

STAFF PAPER

April 2015

Project	Revenue from Contracts with Customers		
Paper topic	Collectability considerations		
CONTACTS	Kathryn Donkersley	kdonkersley@ifrs.org	+44 (0)20 7246 6970
	Henry Rees	hrees@ifrs.org	+44 (0)20 7246 6466

This paper has been prepared by the staff of the IFRS Foundation 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*.

Objective

1. The objective of this paper is to discuss possible actions that the IASB could take in the light of issues regarding collectability highlighted during the Revenue Transition Resource Group (TRG) discussions in January 2015. This topic was first discussed at the March 2015 joint board meeting but no decisions were made by the IASB at that meeting.
2. This paper is structured as follows:
 - (a) Summary of staff recommendation
 - (b) Background
 - (i) Overview
 - (ii) March 2015 FASB tentative decisions
 - (c) Staff analysis
 - (i) Guidance similar to the FASB
 - (ii) Additional illustrative example
 - (iii) Conclusion
 - (d) Question for the IASB
 - (e) Appendix: Background from March 2015 Agenda Paper 7D

3. Throughout this paper, references to the ‘new revenue Standard’ refer to both IFRS 15 *Revenue from Contracts with Customers* and Topic 606 *Revenue from Contracts with Customers* (US GAAP). For ease of reference for IASB members, all Standard paragraph numbers in this paper are identified with reference to the paragraph numbering in IFRS 15.

Summary of Staff Recommendation

4. The staff recommend that the IASB does not make any clarifications or amendments to IFRS 15 in the light of issues regarding collectability highlighted by the TRG.

Background

Overview

5. This topic was first discussed at the March 2015 joint board meeting. The background information included in March 2015 Agenda Paper 7D can be found in the Appendix to this paper.
6. There are two dimensions to the collectability issues arising from TRG discussions:
 - (a) potential changes to IFRS 15; and
 - (b) potential clarifications to IFRS 15.

Potential changes to IFRS 15

7. Questions were discussed by the TRG about whether the accounting required by paragraph 15, for consideration received on contracts that initially or subsequently fail the collectability criterion, is in all cases a faithful depiction of the economics. The staff noted at the March meeting that if the IASB were to decide to address this concern, this would entail a significant *change*, rather than a clarification, to IFRS 15.
8. At the March meeting, the FASB decided not to make any amendments to the new revenue Standard in the light of these concerns. The IASB was not asked to make any decisions on collectability at the meeting. Nonetheless, a number of IASB members noted during the discussion that that they would *at most* expect clarification to be

necessary with respect to the collectability issues identified by the TRG.

Consequently, the staff do not think that the question of potential changes to IFRS 15 needs to be discussed further by the IASB. The remainder of this paper discusses potential *clarifications* to IFRS 15 that have been highlighted by the TRG with respect to collectability.

Potential clarifications to IFRS 15

9. Questions were discussed by the TRG about (i) how to apply the collectability criterion in paragraph 9(e) and (ii) how termination should be determined in paragraph 15(b). These questions suggest that there is some uncertainty about how the Boards intended paragraphs 9(e) and 15 to be interpreted and, consequently, that some clarifications to the guidance to the new revenue Standard might be useful.
10. At the March 2015 joint board meeting:
 - (a) the FASB tentatively decided to take a number of actions in response to the collectability clarification issues highlighted by the TRG. These are summarised below; and
 - (b) the IASB did not make any decisions with respect to collectability.

March 2015 FASB tentative decisions

11. The FASB tentatively decided to make a number of clarifications to the guidance in paragraphs 9(e) and paragraph 15. In particular, the FASB tentatively decided to adopt both ‘Alternative B’ and ‘Alternative C’ as described in FASB Memo No. 1 *Revenue Recognition – Collectibility* from the March 2015 joint board meeting.
12. ‘Alternative B’ described a number of improvements to the articulation of the guidance in paragraph 15 of IFRS 15. The paragraph 15 guidance is used by an entity that has *already* failed Step 1 of the new revenue Standard (either at contract inception or subsequently) in determining when to recognise as revenue any consideration received from the customer. The clarifications described in ‘Alternative B’ of the FASB March memo on collectability were as follows:

