STAFF PAPER

July 2014

REG IASB Meeting

Project	**Conceptual Framework**
Paper topic	Transition and effective date

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Purpose of paper

1. This paper discusses whether it is necessary to include guidance on transition and effective date in the revised *Conceptual Framework* and, if so, what form such guidance should take.

2. This paper does not address whether the IASB should consider making amendments to other IFRSs when it issues the revised *Conceptual Framework*. We will discuss this with you at a future meeting.

Summary of staff recommendation

3. The staff recommend that:

   (a) the IASB and the IFRS Interpretations Committee should start applying the revised *Conceptual Framework* immediately after its publication;

   (b) a transition period of no less than approximately 18 months should be allowed for entities that use the *Conceptual Framework* to develop and apply accounting policies if no IFRS specifically applies to a transaction, other event or condition. Early application should be permitted; and

   (c) no additional guidance on transition should be provided in the revised *Conceptual Framework*. Consequently, entities would be required to apply the provisions of IAS 8 *Accounting Policies, Changes in Accounting*

Estimates and Errors to any changes in accounting policy arising from an application of the revised *Conceptual Framework*.

Structure of paper

4. This paper is structured as follows:
   (a) Background and feedback (paragraphs 5–8);
   (b) Analysis (paragraphs 9–37);
   (c) Staff recommendation and question for the IASB (paragraph 38); and
   (d) Placement on provisions on effective date (paragraphs 30–44).

Background and feedback

5. The summary of, and invitation to comment on, the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the 'Discussion Paper') stated that:

> Once the IASB finalises the revised *Conceptual Framework*, it will start using it immediately. However, a revised *Conceptual Framework* will not necessarily lead to changes to existing IFRSs. Any proposal to change an existing Standard or Interpretation would need to go through the IASB's normal due process (including a formal decision to add the project to the IASB's agenda).

6. The Discussion Paper did not provide any other guidance on transition from the existing *Conceptual Framework* to the revised *Conceptual Framework*.

7. In their comment letters some respondents stated that the revised *Conceptual Framework* should provide transition guidance:

> Applying the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, some entities rely on the existing *Conceptual Framework* to help them determine the appropriate accounting for particular transactions, where there is no specific guidance in the standards. If the revised *Conceptual Framework* includes principles that are different

> from those in the existing *Conceptual Framework*, we would not expect that such entities should need to change their current practices. However, if the IASB thinks that it is necessary for these entities to change their practices; specific guidance should then be given on how entities would transition from the existing *Conceptual Framework* to the revised *Conceptual Framework*. *Ernst and Young Global Limited*

8. Some respondents also suggested that, once the *Conceptual Framework* is revised, the IASB will need to develop guidance for the IFRS Interpretations Committee (the 'Interpretations Committee') to help it interpret Standards developed under an earlier version of the *Conceptual Framework.*

Analysis

9. The *IASB and IFRS Interpretations Committee Due Process Handbook* (the 'Due Process Handbook') states that the effective date and transition paragraphs are one of the mandatory parts of a Standard. The *Conceptual Framework* is not a Standard. However, in the light of the feedback received the staff believe that the IASB should consider whether to include guidance on transition and effective date in the revised *Conceptual Framework.*

10. The *Conceptual Framework* is being revised because it does not cover some important areas, the guidance in some areas is unclear and some aspects of the existing *Conceptual Framework* are out of date and fail to reflect the current thinking of the IASB. Even though the objective of the project is not to fundamentally reconsider all aspects of the *Conceptual Framework*, the revision will lead to the introduction of some new concepts and amendments to some existing concepts.

11. In April 2014, the IASB tentatively decided that the purpose of the *Conceptual Framework* should be to identify the concepts that:

    (a) assist the IASB to develop and revise the Standards;

    (b) assist preparers to develop accounting policies when no Standard applies to a particular transaction, event or condition; and

    (c) assist all parties to understand and interpret the Standards.

12. These parties use the *Conceptual Framework* in different ways and so may be affected in different ways by changes to concepts. Accordingly, the following paragraphs discuss whether the IASB should provide guidance on transition and effective date for:

    (a) the IASB (paragraphs 13–14);

    (b) the IFRS Interpretations Committee (paragraphs 15–20); and

    (c) preparers who use the *Conceptual Framework* to develop accounting policies (paragraphs 21–37).

