# STAFF PAPER

10 March 2015

FASB | IASB Meeting

| Project | Revenue Recognition | | |
|---|---|---|---|
| Paper topic | Practical Expedients Upon Transition – Contract Modifications and Completed Contracts | | |
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## Purpose

1. At the March 18, 2015 Board meeting, the FASB first will be asked to decide whether to add a project to its technical agenda to add new practical expedients to the transition guidance in ASU 2014-09, *Revenue from Contracts with Customers*. If the FASB decides to add this project to its agenda, then the FASB will be asked to make technical decisions about the issues raised in this paper. The staff's intention is that the FASB will complete deliberations at the March 18 meeting and will proceed to issuing an Exposure Draft for vote by written ballot. The Exposure Draft issued by the FASB may also include other proposed changes to Update 2014-09 that the FASB is expected to discuss at the March 18 meeting.

2. The IASB will similarly be asked whether they want to add new practical expedients to the transition requirements in IFRS 15 *Revenue from Contracts with Customers* and, if so, whether to include them in the Exposure Draft of proposed clarifications to IFRS 15 that the IASB tentatively decided to develop at its February meeting.

3. This paper is structured as follows:

    (a) Background

(b) Accounting Guidance

(c) Description of the Issue

(d) Staff Analysis

(e) Staff Recommendations

(f) Disclosure

(g) FASB-only Technical Correction

(h) Effective Date

| **Questions for the Boards** |
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| 1. Do the Boards want to add a project to their agendas to include one or more new practical expedients to the transition guidance in the new revenue standard?<br><br>2. Which of three alternative(s) would the Boards like to include in the transition guidance of the new revenue standard?<br><br>3. If the Boards choose Alternatives A or B, at what date should the expedient(s) be applied?<br><br>4. What transition disclosures do the Boards want to require for the practical expedient(s) added to the new revenue standard?<br><br>**FASB-only questions:**<br><br>5. Does the FASB agree with the technical correction to the transition disclosures proposed by the FASB staff?<br><br>6. Does the Board think that all relevant issues have been deliberated?<br><br>7. Have the Board members received sufficient information and analysis to make informed decisions on those issues? If not, what other information or analysis do they need?<br><br>8. Subject to what we learn through comment letters and other stakeholder outreach, do the expected benefits of the changes justify the perceived costs? |

9. Should the staff proceed to drafting a proposed ASU for a vote by written ballot? If yes, what is the comment period?

**IASB-only question:**

10. Does the IASB agree to include this topic in its forthcoming Exposure Draft of proposed clarifications to IFRS 15?

## Background Information

4. At its January 26, 2015 meeting, the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) discussed potential challenges that stakeholders may encounter when applying the transition guidance in Update 2014-09 and IFRS 15 (collectively referred to as "the new revenue standard") for contracts that have been modified prior to the date of initial application[1] (TRG Agenda ref 24). TRG members generally agreed that an additional practical expedient (or expedients) to the transition guidance in the new revenue standard may help to reduce some of those potential challenges.

5. TRG members did not discuss any specific potential practical expedients. However, several TRG members offered to participate in further staff outreach on this issue. The discussion at the TRG meeting and the information gathered through the staff's outreach form the basis for the alternatives presented in this paper.

[1] The date of initial application is the beginning of the reporting period in which an entity first applies the new revenue standard. For example, the date of initial application is January 1, 2017 for a public business entity with a December 31 year-end.

## Accounting Guidance

*Transition*

6. Paragraph 606-10-65-1(d) [C3][2] requires application of the new revenue standard using one of the following transition methods:

   (a) Retrospectively to each period presented in the financial statements in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10 [IAS 8.23 through 8.27 and .50 through .53],[3] subject to certain expedients ("full retrospective approach").

   (b) Retrospectively only to the most current period presented in the financial statements, with the cumulative effect of initially applying the new revenue standard recognized as an adjustment to the opening balance of retained earnings at the date of initial application ("modified retrospective approach").

7. Paragraph 606-10-65-1(f) [C5] includes the following practical expedients that may be used by an entity electing the full retrospective approach:

   (a) For completed contracts,[4] an entity need not restate contracts that begin and end within the same annual reporting period.

   (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.