- (a) to make clear that the guidance should be evaluated with respect to the legal contract and not the ‘accounting contract’;
 - (b) to make clear that contract termination means that the entity:
 - (i) has the ability (under the contract or by law) to stop transferring additional promised goods or services to the customer; and
 - (ii) has actually stopped transferring goods or providing services to the customer.
 - (c) to explain in the Basis for Conclusions the similarities and differences between the collectability threshold in Step 1 of IFRS 15 and the guidance in paragraph 15 (when an entity does not pass Step 1).
13. ‘Alternative C’ described a number of improvements to the articulation of the guidance in paragraph 9(e). An entity applies paragraph 9 to assess whether it passes Step 1 of the new revenue recognition model. The clarifications described in ‘Alternative C’ of the FASB March memo on collectability were as follows:
- (a) to clarify that an entity should not simply assess the probability of collecting *all* of the consideration promised in the contract. Instead, an entity should consider the probability of collecting the *consideration to which it will be entitled* in exchange for goods or services that *will be transferred* to the customer;
 - (b) to clarify that an entity is required to consider the relative position of their contractual rights to the consideration and performance obligations. In other words, this is a forward looking assessment that considers the entity’s exposure to the customer’s credit risk and the business practices available to the entity to manage its exposure to credit risk throughout the contract, such as stopping providing goods or services, or demanding advance payment(s); and
 - (c) to clarify how paragraph 11 about contract duration relates to (or does not relate to) the collectability assessment in paragraph 9(e).
14. The FASB March memo on collectability also noted that ‘Alternative C’ could include adding an example to illustrate how the guidance should be applied.

15. During the meeting, FASB members specifically stated that all of the tentative decisions made with respect to collectability would be subject to drafting. A high level summary of the decisions made was included in the FASB's reported Tentative Board Decisions from the March meeting, as follows:

Collectibility

The FASB decided to amend the collectibility guidance in Step 1 (Identifying the Contract) in Topic 606 to clarify:

1. When a contract is "terminated" in accordance with paragraph 606-10-25-7 [paragraph 15 of IFRS 15].
2. That the objective of the collectibility threshold in paragraph 606-10-25-1(e) [paragraph 9(e) of IFRS 15] is to assess an entity's exposure to credit risk for the goods and services that will be transferred to the customer. Therefore, in some circumstances, an entity might not assess its ability to collect all of the consideration in the contract in order to meet the collectibility threshold.

Staff Analysis

Guidance similar to the FASB

16. The IASB could consider including additional clarifying guidance in IFRS 15 similar to that decided upon by the FASB. The primary advantage of adopting this approach is that it would retain a fully converged Standard with respect to collectability.
17. The staff think that it is important that the IASB makes changes to the authoritative guidance of IFRS 15 only if they consider those changes to be necessary. This is because we think that there are a number of risks associated with making any changes at this early stage of the implementation process. These risks were discussed in detail in February 2015 Agenda Paper 7A and are briefly summarised below with particular reference to the issues discussed in this paper.

Risks relating to costs of implementation

18. Amendments to IFRS 15 could be disruptive to the implementation process that is already underway. It may cause undue costs if entities and auditors are required to revisit work they have already done to implement the recently issued Standard. In

addition, amending a recently issued Standard may create an unwarranted burden in jurisdictions that are partway through the endorsement process.

19. The staff note that all of the issues discussed in this paper represent potential *clarifications* of the Boards' thinking in developing IFRS 15 rather than *amendments* to the guidance that it contains. As such, we do not anticipate that any significant changes in outcomes would arise if the IASB decides to make any of the clarifications discussed in this paper. On this basis, we question whether the potential uncertainty that might be created from proposing changes to IFRS 15 is justified.
20. We have also considered whether the issues discussed in this paper could be resolved through alternative means that would not have the same cost implications for constituents. We note that questions arising on the implementation of any new Standard are generally resolved as entities, auditors and others work through the issues over time and we expect this to be the case regarding the collectability requirements in IFRS 15.

