

STAFF PAPER

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IASB Meeting

Project	Revenue from Contracts with Customers		
Paper topic	Practical expedients on transition—feedback on ED <i>Clarifications to IFRS 15</i> and redeliberations		
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This paper has been prepared for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose

1. The purpose of this paper is:
 - (a) To summarise the feedback received from respondents on the proposed practical expedients on transition in the [Exposure Draft Clarifications to IFRS 15](#).
 - (b) To ask whether the IASB wishes to finalise the proposed practical expedients on transition.
2. The paper is structured as follows:
 - (a) Transition requirements of IFRS 15
 - (b) Summary of IASB proposals and equivalent FASB proposals
 - (c) Overall summary of feedback
 - (d) Full retrospective additional completed contracts practical expedient
 - (e) Date of application of the contract modifications expedient
 - (f) Additional FASB completed contracts amendment
 - (g) Completed contracts definition

Transition requirements of IFRS 15

3. For the purposes of the transition requirements of IFRS 15 / Topic 606 *Revenue from Contracts with Customers*:
 - (a) the date of initial application is the start of the reporting period in which an entity first applies IFRS 15/Topic 606 (paragraph C2(a)); and
 - (b) a completed contract is a contract for which the entity has transferred all of the goods or services identified in a contract with IAS11 *Construction Contracts*, IAS 18 *Revenue* and related Interpretations (paragraph C2(b)).
4. An entity applies IFRS 15/Topic 606 using one of the following two methods:
 - (a) retrospectively to each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to the expedients in paragraph C5 (the full retrospective method); or
 - (b) retrospectively with the cumulative effect of initially applying IFRS 15/Topic 606 recognised at the date of initial application as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application (paragraph C3(a)) (the modified retrospective method). Under this transition method, an entity applies IFRS 15/Topic 606 retrospectively only to contracts that are not completed contracts at the date of initial application (for example, 1 January 2017 for an entity with a 31 December year-end)

Summary of IASB proposals and equivalent FASB proposals

5. In response to issues raised at meetings of the Revenue Transition Resource Group (TRG), the IASB proposed in ED *Clarifications to IFRS 15* the following two additional practical expedients on transition to IFRS 15.
6. The first practical expedient is intended to reduce the complexity and cost associated with the initial application of IFRS 15 without significantly

compromising the usefulness of the financial information by limiting the population of contracts to which IFRS 15 applies.

7. This expedient would permit an entity electing to use the full retrospective method not to apply IFRS 15 retrospectively to completed contracts (as defined in paragraph C2) at the beginning of the earliest period presented.
8. The second practical expedient is intended to reduce the complexity and cost associated with the initial application of IFRS 15 without significantly compromising the usefulness of the financial information by limiting the number of contract modification calculations in respect of previous modifications to contracts.
9. This expedient would permit an entity to use hindsight in (i) identifying the satisfied and unsatisfied performance obligations in a contract that has been modified before the beginning of the earliest period presented; and (ii) determining the transaction price.
10. See the Appendix for the relevant extracts from the ED *Clarifications to IFRS 15*.
11. In September 2015 the FASB issued its [Proposed Accounting Standards Update Revenue from Contracts with Customers \(Topic 606\) Narrow-Scope Improvements and Practical Expedients](#), which includes its proposals on the practical expedients relating to modified and completed contracts. Comments were due by 16 November 2015. The FASB is not expected to redeliberate its proposals until early 2016.
12. The FASB proposals differ from the IASB in the following respects.
 - (a) With respect to modified contracts, the FASB wording is different but the outcome is expected to be the same, except that the point at which an entity applying the FASB practical expedient could use hindsight is the beginning of the earliest period presented in accordance with Topic 606.
 - (b) With respect to completed contracts:
 - (i) The FASB did not propose to allow the practical expedient proposed by the IASB to permit an entity electing to use the full retrospective method not to apply IFRS 15

retrospectively to completed contracts (as defined in paragraph C2) at the beginning of the earliest period presented.

- (ii) The FASB proposed to amend the definition of a completed contract to ‘a contract for which all (or substantially all) of the revenue was recognized under legacy generally accepted accounting principles (GAAP) before the date of initial application’.
- (iii) IFRS 15/Topic 606 does not permit entities to apply the modified method to completed contracts. The FASB proposed an additional amendment to permit an entity to apply the modified retrospective method either to all contracts at the date of initial application or only to contracts that are not completed contracts at the date of initial application.

