STAFF PAPER

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FASB | IASB Meeting

Project	**Revenue from Contracts with Customers**		
Paper topic	Principal versus Agent Considerations		
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Objective

1. The objective of this paper is to discuss, and obtain Board decisions about, possible amendments to the guidance on principal versus agent considerations in Topic 606, Revenue from Contracts with Customers, and IFRS 15 *Revenue from Contracts with Customers*.

2. This paper is structured as follows:
   (a) Summary of Staff Recommendations
   (b) Background
      (i) Principal versus Agent Considerations Guidance in Topic 606/IFRS 15
      (ii) Activities Since the Issuance of Topic 606/IFRS 15
      (iii) Summary of Stakeholder Feedback on the Principal versus Agent Considerations Guidance in Topic 606/IFRS 15
      (iv) Legacy Principal versus Agent Guidance Considerations

(c) Tentative Decisions Reached by the IASB at its May 2015 Meeting

(d) Staff Analysis

(i) Joint Staff Proposal

(ii) Options Considered but Rejected

(iii) Staff Recommendations

(iv) Questions for the Boards

(e) Appendix A – Revised and Additional Principal versus Agent Examples

Summary of Staff Recommendations

3. The staff recommend that the Boards jointly decide to:

(a) Retain the control principle (as explained in paragraph 606-10-55-37 [B35]) as the basis for determining whether an entity is a principal or an agent, but make *targeted* improvements to the guidance on principal versus agent considerations in Topic 606/IFRS 15 to clarify that guidance. In particular, the staff recommend that the Boards:

(i) Provide guidance on the unit of account for the principal versus agent analysis. Specifically, that an entity is a principal or an agent for each specified good or service in a contract and that the specified good or service may be a bundle of goods or services that are not distinct from each other.

(ii) Provide additional guidance on the nature of the specified good or service that an entity controls before it is transferred to a customer (for example, a right to a good or service).

(iii) Amend paragraph 606-10-55-39 [B37], which includes the existing indicators, to more clearly link the indicators in that paragraph to the notion of control, as defined in paragraph 606-10-25-25 [33], and to help clarify that the role of the indicators is to *assist* entities in determining control in accordance with paragraph 606-10-55-37 [B35]. An evaluation of the indicators does not override or replace the control evaluation, nor is it the entirety of the control evaluation.

(b) Revise the existing illustrative examples in Topic 606/IFRS 15 to more clearly demonstrate:

(i) That the indicators in paragraph 606-10-55-39 [B37] *assist* in (or *support*) the evaluation of whether an entity controls a specified good or service in accordance with the notion of control in paragraph 606-10-25-25 [33] (that is, the indicators do not override or replace the notion of control in paragraph 606-10-25-25 [33], nor do they represent a separate or additional evaluation).

(ii) *How* the indicators assist in the evaluation of the control principle for each of the examples.

(c) Include additional illustrative examples in Topic 606/IFRS 15 to address questions about how to apply the control principle to particular types of transactions (for example, service arrangements).

Background

Principal versus Agent Considerations Guidance in Topic 606/IFRS 15

4. When a party other than the entity is involved in providing goods or services to a customer, Topic 606/IFRS 15 (paragraph 606-10-55-36 [B34], included at the end of this paragraph) sets out a principle that requires the entity to determine whether it is:

   (a) The principal in the transaction because it provides the good or service to the customer (recognizing as revenue the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred); or

   (b) The agent because it *arranges* for the other party to provide the good or service (recognizing as revenue the fee or commission to which it expects to be entitled in exchange for arranging for the other party to provide its goods or services to the customer).

   > When another party is involved in providing goods or services to a customer, the entity shall 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 the other party to provide those goods or services (that is, the entity is an agent). [Emphasis added]

5. Paragraphs 606-10-55-37 through 55-40 [B35–B38] include guidance to help an entity make that determination. In particular:

   (a) Paragraph 606-10-55-37 [B35], included at the end of this paragraph, states that "An entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer." This paragraph establishes that an entity determines whether it *provides*, or *arranges for another party to provide*, a good or service by assessing whether it controls the good or service before it is transferred to the customer.