Risks relating to unintended consequences

21. The staff think that there is potential for unintended consequences if amendments are made within a short time frame to a Standard that was developed over many years.

Risks relating to precedent

22. The staff think that providing guidance in response to issues raised might encourage further requests for even more guidance, and could potentially undermine the objective of principle-based Standards and the use of judgements.

Analysis

23. In the light of these risks, the staff have analysed each element of the clarifying guidance decided upon by the FASB at the March joint board meeting and concluded as to whether we think each clarification is necessary for IFRS 15. In considering this analysis, the staff also think that it is important to note the following with respect to convergence with the FASB:
 - (a) all of the decisions taken by the FASB in March and described in the following paragraph represent *clarifications* to the new revenue Standard as opposed to *amendments*. This means that, whilst the FASB plan to change

some of the wording in Topic 606, the outcomes of applying these changes are expected to be similar to the outcomes of applying the *existing* new revenue Standard;

- (b) the staff note that, for US stakeholders, Topic 606 replaces significantly more specific revenue recognition guidance with a principles based Standard. The opposite is true for IFRS stakeholders who have substantively more guidance in IFRS 15 than in its predecessors. Because of these different starting points, the IASB and the FASB might reasonably be expected to reach different conclusions when considering how to address the issues raised by the TRG; and
- (c) in the event that the FASB make any amendments or clarifications to Topic 606 that are not made in IFRS 15, the IASB’s Post-implementation Review is expected to provide a good opportunity to review the effect of such changes and consider whether they should be incorporated into IFRS 15.

24. The staff analysis in the following paragraph is based on the specific clarifications described in ‘Approach B’ and ‘Approach C’ of FASB Memo No. 1 *Revenue Recognition – Collectibility* from the March joint board meeting. As noted above, all of these clarifications to Topic 606 are subject to drafting.

25. This table summarises the changes proposed under ‘Alternative B’ and ‘Alternative C’ in the FASB March memo on collectability and IASB staff analysis with respect to each element.

IFRS 15 Para.	FASB Decision (March 2015 FASB Memo No. 1: <i>Revenue Recognition – Collectibility</i>)			IASB Staff Analysis
	Ref.	Description	Rationale	
15	Alt. B Para. 57(a)	Clarify that the collectability guidance in paragraph 15 should be evaluated with respect to the legal contract and not the accounting contract. In this context, the ‘accounting contract’ refers to a contract that passes Step 1 of the new revenue Standard.	Response to question raised by TRG as to whether the guidance in paragraph 15 refers to the legal contract or to the accounting contract.	<p>We note that stakeholders have also observed that an entity applies paragraph 15 only if it has already determined that it has a contract that does not pass Step 1 of the new revenue recognition model, ie only when the criteria in paragraph 9 have not been met.</p> <p>On this basis we do not think that it is necessary to clarify in IFRS 15 that the collectability guidance refers to the legal contract rather than the accounting contract. We think that introductory wording of paragraph 15 makes clear that this guidance refers to a contract that does not pass Step 1 of the new revenue Standard.</p> <p>Summary: we think that the existing guidance in IFRS 15 is sufficient.</p>

IFRS 15	FASB Decision (March 2015 FASB Memo No. 1: <i>Revenue Recognition – Collectibility</i>)		IASB Staff Analysis
Para.	Ref.	Description	Rationale
15	Alt. B Para. 57(b)	Clarify that contract termination means that the entity: (a) has the ability (under the contract or by law) to stop transferring additional promised goods or services to the customer; and (b) has actually stopped transferring goods or providing services to the customer.	Stakeholders noted that they usually think about contract termination in a legal context. However, because it would be exceedingly rare for an entity to terminate a contract when a customer still owes the entity some of the consideration under the arrangement, stakeholders are confused as to how ‘termination’ should be defined in the context of paragraph 15. Some think that a contract is terminated when the entity decides not to provide further goods or services to the customer. Others think that the contract is terminated when the entity stops pursuing collection from the customer.
			There is no definition of “contract termination” in IFRS 15. However, we note that contracts often specify that an entity has the right to terminate in the event of non-payment by the customer and that this would not affect the entity’s rights to recover amounts owed. In addition, an entity’s decision to stop pursuing collection would not typically affect the entity’s rights and the customer’s obligations under the contract with respect to amounts owed. Because of this, we think that it should be reasonable to conclude that termination does <i>not</i> refer to the point at which an entity stops pursuing collection of the consideration that it is owed. Therefore, we expect that an entity would generally conclude that a contract is terminated when it stops providing goods or services to the customer based on the existing IFRS 15 guidance (ie <i>without</i> the clarification proposed by the FASB). <i>Summary: we think it is likely that practice will develop to reach the same conclusion as the clarification proposed by the FASB based on the existing guidance in the new revenue Standard.</i>