Transition and effective date for the IASB

13. The Discussion Paper stated that once the IASB finalises the revised *Conceptual Framework*, it will start using it immediately. In their comment letters the respondents did not object to this suggestion.

14. The IASB itself is deciding which concepts will be included in the revised *Conceptual Framework* to make it useful for the future development and revision of the Standards. As the IASB is working on several major projects alongside the revision of the *Conceptual Framework*, its current thinking on conceptual issues is likely to be reflected in those projects and the Board will be able to apply the concepts consistently in future projects. Therefore, the staff recommend that the IASB should reconfirm that it will start using the revised C*onceptual Framework* immediately after its publication. The staff think no additional guidance for the IASB on transition or effective date is necessary in the revised *Conceptual Framework.*

Transition and effective date for the IFRS Interpretations Committee

15. The purpose of the Interpretations Committee is to interpret the application of IFRSs and provide timely guidance on financial reporting issues that are not specifically addressed in IFRSs. The Interpretations Committee applies a principle-based approach founded on the *Conceptual Framework.*

16. Some respondents suggested that after the revised *Conceptual Framework* is published, the Interpretations Committee should base its Interpretations on the version

of the *Conceptual Framework* that was in force when the particular requirements were developed. However, the staff think that it would be confusing to have two (or, if in future the *Conceptual Framework* is revised again, more) coexisting versions of the *Conceptual Framework*. The interpretation process may become even more complicated if with time some requirements in the Standards are wholly or partially amended on the basis of the revised *Conceptual Framework*. Therefore, the staff propose that when the revised *Conceptual Framework* becomes effective, the existing *Conceptual Framework* should be withdrawn.

17. The Interpretations Committee rarely, if ever, bases its Interpretations on the *Conceptual Framework* alone. Primarily, the Interpretations are based on principles established either in the applicable Standard, or in a Standard dealing with similar and related issues. The Interpretations Committee considers the *Conceptual Framework* in the interpretation process but the concepts in the *Conceptual Framework* do not take precedence over the requirements in the Standards.[1]

18. However, if the Interpretations Committee concludes that the requirements in a Standard are not consistent with the *Conceptual Framework*, it consults the IASB in accordance with paragraph 7.8 of the Due Process Handbook:

> Interpretations must not change or conflict with IFRSs or the *Conceptual Framework*. If the Interpretations Committee concludes that the requirements of an IFRS differ from the *Conceptual Framework*, it obtains direction from the IASB before developing the Interpretation further.

19. Accordingly, in future when the Interpretation Committee is faced with inconsistencies between a Standard developed on the basis of the existing *Conceptual Framework* and the concepts in the revised *Conceptual Framework*, it would use the same guidance, ie refer the issue to the IASB.

20. In the light of this provision, the staff do not think it is necessary to add any further guidance for the Interpretation Committee on transition or effective date. The staff recommend that the Interpretations Committee should start using the revised *Conceptual Framework* immediately after its publication.

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[1] On 24 April 2014 the IASB tentatively confirmed the existing status of the *Conceptual Framework* that it is not a Standard and does not override the requirements of specific Standards.

Transition and effective date for preparers

21. Paragraph 11 of IAS 8 states that in developing and applying an accounting policy in the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall refer to the following sources in descending order:

    (a) the requirements in IFRSs dealing with similar and related issues; and

    (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework*[2].

22. If some concepts in the revised *Conceptual Framework* are different from the existing concepts, preparers may need to review the judgements they made in developing their existing accounting policy. The question then is how such entities should account for changes to their current accounting policies that result from any such review.

23. It is difficult to foresee all implications of amending the *Conceptual Framework* for preparers. Moreover, it is unclear to the staff how widely the existing *Conceptual Framework* is used by preparers to determine accounting policies. However, the staff note that most accounting issues are now covered by a specific Standard or Interpretation. Consequently, we believe the *Conceptual Framework* is probably not widely used to develop accounting policies.

