by combining transition changes with other internal changes to processes and systems. Furthermore, it allows the entity to construct a schedule that reflects the availability of both internal and external consultancy and IT resources.
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> (c) Early application by some preparers is a significant benefit to the financial reporting community as a whole as it helps identify practice and transition issues at an early stage. Subsequent application by the majority of preparers is easier and less disruptive as the early-applying preparers, auditors and system providers have already resolved any practical problems that arise.”

[1] This paper highlighted the feedback the board had received from its October 2010 *Request for Views on Effective Dates and Transition Methods*.

11. The board also specifically considered the proposal of early application with respect to the current application issues of IFRIC 15 in February 2012.

The IFRIC 15 practice issue

12. In February 2012, the IFRS Interpretations Committee (the “Interpretations Committee”) requested the board to provide direction on how the Interpretations Committee should address the current application issues related to IFRIC 15 (see the February 2012 agenda paper 9 *Request for Board direction by the IFRS Interpretation Committee*).

13. The application issues related to IFRIC 15 stemmed from uncertainty regarding whether the sale of real estate (specifically residential real estate such as units in a multiple-unit development) can result in a continuous transfer to the customer, or whether those units represent a transfer at a single point in time (typically upon completion). This uncertainty arose from paragraph 17 in IFRIC 15 which appeared to permit the continuous transfer of a good, however provided limited guidance on when that continuous transfer would occur.

14. As a result of the uncertainty about the interpretation of IFRIC 15 and different views on the appropriate timing of recognition of revenue from the sale of residential multiple-unit developments, some jurisdictions have chosen to issue their own interpretations or to exclude IFRIC 15 from their adoption of IFRSs.

15. The Interpretations Committee identified the following three options for responding to those issues:

    (a) retain IFRIC 15 as issued;

    (b) revise IFRIC 15 either to include indicators of the transfer of control or to include a discussion of continuous transfer; or

    (c) withdraw IFRIC 15.

16. After considering these issues at the February 2012 board meeting, the board’s advice to the Interpretations Committee was to retain IFRIC 15 as currently issued. The rationale for the board’s decision was as follows:

(a) the notion of 'continuous transfer' will be specifically addressed in the revenue standard with the inclusion of criteria for a performance obligation satisfied over time; and

(b) given the time required to devise a solution, re-draft IFRIC 15, and complete the necessary due process steps, it might not be possible to issue a revised IFRIC 15 before the revenue standard is issued.

17. In addition, the staff note that some observed that the proposal in the 2011 ED to permit early application of the revenue standard would mean that the diversity in practice could be eliminated by entities who choose to early adopt the revenue standard.

Staff Analysis

18. Reversing the proposal in the 2011 ED and prohibiting early application of the revenue standard will result in interpretation issues and different views related to IFRIC 15 continuing until the revenue standard becomes effective (ie until 1 January 2017 for a calendar year-end company). This tentative decision will also have the effect of perpetuating differences in views in some jurisdictions that have issued their own interpretation of the issue or have not yet adopted IFRIC 15.

19. In the light of these issues and the feedback received subsequent to the February 2013 Board meeting, the staff have identified the following alternatives:

(a) **Alternative A** – revise the tentative decision and permit early application of the revenue standard

(b) **Alternative B –** reaffirm the tentative decision to prohibit early application *and* withdraw IFRIC 15

(c) **Alternative C –** reaffirm the tentative decision to prohibit early application *and* amend IFRIC 15

Alternative A – revise the tentative decision and permit early application

20. The boards' rationale for prohibiting early application at the February 2013 meeting was that extending the effective date to 2017 would result in a longer period in which there would be a loss of comparability in financial statements because of entities choosing to apply the revenue standard early. Some board members were concerned that this loss of comparability may create confusion for financial statement users. However, the staff observe that the transition period of 1 January 2017 is only one year longer than would have resulted from the proposal in the 2011 ED based on the current project timeline (ie the formula explained in paragraph BC334 would have resulted in an effective date of 1 January 2016 based on the current expected publication of the revenue standard in 2013). In addition, the staff observe that the boards also considered a longer lead-time in developing the proposal in the 2011 ED as follows:

> "The long lead-time recommended between issuing the revenue recognition standard and its effective date increases the number of reporting periods during which comparability could be reduced by early application. On the other hand, this long time period also indicates that there is a greater need than usual to permit early application to ensure anticipated improvements to financial reporting are made as soon as possible and are not delayed by the long lead-time." (Excerpt from July 2011 agenda paper 10C)

21. Given the importance of comparability to users, the staff observes that the board also considered the views of users in developing the proposal to permit early application in the 2011 ED. To gather those views, the IASB and the FASB included a question related to early application in a joint investor outreach questionnaire issued in April 2011 (see also paragraph BC332).

> "Responses to the question whether early application should be permitted were evenly split. Half the respondents believe that early application should be permitted for all the new standards, to reflect the improvement to reporting at the earliest possible time. Slightly fewer than half the respondents did not believe

> early application should be permitted due to the reduced comparability of financial statements.” (Excerpt from July 2011 agenda paper 10C)

22. The staff acknowledge the concerns regarding lack of comparability that may result from the decision to permit early application of the revenue standard. However, as explained above, the staff think that the interpretation issues and different views in relation to IFRIC 15 already leads to some loss of comparability today. Therefore, in the staff’s view, early application may actually improve comparability in some jurisdictions with regards to revenue recognition for residential real estate.

23. In addition, the staff observe that there may also be other instances of diversity in practice today in areas of revenue recognition where IAS 18 *Revenue* provides limited guidance, such as for multiple-element arrangements. In these cases, early application of the additional guidance in the revenue standard may “improve accounting for revenue” (paragraph BC335) and may also create greater comparability between entities before the effective date of the revenue standard.

24. Furthermore, although the revenue standard will provide additional guidance in a number of areas, the staff note that it will not result in substantial changes in accounting for many types of transactions. Therefore early application should not significantly reduce comparability and will improve financial reporting before the effective date. The staff also note that improving financial reporting is one of the boards’ objectives in the revenue project and the benefits from improving financial reporting before the effective date should outweigh any concerns about the lack of comparability that may be produced by early application.

Alternative B – reaffirm tentative decision and withdraw IFRIC 15

25. This alternative would reaffirm the tentative decision of the board to prohibit early application. However, to address the issues identified above, this alternative would also require the board to withdraw IFRIC 15 when the revenue standard is issued. This would mean that entities would rely instead on the principles in IAS 11 *Construction Contracts* or IAS 18 to determine the appropriate pattern of revenue recognition for multi-unit residential real estate. This would reinstate the

uncertainty in accounting for residential real estate that existed before IFRIC 15 was issued, because an entity would be required to determine whether the development represents the sale of a good (which results in revenue recognised at a point in time) or the rendering of a service (which results in revenue being recognised using percentage of completion)—which is an area where IAS 18 provides no guidance. The staff note that this alternative would not address any other practice issues that may have developed as a result of other areas of limited guidance in IAS 18.

26. As explained above, in February 2012 the board considered but rejected this alternative as a path forward for the Interpretations Committee. This is because withdrawing IFRIC 15 might have eliminated some issues in some jurisdictions, however it would create uncertainty in other jurisdictions that are relying on IFRIC 15 to determine the appropriate revenue recognition pattern for residential real estate. Furthermore, the board noted that the due process steps required to withdraw IFRIC 15 might not be completed before the revenue standard is issued. In the staff's view, both of these factors continue to be relevant. In addition, the staff observe that by creating uncertainty in some jurisdictions that may be currently relying on IFRIC 15, there may be considerable resistance to withdrawing it.

27. By withdrawing IFRC 15, there would no longer be explicit guidance for revenue recognition related to development of residential real estate. This absence of guidance may mean that some entities would look to paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to allow them to apply the guidance in the revenue standard related to performance obligations satisfied over time. Effectively, this would mean that some entities may try to early adopt parts of the revenue standard before its effective date. In the staff's view, this would create significant tension with the board's tentative decision to prohibit early application. In addition, it may create a different type of diversity in practice because while some entities may choose to rely on paragraph 10 of IAS 8, other entities may conclude that paragraph could not be used to apply parts of a standard that is not yet in effect and specifically precludes early application.