IFRS 15	FASB Decision (March 2015 FASB Memo No. 1: <i>Revenue Recognition – Collectibility</i>)			IASB Staff Analysis
Para.	Ref.	Description	Rationale	
15	Alt. B Para. 57(c)	Provide an explanation in the Basis for Conclusions of the similarities and differences between the collectability threshold in Step 1 (ie paragraph 9) and the guidance in paragraph 15 (when an entity does not pass Step 1).	Some FASB members questioned the practical difference between the clarifications proposed relating to paragraph 15 and those relating to paragraph 9. This explanation in the Basis for Conclusions would be intended to make clear that the collectability criteria in paragraph 9 is used to assess whether a contract passes Step 1 of the Standard. The guidance in paragraph 15 however is to be used by an entity that has <i>already</i> failed Step 1 in determining when to recognise as revenue any consideration received from the customer.	We think that the introductory language of paragraph 9 (“An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met”) and paragraph 15 (“When a contract with a customer does not meet the criteria in paragraph 9...”) are sufficiently clear in explaining the difference between the collectability considerations included in each of these paragraphs. We do not think that it is necessary to add any additional explanation to the Basis for Conclusions. Summary: we think that the existing guidance in IFRS 15 is sufficient.
9(e) & 11	Alt. C Para. 63(a)	Clarify that an entity should not simply assess the probability of collecting <i>all</i> of the consideration promised in the contract. Instead, an entity should consider the probability of collecting the <i>consideration to which it will be entitled</i> in exchange for goods or services that <i>will be transferred</i> to the customer. Therefore, as noted in paragraph BC46 “if the customer were to fail to perform as promised and consequently the entity would respond to the customer’s actions by not	Response to TRG feedback that some stakeholders believe that the collectability assessment should be based on the <i>total</i> transaction price. For example, consider a scenario in which goods or services are provided over an extended period and paid for in instalments by a customer with poor credit quality. In this scenario, some stakeholders would conclude that the contract ‘fails’ Step 1 of the new revenue Standard because it is not probable that <i>all</i> of the revenue will be collected	The existing paragraph 9(e) states that “it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer”. We think that paragraph BC46 is helpful in explaining why this paragraph is worded as it is (ie that the “ <i>will be entitled</i> ” and “ <i>will be transferred</i> ” language mean that an entity would not consider the likelihood of payment for goods or services that would not be transferred in the event of default by the customer). However, we think that