Overall summary of feedback

- 13. There was widespread support for the IASB proposals in the 74 comment letters.
- 14. The majority of respondents either agreed with the proposals or made no comment. All but one of the remaining 31 respondents broadly agreed but with reservations or observations about some aspect of the proposals.
- 15. Many respondents made the general point that it is desirable for the IASB and FASB to conform their practical expedients as much as possible for comparability across jurisdictions and for operational efficiency in entities reporting under both IFRS and US GAAP (‘dual reporters’).
- 16. There were significant comments that are detailed below in three specific areas:
 - (a) The date of application of the contract modifications practical expedient—see paragraphs 20–35 below
 - (b) The additional FASB completed contracts expedient (described in paragraph 12(b)(iii) above)—see paragraphs 36–40 below
 - (c) The definition of a completed contract for the purposes of transition—see paragraphs 41–53 below.

17. A number of respondents referred to the discussion in July 2015 about completed contracts by the members of the Revenue Transition Resource Group (TRG), who had different views on what constituted a completed contract and on how to account for completed contracts after adoption of the new standard. However it is unclear to what extent these respondents have considered the further discussion of completed contracts at the September 2015 IASB meeting.

Full retrospective additional completed contracts practical expedient

18. No respondent had any significant reservations about the proposed expedient to permit an entity electing to use the full retrospective method not to apply IFRS 15 retrospectively to completed contracts (as defined in paragraph C2) at the beginning of the earliest period presented.
19. The staff therefore recommend the IASB confirms this further expedient.

Question for the IASB

Does the IASB agree with the staff recommendation to confirm the proposal in the ED to permit an entity electing to use the full retrospective method not to apply IFRS 15 retrospectively to completed contracts (as defined in paragraph C2) at the beginning of the earliest period presented?

Date of application of the contract modifications practical expedient

20. Both boards decided to permit the use of hindsight with respect to contract modifications. Rather than requiring entities to perform a separate recalculation of the contract revenue for each previous modification, entities would perform one recalculation based on the position of the contract after the final previous modification. Any subsequent modifications would continue to be accounted for in accordance with IFRS 15/Topic 606. However:
- (a) The IASB proposed that entities should apply the expedient at the beginning of the earliest period presented.

- (b) The FASB proposed that entities apply the expedient at the beginning of the earliest period presented in accordance with Topic 606.
21. The date of application will be the same for entities adopting the full retrospective method but different for those adopting the modified retrospective method.
22. Consider an entity with an effective date of 1 January 2018 and two years of comparative figures. For entities electing the full retrospective method, the IASB and FASB proposals would both result in the expedient being applied at 1 January 2016. However for entities electing the modified retrospective method, the IASB expedient would be applied at 1 January 2016 but the FASB expedient would be applied at the later date of initial application of Topic 606 ie 1 January 2018.

Summary of feedback

23. There was general support for the expedient.
24. Only one respondent explicitly disagreed with the proposals to any significant extent, in respect of the contract modifications practical expedient. This respondent preferred the ‘frozen balances’ approach rejected by both Boards over the ‘hindsight’ approach proposed by the Boards.
25. A few respondents encouraged the Boards to converge the application dates. Four expressed no preference between the IASB and FASB dates. Two preparers preferred the FASB date, of whom one thought the earlier IASB date diluted the usefulness of the expedient to some extent because entities would have to evaluate the effect of modifications after the beginning of the earliest comparative period separately. Under the FASB proposal entities would not evaluate the effect of contract modifications separately until the later date of initial application.
26. Another respondent, a large accounting firm, expressed a preference for the IASB date, on the basis that using the later date may not allow sufficient time between finalising transition and reporting for the first time, particularly for entities that report on a quarterly basis, and made no comment about convergence.

