30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**16 October 2007, London**
Project:	**2008 Annual improvements process**
Subject:	**Determining whether an entity is acting as a principal or as an agent (Agenda Paper 6A)**

Background

1. The IFRIC received a request for an interpretation of how IAS 18 *Revenue* paragraph 8 should be applied to situations in which an entity employs another entity to meet the requirements of a customer under a sales contract. The request questioned whether there is a need for more general interpretative guidance in this area.

2. The IFRIC noted that IAS 18 specifies the accounting for agency relationships. Paragraph 8 states that 'in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.' Paragraphs 6 and 18(d) of the Appendix to IAS 18 refer to the substance of the transaction to identify whether the entity is acting as agent or principal.

3. The IFRIC acknowledged that no detailed guidance is given in IFRSs on identifying agency relationships. However, the IFRIC noted that:

- determining whether an entity is acting as a principal or as an agent depends on facts and circumstances and that judgement is required;
- any guidance beyond that given in IAS 18 would be more in the nature of implementation guidance than an Interpretation.

4. For these reasons the IFRIC decided not to develop an Interpretation and to remove this item from its agenda. However, the IFRIC noted that this issue has widespread and practical relevance and that some constituents might not be aware of the existing guidance that has been issued in some jurisdictions (e.g. in the US and the UK). One IFRIC member was also concerned that divergent accounting treatments arise depending on which existing guidance is followed.
5. The IFRIC noted that this issue could be resolved efficiently by including guidance in the Appendix to IAS 18 to help constituents to determine whether an entity is acting as a principal or as an agent, taking the form of implementation guidance. Therefore, the IFRIC decided to recommend to the Board that such guidance should be included in the Annual Improvements project.

Staff analysis

6. The staff identified the following existing guidance on this topic:
   - EITF 99-19 *Reporting Revenue Gross as a Principal versus Net as an Agent* gives a set of eight indicators of gross revenue reporting and three indicators for net revenue reporting (see appendix 2 of this paper), some indicators being stronger than others. It also provides 13 illustrative examples.
   - UK FRS 5 *Reporting the Substance of Transactions* includes Application Note G *Revenue Recognition* that states that ‘The general principles of the standard require that, in order for a seller to account for exchange transactions as principal, it should normally have exposure to all significant benefits and risks associated with at least one of the following: a) selling price […]; or b) stock’ (see appendix 3 for more details).
7. When reviewing the guidance proposed by the staff that could be included in the Appendix to IAS 18, the IFRIC favoured high-level guidance, generally consistent with US GAAP, with non-weighted indicators and without illustrative examples. This proposed guidance is set out in paragraph 10 of this paper. The

staff also provides in appendix 1 a comparison between this guidance and the indicators of EITF 99-19.

Staff recommendation

8. The staff recommend that the proposed guidance set out in paragraph 10 of this paper should be included in the Appendix to IAS 18.

9. **Questions to the Board:**

- **Does the Board agree with the staff recommendation?**
- **If yes, does the Board have any comments on the proposed guidance set out in paragraph 10?**

Drafting

10. The staff propose the following guidance for inclusion in the Appendix to IAS 18:

Determining whether an entity is acting as a principal or as an agent

21 Paragraph 8 states that ‘in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.’

Determining whether an entity is acting as a principal or an agent depends on facts and circumstances and requires judgement. An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that, individually or in combination, may indicate that an entity is acting as a principal include:

(a) the entity has the primary responsibility for providing the goods or services desired by the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;

(b) the entity has inventory risk before or after the customer order, during shipping or on return;

(c) the entity has discretion in establishing prices directly or indirectly, such as by providing additional goods or services;

(d) the entity has credit risk.

An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature that may indicate that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.

Appendix 1: Comparison between the proposed guidance and EITF 99-19

Indicators of gross revenue:

Proposed guidance for inclusion in the Appendix to IAS 18	**EITF 99-19 indicators**
(a) the entity has the primary responsibility for providing the goods or services desired by the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;	7. The company is the primary obligor in the arrangement Sub-indicator: If a company is responsible for fulfillment, including the acceptability of the product(s) or service(s) ordered or purchased by the customer, that fact is a strong indicator that a company has risks and rewards of a principal in the transaction and that it should record revenue gross based on the amount billed to the customer.
	10. The company changes the product or performs part of the service
	11. The company has discretion in supplier selection
	12. The company is involved in the determination of product or service specifications
(b) the entity has inventory risk before or after the customer order, during shipping or on return;	8. The company has general inventory risk (before customer order is placed or upon customer return)
	13. The company has physical loss inventory risk (after customer order or during shipping)
(c) the entity has discretion in establishing prices directly or indirectly, such as by providing additional goods or services;	9. The company has latitude in establishing price
(d) the entity has credit risk.	14. The company has credit risk

