

Memo No. **8**

**Memo**

Issue Date **December 8, 2015**

Meeting Date(s) **BM December 16, 2015**

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Project	<b>Revenue Recognition – Gross versus Net Revenue Reporting</b>		
Project Stage	<b>Redeliberations</b>		
Issue(s)	<b>Comment Letter Summary</b>		

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**Purpose of This Memo**

1. The December 16, 2015 joint Board meeting of the FASB and the IASB is a decision-making meeting. The purpose of the Board meeting is to:
  - (a) Provide a summary of the feedback received on the principal versus agent considerations in the FASB’s proposed Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* and the IASB’s Exposure Draft, *Clarifications to IFRS 15*.
  - (b) Provide alternatives for the Boards to consider in light of the feedback received and reach technical decisions with respect to those alternatives.
  
2. This memo summarizes the comment letters received by the FASB on the proposed amendments. This memo should be read in conjunction with IASB Agenda Ref No. 7F (IASB’s comment letter feedback) and FASB Memo No. 9/IASB Agenda Ref. No. 7G (joint paper about technical decisions for principal versus agent). The FASB staff would

intend for the FASB to complete redeliberations at the December 16, 2015 meeting and will proceed to issuing an Accounting Standards Update for vote by written ballot.

3. This memo is structured as follows:
  - (a) Background Information
  - (b) Comment Letter Demographics
  - (c) Summary of Feedback Received

### **Background Information**

4. Implementation issues related to principal versus agent were first discussed by the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) at its July 2014 meeting. Based on the discussion, Board members instructed the staff to perform additional research on the topic.
5. Following the July 2014 TRG meeting, the staff conducted further outreach with stakeholders. On the basis of feedback received, the staff confirmed that there are concerns with the principal versus agent guidance as issued in Topic 606 primarily due to the interaction between (i) the requirement to assess whether an entity is a principal or an agent based on whether it controls the good or service before it is transferred to the customer and (ii) the indicators that an entity is an agent in paragraph 606-10-55-39. The staff identified the following specific issues:
  - (a) Stakeholder misconceptions related to the indicators remaining substantially the same as current U.S. GAAP, despite the change from a “risks and rewards” based principal versus agent evaluation to based on a “control” principle (that is, whether the entity controls the good or service before it is transferred to the customer)
  - (b) Uncertainties surrounding the relationship of the control indicators to the assessment of control (for example, were the indicators part of the overall assessment of the control principle or, instead, did the indicators constitute an additional or separate evaluation mechanism)

- (c) Inconsistencies in the illustrative examples that contributed to different stakeholder interpretations of the relationship between the control principle and the indicators
  - (d) Challenges in applying the control principle to services and transactions for intangible goods (including virtual goods)
  - (e) Lack of clarity as to the unit of account to be used in the principal versus agent analysis (for example, should an entity assess whether it is a principal or an agent only for a distinct good or service [or distinct bundle of goods or services] or at a different level).
6. On June 22, 2015, the FASB and the IASB had a joint Board meeting to discuss the issues identified related to the guidance on principal versus agent considerations. Additionally, on July 29, 2015, the FASB had a Board meeting to discuss the issue of estimating gross revenue as a principal when the entity does not know (and never will know) the amount paid by the end customer to the entity's customer, but decided not to include that issue in the scope of this project. The FASB's tentative decisions from those Board meetings are included in Appendix A.
7. The FASB issued its proposed Update on August 31, 2015 and the comment period ended on October 15, 2015. The IASB issued their Exposure Draft on July 30, 2015 and the comment period ended on October 28, 2015. The proposed amendments to the application guidance on principal versus agent considerations are the same in both the FASB proposed Update and the IASB Exposure Draft. The proposed amendments were intended to achieve the following objectives:
- (a) Clarify the relationship between the control principle for the principal versus agent evaluation and the indicators that an entity is an agent in paragraph 606-10-55-39 (which were reframed to indicators that an entity controls a good or service)
  - (b) Clarify how control, in the context of the principal versus agent evaluation, applies to transactions for which stakeholders are experiencing difficulties in applying the principal versus agent guidance (for example, service arrangements)
  - (c) Clarify the unit of account for the principal versus agent evaluation.

