STAFF PAPER

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IASB Meeting

Project	**Revenue Recognition**
Paper topic	Transition: First-time adopters and IAS 8 disclosures

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Purpose of this paper

1. This paper addresses the following issues related to transition:
   - (a) Transition methods available for first-time adopters;
   - (b) The applicability of disclosures required by paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to entities already applying IFRSs who use the retrospective transition method.

Staff recommendations

2. The staff recommend that:
   - (a) The Board does not amend IFRS 1 *First-time Adoption of International Financial Reporting Standards* to permit first-time adopters of IFRSs to use the alternative transition method (as outlined by the boards in February 2013) to transition to the revenue standard.
   - (b) The Board does not provide an exemption for first-time adopters to ignore, in their application of IFRS 1, contracts that are completed under legacy revenue requirements before the earliest comparative period presented (ie before the date of transition to IFRSs).

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(c) The Board does not require entities to apply paragraph 28(f) of IAS 8 for the *current* period when the entity applies the retrospective transition method (paragraph 28(f) of IAS 8 requires an entity to disclose the amount of adjustments for each financial statement line item affected, in the current and prior periods, as a result of applying a new IFRS).

Structure of the paper

3. First-time adopters

   (a) Background (paragraphs 5-9)

   (b) Staff analysis and recommendations (paragraphs 10-17)

4. IAS 8 transition disclosures

   (a) Background, staff analysis and staff recommendation (paragraphs 18-22)

First-time adopters

Background

5. The revised Exposure Draft *Revenue from Contracts with Customers*, published in November 2011 ("the 2011 ED") proposed that the revenue standard should be applied retrospectively. This approach is broadly consistent with the objective of IFRS 1, which is to provide a suitable starting point for accounting in accordance with IFRSs.

6. The 2011 ED also proposed some practical expedients to ease the burden of retrospective application for existing IFRS preparers. The IASB decided to extend three of the four practical expedients proposed in the 2011 ED to first-time adopters by proposing an amendment to IFRS 1. Those practical expedients (referred to as 'transitional provisions' in the amendment to IFRS 1) were included in paragraphs C3(a), C3(b) and C3(d) of the 2011 ED and are summarised as follows:

(a) For contracts completed before the date of initial application[1], 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[1] 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) For all periods presented before the date of initial application[1], 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 recognise that amount as revenue (as specified in paragraph 119 of the 2011 ED).

7. The Board decided to extend those practical expedients to first-time adopters because the reliefs are compatible with the objective of IFRS 1—that is, they would maintain comparability across reporting periods.

8. The Board decided to retain the practical expedients for existing IFRS preparers at the February 2013 joint board meeting. Respondents to the 2011 ED did not raise any comments about the applicability of those expedients to a first-time adopter. Hence, the staff think it is not necessary for the Board to redeliberate the application of these practical expedients to first-time adopters of IFRS.

9. At the February 2013 meeting, the boards decided that, as an alternative to retrospective transition, an existing IFRS preparer could elect to apply an alternative transition method—a cumulative catch-up method. This would require an entity to:

(a) Apply the revenue standard to contracts that are not completed under legacy IFRSs/US GAAP at the date of initial application (Completed contracts are contracts for which the entity has fully performed its obligations as of the date of initial application of the revenue standard, as determined under legacy revenue requirements);

[1] For first-time adopters, the 'date of initial application' should be interpreted as the beginning of the first IFRS reporting period.

(b) Recognise the cumulative effect of initially applying the revenue standard as an adjustment to the opening balance of each affected component of equity at the date of initial application (that is, comparative years would not be restated); and

(c) In the year of initial application, provide the following additional disclosures:

  (i) The amount by which each financial statement line item is affected in the current year as a result of the entity applying the revenue standard; and

  (ii) An explanation of the significant changes between the reported results under the revenue standard and legacy IFRSs/US GAAP.

Staff analysis and recommendations

The alternative transition method - first-time adopters

10. Paragraph 9 of IFRS 1 explains that transitional provisions in other IFRSs do not apply to a first-time adopter's transition to IFRSs. Therefore, the first question for the Board is whether an entity applying IFRS 1 could also apply the alternative transition method upon first-time adoption of IFRS.

11. The staff think that the position of a first-time adopter of IFRSs is different than that of an existing IFRS preparer who is applying the revenue standard for the first time. This is because first-time adoption requires an orderly adoption of all IFRSs from the transition date to provide a suitable starting point for entities applying IFRSs. In addition, first-time adoption tries to create comparability within a first-time adopter's first IFRS financial statements. Paragraph BC10 of IFRS 1 explains that this comparability is important, as is the comparability between different entities adopting IFRSs for the first time at a given date, but notes that comparability between first-time adopters and entities that already apply IFRSs is a secondary objective.

12. The staff note that the alternative transition method provides relief from retrospective application and would not achieve comparability within a first-time adopter's first IFRS financial statements. This is because the alternative transition

method would not require an entity to restate comparative years for the effects of applying the revenue standard and, instead, would require an entity to recognise the cumulative effect of initially applying the revenue standard as an adjustment to the opening balance of each affected component of equity at the date of initial application. (For first-time adopters, the 'date of initial application' would be the beginning of the first IFRS reporting period. In contrast, retrospective application would require an entity to recognise the cumulative effect at the beginning of the earliest year presented.)