Indicators of net revenue:

Proposed guidance for inclusion in the Appendix to IAS 18	**EITF 99-19 indicators**
None*	15. The supplier (not the company) is the primary obligor in the arrangement
One feature that may indicate that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer	16. The amount the company earns is fixed
None*	17. The supplier (and not the company) has credit risk

(*) The staff believe it is more useful to emphasise the general principle about risks and rewards and put forward the indicator on fixed earnings.

Appendix 2: EITF 99-19

Full text: http://www.fasb.org/pdf/abs99-19.pdf

Below, an extract from paragraph 6 to 18

'EITF DISCUSSION

6. The Task Force reached a consensus that whether a company should recognize revenue based on (a) the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or (b) the net amount retained (that is, the amount billed to the customer less the amount paid to a supplier) because it has earned a commission or fee is a matter of judgment that depends on the relevant facts and circumstances and that the factors or indicators set forth below should be considered in that evaluation. The Task Force reached a consensus that none of the indicators should be considered presumptive or determinative; however, the relative strength of each indicator should be considered.

Indicators of Gross Revenue Reporting

7. **The company is the primary obligor in the arrangement—**Whether a supplier or a company is responsible for providing the product or service desired by the customer is a strong indicator of the company's role in the transaction. If a company is responsible for fulfillment, including the acceptability of the product(s) or service(s) ordered or purchased by the customer, that fact is a strong indicator that a company has risks and rewards of a principal in the transaction and that it should record revenue gross based on the amount billed to the customer. Representations (written or otherwise) made by a company during marketing and the terms of the sales contract generally will provide evidence as to whether the company or the supplier is responsible for fulfilling the ordered product or service. Responsibility for arranging transportation for the product ordered by a customer is not responsibility for fulfillment.

8. **The company has general inventory risk (before customer order is placed or upon customer return)—**Unmitigated general inventory risk is a strong indicator that a company has risks and rewards as a principal in the transaction and, therefore, that it should record revenue gross based on the amount billed to the customer. General inventory risk exists if a company takes title to a product before that product is ordered by a customer (that is, maintains the product in inventory) or will take title to the product if it is returned by the customer (that is, back-end inventory risk) and the customer has a right of return. Evaluation of this indicator should include arrangements between a company and a supplier that reduce or mitigate the company's risk level. For example, a company's risk may be reduced significantly or essentially eliminated if the company has the right to return unsold products to the supplier or receives inventory price protection from the supplier. A similar and equally strong indictor of gross reporting exists if a customer arrangement involves services and the company is obligated to compensate the individual service provider(s) for work performed regardless of whether the customer accepts that work.

9. **The company has latitude in establishing price—**If a company has reasonable latitude, within economic constraints, to establish the exchange price with a customer for the product or service, that fact may indicate that the company has risks and rewards of a principal in the transaction and that it should record revenue gross based on the amount billed to the customer.

10. **The company changes the product or performs part of the service—**If a company physically changes the product (beyond its packaging) or performs part of the service ordered by a customer, that fact may indicate that the company is primarily responsible for fulfillment, including the ultimate acceptability of the product component or portion of the total services furnished by the supplier, and that it should record revenue gross based on the amount billed to the customer. This indicator is evaluated from the perspective of the product or service itself such that the selling price of that product or service is greater as a result of a company's physical change of the product or performance of the service and is not evaluated based on other company attributes such as marketing skills, market coverage, distribution system, or reputation.

11. **The company has discretion in supplier selection—**If a company has multiple suppliers for a product or service ordered by a customer and discretion to select the supplier that will provide the product(s) or service(s) ordered by a customer, that fact may indicate that the company is primarily responsible for fulfillment and that it should record revenue gross based on the amount billed to the customer.

12. **The company is involved in the determination of product or service specifications—**If a company must determine the nature, type, characteristics, or specifications of the product(s) or service(s) ordered by the customer, that fact may indicate that the company is primarily responsible for fulfillment and that it should record revenue gross based on the amount billed to a customer.