**Comment Letter Demographics**

- 8. The remainder of this memo summarizes feedback on the FASB’s proposed Update.
- 9. Twenty-one comment letters were received in response to the proposed Update. The number of comment letters by type of respondent is included in the table below:

Type of Respondent	Number of Respondents
Preparer (including industry groups)	6
Accounting/Consulting Firm	10
State CPA Society	4
Standard Setter	1
<b>Total</b>	<b>21</b>

**Summary of Feedback Received**

- 10. Overall, respondents were supportive of the Board’s proposal. Nineteen respondents commented favorably on the proposal citing improvements to the operability and understandability and reduced cost and complexity in applying the guidance. For example, IBM (CL #6) stated:

“Overall, we are supportive of the proposed revisions to the guidance and illustrative examples, and believe these changes improve the operability and understandability of the principal versus agent guidance in Topic 606.”

Additionally, Crowe Horwath (CL #17) stated:

“We believe the amendments proposed by the Board will reduce the risk of diversity in practice regarding the application of principal versus agent guidance. The amendments should also result in a reduction of the cost and complexity of applying the guidance contained in Topic 606.”

11. In contrast, only 2 respondents did not agree with the proposal. Groupon (CL #16) disagreed with the proposal because they cite that in general netting amounts in financial statements provides less information to investors about the reporting entity's activities. Additionally, this respondent does not agree with using the notion of control to perform the principal versus agent assessment. The Equipment Leasing and Finance Association (CL #18) also expressed concerns about the principal versus agent guidance in Topic 606. However, their comments were narrowly tailored as to their views about the perceived possible effect of the guidance on sale and leaseback transactions and, therefore, presumably would apply to the issued guidance as well as the amendments proposed. ELFA has not, in general, been supportive of the Board's decisions on sale and leaseback transactions in the forthcoming final leases standard and the staff notes that much of their letter reiterated various points of opposition to those decisions.
12. Nine respondents to the proposed Update explicitly expressed support for the Board's decision to maintain convergence with the IASB on principal versus agent considerations and expressed that the Boards should consider issuing converged final amendments for this guidance as a paramount objective. For example, the Accounting Standards Board of Japan (CL #20) stated:

“We greatly appreciate that the FASB and the International Accounting Standards Board (the “IASB”) have made a consistent proposal to revise the guidance for determining whether an entity is a principal or an agent. As the determination of whether an entity is a principal or an agent would have significant effects on the entity's revenue amount recognized, we believe it is highly desirable to maintain the proposed level of convergence when finalizing the standard.”

13. Stakeholders were asked the following questions in the proposed Update:

**Question 1:** The proposed amendments to paragraph 606-10-55-36 clarify the unit of account (the “specified good or service”) at which an entity would determine whether it is a principal or an agent and clarify that an entity can be both a principal and an agent in a single contract.

Would the proposed amendments improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

**Question 2:** Paragraph 606-10-55-37A clarifies application of the control principle to certain types of arrangements by explaining what a principal controls before the specified good or service is transferred to the customer. Would the proposed amendments improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

**Question 3:** The proposed amendments to paragraph 606-10-55-39 provide indicators of when an entity controls the specified good or service before it is transferred to the customer and, therefore, would be a principal. The amendments also clarify the relationship of each indicator to the control principle in paragraph 606-10-55-37. Paragraph 606-10-55-39A was added to explain that the indicators may be more or less relevant to the principal versus agent assessment depending on the nature of the arrangement and that different indicators may provide more or less persuasive evidence about whether the entity controls the specified good or service before it is transferred to the customer in different contracts. Would the proposed amendments improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

**Question 4:** Would the revisions to the principal versus agent illustrative examples (Examples 45 through 48) and the added illustrative examples (Examples 46A and 48A) improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