24. This belief was (in part) confirmed at the Global Preparers Forum (GPF) meeting held in March 2014. Many GPF members stated that they do not use the *Conceptual Framework* often, and it is mostly used as a point of reference. Examples of applying the *Conceptual Framework* included:

    (a) referring to the definitions and recognition criteria when some issue is unclear or the Standards suggest two alternative accounting treatments;

    (b) when writing comment letters; and

    (c) when preparing the entity's internal implementation guidance on accounting Standards.

25. Most GPF members indicated that it is difficult to base an accounting policy decision on the *Conceptual Framework* alone. They prefer to use other sources, such as

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[2] In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*

national accounting requirements or accounting manuals produced by accounting firms, which is permitted in paragraph 12 of IAS 8. However, some GPF members suggested that if the *Conceptual Framework* was more developed they might use it more.

26. Because it is not entirely clear how entities use the *Conceptual Framework*, the staff do not think it is feasible to develop tailored transition guidance for the *Conceptual Framework* as is sometimes done for Standards and Interpretations. Therefore, the IASB could consider three potential approaches to accounting for changes in the accounting policy resulting from the revision of the *Conceptual Framework*:

    (a) approach 1: allow preparers not to change their existing accounting policy;

    (b) approach 2: require prospective application; or

    (c) approach 3: require that a change in accounting policy is accounted for retrospectively in accordance with IAS 8.

27. The staff do not support approach 1 because it could result in financial statements prepared on the basis of concepts that could be inconsistent with those included in the revised *Conceptual Framework.* Such financial statements may not meet the requirements set in paragraph 15 of IAS 1 *Presentation of Financial Statements*:

    > Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*. […]

28. In addition, if some concepts in the existing *Conceptual Framework* are withdrawn or superseded, it is likely that the IASB no longer thinks they would produce the most useful financial information. Accordingly, the staff think that preparers should not continue to apply accounting policies based solely on a superseded *Conceptual Framework.*

29. In order to choose between retrospective and prospective application, the IASB should consider how accounting for the effect of changes would affect the usefulness of the financial statements.

30. Prospective application means that a new accounting policy would be applied from the start of the period when the *Conceptual Framework* becomes effective. It would be easier for preparers to implement because no changes to prior periods are required. However, it would compromise the comparability of financial statements.

31. Retrospective application is potentially more complex and costly for preparers than prospective application. However, retrospective application means that a new accounting policy would be applied to transactions, other events and conditions as if that policy had always been in place, therefore information presented about prior periods would be prepared on the same basis as information about the current period, and so would be comparable.

32. Consequently, the staff think preparers should account for any changes in accounting policy arising from an application of the revised *Conceptual Framework* retrospectively.

33. IAS 8 requires entities to consider the *Conceptual Framework* when selecting accounting policies. Once a revised *Conceptual Framework* comes into effect, entities would need to consider whether their accounting policies are still appropriate. If they conclude that their existing policies are no longer appropriate they would need to change their policies. IAS 8 requires retrospective application for changes in accounting policies subject to impracticability provisions in paragraphs 23 – 27 and 50 – 53 of the Standard (see Appendix to this Agenda Paper).

34. The staff think that the requirements of IAS 8 are suitable for accounting for changes in accounting policies related to the revision of the *Conceptual Framework*, and we do not recommend providing any additional guidance on transition in the revised *Conceptual Framework*.

35. Another issue that should be considered is when entities should start applying the concepts in the revised *Conceptual Framework*. Again, because we do not know all situations in which the *Conceptual Framework* is used to develop accounting policies, it is difficult to estimate how long the transition period should be. For some entities the changes might be significant and if so they will need time to review the effects of revised concepts on their policies and prepare for retrospective application of the changes.

36. Consequently, the staff recommend that the IASB should allow for a sufficient transition period, ie no less than approximately eighteen months, between the publication date of the revised *Conceptual Framework* and its effective date for entities. Assuming that the revised *Conceptual Framework* is issued in the first half of 2016, the effective date for entities that use the *Conceptual Framework* to develop and apply accounting policies if no IFRS specifically applies to a transaction, other event or condition would be for annual periods beginning on or after 1 January 2018.

37. On the other hand, the staff think that some entities may have enough information and would not find it difficult to start applying the revised *Conceptual Framework* straightaway. Therefore, the staff recommend permitting early application of the revised *Conceptual Framework*.

