



FASB and IASB to Propose Amendments to Principal-Agent Guidance in Revenue Standard

At their June 2015 joint meeting, the FASB and IASB decided to propose amendments to their respective revenue recognition standards to clarify how the principal versus agent guidance should be applied for determining whether revenue should be presented gross (as a principal) or net (as an agent).¹

Key Facts

- This will be the FASB's third exposure draft to improve the understandability and operability of the revenue standard since its issuance in May 2014, although this will be the first proposed amendment to the principal-agent guidance. In addition, the FASB issued an exposure draft proposing to defer the standard's effective date by one year.²
- The FASB's proposal will not amend principal-agent guidance in existing U.S. GAAP.³
- The IASB intends to issue a single exposure draft containing all of its proposed amendments to its standard.

Key Impact

- The Boards' decisions aim to minimize diversity in practice while maintaining substantial convergence between U.S. GAAP and IFRS.

Contents

Gross versus Net Revenue Reporting	2
Next Steps	4

¹ FASB Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, available at www.fasb.org; IFRS 15, Revenue from Contracts with Customers.

² FASB Proposed Accounting Standards Update, Deferral of the Effective Date, April 29, 2015, available at www.fasb.org.

³ FASB ASC Subtopic 605-45, Revenue Recognition – Principal Agent Considerations, available at www.fasb.org.

Gross versus Net Revenue Reporting

Gross versus net revenue reporting has been a complex issue for years. Arrangements that involve multiple parties providing goods or services to customers require a reporting entity to exercise significant judgment in evaluating whether it is a principal (presenting revenue gross) or an agent (presenting revenue net) in the transaction. Current U.S. GAAP includes indicators to be evaluated in making this determination. Applying these indicators has often been challenging for preparers, particularly in an evolving economic environment that now includes virtual goods and services.

The revenue standard supersedes existing principal-agent guidance and requires an entity to determine if the nature of its performance obligation is to provide specified goods or services to the customer (the entity is a principal) or to arrange for another party to provide those goods or services (the entity is an agent). The standard specifies that an entity is a principal if it controls the goods or services before transferring them to the customer. The standard also provides indicators of when an entity is acting as an agent.

Principal versus Agent Considerations

Questions have arisen about how the control principle in the implementation guidance interacts with the agency indicators. Some question whether the control principle should be applied independently of the indicators (e.g., based on how control is evaluated elsewhere in the revenue standard) or whether the agency indicators are part of the control assessment. Some have suggested that the indicators are confusing because they do not directly answer the question of whether an entity controls goods or services before transfer. Also, some have questioned whether, and if so how, some indicators should be weighted more heavily than others, particularly when indicators provide contradictory evidence.

Determining whether an entity controls goods or services is particularly difficult in contracts for the transfer of a nonphysical item (e.g., a software developer sells its app through another party's website) or the provision of some services (e.g., an entity arranges for its advertising to be placed on another party's website through a virtual advertising exchange). In those situations it may not be clear how the control principle interacts with the agency indicators. It also may not be clear which party is responsible for fulfilling the contract, what constitutes inventory risk, how to identify an entity's promise, or how to identify the customer.

The Boards decided to retain the control principle as the basis for determining whether an entity is a principal or an agent. To facilitate this determination, the Boards decided to propose four amendments to the revenue standard.

Entities Must Identify the Nature of the Specified Good or Service Provided to the Customer. This could include a right to goods or services (e.g., an airline ticket) or a bundle of goods or services that are not distinct from each other. This amendment's objective is to more clearly link the unit of account in the principal-agent analysis with the guidance on identifying performance obligations.

Clarify How an Entity Can Control a Service. The standard would state that an entity that is a principal controls a right to a service to be performed by a third party, which gives the entity the ability to direct the third party on the entity's behalf. For example, an entity enters into a maintenance services contract with a customer and engages a third party to perform those services under the entity's direction.

Re-frame Indicators to Provide Evidence of When an Entity Controls a Specified Good or Service. These indicators would be provided instead of indicators of when the entity is an agent. Although the amendment would not provide guidance on how to weight the indicators, it would clarify that certain indicators may be more or less persuasive based on facts and circumstances. The indicators are not intended to be all-inclusive.

Revise Examples. Some examples in the revenue standard would be revised and others would be added, specifically those focused on linking the principal-agent conclusion to the notion of control and illustrating how the indicators should be used to support the evaluation of control.

The joint staff paper included an example in which a retailer does not obtain title to its inventory, except momentarily at the point of sale (referred to as flash title). The Boards discussed the example and agreed that the retailer controls the products before they are transferred to the end customer and is therefore the principal in the transaction. However, the Boards expressed reluctance to include the example in the proposed amendments as they believe contracts are often unique, and changes in facts and circumstances could result in a different conclusion.

IASB Actions on Principal versus Agent Considerations

The IASB reaffirmed its prior decision to add examples to IFRS 15 to clarify the application of the principal versus agent guidance.⁴ The IASB also agreed with the FASB's clarifications to the principal versus agent guidance and will propose similar amendments to IFRS 15.

Estimating Gross Revenue

In some arrangements in which another party is involved in making an entity's goods or services available to a customer, the entity may be the principal but does not know the price paid by the end customer to the other party. For example, an app developer sells its products through a social media intermediary. The intermediary pays the app developer a fixed amount for each product sold. However, the intermediary does not report to the app developer the amounts charged to the end customers.

In current practice, some companies report the amount received from the other party as revenue. Other companies report the estimated amount charged to the end customer as revenue and the difference between the estimated amount and the amount received as a cost.

The FASB directed the staff to perform additional outreach about whether an entity applying the amended principal versus agent guidance could reach a conclusion that it was a principal in a transaction with an end customer when the entity uses an intermediary and does not know the price (or will not know the price) charged by the intermediary (i.e., the intermediary is not the entity's customer). Once it has these results, the FASB will decide whether additional amendments to the standard are needed to achieve consistency in practice.

⁴ IFRS 15, Revenue from Contracts with Customers.

IASB Actions on Estimating the Transaction Price

The IASB decided not to amend its standard to estimate the transaction price as a principal because the issue only affects a limited population of contracts. Feedback from constituents indicated that they were generally able to apply judgment and reach reasonable conclusions.

Next Steps

The FASB and IASB will issue separate exposure drafts on principal versus agent considerations with clarifications and additional examples. Prior to issuing its exposure draft, the FASB will discuss how to estimate gross revenue at a future Board meeting. The FASB and IASB expect to have joint redeliberations on their respective exposure drafts on principal-agent guidance.

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