14. The staff has provided a summary of respondents' comments to each question in the paragraphs below.

**Unit of Account and Entity can be both a Principal and an Agent in a Single Contract (Question 1)**

15. The Board asked a question in the proposed Update about whether the proposed amendments to paragraph 606-10-55-36, which clarify the unit of account (the “specified good or service”) at which an entity would determine whether it is a principal or an agent and that an entity can be both a principal and an agent in a single contract, would improve the operability and understandability of the principal versus agent guidance in Topic 606. An analysis of respondents’ comments follows:

<b>Unit of Account and Entity can be both a Principal and an Agent in a Single Contract</b>	<b>Number of Respondents</b>
Supports the proposed amendment	13
Supports the proposed amendment, but recommends certain clarifications or modifications	6
Opposes the proposed amendment	1*
No response provided	1
<b>Total</b>	<b>21</b>

\* Equipment Leasing and Finance Association- Refer to overall respondent summary

16. Nineteen respondents generally supported the proposed amendments to paragraph 606-10-55-36 because it improved the operability and understandability of the principal versus agent guidance in Topic 606. For example, the New York State Society of Certified Public Accountants (CL #8) stated:

“We agree that the requirement to consider each distinct good or service concept enhances the guidance in determining whether the reporting entity is a principal or an agent.”

17. PwC (CL#15) stated:

“We believe that stating that the “unit of account” is a “distinct specified good or service (or distinct bundle of goods and services)” adds clarity to the principal versus agent assessment. We believe

the proposed amendments will improve the operability and understandability of the principal versus agent guidance.”

18. Although response to the proposed amendments was overall positive, some clarifications and modifications were suggested to further improve the operability and understandability of the guidance. The feedback indicated that not all respondents understood that the term “specified good or service” was a “distinct good or service.” Specifically, two respondents recommended that the Board consider providing further explanation of the relationship between the “specified good or service” and performance obligation because of the similarities in their definitions by including some of the discussion in paragraph BC13 (see below). Two respondents recommended that the Board use existing terminology in Topic 606 (that is, performance obligation) instead of “specified good or service.” The staff notes, however, that the Boards proposed to refer to the “specified good or service” throughout the guidance on principal versus agent considerations because use of the term “performance obligation” would likely have been confusing if an entity is an agent. This is because the principal versus agent guidance in paragraph 606-10-55-36 (as proposed, excerpt below) states that the objective of the principal versus agent evaluation is to determine with the entity’s *performance obligation* is to provide the specified goods or services (that is, the entity is the principal to the end customer) or to arrange for those goods or services to be provided by another party (that is, the entity is an agent). An agent’s *performance obligation* is to arrange for goods or services to be provided by another party; it does not promise to provide the goods or services itself to the end customer. Accordingly, the specified good or service to be provided to the end customer is not the performance obligation of the agent. The specified good or service is the unit of account for the analysis to determine what the entity’s performance obligation is (that is, to provide that specified good or service or arrange for it to be provided by another party).

**606-10-55-36 (as proposed)** When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise **is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods or services to be provided by the**



**other party to provide those goods or services (that is, the entity is an agent)... [emphasis added]**

**BC13.** Throughout the guidance on principal versus agent considerations, the Boards decided to refer to the specified good or service transferred to the customer (as in paragraph 606-10-55-36), rather than the performance obligation. This is because use of the term performance obligation would have been confusing if the entity is an agent. An agent's performance obligation is to arrange for goods or services to be provided by another party; it does not promise to provide the goods or services itself to the end customer. Accordingly, the specified good or service to be provided to the end customer is not the performance obligation of the agent.