13. **The company has physical loss inventory risk (after customer order or during shipping)—**Physical loss inventory risk exists if title to the product is transferred to a company at the shipping point (for example, the supplier's facilities) and is transferred from that company to the customer upon delivery. Physical loss inventory risk also exists if a company takes title to the product after a customer order has been received but before the product has been transferred to a carrier for shipment. This indicator may provide some evidence, albeit less persuasive than general inventory risk, that a company should record revenue gross based on the amount billed to the customer.

14. **The company has credit risk—**If a company assumes credit risk for the amount billed to the customer, that fact may provide weaker evidence that the company has risks and rewards as a principal in the transaction and, therefore, that it should record revenue gross for that amount. Credit risk exists if a company is responsible for collecting the sales price from a customer but must pay the amount owed to a supplier after the supplier performs, regardless of whether the sales price is fully collected. A requirement that a company return or refund only the net amount it earned in the transaction if the transaction is cancelled or reversed is not evidence of credit risk for the gross transaction. Credit risk is not present if a company fully collects the sales price prior to the delivery of the product or service to the customer (in other words, before the company incurs an obligation to the supplier). Credit risk is mitigated, for

example, if a customer pays by credit card and a company obtains authorization for the charge in advance of product shipment or service performance. Credit risk that has been substantially mitigated is not an indicator of gross reporting.

Indicators of Net Revenue Reporting

15. **The supplier (not the company) is the primary obligor in the arrangement—** Whether a supplier or a company is responsible for providing the product or service desired by a customer is a strong indicator of the company's role in the transaction. If a supplier (and not the company) is responsible for fulfillment, including the acceptability of the product(s) or service(s) ordered or purchased by a customer, that fact may indicate that the company does not have risks and rewards as principal in the transaction and that it should record revenue net based on the amount retained (that is, the amount billed to the customer less the amount paid to a supplier). Representations (written or otherwise) made by a company during marketing and the terms of the sales contract generally will provide evidence as to a customer's understanding of whether the company or the supplier is responsible for fulfilling the ordered product or service.

16. **The amount the company earns is fixed—**If a company earns a fixed dollar amount per customer transaction regardless of the amount billed to a customer or if it earns a stated percentage of the amount billed to a customer, that fact may indicate that the company is an agent of the supplier and should record revenue net based on the amount retained.

17. **The supplier (and not the company) has credit risk—**If credit risk exists (that is, the sales price has not been fully collected prior to delivering the product or service) but that credit risk is assumed by a supplier, that fact may indicate that the company is an agent of the supplier and, therefore, the company should record revenue net based on the amount retained.

18. The examples in Exhibit 99-19A are presented to illustrate the application of the consensus.’

Appendix 3: UK FRS 5 – Application note G

Extract:

‘Analysis

G62 The purpose of the analysis below is to determine whether a seller obtains the right to consideration by performing its contractual obligations:

- (a) as principal in an exchange transaction with its customer; or
- (b) as agent in relation to a transaction between its principal and the principal’s customer.

G63 The general principles of the standard require that, in order for a seller to account for exchange transactions as principal, it should normally have exposure to all significant benefits and risks associated with at least one of the following:

- (a) Selling price: the ability, within economic constraints, to establish the selling price with the customer, either directly or, where the selling price of an item is fixed, indirectly by providing additional goods or services or adjusting the terms of a linked transaction; or
- (b) Stock: exposure to the risks of damage, slow movement and obsolescence, and changes in suppliers’ prices.

G64 Where the seller has not disclosed that it is acting as agent, there is a rebuttable presumption that it is acting as principal.

G65 Additional factors which indicate that a seller may be acting as principal include:

- (a) performance of part of the services, or modification to the goods supplied;
- (b) assumption of credit risk; and
- (c) discretion in supplier selection.

G66 In contrast, where a seller acts as agent it will not normally be exposed to the majority of the benefits and risks associated with the exchange transaction. Agency arrangements will typically include the following characteristics:

- (a) the seller has disclosed the fact that it is acting as agent;
- (b) once the seller has confirmed its customer’s order with a third party, the seller will normally have no further involvement in the performance of the ultimate supplier’s contractual obligations;
- (c) the amount that the seller earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer; and
- (d) the seller bears no stock or credit risk, other than in circumstances where it receives additional consideration from the ultimate supplier in return for its assumption of this risk.’