[2] IFRS 15 references are included in "[XX]" throughout this paper.
[3] Paragraph 250-10-45-5 [IAS 8.23] states that an entity shall report a change in accounting principle through retrospective application of the new accounting principle to all prior periods, unless it is impracticable to do so. Paragraphs 250-10-45-6 through 45-7 [IAS 8.3 through .4] provide guidance about the accounting in the event it is impracticable to apply an accounting standard retrospectively. That guidance essentially states that if it is impracticable to apply an accounting principle retrospectively to all prior periods, an entity should apply the new accounting principle as of the earliest date practicable.
[4] Paragraph 606-10-65-1(c) [C2(b)] states that a completed contract is a contract for which an entity has transferred all of the goods or services identified in accordance with revenue guidance that is in effect before the date of initial application.

(c) 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 recognize that amount as revenue.

8. An entity using the full retrospective approach is permitted to apply none, some or all of the expedients in paragraph 606-10-65-1(f) [C5]. However, paragraph 606-10-65-1(g) [C6] requires that any expedients used by an entity be applied consistently to all contracts within all reporting periods presented. In addition, an entity is required to disclose the following:

(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.

9. Paragraph 606-10-65-1(h) [C7] requires an entity using the modified retrospective approach to apply the new revenue standard to contracts that are in progress at the date of initial application, with an adjustment to opening retained earnings, as necessary. That is, contracts that are not completed before the date of initial application will have to be evaluated as if the entity had applied the new standard to those arrangements since inception of the arrangement.

*Contract Modifications*

10. Paragraph 606-10-25-10 [18] states that a contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, by oral agreement, or implied by customary business practices.

11. An entity might be required to account for a contract modification prior to finalization of the modification. Paragraph 606-10-25-11 [19] states that a contract modification might exist even though the parties to the contract have a dispute

about the scope or price (or both) of the modification or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. In determining whether the rights and obligations that are created or changed by a modification are enforceable, an entity shall consider all relevant facts and circumstances including the terms of the contract and other evidence. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, an entity shall estimate the change to the transaction price arising from the modification.

12. Paragraph 606-10-25-12 [20] requires an entity to account for a contract modification as a separate contract if both of the following conditions are present:

    (a) The scope of the contract increases because of the addition of promised goods or services that are distinct.

    (b) The price of the contract increases by an amount of consideration that reflects the entity's standalone selling prices of the additional promised goods or services and any appropriate adjustments to reflect the circumstances of the particular contract.

13. If a contract modification is not accounted for as a separate contract, paragraph 606-10-25-13 [21] requires an entity to account for the promised goods or services that are not yet transferred at the date of the modification (that is, the remaining promised goods or services) in whichever of the following ways is applicable:

    (a) If the remaining goods and services after the contract modification are distinct from the goods or services transferred on or before the contract modification, an entity shall account for the modification as if it were the termination of the old contract and the creation of a new contract. Revenue recognized to date on the original contract is not adjusted. Rather, the remaining portion of the original contract and the modification are accounted for together on a prospective basis by allocating the remaining consideration to the remaining performance obligations.

(b) If the remaining goods and services to be provided after the contract modification are not distinct from those goods and services already provided and, therefore, form part of a single performance obligation that is partially satisfied at the date of modification, the entity should account for the contract modification as if it were part of the original contract. Revenue previously recognized is adjusted, either up or down, to reflect the effect that the contract modification has on the transaction price and the measure of progress (that is, the revenue adjustment is made on a cumulative catch-up basis).

(c) A change in a contract also might be treated as a combination of items (a) and (b). The accounting for completed performance obligations that are distinct from the modified goods or services is not adjusted. However, the revenue previously recognized is adjusted, either up or down, to reflect the effect of the contract modification on the estimated transaction price allocated to performance obligations that are not distinct from the modified portion of the contract and the measure of progress.

## Description of the Issue

14. Some entities have a significant volume of contract modifications. For example, some entities in the telecommunications and cable industries may have millions of contract modifications in a month as customers increase or decrease data in a wireless plan, add or remove lines and devices from a shared data plan, or add or remove channels or other services. The duration of those contracts varies, but in some cases those contracts may span over a decade. Contract modifications in other industries (for example, the software and aerospace and defense (“A&D”) industries) may not occur as frequently as in the telecommunications industry, but the significance of each contract modification may be greater. Contracts in the software and aerospace and defense industries also may span over a period of several decades.

15. Some stakeholders think the frequency and extent of contract modifications may make an evaluation of each of those modifications during transition complex and costly. Some stakeholders think an evaluation of certain modifications may not be possible because the data necessary for the evaluation is no longer available. Those potential challenges may exist regardless of the transition method selected. Some stakeholders also question whether the accounting for modifications that occur in prior periods provides useful information to financial statement users because, for example, the modification may have occurred many years ago. However, the staff notes that accounting for modifications could impact trends in revenue and various measures of profit.

