IFRS 15: Transition

Extract, IFRS Discussion Group Report on Meeting – May 14, 2015

The IASB issued IFRS 15 *Revenue from Contracts with Customers* in May 2014 and the standard is converged with ASU 2014-09 Topic 606, the U.S. GAAP equivalent standard.

IFRS 15 establishes a single comprehensive framework for revenue recognition that replaces all previous revenue standards and related interpretations. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying this principle, a five-step model for revenue recognition is introduced:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

As of the mandatory effective date, IFRS 15 will have to be retrospectively applied. Appendix C of the standard contains two possible transition methods that can be used in applying the standard. These two methods are referred to in the Group's discussion as follows:

- the "full retrospective" method, subject to a number of practical expedients; and
- the "modified retrospective" method with the cumulative effect of initially applying the standard recognized at the date of initial application.

Regardless of the transition method applied, entities may have to change accounting policies and apply the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* more broadly.

Transition Methods

Under the full retrospective method, an entity recognizes the cumulative effect of applying IFRS 15 at the start of the earliest comparative period presented as an adjustment to opening retained earnings and retrospectively adjusts each comparative period presented in its financial statements.

To ease transition under this method, paragraph C5 of IFRS 15 states:

"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 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; and

(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 recognise that amount as revenue (see paragraph 120)."

Paragraph C3(a) of IFRS 15 is referring to the full retrospective method. If practical expedients are used under this method, an entity shall disclose additional information to explain which expedient has been used, and to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

Under the modified retrospective method, an entity recognizes the cumulative effect of applying IFRS 15 as an adjustment to opening retained earnings at the date of initial application without restating the comparative periods presented. Under this method, IFRS 15 is only applied retrospectively to contracts that are not completed as of the date of initial application. However, since comparative figures are not restated, specific disclosures are required to help users of financial statements understand the effect on trend information.

Considerations given to each transition method

There are both advantages and disadvantages to each of the transition methods. Therefore, entities will have to carefully assess the merits and drawbacks to determine which approach is best based on their specific circumstances. The following are some points for consideration.

An advantage of the full retrospective method would be having a more complete depiction of financial performance and greater comparability. Also, there are a number of practical expedients that are available for use that may ease transition under this method. However, this could be seen as a disadvantage as the use of expedients could reduce comparability. Another disadvantage would be the need to obtain a larger population of contracts to perform the assessment over. It could be difficult to obtain historical information, and may likely increase the associated time and preparation costs.

An advantage of the modified retrospective method would be analyzing and assessing a smaller population of contracts (i.e., all contracts that are completed as of the date of initial application do not need to be reassessed). Also, there is no requirement to restate comparative period figures, thus reducing the volume of information that may need to be obtained. A disadvantage would be limited comparability among periods. Although additional disclosures are required in order to facilitate a level of comparability for the user, these disclosures may require an entity to maintain two sets of records, systems, etc. and could result in significant efforts.

The Group's Discussion

Group members agreed that the summary regarding the transition methods described above is consistent with their understanding of the requirements.

Group members observed that the IASB/FASB Joint Transition Resource Group for Revenue Recognition has discussed several practical application challenges associated with this new revenue standard. These issues are being brought forward and deliberated by the IASB and FASB. As a result, it is expected that proposed amendments will be issued in the near future. One amendment could be including a transition practical expedient that would permit the application of hindsight in accounting for contract modifications. As well, both Boards have tentatively decided to defer the effective date of the standard by one year, to annual reporting periods beginning on or after January 1, 2018 with early adoption permitted, to allow more time to address these application challenges.

Group members commented that there is not enough focus on IFRS 15 because stakeholders are possibly underestimating the implications of this new revenue standard and delaying the assessment given an expected deferral in the effective date. Group members encouraged stakeholders to start early to assess the effect that IFRS 15 will have on their financial statements and give consideration to how the Management's Discussion and Analysis may be affected.

The Group's discussion raises awareness about the item. At this point, no further action is recommended to the AcSB but the Group will continue to monitor for future application issues.

(For a full understanding of the discussions and views expressed, listen to the audio clip).