> ***An entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer***. However, an entity is not necessarily acting as a principal if the entity obtains legal title of a product only momentarily before legal title is transferred to a customer. An entity that is a principal in a contract may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf. When an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred. [Emphasis added]

(b) Paragraph 606-10-55-39 [B37] provides "indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer)" that are intended to assist entities in determining whether they control the good or service before it is transferred to the customer and, therefore, whether they are a principal.

> Indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer) include the following:
>
> a) Another party is primarily responsible for fulfilling the contract.

b) The entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping, or on return.

c) The entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited.

d) The entity's consideration is in the form of a commission.

e) The entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services.

6. The Basis for Conclusions to ASU 2014-09 (which codified Topic 606 into U.S. GAAP) and IFRS 15 explains the Boards' considerations in developing the guidance on principal versus agent considerations. BC382 is particularly relevant to the discussion in this agenda paper:

> The nature of the entity's promise may not always be readily apparent. For that reason, the Boards included indicators in paragraph 606-10-55-39 [B37] ***to help an entity determine whether the entity controls the goods or services before transferring them and thus whether the entity is a principal or an agent***. Those indicators are based on indicators that were included in previous revenue recognition guidance in U.S. GAAP and IFRS. However, as noted in paragraph BC380, the indicators in Topic 606 [IFRS 15] have a different purpose than previous revenue recognition guidance in that they are based on the concepts of identifying performance obligations and the transfer of control of goods or services. [emphasis added]

Activities Since the Issuance of Topic 606/IFRS 15

7. At its July 2014 meeting, the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) considered (Agenda Paper 1) the following two issues relating to principal versus agent considerations:

   (a) *Issue 1*: Implementation questions about the principal versus agent requirements in paragraphs 606-10-55-36 through 55-40 [B34–B38] (discussed later in this paper); and

   (b) *Issue 2*: Estimating gross revenue if the entity is the principal but is unaware of amounts being charged by an intermediary to the transaction (this issue is addressed in FASB Memo No. 3 for this Board meeting; as discussed in IASB Agenda Paper 7A for the May 2015 IASB meeting, the IASB previously decided not to undertake further consideration of this issue).

8. Those two issues were discussed jointly by the IASB and the FASB at the March 2015 joint Board meeting. At that meeting, the staff provided the Boards with an update about the ongoing research and outreach on principal versus agent considerations. While the key aspects of stakeholder feedback and concerns relevant to the analysis in this agenda paper are included in the next section, the staff note that IASB Agenda Paper 7E and FASB Memo No. 1 for the March 2015 meeting provide some additional background on those issues.

9. The IASB met in May 2015 to discuss possible actions that the IASB could take to resolve the issues, which were outlined in IASB Agenda Paper 7A. The tentative decisions reached by the IASB are summarized later in this background section of this agenda paper.

Summary of Stakeholder Feedback on the Principal versus Agent Considerations Guidance in Topic 606/IFRS 15

10. In addition to the July 2014 TRG meeting, the staff have conducted a significant amount of outreach with stakeholders (mainly, but not exclusively, in the U.S.) about the principal versus agent guidance in Topic 606/IFRS 15 over the course of the last year. The outreach included auditors, preparers, users, and regulators. On the basis of that outreach, there are substantive implementation questions about the principal versus agent guidance in Topic 606/IFRS 15 that stem primarily from questions about the relationship between (a) 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 (b) the indicators in paragraph 606-10-55-39 [B37].

11. For some stakeholders, the issue appears to be as fundamental as trying to determine whether the Boards intended to substantively change the principal versus agent evaluation. On the one hand, the fact that the indicators in paragraph 606-10-55-39 [B37] are substantially the same as the indicators in the previous principal versus agent guidance, which was based on a different evaluation principle, has led those stakeholders to think that the Boards did not intend to substantially change the principal-agent evaluation from previous U.S. GAAP and IFRS. On the other hand, those same stakeholders typically acknowledge that paragraph 606-10-55-37 [B35] (as well as the Basis for Conclusions) *states* that the principal versus agent evaluation is based on assessing whether the entity controls the specified good or service before it is transferred to the customer.