16. Some stakeholders also think it is unclear whether the challenges related to an evaluation of contract modifications during transition would render retrospective application of the transition guidance in the new revenue standard "impracticable." Topic 250 [IAS 8] explains that a requirement is impracticable when an entity "cannot apply it after making every reasonable effort to do so." However, some stakeholders think that an impracticability assertion in the context of applying the transition guidance in the new revenue standard imposes a high threshold. Further, the staff thinks that if the Boards were to interpret what renders application of certain aspects of the new revenue standard as "impracticable," there may be consequences to how impracticability is assessed in other areas of GAAP/IFRS.

17. Consequently, those stakeholders have requested that the Boards consider adding an additional practical expedient (or expedients) to the transition guidance in the new revenue standard for contracts that have been modified prior to the date of initial application.

## Staff Analysis

18. The staff performed outreach with preparers in the telecommunications, software, construction, and A&D industries and also with audit firms. Based on feedback received during outreach, the staff identified three potential practical expedients that it believes could reduce the challenges associated with accounting for contracts

modified during transition. However, the staff thinks that the degree to which those challenges are reduced may differ significantly among the various alternatives. The staff also thinks that the quantitative financial information (for example, contract assets, contract liabilities, and revenue recognized in each period) could differ significantly among the various alternatives.

19. As discussed further below, Alternatives A and B would provide an expedient that could help to reduce the complexities specifically associated with application of the transition guidance in the new revenue standard for contracts modified prior to the date of initial application.

20. The third alternative (that is, Alternative C) offers an expedient that could help to reduce broader complexities associated with application of the full retrospective approach for contracts that were completed contracts under GAAP/IFRS in effect before the beginning of the earliest period presented in the financial statements.

21. The staff notes that Alternative C is not mutually exclusive of Alternatives A and B. That is, if the Boards determine that a practical expedient should be provided, they could pursue a combination of Alternatives A and/or C or Alternatives B and/or C.

22. The descriptions of Alternatives A and B use the term "Contract Modification Adjustment Date" (CMAD) to describe the date at which an entity would apply the various expedients. For example, the CMAD for a U.S. SEC registrant with a December 31 year-end would be January 1, 2017 (or a date prior) under the modified retrospective approach or January 1, 2015 under the full retrospective approach. Considerations for determining the CMAD are discussed further below.

23. The alternatives identified by the staff are as follows:

    (a) Alternative A (the "frozen balances" expedient) – Provide a practical expedient that would permit an entity to account for the unsatisfied performance obligations in a modified contract at the CMAD as if there was a termination of the original contract and the creation of a new contract as of that date.

(b) Alternative B (the "use of hindsight" expedient) – Provide a practical expedient that would permit an entity to account for a modified contract by determining the transaction price at the CMAD and performing a single standalone selling price allocation (with the benefit of hindsight) that would include all satisfied and unsatisfied performance obligations in the contract from inception.

(c) Alternative C (the "completed contracts" expedient) – Provide a practical expedient to the guidance in paragraph 606-10-65-1(f) [C5] to permit an entity electing the full retrospective approach to apply the new revenue standard retrospectively only to contracts that are not completed contracts as of the beginning of the earliest period presented.

*Alternative A (the "frozen balances" expedient)*

24. Alternative A would permit an entity to apply the new revenue standard only to the remaining unsatisfied performance obligations in a modified contract that are in existence as of the CMAD. That is, under alternative A an entity would account for a contract as if there had been a termination of the existing contract and the creation of a new contract at the CMAD. The amount of consideration to be allocated to the unsatisfied performance obligations would be the total consideration promised by the customer (including amounts already received) less any amounts previously recognized as revenue under GAAP/IFRS in existence prior to the CMAD. For purposes of allocating the transaction price, an entity would use the historical standalone selling prices of the unsatisfied performance obligations. Any unbilled receivable amounts at the CMAD would be converted to contract assets and any deferred revenue amounts would be converted to contract liabilities. Any modifications subsequent to the CMAD would be accounted for in accordance with the new revenue standard.

25. Proponents of Alternative A think that permitting an entity to account for certain contracts as a new contract could significantly reduce the cost and complexity of applying the new revenue standard by eliminating the need to evaluate the effects

of modifications taking place prior to the CMAD. Proponents of Alternative A view the accounting under Alternative A as similar in principle to the accounting for contract modifications required by paragraph 606-10-25-13(a) [21(a)].