***Application of the Control Principle (Question 2)***

19. The Board asked a question in the proposed Update about whether the proposed amendments to paragraph 606-10-55-37A, which clarify application of the control principle to certain types of arrangements by explaining what a principal controls before the specified good or service is transferred to the customer, would improve the operability and understandability of the principal versus agent guidance in Topic 606. An analysis of respondents' comments follows:

<b>Application of the Control Principle</b>	<b>Number of Respondents</b>
Supports the proposed amendment	10
Supports the proposed amendment, but recommends certain clarifications or modifications	9
Opposes the proposed amendment	1*
No response provided	1
<b>Total</b>	<b>21</b>

\* Equipment Leasing and Finance Association- Refer to overall respondent summary

20. Nineteen respondents supported the proposed amendments to paragraph 606-10-55-37A6 and stated that they improved the operability and understandability of the principal versus agent guidance in Topic 606. Two of the respondents expressly noted that the amendments will be particularly helpful related to application of the control principle to service contracts. Although responses to the proposed amendments were quite positive, some clarifications and modifications were suggested to further improve the operability and understandability of the guidance primarily related to application of the control principle to services and situations that involve a significant integration service.
21. Six respondents commented on the difficulty of assessing whether the control principle should be applied to the right to a service or the underlying service that will be transferred to the customer. Several respondents noted that the uncertainty of whether the specified good or service is a ‘right’ can be partially attributed to the examples. For example, Ernst & Young (CL #10) stated:
- “We recommend that the proposed guidance be further clarified to clearly explain when an entity should identify the specified good or service as a right to a good or service or the actual good or service that will be transferred to the customer. For example, paragraph 606-10-55-324D in Example 46A identifies the office maintenance services as the unit of account but does not explain why the specified good or service is not the right to the maintenance services under paragraph 606-10-55-36A(a). Similarly, the application of paragraph 606-10-55-36A(a) is not explained in Examples 47 and 48, where the units of account are determined to be the right to the service and not the actual service desired by the customer.”
22. The six respondents also recommended incorporating language from paragraphs BC24, BC30, and BC31 to provide additional guidance on how to apply paragraph 606-10-55-37A to rights to services. BC24 explains that to evaluate whether the entity controls the right to services before that right is transferred to the customer, it is relevant to assess whether the right is created only when it is obtained by the customer, or whether it exists before the customer obtains the right and that if the right does not exist before the customer

obtains it, the entity would be unable to control that right before it is transferred. BC30 states that an entity can control a service to be provided by another party when it controls the right to the specified services from the other party that will be provided to the customer and describes types of these contracts in which the entity is a principal. BC31 explains that in contracts in which an entity directs another party to provide the services to the customer, an agent would likely be arranging for the provision of services; whereas, a principal would be controlling the rights to the services and then directing those rights to the customer. Overall, the feedback indicates that the proposal could be improved by including guidance on determining whether the entity controls a right by evaluating the timing of when the right arises.

23. Three respondents had questions about the guidance in paragraph 606-10-55-37A(c), which as proposed, would establish that when the specified good or service is a distinct *bundle* of goods or services (for example, the specialized equipment in Example 46 to the proposed Update), the entity providing a significant service of integrating the component goods or services into the specified good or service demonstrates the entity is the principal with respect to providing the specified good or service. Questions included whether the guidance in this paragraph is determinative (that is, if the criteria is met does an entity still need to evaluate the indicators in paragraph 606-10-55-39) and whether the guidance would be better framed as an indicator of control.
24. The staff thinks it is important to note that nearly all of those respondents that suggested clarifications as outlined above also expressed the view that the principal versus agent guidance in Topic 606 should remain completely converged with that in IFRS 15.

**Control Indicators (Question 3)**

25. The Board asked a question about whether the proposed amendments to paragraph 606-10-55-39 and addition of paragraph 606-10-55-39A would improve operability and understandability by providing indicators of when an entity controls the specified good or service and, therefore, would be a principal. An analysis of respondents' comments follows:

Control Indicators	Number of Respondents
Supports the proposed amendment	7

Supports the proposed amendment, but recommends certain clarifications or modifications	11
Opposes the proposed amendment	2*
No response provided	1
<b>Total</b>	<b>21</b>

\* Includes Equipment Leasing and Finance Association- Refer to overall respondent summary. Also includes ASBJ (see below for details).