Alternative C – reaffirm tentative decision and amend IFRIC 15

28. This alternative would reaffirm the tentative decision of the board to prohibit early application. However, to address the issues above, this alternative would also require the board to request the Interpretations Committee to amend IFRIC 15 to address the current diversity in practice. To eliminate this current diversity in practice, the Interpretations Committee would need to clarify what continuous transfer of a good means in paragraph 17 of IFRIC 15, possibly by providing indicators of when continuous transfer occurs.

29. The staff observe that some might suggest that the Interpretations Committee consider the guidance in the revenue standard on determining when a performance obligation is satisfied over time as indicators of when continuous transfer occurs. As noted above, the board considered but rejected this option in February 2012 when providing direction to the Interpretations Committee. This is because IFRIC 15 is an interpretation based on IAS 11 and IAS 18, which have fundamentally different core principles to determine the appropriate pattern of revenue recognition. For example, IAS 18 differentiates between the sale of goods and services and the criteria for the sale of goods in IAS 18 is based (in part) on the transfer of risks and rewards and the notion of continuing managerial involvement. However, the revenue standard focuses on when goods or services are transferred to a customer and when a performance obligation is satisfied. Consequently, it may not be possible to bridge that technical gap and incorporate guidance from the revenue standard into an interpretation of existing IFRSs. This may result in a need for the Interpretations Committee to develop different criteria or indicators to explain the notion of continuous transfer in the context of IAS 18, which may take time. It may also result in the amended IFRIC 15 being in effect for only a limited period of time before the revenue standard is effective on 1 January 2017. Consider the following timetable (which assumes that resources are currently available and there are limited difficulties in drafting the amendments):

May 2013	July2013	Sept 2013	Oct 2013	Feb 2014	July 2014	1 Jan 2015
Staff Draft	IFRIC decides	Amendments to IFRIC 15 drafted	Board approves	Comment ends	Issue revised IFRIC 15	Effective date

30. The staff also observes the following challenges if the Interpretations Committee is required to clarify the continuous transfer notion without reference to the revenue standard:

    (a) IAS 18 does not have a Basis for Conclusions nor does it discuss the notion of continuous transfer of a good. It may not be possible technically to devise indicators for a notion that was not envisaged in IAS 18.

    (b) Many constituents believe that indicators are difficult to apply unless they have a clear hierarchy or can be ranked in some way. If IFRIC 15 were revised to include indicators, constituents might find that an assessment made on indicators did not provide the needed clarity.

Staff recommendation

31. The staff recommend that the board revise its tentative decision and permit early application of the revenue standard (ie Alternative A). This is because early application will improve accounting for revenue in the short term, and will eliminate the application issues related to IFRIC 15 and other practice issues that result from limited guidance in IAS 18. The staff also observe that the transition disclosures required by the revenue standard and IAS 8 would provide adequate information about the effect of the change to accounting policies.

32. Furthermore, the staff do not think that Alternatives B and C (ie to prohibit early application and withdraw or amend IFRIC 15) are viable. This is because those approaches are likely to be time-consuming, may not be technically feasible and are likely to provide limited benefits. The staff also considered, but rejected another alternative of an earlier effective date (without early application). The staff rejected this alternative because an earlier effective date would not be

responsive to the feedback regarding the anticipated difficulties in applying the revenue standard (considered at the February 2013 meeting). In addition, in the staff's view, the decision on early application should be made independent of the effective date. The staff also note that it is critical for the FASB and the IASB to be converged on the effective date and therefore any decision related to the effective date should be considered jointly.

33. However, the staff note that convergence on the issue of early application is not necessary, because legacy revenue standards are not converged and therefore early application would not create any additional comparability issues before the effective date. Furthermore the decision to permit early application "should not result in differences after the effective date in the accounting of revenue between entities applying US GAAP and those entities applying IFRSs that adopt the standard early, even for contracts that straddle the effective date" (paragraph BC335).

Question for the board
Does the board agree with the staff recommendation to permit early application of the revenue standard?