IFRS 15 Para.	FASB Decision (March 2015 FASB Memo No. 1: <i>Revenue Recognition – Collectibility</i>)			IASB Staff Analysis
	Ref.	Description	Rationale	
		transferring any further goods or services to the customer, the entity would not consider the likelihood of payment for those goods or services that would not be transferred”.	at contract inception.	the information in BC46 is explanatory only and, as such, that it is appropriately included in the Basis for Conclusions as opposed to the Standard itself. Summary: we think that the existing guidance in IFRS 15 and explanatory material in the Basis for Conclusions are sufficient.
9(e) & 11	Alt. C Para. 63(b)	Clarify that an entity is required to consider the relative position of its contractual rights to the consideration and its performance obligations. In other words, this is a forward looking assessment that considers the entity’s exposure to the customer’s credit risk and the business practices available to the entity to manage its exposure to credit risk throughout the contract, such as stopping providing goods or services, or demanding advance payment(s). The assessment would include considering legal rights and obligations as well as past practice (for example, terminating a service if the customer does not pay). The objective of the assessment is to help the entity determine whether there is a valid contract.	Some stakeholders have reported that the reason they believe that collectability should be assessed with respect to the <i>total</i> transaction price is because of references to the <i>contract</i> in this guidance. For example, the introduction to the paragraph 9 guidance which states that an “entity shall account for a <i>contract</i> with a customer that is within the scope of this contract only when....” (emphasis added). Because of such references to the term “contract”, some preparers and auditors conclude that the collectability assessment should be based on the transaction price of the entire contract.	We note that paragraph 9(e) states that “In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer’s ability and intention to pay that amount of consideration when it is due ” (emphasis added). We think that this existing wording of paragraph 9(e) is clear that an entity should consider the <i>relative position</i> of its contractual rights to the consideration and its performance obligations and not necessarily the collectability of the total transaction price at inception of the contract. The above noted paragraph BC46 also provides a helpful explanation as to the Boards’ thinking with respect to this wording in paragraph 9. Summary: we think that the existing guidance in IFRS 15 and explanatory material in the Basis for Conclusions are sufficient.

IFRS 15 Para.	FASB Decision (March 2015 FASB Memo No. 1: <i>Revenue Recognition – Collectibility</i>)			IASB Staff Analysis
	Ref.	Description	Rationale	
11	Alt. C Para. 64	<p>Clarify how paragraph 11 relates, or does not relate, to the collectability assessment in paragraph 9.</p> <p>Paragraph 11 states that “an entity shall apply this Standard to the duration of the contract in which the parties to the contract have present enforceable rights and obligations”. As such, if goods or services are provided over an extended period and there is a no-penalty termination clause, the evaluation of the collectability criterion would reflect <i>only</i> the <i>non-cancellable</i> term of the contract.</p>	<p>Some FASB members were concerned about the linkage between the paragraph 9 clarifications discussed in this paper and paragraph 11. In particular, they thought that specifying that the collectability criterion in paragraph 9 did not need to be assessed with respect to the <i>total</i> contract consideration could be applied incorrectly to the contract term guidance in paragraph 11. For example, some FASB members were concerned that this clarification might be interpreted to mean that a large up-front fee should be amortised over a shorter period than the contractual term of the contract referred to in paragraph 11.</p>	<p>The paragraph 9(e) collectability criteria (and any potential clarifications) are intended to contribute only to an entity’s judgement as to whether a valid contract exists. The staff think that:</p> <p>(a) paragraph 11 could be viewed as setting a ‘cap’ on the contract term that might be considered when assessing paragraph 9(e) (ie it indicates that potential goods or services that might be transferred after the contractual period, and the associated consideration, are not relevant to the paragraph 9(e) assessment); and</p> <p>(b) the reverse is not applicable – ie paragraph 9(e) does not have any effect on defining the contract term.</p> <p>The staff think that this relationship is clear from the wording of paragraph 9(e) and paragraph 11, and the explanatory information in BC46.</p> <p>Summary: we think that the existing guidance in IFRS 15 and explanatory material in the Basis for Conclusions are sufficient.</p>
Illustrative Examples	Alt. C Para. 65	<p>Include an illustrative example (or an example with two or three changes to the facts or assumptions) to illustrate how guidance should be applied.</p>	<p>An illustrative example might provide helpful guidance with regard to the issues discussed in this paper.</p>	<p>Refer to paragraphs 27-36 of this paper which discuss an additional illustrative example.</p>

26. As described in the table in paragraph 25 of this paper, the staff think that IFRS 15 and the accompanying Basis for Conclusions already provide sufficient guidance and explanation with respect to the clarifications decided upon by the FASB at the March joint board meeting. Therefore, we do not recommend that the IASB make these clarifications in IFRS 15.