26. Opponents of Alternative A think that an expedient that would permit an entity to disregard the effects of the new revenue standard on modifications prior to the CMAD could result in financial information (for example, contract assets, contract liabilities, and revenue recognized in periods subsequent to the CMAD) that differs significantly from what would have been presented absent use of the expedient. In addition, the staff is concerned that Alternative A may be subject to more manipulation than Alternative B because revenue recognition under Alternative A would be based on the most recent contract modification. Under Alternative B, revenue recognition would be based on all of the promises and all of the consideration for the duration of the contract.

*Alternative B (the "use of hindsight" expedient)*

27. Alternative B would permit an entity to identify all satisfied and unsatisfied performance obligations from contract inception through the CMAD. An entity would determine the transaction price for the contract at the CMAD (using hindsight to reflect all modifications from contract inception) and would allocate the transaction price to the identified satisfied and unsatisfied performance obligations based on the historic standalone selling prices of each performance obligation. Under Alternative B, an entity would not be required to separately evaluate the effects of each contract modification prior to the CMAD as of the date of each prior modification, as would otherwise be required by paragraphs 606-10-25-12 through 25-13 [20 through 21]. Any modifications subsequent to the CMAD would be accounted for in accordance with the new revenue standard.

28. Proponents of Alternative B think that an expedient that would relieve an entity from having to separately evaluate the effects of each contract modification prior to the CMAD as of the date of each prior modification could significantly reduce the cost and complexity of applying the new revenue standard. Proponents also

question whether separately accounting for each modification prior to the CMAD provides sufficient incremental, useful information to financial statement users to justify the costs of accounting for each modification separately.

29. Proponents of Alternative B think that the financial information presented by using this expedient (for example, contract assets, contract liabilities, and revenue recognized in each period) as opposed to Alternative A would more closely align with the financial information that otherwise would have been presented absent the use of an expedient. This is because the accounting under Alternative B gives consideration to modifications occurring prior to the CMAD. While the staff thinks this is a reasonable assertion in many cases (refer to the examples in Appendix A), the staff can never know whether this would always be the case.

30. Opponents of Alternative B think that eliminating the requirement to separately evaluate contract modifications does not eliminate some of the more significant challenges identified by stakeholders. For example, an entity would still need to identify all satisfied and unsatisfied performance obligations in a contract as well as their related standalone selling prices. Opponents of Alternative B think that obtaining the data necessary to apply Alternative B may present challenges for some entities and may not significantly reduce the amount of work required to apply the transition guidance in the new revenue standard.

*Determining the CMAD*

31. Under either Alternative A or B, a determination must be made regarding the CMAD. The CMAD could be determined by reference to the date of initial application or earlier (under the modified retrospective approach) or the beginning of the earliest period presented (under the full retrospective approach).

32. Some stakeholders think that if the CMAD is the date of initial application, an entity (particularly an entity with frequent contract modifications) applying the modified retrospective approach may not have sufficient time to gather the data necessary to apply either Alternative A or B in time for preparation of its March 31, 2017 interim financial statements (that is, in time for the entity’s first interim

financial statements prepared in accordance with the new revenue standard). For example, under Alternative B, an entity would need to identify all satisfied and unsatisfied performance obligations from contract inception through the CMAD. The entity would then determine the transaction price and allocate the transaction price to those performance obligations as of that date. An entity would not be able to finalize its hindsight calculations prior to the CMAD because those calculations would be required to include all contract modifications through the CMAD. If the CMAD is January 1, 2017 (assuming a calendar year-end public business entity applying the modified retrospective approach), an entity may not have sufficient time to gather the data necessary in time for preparation of its March 31, 2017 interim financial statements.[5] Accordingly, those stakeholders think that, for practical purposes, the CMAD for an entity applying the modified retrospective approach should be a date prior to January 1, 2017.

33. Entities applying the full retrospective approach are not faced with the same challenge. For those entities, the CMAD could be January 1, 2015 (assuming a calendar year-end public business entity presenting two years' comparatives), which would provide sufficient time for an entity to gather the data necessary to apply the expedient in time for preparation of its March 31, 2017 interim financial statements.

*Alternative C (the "completed contracts" expedient)*

34. Alternative C would require an entity electing the full retrospective approach to apply the new revenue standard only to contracts that are not completed contracts as of the beginning of the earliest period presented. That is, an entity would not be required to apply the new revenue standard to contracts for which the entity has transferred all of the goods and services identified in accordance with GAAP/IFRS that is in effect before the beginning of the earliest period presented. An entity would apply the new revenue standard to all contracts that are not completed

[5] A U.S. SEC registrant is required to file its quarterly report on Form 10-Q within 40 to 45 days (depending on the registrant's filing status) of each quarter end.

contracts as of the beginning of the earliest period presented. A similar accommodation is provided by paragraph 606-10-65-1(h) [C7] for entities electing the modified retrospective approach.