Staff analysis

27. All but one respondent agreed with allowing the use of hindsight for contract modifications.
28. The ‘frozen balances’ approach is computationally simpler because it treats a modified contract at transition as if the original contract were terminated and a new contract created as of the transition date. However the boards previously rejected this approach because it could result in financial information about contract balances and a pattern or revenue recognition that is significantly different to that under IFRS 15 / Topic 606 and would therefore impair comparability. Therefore the staff recommend the IASB confirm the contract modifications hindsight practical expedient.
29. With respect to the date at which the hindsight adjustment is applied, the IASB chose the date of the earliest period presented for both the full and modified retrospective methods because entities with large numbers of contracts subject to frequent modifications (eg telecommunication entities) might have a logistical problem if they are required to wait until the date of initial application before finalising the accounting for previous modifications. This is because of the large number of contracts that would need to be evaluated in a relatively short time.
30. These entities stated that they would be practically constrained from using the expedient or its value will be considerably diluted. However not all entities will have this issue as evidenced by the conflicting feedback received.
31. In view of the limited and conflicting feedback on the application date, the staff recommend the IASB affirms that entities apply this practical expedient at the date of the beginning of the earliest period presented for both methods of transition.
32. The staff notes that the FASB may affirm the later date of initial application for the modified retrospective method. If so, any lack of comparability is unlikely to be significant in practice and will not persist beyond the contracts that are live in the comparative period.
33. However, dual reporting entities with components that report under both IFRS and US GAAP will find it operationally cumbersome if components are required to

apply the expedient at different dates or are practically constrained from using the expedient.

34. The staff therefore recommend the IASB allow entities using the modified retrospective method the option to select the IASB or FASB date but not any other date.
35. Entities with components that report under US GAAP using the modified retrospective method would be free to select the later FASB date of initial application without curtailing the ability of other entities to use the (for them) more operational earlier IASB date of the beginning of the earliest period presented.

Questions for the IASB

1. Does the IASB agree with the staff recommendation to confirm the proposal in the ED to permit an entity to use hindsight in (i) identifying the satisfied and unsatisfied performance obligations in a contract that has been modified before the beginning of the earliest period presented; and (ii) determining the transaction price?
2. Does the IASB wish to allow entities electing the modified retrospective method and applying the contract modifications practical expedient the option to select the IASB or FASB date, but not any other date?

Additional FASB completed contracts amendment

36. Paragraph C7 of IFRS 15/Topic 606 requires entities applying the modified retrospective method to apply IFRS 15/Topic 606 retrospectively only to contracts that are not completed contracts at the date of initial application. The IASB confirmed at its September 2015 meeting that to the extent that completed contracts have revenue that has not been recognised under the previous standards, this revenue will be recognised in accordance with the previous standards.
37. In its exposure draft, the FASB added a further amendment so that an entity applying the modified retrospective method may elect to apply IFRS 15/

Topic 606 retrospectively either to all contracts at the date of initial application, or to contracts that are not completed contracts at the date of initial application.

Summary of feedback

38. Two respondents, a preparer and a large accounting firm, suggested the IASB should also make the additional amendment.

Staff analysis

39. The staff recommend that the IASB permit entities to use this additional option.
40. Any decrease in comparability between entities will be transitory by definition and outweighed by the following advantages:
- (a) Some entities will find applying the modified retrospective method to all contracts less complex operationally than either continuing to record completed contracts with residual revenue under legacy GAAP and their remaining contracts under IFRS 15, or adopting the full retrospective method;
 - (b) It will be consistent with the full retrospective method, under which entities can choose whether to restate completed contracts at the earliest date presented (assuming the IASB confirms the full retrospective additional completed contracts practical expedient);
 - (c) Entities applying the modified retrospective method to all contracts would be applying the modified retrospective method more rather than less comprehensively; and
 - (d) It will allow dual reporters to remain aligned between IFRS and US GAAP even if the IFRS and US GAAP definitions of a completed contract diverge, see next section.

Question for the IASB

Does the IASB wish to permit entities to apply the modified retrospective method either to all contracts at the date of initial application, or to contracts that are not completed contracts at the date of initial application?

Completed contracts definition

41. At its September 2015 meeting, the IASB discussed two issues about completed contracts that had emerged from the July 2015 TRG discussions and the tentative decisions made by the FASB at its meeting on 31 August 2015.
- (a) The IASB reaffirmed the decision not to require an entity using the modified retrospective method to apply IFRS 15/Topic 606, either retrospectively or prospectively, to completed contracts at the date of initial application. An entity would continue to account for any completed contracts after the date of initial application in accordance with previous revenue standards.
- (b) In August 2015 the FASB had decided to propose redefining a completed contract as ‘a contract for which all (or substantially all) of the revenue was recognized under legacy generally accepted accounting principles (GAAP) before the date of initial application’. At its September meeting the IASB decided that no amendments should be made to IFRS 15/Topic 606.