Additional Illustrative Example

27. The IASB could instead consider including an additional illustrative example in IFRS 15 that is intended to address some of the issues discussed in this paper. This approach would be responsive to the concerns raised without changing any of the authoritative guidance of the Standard. The staff think that an additional illustrative example carries a lower risk of unintended consequences than making any clarifications to authoritative guidance. This is because such an example would simply illustrate the words that are already in IFRS 15.
28. The staff's initial thoughts on the potential content of an additional illustrative example are presented below. This example addresses what the staff consider to be the primary set of clarifications addressed in this paper – ie that:
- (a) the collectability criteria in paragraph 9(e) exists *only* to contribute to an entity's judgement as to whether a valid contract exists; and
 - (b) paragraph 9(e) is *not* expected to result in very many contracts failing to pass Step 1 of IFRS 15 that would otherwise pass Step 1.

If the IASB would also like to include an example addressing the clarifications described in this paper that relate to paragraph 15 of IFRS 15, this would need to be a separate second example. This is because a contract that satisfies the paragraph 9 criteria would, by definition, not be in the scope of the paragraph 15 guidance.

29. The example below is prepared based on the facts and circumstances of the example discussed by the FASB in making its March decisions relating to collectability:

Illustrative Example

An entity, a telecommunications services provider, enters into a contract for a 3-year service contract with a customer of low credit quality at the beginning of a calendar month.

The total contract price is CU720, and CU20 is due at the end of each month, which is equal to the stand-alone selling price of the service.

The entity's history with this class of customer indicates that the customer will pay for six months. Additionally, in response to non-payment, the entity's customary business practice is to limit its credit risk by not transferring further services to a customer after 60 days of non-payment and to pursue collection for the unpaid services. The entity's debt collection has historically been successful.

In assessing whether the contract meets the criteria in paragraph 9, the entity assesses whether it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. This includes assessing the entity's history with this class of customer and its business practice of stopping service after 60 days in response to non-payment.

While it is not probable that the entity will collect the total consideration promised by the customer (CU720) due to the customer's low credit quality, the entity's customary business practice is to stop providing service after 60 days if the customer does not pay consideration when it is due. Therefore, the entity does not consider the likelihood of payment for those goods or services that would not be transferred beyond 60 days because the entity does not have credit risk on those services.

The entity concludes that the criterion in paragraph 9(e) is met and therefore accounts for the contract in accordance with Steps 2 to 5 of IFRS 15.

30. The staff think that an additional illustrative example should be included in IFRS 15 only if the IASB conclude that it is necessary in order for stakeholders to understand how to apply the requirements of paragraph 9(e). The staff think that the discussions on this topic held by the TRG, the IASB and the FASB, along with the associated papers, provide clarification as to how the Boards intended paragraph 9(e) to be

applied. An illustrative example within IFRS 15 would provide a more permanent and accessible piece of clarifying guidance in this respect.

31. The fact that concerns have been highlighted by TRG discussions suggests that additional guidance could be useful. However, the staff think that in order to conclude that the provision of an additional illustrative example is necessary, the inclusion of that example would need to be expected to change the outcomes of an entity applying IFRS 15. Because the example is intended only to provide clarification, we think that the only circumstance in which it would appropriately cause a change in outcomes is if the example caused an entity that had previously incorrectly interpreted paragraph 9(e) to interpret it correctly.
32. However, the staff think that this scenario is unlikely because, as described in detail in the table in paragraph 25, we think that IFRS 15 and the accompanying Basis for Conclusions already provide sufficient guidance and explanation with respect to interpreting paragraph 9(e). In other words, we think that the additional illustrative example would not clarify anything that is not already in the existing guidance. We also think that interpretation questions about this paragraph have been adequately answered via the TRG process and related board discussions. On this basis, we expect that paragraph 9(e) will be interpreted in practice in the way that the Boards intended.
33. The staff also think that the concerns raised about collectability are different from other areas for which the IASB has decided to include an additional illustrative example (such as that relating to performance obligations). This is because the potential clarifications on collectability do not relate to areas of significant judgement. For example, we think that clarification of whether an entity should consider collectability of *all* of the potential contract consideration in assessing whether paragraph 9(e) is satisfied is a question of factual interpretation of the paragraph. We think that the inclusion of an additional illustrative example will not change the outcome of applying a correctly interpreted paragraph 9(e). (This is as opposed to a more judgemental question such as *how* an entity should judge whether a specified element of revenue is collectable. In an area where judgement needs to be applied, a permanent piece of guidance in the form of an illustrative example might be more likely to change outcomes.)