35. The following is an example of a completed contract under former GAAP/IFRS that might not be a completed contract under the new revenue standard. Assume a retailer sells one consumer product to a customer. In connection with the arrangement, the retailer provides the customer with a material right (for example, a significant discount on the customer's next purchase or a right to a free product if the customer makes three more purchases). Under former GAAP/IFRS, the retailer might conclude that the contract is complete because it has no further deliverables (it might be accounting for the material right as a cost accrual); whereas, under the new revenue standard, the entity would have an unsatisfied performance obligation if it concludes the arrangement includes a material right.

36. Proponents of Alternative C think that limiting the population of contracts to which the new revenue standard applies could significantly reduce the effort and cost associated with its initial application. Proponents of Alternative C also think that entities electing the full retrospective approach should be afforded with an accommodation similar to that offered by paragraph 606-10-65-1(h) [C7] for entities electing the modified retrospective approach.

37. Proponents of Alternative C also question the usefulness of the information provided by applying the new revenue standard to a contract for which an entity has transferred all of the goods and services identified in accordance with GAAP/IFRS that is in effect before the beginning of the earliest period presented. For example, assume an U.S. SEC registrant with a December 31 year-end elects the full retrospective approach. The entity's date of initial application would be January 1, 2017. The entity's December 31, 2017 annual financial statements would include a statement of income presenting information for the periods ending December 31, 2017, 2016 and 2015. The financial statement also would include balance sheets as of December 31, 2017 and 2016. If the entity elects to apply the expedient in Alternative C, it would not change its accounting for contracts completed on or

before December 31, 2014. The accounting for contracts that were not completed contracts on or before December 31, 2014 would be accounted for in accordance with the new revenue standard. Some stakeholders question whether changing the accounting for contracts completed prior to December 31, 2014 would provide useful information to a user making an investment decision in 2017 or 2018. The staff observes that other transition alternatives in the new revenue standard and/or contemplated in this paper may be more impactful to the financial information provided to users than Alternative C. For example, the new revenue standard permits an entity to elect either the full or modified retrospective approach. If the entity in the fact pattern above elected the modified retrospective approach, then it would not restate any information for 2015 or 2016. In addition, the entity would not change its accounting for any completed contracts on or before December 31, 2016.

38. Proponents of Alternative C from IFRS jurisdictions note that under Appendix D of IFRS 1 (D35), first time adopters are afforded a similar accommodation and are not required to restate contracts that were completed before the earliest period presented under their previous GAAP. The difference between previous GAAP and IFRS might be significantly more divergent than the difference between former IFRS revenue standards (IAS 18 and IAS 11) and the new revenue standard.

39. Opponents of Alternative C think that an expedient that would permit an entity to apply the new revenue standard only to contracts that are not completed contracts as of the beginning of the earliest period would be a significant change to the transition guidance in the new revenue standard and could affect the comparability of financial information currently afforded by the full retrospective approach. That is, the contracts for an entity electing to use the expedient under Alternative C may be recognized and measured inconsistently across the periods presented in the financial statements. As a result, the full retrospective approach may no longer provide users with useful trend information across periods. For example, the new revenue standard requires that a material right be accounted for a separate performance obligation. Under current GAAP/IFRS, an entity may not have identified the material right as a deliverable in the arrangement. Opponents of

Alternative C observe that two identical contracts may be accounted for differently, depending on whether or not those contracts were completed contracts as of the beginning of the earliest period presented.

40. As noted, Alternative C (without Alternatives A or B) does not directly address the issues discussed by the TRG about contract modifications. Some entities electing the modified retrospective approach have experienced challenges when applying the transition guidance in the new revenue standard to contracts modified prior to the date of initial application, despite the expedient provided in paragraph 606-10-65-1(h) [C7] (which is similar to Alternative C). Consequently, some stakeholders think the Boards should permit either Alternative A or B, regardless of whether the Boards permit Alternative C.

## Staff Recommendations

41. The staff recommends the Boards permit entities to apply Alternatives B and C to all contracts with similar characteristics. The staff thinks those alternatives provide limited and targeted relief that has the potential to reduce the cost and complexity associated with applying the transition guidance in the new standard without significantly affecting the comparability of financial information that otherwise would have been provided, absent use of an expedient.