> **Note:** IAS 18 *Revenue* states "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." In contrast, Subtopic 605-45, Principal-Agent Considerations, does not have an *explicit* underlying principle, but it is *understood* to have a similar underlying risk and rewards principle.

12. Other stakeholders express the following specific concerns. These concerns are closely related to each other in that the concerns in (b) and (c) largely result from (a).

(a) It is unclear how the indicators in paragraph 606-10-55-39 [B37] correlate to the notion of control defined in paragraph 606-10-25-25 [33] (that is, how the indicators relate to determining whether an entity has the ability to direct the use of, and obtain substantially all the remaining benefits from, a good or service). This question arises because the indicators are substantially the same as those used to apply the previous risks and rewards principle in Subtopic 605-45 and IAS 18. Some stakeholders think one or more of the indicators are not relevant to a control evaluation based on the principle of control in paragraph 606-10-25-25 [33]. The July 2014 TRG memo (Agenda Paper 1) noted that stakeholders expressing this view typically do so in relation to indicators (d) and (e) in paragraph 606-10-55-39 [B37] (that is, the indicators related to the form of the entity's fee in the arrangement and exposure to credit risk).

(b) It is unclear whether:

   (i) An entity first assesses control (for example, in accordance with how control is defined in paragraph 606-10-25-25 [33]), and then evaluates the indicators if (1) it is unclear whether the entity controls the good or service before that good or service is transferred to the customer or (2) as a secondary analysis.

   (ii) An entity evaluates control *by* applying the indicators, rather than on the basis of control that is included in paragraph 606-10-25-25 [33] – which would mean that the indicators effectively govern the principal-agent evaluation as *the* way to apply the principle in paragraph 606-10-55-37 [B35].

(iii) The indicators *complement* an evaluation of control that is intended to focus on the notion of control in paragraph 606-10-25-25 [33]. In this case, an entity would use the indicators to assist in making that evaluation.

(c) The illustrative examples contribute to the different interpretations of the relationship between control and the indicators. For example:

(i) Example 45 appears to conclude, in paragraph 606-10-55-318 [IE232], that the entity does not obtain control of the goods before they are transferred to the customer, but then further evaluates the indicators. This suggests to some that the indicators are an alternative analysis (see b(i) above) that *could* result in a different conclusion.

(ii) The other examples can be read to imply that the indicators are the primary, or only, mechanism to evaluate whether the entity obtains control of the good or service before it is transferred to the customer (see b(ii) above). Examples 46-48 each state something similar to "In determining whether the entity obtains control of the ------- before control transfers to the customer, the entity considers the indicators in paragraph 606-10-55-39 [B37]" and concludes in the manner of "On the basis of the indicators in paragraph 606-10-55-39 [B37], the entity concludes that it controls [or does not control] the -------- before it is transferred to the customer." Those examples do not directly refer to the notion of control included in paragraph 606-10-25-25 [33] in the conclusion to each fact pattern.

13. The TRG discussions, as well as subsequent outreach, have also highlighted that the principal versus agent guidance based on a control principle is generally easier to apply to transactions for tangible goods as opposed to services and transactions for virtual or intangible goods (for example, a right to a meal in a restaurant). However, it is those latter transactions that have gained greater prominence in some markets in recent years. The implementation challenges with respect to those latter transactions have led some to question whether control is the appropriate basis upon which to assess whether an entity is a principal or an agent.

14. It is noteworthy that the principal versus agent guidance was not raised as a significant area of concern in the feedback on the 2010 ED, nor the 2011 ED, both of which included proposals that were largely the same as the guidance in Topic 606/IFRS 15. Much of the concern about principal versus agent evaluations has arisen relatively recently, in relation to new types of transactions. The focus on the issue often derives from difficulties that entities are experiencing in applying the principal versus agent guidance in previous U.S. GAAP.

