



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

The FASB and the IASB met on December 16, 2015, and redeliberated their proposed amendments to the principal versus agent guidance in their respective revenue recognition standards.¹ The Boards instructed their staffs to draft final standards to incorporate the proposed amendments with only minor changes.

Key Facts

- Most comment letters supported the proposed amendments.
- The Boards decided to remove credit risk as an indicator of whether the entity is a principal in the transaction with the customer.
- It is unclear whether the Basis for Conclusions will discuss whether an entity should estimate gross revenue when it is the principal but is unaware of the amount that an intermediary charges the end customer.

Key Impacts

- An entity should first consider the nature of the goods or services promised in the contract with the customer.
- An entity should then determine whether it controls each good or service before the good or service is transferred to the customer. It should evaluate whether the entity is a principal or agent for the underlying good or service to be provided to the customer under the contract.
- The Boards' respective revenue recognition standards will remain substantially converged in this area.

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¹ FASB Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, and FASB Proposed Accounting Standards Update, Principal versus Agent Considerations (Reporting Revenue Gross versus Net), August 31, 2015, both available at www.fasb.org. IFRS 15, Revenue from Contracts with Customers, and IASB Exposure Draft ED/2015/6, Clarifications to IFRS 15, available at www.ifrs.org.

Principal versus Agent Considerations

In the third quarter of 2016, the FASB and IASB proposed amendments to their respective revenue standards related to principal versus agent considerations. The proposed amendments were substantially converged, except for discussions in the Basis for Conclusions for fact patterns that the Boards believe occur infrequently. The FASB received 21 comment letters, and reported that 19 respondents supported its proposed amendments. The IASB reported that it received 62 comment letters that responded to its question on principal versus agent, and that nearly all respondents agreed with the proposals.

The proposed amendments clarify that the control principle is the basis for determining the nature of the entity's promise to the customer and whether an entity is a principal or an agent with respect to the underlying good or service to be provided to the customer. An entity is a principal if it controls a good or service before transferring it to the customer. The Boards agreed to issue guidance based on the proposed amendments that require an entity to analyze whether it is a principal or an agent by:

Identifying the Nature of the Good or Service Provided to the Customer.

The forthcoming ASU will clarify that an entity determines whether it is a principal or agent in a transaction for each good or service (i.e., each distinct good or service or distinct bundle of goods or services) promised to the customer. An entity can be a principal for some goods or services and an agent for others within the same contract.

Clarifying How an Entity Can Control a Service or a Good or Service That Is Combined with Other Goods or Services. The forthcoming ASU will provide more guidance on how to apply the control principle when services are provided and when a good or service is combined with other goods or services.

The forthcoming ASU will specify that when another party is involved in providing services to a customer, an entity that is a principal obtains control of a service to be performed by a third party. This gives the entity the ability to direct the third party to provide the service to the customer on the entity's behalf. For example, this situation would occur when an entity enters into a maintenance services contract with a customer and then engages a third party to perform those services under the entity's direction. The entity may also be a principal if it controls the right to a service provided by another party. For example, a ticket broker may obtain control of a plane ticket by acquiring specific seats on flights and taking inventory risk before selling the ticket to a customer.

The forthcoming ASU also will specify that an entity controls a good or service if it provides a significant service of integrating goods or services provided by another party into the good or service for which the customer has contracted. This would occur when the entity obtains control of the good or service from the other party, and then directs its use to create the combined output for which the customer has contracted (e.g., directing the activities of subcontractors to construct a building).

Evaluating Indicators of When an Entity Controls a Specified Good or Service.

The revenue standard as originally issued included indicators that an entity is an agent. Questions arose about how the indicators interact with the control principle. The amendments clarify that the indicators are for determining whether an entity controls a good or service. In some situations, it may be clear that an entity controls the good or service without considering the indicators. In those situations, the staff stated that the control principle should guide the outcome, as the indicators are included only to support the principle. The forthcoming ASU will not provide guidance on how to weight the indicators. Instead, it will state that certain indicators may be more or less relevant or persuasive based on facts and circumstances, and some indicators may be present even when an entity is an agent.

The forthcoming ASU will identify three indicators of when an entity controls a good or service and, therefore, is a principal in the transaction with the customer:

- The entity is primarily responsible for fulfilling the promise to provide the good or service. This typically includes responsibility for the acceptability of the good or service.
- The entity has inventory risk before the good or service has been transferred to a customer or after transfer (e.g., a right of return).
- The entity has discretion in establishing the pricing for the good or service. However, an agent can have discretion in establishing prices in some cases.

Based on comment letters received, the Boards decided to remove credit risk as an indicator from the final amendment because it is not directly related to whether the entity obtains control of the good or service.

Applying Revised Examples. The forthcoming ASU will include revised examples and add new examples that specifically address linking the principal-agent conclusion to the notion of control and illustrate how the indicators should be used to support the evaluation of control.

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 not know the price that the end customer paid to the intermediary.

The Boards decided not to address this issue directly because they believe it is limited to a narrow set of situations. This includes when an online intermediary sells an entity's product for varying amounts, and the entity does not know at the time of the sale what those amounts are and may not ever know. However, the issue seems to be more common than the Boards appear to have contemplated. It is unclear whether the Boards will provide background information in the Basis for Conclusions about how they would approach the issue. The staff paper stated that the Boards will work together to ensure that there is no conflicting information in their respective Bases for Conclusions.

Next Steps

The FASB and the IASB expect to issue their respective final amendments on principal versus agent in the first quarter of 2016. The FASB also is evaluating other changes to its revenue recognition standard.

- Performance obligations and licensing – the FASB has discussed comments received on its exposure draft. A final standard is expected in the first quarter of 2016.²
- Narrow-scope improvements and practical expedients – the comment period ended on November 16, 2015. A final standard is expected in the first quarter of 2016.³
- Potential technical corrections on pre-production cost guidance for long-term contracts and the scoping of fixed-odds wagering contracts. It is unclear whether the FASB will make these technical corrections.⁴
- The next TRG meeting is not yet scheduled, but is expected to take place in the first half of 2016.

The IASB recently redeliberated its exposure draft on revenue and plans to issue its final amendments, including those on principal versus agent, in the first quarter of 2016.

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² FASB Proposed Accounting Standards Update, Identifying Performance Obligations and Licensing, May 12, 2015, available at www.fasb.org. Defining Issues No. 15-46, FASB Redeliberates Revenue Guidance on Licensing and Performance Obligations, October 2015, available at www.kpmginstitutes.com.

³ FASB Proposed Accounting Standards Update, Narrow-Scope Improvements and Practical Expedients, September 30, 2015, available at www.fasb.org. Defining Issues No. 15-44, FASB Proposes Further Amendments to Revenue Standard, September 2015, available at www.kpmginstitutes.com.

⁴ Defining Issues No. 15-49, Revenue TRG Discusses Optional Purchases, Licenses, Pre-production Activities, and Fixed-odds Wagers, November 2015, available at www.kpmginstitutes.com.