42. For entities electing the modified retrospective approach, the IASB staff recommends that the CMAD be determined based on the date of the last modification preceding the beginning of the annual period prior to the date of initial application (for example, January 1, 2016) so that entities do not need to wait until the date of initial application (for example, January 1, 2017) before finalizing the accounting for previous modifications. The FASB staff recommends that the date of initial application (for example, January 1, 2017) be used as the CMAD. The FASB staff thinks that this date most closely aligns with the date at which the new revenue standard is intended to be applied under the modified retrospective approach. The FASB staff does not think the challenges associated with application of an expedient as of the date of initial application warrant a further

accommodation that would permit an entity to apply the new revenue standard as of an earlier date.

43. Under the full retrospective approach, the FASB and IASB staff recommend that the beginning of the earliest period presented be used as the CMAD in order to preserve the comparability of financial information across all periods presented.

44. The IASB staff also recommends that the IASB permit a first-time adopter of IFRSs to apply Alternative B. This would be consistent with the permission already granted to a first-time adopter to apply the existing practical expedients under the full retrospective approach.

## Disclosure

45. If the Boards pursue Alternatives A, B or C (or some combination), the staff recommends that the Boards require transition disclosures required by paragraph 606-10-65-1(g) [C6] for use of that expedient. Those disclosures would require an entity to disclose all of 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.

## FASB-only Technical Correction

46. In addition to the issues described in this paper, the FASB staff has identified a technical correction related to the transition guidance in Topic 606. The staff recommends that, if the FASB is otherwise issuing an Exposure Draft to make changes to the transition guidance in Topic 606, the staff thinks the Board also should make a technical correction that could further clarify the transition guidance.

47. Some stakeholders have raised questions about the guidance in paragraph 606-10-65-1(e) for application of the full retrospective approach. That paragraph states that an entity applying the full retrospective approach is required to provide the

accounting change disclosures in paragraphs 250-10-50-1 through 50-3 in the period of adoption. Paragraph 250-10-50-1(b)(2) states that an entity shall disclose the following in the fiscal period in which a change in accounting principle is made:

> 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**.**
> [Emphasis added.]

48. That paragraph would require an entity electing the full retrospective approach to disclose current period financial information in period of adoption under former GAAP. In other words, the entity would apply the new revenue standard retrospectively to all periods presented (for example, 2017, 2016, and 2015) and disclose what its financial information would have been under former GAAP in the period of adoption (for example, 2017). This requirement would significantly increase transition costs because an entity would have to account for contracts with customers under former GAAP and the new revenue standard for one additional year (for example, 2017).

49. This issue does not exist with IFRS. Paragraph C4 of IFRS 15 states that, notwithstanding the requirements of paragraph 28 of IAS 8, when an entity electing the full retrospective approach first applies the new revenue standard, it need only present the quantitative information required by paragraph 28(f) for the annual period immediately <u>preceding</u> the first annual period for which the new revenue standard is applied. Paragraph 28(f) of IAS 8 requires the following:

> 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:

(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; and
(ii) if IAS 33 Earnings per Share applies to the entity, for basic and diluted earnings per share.

50. Paragraph C4 of IFRS 15 states that an entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.

51. Stakeholders have observed that they do not think that the FASB intended for an entity electing the full retrospective approach to disclose the effects of the new revenue standard on all statements of income presented (including the current period). Those stakeholders also observe that the IFRS requirements are different than the Topic 606 requirements for this matter, which indicates a technical correction to Topic 606 might be warranted.

52. The FASB staff agrees with those stakeholders. Consequently, the staff recommends the Board make a technical correction to paragraph 606-10-65-1(e).

## Effective Date

53. The issues described in this paper relate to updates of guidance that is not yet effective. Therefore, the staff proposes that the effective date of any proposed update resulting from this project would be identical to the new revenue standard.