34. Consequently, the staff do not think that an additional illustrative example is necessary. Furthermore, we think that for those stakeholders that have been following the TRG process, the clarification provided by an additional illustrative example is already apparent from the papers prepared for the March and April board meetings. However, stakeholders that have not been following the TRG process closely might assume that the IASB would publish a new example only if it were expected to give rise to a change in outcomes. We think this could create the risk of additional costs for those constituents who have already begun the implementation process (eg by spending resource trying to identify the practical effect of the new example). We also think there is a risk of such entities making changes to their implementation conclusions if they expect a change in outcomes to result from the new illustrative example.
35. In addition, we think that this approach might enhance stakeholders' expectations for further clarifications in other areas.
36. Overall, the staff do not recommend that the IASB include an additional illustrative example in IFRS 15. This is primarily because we do not think that such an example is necessary.

Conclusion

37. Overall, the staff do not think that the potential benefits of making any changes to IFRS 15 (including an additional illustrative example) at this stage outweigh the potential costs and consequences of doing so. This is primarily because we do not anticipate that any practical change in outcomes would arise if any of the clarifications discussed in this paper were made.
38. Furthermore, the staff think that the normal Post-implementation Review will be an opportunity to assess the effect of IFRS 15, including any diversity in practice and the consequences of any clarifications made by the FASB to Topic 606.
39. Therefore, the staff recommend that the IASB does not take any action in response to the issues regarding collectability highlighted by the TRG.

Question for the IASB

Question for the IASB

Does the IASB agree with the staff recommendation to not take any action in response to the issues regarding collectability highlighted by the TRG? If not, what approach does the IASB prefer?

Appendix: Background from March 2015 Agenda Paper 7D**IFRS 15**

A1. Step 1 of the new revenue Standard specifies five criteria that must be met before a contract qualifies to be accounted for under the remainder of the revenue recognition model. Those five criteria are set out in paragraph 9 of IFRS 15 as follows:

9 An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

- (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each party's rights regarding the goods or services to be transferred;
- (c) the entity can identify the payment terms for the goods or services to be transferred;
- (d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
- (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession.

A2. The assessment of these criteria is performed at contract inception. Paragraph 43 of the Basis for Conclusions explains that the criterion in paragraph 9(e) is 'an extension

of the other requirements in paragraph 9... In essence, the other criteria in paragraph 9 require an entity to assess whether the contract is valid and represents a genuine transaction.’

- A3. If a contract meets all of the criteria in paragraph 9 at inception, paragraph 13 specifies that an entity ‘shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances. For example, if a customer’s ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which the entity will be entitled in exchange for the remaining goods or services that will be transferred to the customer’.
- A4. If a contract fails any of the five criteria in paragraph 9, including the collectability criterion in paragraph 9(e), paragraph 14 requires an entity to ‘continue to assess the contract to determine whether the criteria in paragraph 9 are subsequently met’.
- A5. In the event of failing the criteria in paragraph 9, paragraph 15 specifies when the entity should recognise any consideration received as revenue as follows:
- 15 When a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:
- (a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
 - (b) the contract has been terminated and the consideration received from the customer is non-refundable.
- A6. Although both the IASB and FASB versions of the new revenue Standard use the term ‘probable’ in the collectability criterion, that term has a different meaning in IFRS and US GAAP. Under IFRS, probable is defined as ‘more likely than not’ whereas under US GAAP it indicates a higher threshold (under US GAAP, the term was initially defined in Topic 450 Contingencies as ‘likely to occur’). Although the Boards did not think that this difference in the meaning of probable would have a

significant practical effect on outcomes, that difference might potentially affect stakeholders' perceptions about the prevalence of the issues in this paper under IFRS and US GAAP.