Legacy Principal versus Agent Guidance Considerations

15. FASB Memo No. 1 for the March 2015 joint meeting provides a more detailed discussion of the issues U.S. stakeholders have communicated about the previous principal versus agent guidance in Subtopic 605-45. Because the staff are not recommending that either Board consider changes to Subtopic 605-45 or IAS 18, the full discussion from that paper has not been carried forward to this agenda paper. However, there are two *key* drivers of the application issues with respect to the previous principal-agent guidance in Subtopic 605-45 that are relevant to the

staff's analysis and recommendations about the guidance in Topic 606/IFRS 15 in this agenda paper.

16. First, many stakeholders have asserted that there is insufficient guidance in Subtopic 605-45 about how to make determinations in a consistent manner that are key to applying the principal versus agent guidance. Nearly every stakeholder with whom the FASB staff have engaged on this topic has highlighted that a proper principal-agent evaluation must begin with an entity properly identifying the deliverable in the contract and the entity's customer. Appropriately identifying the deliverable includes establishing the proper unit of account and, more fundamentally, answering questions such as whether the deliverable is an underlying good or service (for example, a flight or a meal) or, instead, a right to obtain that good or service (for example, a ticket or a voucher). Stakeholders generally think that the guidance in Subtopic 605-45 is lacking with respect to (i) providing guidance within the Subtopic or (ii) more directly referring to guidance elsewhere in U.S. GAAP that would assist entities in making those key determinations.

17. Second, many stakeholders assert that there are too many indicators in the existing guidance. A significant amount of the judgment required to apply the guidance in Subtopic 605-45 is because the guidance includes 11 indicators to consider. For example, despite the fact that Subtopic 605-45 establishes a stronger relative weighting to some of the indicators, there is still a significant amount of judgment as to, for example, how much stronger one indicator is than another and how many (or whether) "weaker" indicators can overcome a stronger indicator.

18. During the course of recent outreach discussions, stakeholders have communicated that those criticisms of the previous principal versus agent guidance are also criticisms of the new principal versus agent guidance in Topic 606/IFRS 15. Those stakeholders think that consideration of the two points above (in particular the first relating to the identification of the deliverable) is necessary

to improve the application of the principal versus agent guidance, in addition to clarifying the relationship between control and the indicators in paragraph 606-10-55-39 [B37]. Those stakeholders think that inaction in this regard will perpetuate those issues to the application of the new guidance.

Tentative Decisions Reached by the IASB at its May 2015 Meeting

19. Tentative to discussing jointly with the FASB at the June 2015 joint meeting, the IASB decided to make some targeted amendments to the guidance on principal versus agent considerations in IFRS 15 to clarify the application of control to services, in the context of the principal versus agent evaluation. That amendment would explain the scenarios in which an entity that is a principal can control a service to be performed by another party for the entity's customer.

20. The IASB also tentatively decided to amend Examples 45–48 accompanying IFRS 15, and to include some additional examples, to clarify the application of the principal versus agent guidance.

21. The IASB tentatively decided not to either:

    (a) Amend the application guidance in IFRS 15 regarding the identification of the specified good or service (that is, identifying the unit of account); or

    (b) Change, or eliminate, any of the indicators in paragraph B37 of IFRS 15.

22. The IASB's tentative decision with respect to (a) was based on the view that entities should be able to appropriately reach these determinations by applying the guidance that exists elsewhere in IFRS 15, together with the illustrative examples. The IASB supported amending the illustrative examples (and including additional examples) in a way that would emphasize, and clarify, the importance of

appropriately identifying the specified good or service as a first step in evaluating whether an entity is a principal or an agent.

Staff Analysis

23. In response to the feedback received from stakeholders, the staff have developed a *package* of amendments (the joint staff proposal) that they think, *together*, resolve the key issues identified with respect to the principal versus agent guidance in Topic 606/IFRS 15. The staff think the revised Topic 606/IFRS 15 guidance would also *help* to resolve some of the existing practice issues regarding the principal versus agent guidance in Subtopic 605-45. Importantly, however, the staff do not think that any of the amendments in this package would change the conclusions already reached by the Boards, or the principles embedded in Topic 606/IFRS 15, but would help entities to *appl*y those conclusions/principles. The staff think this package of amendments, together, will achieve the following objectives:

    (a) Clarify the relationship between the control principle for the principal versus agent evaluation, and the indicators in paragraph 606-10-55-39 [B37].