# Appendix A – Illustrative Examples (Alternative B)

*Example 1: Telecommunications Contract*

**Topic 606 [IFRS 15]**

On January 1, 2014 Telco enters into a two-year contract with a customer for a 4GB data plan with unlimited talk/text for $50/month and a subsidized handset for which the customer pays $200. The customer also is charged an access fee of $30 per month for the device. Telco estimates the standalone selling price of the handset to be $650.

| | TP | SSP | Percent | Allocation | Contract Asset | Revenue Per Month | Revenue Recognized | Total Revenue Comparison |
|---|---|---|---|---|---|---|---|---|
| Handset | $ 200 | $ 650 | 29% | $ 624 | $ 424 | | $ 624 | |
| Wireless Service and Access Fee | $ 1,920 | $ 1,560 | 71% | $ 1,496 | | $ 62 | $ 374 | |
| | $ 2,120 | $ 2,210 | | $ 2,120 | | | $ 998 | $ 998 |

After 6 months, the customer extends the term of the contract for an additional 6 months. The level of service remains at 4GB and the customer only has the ability to use Device 1 for the rest of the initial contract term of 24 months. The customer also adds a second handset at a cost of $200. The price of the wireless service remains at $50/month and the customer is charged an access fee of $30/month for the second handset. Telco estimates the standalone selling price of the additional handset to be $650, the data to be $50/month and access fee to be $15/month. Telco evaluates the modification and determines that it should be accounted for in accordance with paragraph 606-10-25-13(a) [21(a)]. That is, Telco accounts for the modification as if it were a termination of the existing contract and the creation of a new contract.

| | TP | SSP | Percent | Allocation | Contract Asset | Revenue Per Month | Revenue Recognized | |
|---|---|---|---|---|---|---|---|---|
| Handset 2 | $ 200 | $ 650 | 26% | $ 614 | $ 732 | | $ 614 | |
| Wireless Service Months 7-24 | $ 1,980 | $ 1,440 | 58% | $ 1,360 | | $ 76 | $ 1,360 | |
| Wireless Service 25-30 | $ 480 | $ 390 | 16% | $ 368 | | $ 61 | $ 368 | |
| Less Contract Asset | $ (318) | | | | | | | |
| | $ 2,342 | $ 2,480 | | $ 2,342 | | | $ 2,342 | $ 2,342 |
| | | | | | | | | $ 3,340 |

| Reconciliation of TP | |
|---|---|
| Original Transaction Price | $ 2,120 |
| Consideration for Additional Handset | $ 200 |
| Consideration for Additional Service and Access Fee | $ 1,020 |
| Less Handset Revenue Recognized | $ (624) |
| Less Service and Access Fee Recognized | $ (374) |
| | $ 2,342 |

| January 1, 2015 Cumulative Effect: | |
|---|---|
| Contract Asset | $ 525 |
| Retained Earnings | $ (525) |

| Contract Asset as of: | 1/1/2015 | 12/31/2015 | 6/30/2016 |
|---|---|---|---|
| | $ 525 | $ 112 | $ - |

| Revenue: | |
|---|---|
| 2015 | $ 907 |
| 2016 | $ 368 |

**Practical Expedient (Alternative B)**

Telco elects to use the practical expedient (Alternative B) that allows it to identify all goods and services delivered in the arrangement from contract inception through the CMAD, reflecting the contract modifications that occurred during that period. Telco determines the transaction price for the contract at the CMAD, taking into account modifications that have occurred since inception. Telco then performs a single standalone selling price allocation using historical standalone selling prices.

| | TP | SSP | Percent | Allocation | Contract Asset | Revenue Per Month | Revenue Recognized Over Contract | |
|---|---|---|---|---|---|---|---|---|
| Device 1 | $ 200 | $ 650 | 18% | $ 617 | $ 417 | | $ 617 | |
| Device 2 | $ 200 | $ 650 | 18% | 617 | $ 417 | | $ 617 | |
| Wireless Service Months 1-6 | $ 480 | $ 390 | 11% | 370 | | $ 62 | $ 370 | |
| Wireless Service Months 7-24 | $ 1,980 | $ 1,440 | 41% | 1,366 | | $ 76 | $ 1,366 | |
| Wireless Service 25-30 | $ 480 | $ 390 | 11% | 370 | | $ 62 | $ 370 | |
| | $ 3,340 | $ 3,520 | | $ 3,340 | | | $ 3,340 | $ 3,340 |

| **January 1, 2015 Cumulative Effect:** | |
|---|---|
| Contract Asset | $ 519 |
| Retained Earnings | $ (519) |
| **Revenue:** | |
| 2015 Revenue | $ 911 |
| 2016 Revenue | $ 370 |

| **Contract Asset as of:** | 1/1/2015 | 12/31/2015 | 6/30/2016 |
|---|---|---|---|
| | $ 519 | $ 110 | $ 0 |

*Example 2: Design and Build Contract*

**Topic 606 [IFRS 15]**

On January 1, 2013 Contractor enters into an arrangement to design a Protype and manufacture five Prototype units for Customer A for $100 million. Customer A does not have rights to the Prototype design plans. Rather, Customer A only has rights to the Prototype units. Contractor estimates it will take five years to design and manufacture the Prototype units.