26. Eighteen respondents supported the proposed amendments and stated that they would improve the operability and understandability of the principal versus agent guidance. Edison Electric Institute and the American Gas Association (CL #13) provided an explanation for their support:

“We believe these amendments improve the standard. We particularly appreciate that the new guidance clarifies that none of the indicators is stronger than others, but rather, indicates that some indicators may not be as relevant in certain types of transactions. We also believe that clarity is improved by defining the characteristics of a principal affirmatively.”

27. Although responses to the proposed amendments were generally positive, some clarifications and modifications were suggested to further improve operability and understandability. Additionally, one respondent (ASBJ CL#20) opposed the proposed amendments on the basis that the indicators were not sufficiently aligned with the notion of control, but rather still appeared to be derived from the “risks and rewards” principle in the current principal versus agent guidance.

*When to Apply Control Indicators*

28. Four respondents expressed continued uncertainty about whether entities must look to the control indicators if assessment of the control principle is conclusive. Those respondents appear to base their uncertainty on the analysis in some of the illustrative examples. For instance, in Example 46 (specialized equipment) the conclusion is that the entity controls the equipment (in accordance with paragraph 606-10-55-37A(c)) and there is no evaluation

of the indicators. In Example 46A (cleaning service) the entity concludes it obtains control because it has the ability to direct the service provider to provide the specified services on the entity's behalf. Although the example concludes that the entity has control of the service (in accordance with control as defined in 606-410-25-25) the example also includes analysis of the indicators as further evidence of control.

29. Three respondents recommended changes to the guidance to clarify when the entity should or should not apply the indicators in paragraph 606-10-55-39. Some respondents suggested that these amendments could incorporate some of the discussion from BC15 of the proposed Update, which states that “the indicators (a) do not override the assessment of control, (b) should not be viewed in isolation, (c) do not constitute a separate or additional evaluation, and (d) should not be considered a checklist of criteria to be met, or factors to be considered, in all scenarios.” Two respondents pointed to questions on the illustrative examples regarding the outcome of the initial control evaluation such as whether the control evaluation could be conclusive without evaluating the indicators and how each indicator was deemed to be relevant or not relevant in every example. The respondents were concerned that diversity in practice could result from this uncertainty. For example, McGladrey (CL #1) stated:

“We believe the proposed amendments clarify application of the control principle to the specified good or service, particularly through application in the examples. However, we also believe the proposed amendments raise a question about how to determine whether an analysis of the control principle is conclusive such that the indicators in ASC 606-10-55-39 do not need to be evaluated”

*Relevance of the Indicators*

30. Three respondents recommended that certain indicators should be identified as “stronger” (or more relevant) than others. Those respondents commented that this addition to the guidance would mitigate the risk of diversity in practice. For example, CFGI, a consulting firm, (CL #14) stated:

“Under the previous ASC 605-45 guidance, certain indicators were identified as being “strong indicators”. In our experience, the analysis over the entity with primary responsibility for fulfilling the

promise (previously known as the “primary obligor”) has been the most relevant indicator in determining the principal or agent. In our opinion, by omitting similar language highlighting strong indicators in the ED, there is increased risk of inconsistency in practice. We recommend that consideration should be given to specifically identify ‘strong’ indicators to aid users in determining the relevance of that indicator in making the principal or agent determination, consistent with ASC 605-45-3 through 45-18.”

31. Two respondents recommended that explanations of the relevance of each indicator be provided when it is deemed necessary to apply the control indicators in the illustrative examples. This approach would provide more guidance on how the relevance of the indicators varies depending on the situation to which they are applied and demonstrate that all indicators must be considered.

*Suggested Removal of Certain Indicators*

32. Four respondents stated that credit risk was not an appropriate indicator and should be removed. The rationale for this recommendation was uncertainty as to how the indicator could be evaluated in the context of control. For example, Grant Thornton (CL #9) stated:

“With regard to credit risk, we believe that the indicator similarly presents nearly equally weighted arguments for principal and agent, which would lead to difficulty in application. Additionally, it is unclear how an entity would assess credit risk as an indicator of control (the ability for an entity to derive all or substantially all of the benefits of an asset).”