Staff recommendation and question for the IASB

38. The staff recommend that:

    (a) the IASB and the IFRS Interpretations Committee should start applying the revised *Conceptual Framework* immediately after its publication;

    (b) a transition period of no less than approximately 18 months should be allowed for entities that use the *Conceptual Framework* to develop and apply accounting policies if no IFRS specifically applies to a transaction, other event or condition. Early application should be permitted; and

    (c) no additional guidance on transition should be provided in the revised *Conceptual Framework*. Consequently, entities would be required to apply the provisions of IAS 8 to any changes in accounting policy arising from an application of the revised *Conceptual Framework*.

Question for the IASB
Do you agree with the staff recommendation in paragraph 38?

Placement of provisions on effective date

39. The existing *Conceptual Framework* was issued in September 2010 as a result of completing the first phase of the *Conceptual Framework* project – Chapter 1 *The objective of general purpose financial reporting* and Chapter 3 *Qualitative characteristics of useful financial information*. It superseded the *Framework for the Preparation and Presentation of Financial Statements* and did not include any provisions on transition or effective date.

40. The project is no longer conducted in phases, so, when finalised, the revised *Conceptual Framework* will be issued as a single document. As noted above, because of the wider scope of possible changes, the staff recommend setting an effective date for the revised *Conceptual Framework*.

41. There are two possible approaches to setting the effective date:

    (a) approach 1 – setting the effective date in the revised *Conceptual Framework* itself; and

    (b) approach 2 – stating in the revised *Conceptual Framework* that it supersedes the previous version, ie it will come into force immediately after publication, and setting within IAS 8 the effective date for entities that, in accordance with IAS 8, use the *Conceptual Framework* in developing an accounting policy.

42. Applying approach 1, the revised *Conceptual Framework* will include a section on effective date with separate provisions for (a) the IASB and the Interpretations Committee and (b) for entities that use the *Conceptual Framework* to develop accounting policies in the absence of an IFRS that specifically applies to a transaction, other event or condition.

43. The second approach might be appropriate because entities can use the *Conceptual Framework* to develop an accounting policy only on the basis of paragraph 11(b) of IAS 8. The downside of this approach is that in certain jurisdictions the amendments to IAS 8 will have to be endorsed before they become effective and in the meantime the existing IAS 8 will refer entities to the revised *Conceptual Framework* that will become effective immediately after publication.

44. It may be necessary to consider proposing making other amendments to IAS 8 because of changes in the scope and terminology of the *Conceptual Framework*. We will discuss any possible amendments to IAS 8 with you at a future meeting. We suggest that a decision on where to provide guidance on the effective date of the new concepts in the *Conceptual Framework* is made after the scope of possible changes, if any, to IAS 8 becomes clearer.

Appendix – IAS 8 requirements for changes in accounting policies

Changes in accounting policies

14 An entity shall change an accounting policy only if the change:

(a) is required by an IFRS; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

15 Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the criteria in paragraph 14.

[…]

Applying changes in accounting policies

19 Subject to paragraph 23:

(a) an entity shall account for a change in accounting policy resulting from the initial application of an IFRS in accordance with the specific transitional provisions, if any, in that IFRS; and

(b) when an entity changes an accounting policy upon initial application of an IFRS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.

20 For the purpose of this Standard, early application of an IFRS is not a voluntary change in accounting policy.

21 In the absence of an IFRS that specifically applies to a transaction, other event or condition, management may, in accordance with paragraph 12, apply an accounting policy from the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.

Retrospective application

22 Subject to paragraph 23, when a change in accounting policy is applied retrospectively in accordance with paragraph 19(a) or (b), the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Limitations on retrospective application

23 **When retrospective application is required by paragraph 19(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.**

24 **When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.**

25 **When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.**

26 When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing statements of financial position for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with an IFRS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.

27 When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, in accordance with paragraph 25, applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period. Paragraphs 50–53 provide guidance on when it is impracticable to apply a new accounting policy to one or more prior periods.

[…]

Impracticability in respect of retrospective application and retrospective restatement

50 In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 51–53, its prospective application to prior periods) or retrospective

restatement to correct a prior period error, and it may be impracticable to recreate the information.

51 It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

52 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

(b) would have been available when the financial statements for that prior period were authorised for issue

from other information. For some types of estimates (eg a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with IAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.