Contractor evaluates the guidance in paragraph 606-10-25-19(b) [27(b)] and determines that the goods and services are not distinct within the context of the contract (on the basis of the factors in paragraph 606-10-25-21 [29]). That is, Contractor's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that Contractor provides a significant service of integrating the design services into the Prototype units. Contractor evaluates the guidance in paragraphs 606-10-25-33 through 25-37 [41 - 45] and determines that a cost-based measure of progress provides an appropriate measure of progress toward complete satisfaction of the performance obligation. Contractor estimates total costs for the design and development of the Prototype units of $70 million to be incurred as follows: $20 million (2013), $15 million (2014), $15 million (2015), $10 million (2016), and $10 million (2017).

| | Transaction Price | Costs Incurred | Revenue for Period | Cumulative Revenue |
|---|---|---|---|---|
| 2013 | | $ 20,000,000 | $ 28,571,429 | $ 28,571,429 |
| 2014 | | 15,000,000 | 21,428,571 | 50,000,000 |
| 2015 | | 15,000,000 | 21,428,571 | 71,428,571 |
| 2016 | | 10,000,000 | 14,285,714 | 85,714,286 |
| 2017 | | 10,000,000 | 14,285,714 | 100,000,000 |
| | $ 100,000,000 | $ 70,000,000 | $ 100,000,000 | |

On July 1, 2014 (while still in the design phase), Customer A determines that it would like to make changes to certain aspects of the Prototype units. Contractor agrees to Customer A's change and charges Customer A an additional $30 million. Contractor estimates the total additional costs for the changes will be $20 million to be incurred as follows: $6 million (2014), $8 million (2015), $3 million (2016), and $3 million (2017). Contractor evaluates the modification and determines that it should be accounted for in accordance with paragraph 606-10-25-13(b) [21(b)]. That is, Contractor accounts for the modification as if it were a part of the existing contract because the remaining goods and services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification.

| | Transaction Price | Costs Incurred | Revenue for Period | Cumulative Catch-Up Adjustment | Cumulative Revenue |
|---|---|---|---|---|---|
| 2013 | | $ 20,000,000 | $ 28,571,429 | | $ 28,571,429 |
| January - June 2014 | | 7,500,000 | 10,714,286 | | 39,285,714 |
| | | | 436,508 | 436,508 | 39,722,222 |
| July - December 2014 | | 13,500,000 | 19,500,000 | | 59,222,222 |
| 2015 | | 23,000,000 | 33,222,222 | | 92,444,444 |
| 2016 | | 13,000,000 | 18,777,778 | | 111,222,222 |
| 2017 | | 13,000,000 | 18,777,778 | | 130,000,000 |
| | $ 130,000,000 | $ 90,000,000 | $ 130,000,000 | | |

| **Revenue:** | |
|---|---|
| 2013 | $ 28,571,429 |
| 2014 | 30,650,794 |
| 2015 | 33,222,222 |
| 2016 | 18,777,778 |
| 2017 | 18,777,778 |
| | $ 130,000,000 |

**Practical Expedient (Alternative B)**

Contractor elects to use the practical expedient (Alternative B) that allows it to identify all goods and services delivered in the arrangement from contract inception through the CMAD, reflecting the contract modifications that occurred during that period. Contractor determines the transaction price for the contract at the CMAD, taking into account modifications that have occurred since inception. Because Contractor has concluded that the goods and services in the arrangement represent a single performance obligation, it is not required to perform a selling price allocation.

| | Transaction Price | Costs Incurred | Revenue for Period | Cumulative Revenue |
|---|---|---|---|---|
| 2013 | | $ 20,000,000 | $ 28,888,889 | $ 28,888,889 |
| 2014 | | 21,000,000 | $ 30,333,333 | 59,222,222 |
| 2015 | | 23,000,000 | $ 33,222,222 | 92,444,444 |
| 2016 | | 13,000,000 | $ 18,777,778 | 111,222,222 |
| 2017 | | 13,000,000 | $ 18,777,778 | 130,000,000 |
| | $ 130,000,000 | $ 90,000,000 | $ 130,000,000 | |

**Revenue:**

| | |
|---|---|
| 2013 | $ 28,888,889 |
| 2014 | 30,333,333 |
| 2015 | 33,222,222 |
| 2016 | 18,777,778 |
| 2017 | 18,777,778 |
| | $ 130,000,000 |