33. One respondent commented that the pricing discretion indicator should also be removed from the guidance. That respondent questioned how the entity’s right to establish pricing of a specified good or service translated to control and that as written it was not helpful in differentiating between pricing discretion for a principal versus an agent.

***Illustrative Examples (Question 4)***

34. The Board asked a question about whether its revisions to the principal versus agent illustrative examples and the added illustrative examples would improve operability and

understandability of the principal versus agent guidance in Topic 606. An analysis of respondents’ comments follows:

Illustrative Examples	Number of Respondents
Supports the proposed amendments	10
Supports the proposed amendments, but recommends certain clarifications or modifications	9
Did not conclude, but suggests modifications	1
No response provided	1
<b>Total</b>	<b>21</b>

35. Nineteen respondents supported the proposed amendments and commented that they would improve the operability and understandability of the principal versus agent guidance. Edison Electric Institute and the American Gas Association (CL #13) provided the following explanation of how the amendments would be beneficial for preparers:

“We believe the revisions to the existing examples and the added illustrative examples provide clarity on application of the principal versus agent guidance. The examples demonstrate consistent application of the principles outlined in the standard and will benefit financial statement preparers in our industry. We believe the inclusion of examples is important in a principles-based standard that does not provide industry-specific guidance.”

36. Although responses to the proposed amendments were generally positive, some clarifications and modifications were suggested to further improve operability and understandability, including from a number of respondents who cite converged guidance as a paramount objective for these amendments. Specific recommendations by respondents are included in the analysis of ED questions 2 and 3 in this memo.

***Other Significant Comments- Estimating Gross Revenue as a Principal***

37. Five respondents (four audit firms and one preparer group) cited concerns with the discussion in the Basis for Conclusions on estimating gross revenue in transactions in which an entity is a principal in a transaction but is (and expects to remain) unaware of the price charged to the customer for its goods or services by an intermediary. However, the respondents had different reasons for their concerns. Two of those respondents recommended removing the discussion of estimating gross revenue as a principal from the Basis for Conclusions. For example, PwC (CL #5) stated:

“We understand that this discussion is intended to address a narrow fact pattern; however, we are concerned that it may be misinterpreted and applied too broadly. We are also concerned about the implications of differing guidance on this topic in the FASB’s and IASB’s basis for conclusions. We disagree with the statement in BC36 of the FASB’s ED that the transaction price should be reported net in cases “when the entity is (and expects to remain) unaware of the amount the intermediary charged to the end customer” and the implications of setting a precedent that a lack of access to data is a basis to not make estimates.”

38. Conversely, two respondents suggesting incorporating the discussion from the Basis for Conclusions into the authoritative guidance in the Codification. Deloitte (CL #15) stated:

“With respect to determining the transaction price as a principal, it is unclear how an entity would account for situations in which there is a difference between the amount to which the entity is entitled from the intermediary and the amount charged by the intermediary to an end customer. We note that paragraphs BC36 – BC38 of the proposed ASU’s Basis for Conclusions indicate that a principal does not include in the transaction price “the difference between the amount to which an entity is entitled from the intermediary and the amount charged by the intermediary to an end customer when the entity is (and expects to remain) unaware of the amount that the intermediary charged to the end customer.” We recommend that the Board move the guidance in these paragraphs into the final standard rather than the basis for conclusion. Further, we believe



that the Board should clarify the guidance to address such differences for situations in which the entity is aware of the amount charged by the intermediary to the end customer."

39. One respondent recommended a modification to the proposed Basis for Conclusions to specify what the transaction price would be in the example included in paragraph BC33 (transactions where the entity receives a fixed percentage [for example, 65 percent] of a contractually-agreed "list price" from the intermediary, regardless of whether the intermediary increases or discounts that list price to the end customer).