13. In addition, the staff think that the alternative transition method may be more challenging for first-time adopters, and possibly confusing for investors, because it would potentially require *two* separate reconciliations of equity as follows:

    (a) A reconciliation of equity for the transition to IFRS which would be recognised in the *earliest comparative period* presented in the entity's first IFRS financial statement (ie the date of transition to IFRS); and

    (b) A reconciliation of equity for the transition to the new revenue standard which would be recognised at the beginning of the entity's first IFRS reporting period (ie the *latest reporting period* covered by an entity's first IFRS financial statements).

14. In the light of these factors, the staff recommend that the Board does not amend IFRS 1 to permit first-time adopters of IFRSs to use the alternative transition method (as outlined by the boards in February 2013) to transition to the revenue standard.

Question 1 – Alternative transition method for first-time adopters
Does the Board agree with the staff recommendation not to amend IFRS 1 to permit first-time adopters of IFRS to use the alternative transition method (as outlined by the Board in February 2013) to transition to the revenue standard?

Other transitional reliefs for first-time adopters?

15. During the February 2013 joint board discussion regarding transition, the boards considered whether 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) should be broadened to include contracts completed under legacy revenue requirements before the earliest comparative period presented (ie, 1 January 2016, assuming one year of comparatives). Although the boards did not agree to that alternative, the staff note that this relief is essentially provided to existing IFRS preparers through the alternative transition method. However the alternative transition method goes further by permitting existing IFRS preparers to not restate contracts that are completed before the date of initial application (ie 1 January 2017).

16. As described in paragraphs 10-1314 above, the alternative transition method would not be appropriate for first-time adopters. However, the staff note that first-time adopters would have the same concerns as other preparers—that is, that the cost of restating contracts that were closed before the earliest comparative period could be quite high and there may be little benefit to users. In addition, the historical information could be inaccessible. As such, the staff think that the Board could consider providing an exemption for first-time adopters to ignore, in their application of IFRS 1, contracts that are completed under legacy revenue requirements before the earliest comparative period presented. This may be appropriate because it would alleviate the costs of applying the revenue standard for first-time adopters, however would still require restatement of all comparative periods presented in the first set of IFRS financial statements and thus be consistent with the principles of IFRS 1 as explained above. The staff note that IFRS 1 already includes some exemptions that provide relief where an entity applying IFRS for the first time might not be able to apply IFRSs under what many see as a "fully retrospective approach," for example, IFRS 1 appendix C (exemptions for business combinations), D1(f) (setting the cumulative translation differences to zero on transition), D1(l) (simplifying the calculation of the decommissioning liabilities included in the cost of property, plant and equipment).

17. Despite these arguments, the staff recommend that the Board does not provide an exemption for first-time adopters to ignore, in their application of IFRS 1, contracts that are completed under legacy revenue requirements before the earliest comparative period presented. This is because:

(a) First-time adopters will be using a variety of legacy revenue requirements and the principles for classifying revenue contracts as completed may vary significantly; and

(b) First-time adopters of IFRSs today must retrospectively apply IASs 11 and 18 to both completed and incomplete contracts—that is, no similar relief to that proposed in paragraph 15 above is currently provided.

Question 2 – 'Completed contracts' relief for first-time adopters
Does the Board agree with the staff recommendation to not provide an exemption and therefore require a first-time adopter of IFRS to apply the revenue standard like other IFRSs as specified by IFRS 1? ?

Disclosures required by paragraph 28(f) of IAS 8

Background and staff analysis

18. In 2012, the Board discussed paragraph 28(f) in IAS 8 which states:

> 28 When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
>
> (a) …
>
> (f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
>
> (i) for each financial statement line item affected;
>
> (ii) …
>
> (g) …

19. At its May 2012 meeting, the Board tentatively decided to remove the reference to the "current period" in IAS 8. However, at its September 2012 meeting, instead of removing that paragraph, the Board decided to consider on a standard by standard basis, whether that paragraph should apply. In addition, the Board decided that

IAS 8 will be reconsidered on a more holistic basis in the Conceptual Framework project.

20. Paragraph 28(f) is only relevant for those entities who are retrospectively applying the revenue standard. This is because the revenue standard will include the requirements (including the disclosure requirements) that prescribe how an entity should apply the alternative transition method (specified in paragraph 7 above) to transition to the revenue standard.

21. The staff think that the disclosure required by IAS 8.28(f) is not necessary for the *current period* when retrospective application is used. This is because it would require entities to disclose the effect on the financial statements in the current year as if the entity had continued to apply legacy requirements. In the staff's view, this information is not necessary for users because they will obtain trend information through retrospective application of the standard, rather than through this additional disclosure. In addition, this disclosure will be costly to implement because it will require an entity to maintain dual systems in the year of initial application.

22. Given this, the staff recommend that the Board do not require an entity to disclose the adjustments required by IAS 8.28(f) for the current period, if that entity has applied the revenue standard retrospectively.

Question 3 – IAS 8
Does the Board agree that entities should not be required to provide the amount of adjustments in the current period as required by paragraph 28(f) of IAS 8, when the entity applies the retrospective transition method?