Summary of feedback

42. A few respondents requested clarification of how to account on completed contracts for any residual revenue under legacy GAAP at the date of initial application.
43. A few respondents made the general comment that the topic of completed contracts should be more clearly explained.
44. In the comment letters the most frequent comment was for the IASB to retain convergence of the completed contract definition. In most cases respondents did not express a preference. Four respondents, mainly the large accounting firms,

preferred the FASB's revised definition, because the current definition of a completed contract might mean that an entity reporting under IFRS would continue to recognise some revenue under IASs 11 and 18 etc for several years after transition. This might result in a lack of comparability between similar transactions, and could require an entity to maintain two accounting systems after adoption until all revenue has been recognised on legacy contracts.

Staff analysis

45. As noted above, this is the topic with respect to transition on which we have received the most comments. A significant number of respondents think it would be helpful if the definition of a completed contract remains converged.
46. However at its September meeting the IASB considered the definition in IFRS 15/Topic 606 in light of the FASB's decision to propose an amendment to the definition and made no change.
47. Moreover, some preparers in IFRS jurisdictions have already early adopted IFRS 15 or are planning to do so.
48. The staff therefore do not recommend conforming the IFRS definition with the proposed FASB definition.
49. As an alternative, in order to ease the operational complexities for dual reporters under IFRS and US GAAP, the IASB could consider giving entities the option to use either definition.
 - (a) Dual US/IFRS reporters could use the US GAAP definition.
 - (b) IFRS early adopters could use the IFRS definition.
 - (c) Any diversity would be transitory by definition.
50. However this would introduce another alternative into the transition requirements, increasing complexity.
51. Furthermore, if the IASB accepts the previous recommendations with respect to the full retrospective additional completed contracts practical expedient and the additional FASB completed contracts amendment, then dual reporters would be able to remain aligned between IFRS and US GAAP under the full and modified retrospective methods by a different means. They could achieve this by electing

to apply IFRS 15 to all contracts, rather than to contracts that are not completed contracts, albeit at the cost of having to apply IFRS 15 to more contracts.

52. The staff therefore do not recommend giving entities the option to use either definition.
53. However, more explanation of the topic of completed contracts, including how to account for any residual revenue under legacy GAAP, could be provided by incorporating a summary of the discussion at the September IASB meeting into the Basis for Conclusions on IFRS 15.

Questions for the IASB

Does the IASB wish to retain the existing definition of a completed contract?

Appendix

Extracts from ED *Clarifications to IFRS 15*

Transition

C2 For the purposes of the transition requirements in paragraphs C3–C8A:

- (a) the date of initial application is the start of the reporting period in which an entity first applies this Standard; and
- (b) a completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with IAS 11 *Construction Contracts*, IAS 18 *Revenue* and related Interpretations.

C3 An entity shall apply this Standard using one of the following two methods:

- (a) retrospectively to each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to the expedients in paragraph C5; or
- (b) retrospectively with the cumulative effect of initially applying this Standard recognised at the date of initial application in accordance with paragraphs C7–C8.

...

C5 An entity may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph C3(a):

- (a) for completed contracts, an entity need not restate contracts that:
 - (i) begin and end within the same annual reporting period; or
 - (ii) are completed contracts at the beginning of the earliest period presented.
- (b) for completed contracts 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; and
- (c) for contracts that were modified before the beginning of the earliest period presented, an entity need not retrospectively restate the contract for those contract modifications in accordance with paragraphs 20–21. Instead, an entity shall reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented when:

- (i) identifying the satisfied and unsatisfied performance obligations;
- and
- (ii) determining the transaction price.

~~(e)~~(d) for all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue (see paragraph 120).

C6 For any of the practical expedients in paragraph C5 that an entity uses, the entity shall apply that expedient consistently to all contracts within all reporting periods presented. In addition, the entity shall disclose all of the following information:

- (a) the expedients that have been used; and
- (b) to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

C7A An entity may also use the practical expedient described in paragraph C5(c) when applying this Standard retrospectively in accordance with paragraph C3(b). If an entity uses this practical expedient, the entity shall apply the expedient consistently to all contracts and disclose the information required by paragraph C6.

...

C8A An entity shall apply [Draft] *Clarifications to IFRS 15* (see paragraph C1A) retrospectively in accordance with IAS 8. In applying the amendments retrospectively, an entity shall apply the amendments as if they had been included in IFRS 15 at the date of initial application. As a consequence, an entity does not apply the amendments to reporting periods or contracts to which the requirements of IFRS 15 are not applied in accordance with paragraphs C2–C8. For example, if an entity applies the transition method in paragraph C3(b), the entity does not restate contracts that are completed at the date of initial application for the effects of these amendments.