    (b) Clarify how control, in the context of the principal versus agent evaluation, applies to those types of transactions for which stakeholders are experiencing difficulties in applying the principal versus agent guidance (for example, service arrangements).

    (c) Clarify how an entity should identify the unit of account for the principal versus agent evaluation. As noted above, this is a key issue under previous U.S. GAAP guidance and, based on outreach, is expected to continue to be an issue in applying the principal versus agent guidance in Topic 606/IFRS 15, if not addressed as part of the clarifications to the guidance.

24. Each of the amendments outlined in the staff proposal have been discussed with some stakeholders. Based on those discussions, the staff are of the view that the staff proposal represents a substantive improvement to Topic 606/IFRS 15. The staff do *not* expect that the amendments proposed herein will eliminate judgment in this area. The staff expect that, for a subset of transactions, significant judgment will be required to determine whether an entity is a principal or an agent, as is the case under the previous principal versus agent guidance. However, the staff also think that the proposals herein will assist entities in making some of those judgments and improve consistency in applying the guidance.

Joint Staff Proposal

25. As noted above, the joint staff proposal is a package of amendments. Each of those amendments is outlined and explained in the following paragraphs.

Amendment 1

26. The staff think it is important for the authoritative guidance to set the unit of account for the principal versus agent analysis and to more clearly link the identification of that specified good or service to the Topic 606/IFRS 15 guidance on identifying performance obligations (that is, Step 2 of the revenue model).

27. The staff think this addition to the implementation [application] guidance would be similar to the following:

> <u>**606-10-55-36A [B34A]** To determine the nature of its promise (see paragraph 606-10-55-36 [B34]), the entity shall:</u>
>
> <u>(a) Identify the nature of the specified good or service to be provided to the customer. For example:</u>

<u>(i) The specified good could be a right to goods or services (see paragraph 606-10-25-18 [26]).</u>

<u>(ii) The specified good or service could be a bundle of goods or services that are not distinct from each other (see paragraphs 606-10-25-19 through 25-22 [27–30]).</u>

28. This amendment would achieve the following objectives:

(a) It would provide a better framework (that is, clarify the thought process) to be applied when assessing whether an entity is a principal or an agent.

(b) It would emphasize the importance of appropriately identifying the nature of the specified good or service (which could be a right to a good or service in some cases) that will be transferred to the customer. This is key to assessing whether the entity controls that specified good or service before it is transferred.

(c) It would clarify that the "specified good or service" (that is, the unit of account for the principal versus agent evaluation) is each distinct good or service (or distinct bundle of goods or services). It, therefore, also would clarify that, because a contract with a customer may include multiple specified goods or services, an entity may be a principal for one or more specified goods or services in a contract and an agent for others.

Amendment 2

29. At its May 2015 meeting, the IASB tentatively decided to make an amendment to the principal versus agent guidance to help explain the scenarios in which an entity that is a principal can control a service to be performed by another party for

the entity's customer. That amendment (to paragraph 606-10-55-37 [B35]) would be similar to the following:

> <u>An entity that is a principal controls:</u>
>
> <u>(a) A good or another asset (for example, a right) that it obtains from another party that it then transfers to the customer;</u>
>
> <u>(b) A right to a service to be performed by the other party, which gives the entity the ability to direct the other party to provide that service to the customer on the entity's behalf in satisfying its performance obligation; or</u>
>
> <u>(c) A good or service that it then integrates with other goods or services into a bundle of goods or services that represents the performance obligation to the customer.</u>

30. The staff proposal would include a substantially similar amendment, subject to drafting, reaffirming the IASB's tentative decision. Given the difficulty stakeholders are having in applying the control principle to some types of transactions, the staff think that this amendment would provide useful guidance to entities. In particular, clarifying that a principal can *direct another party to perform a service for the customer on its behalf* explains how an entity can control a service, even when another party actually *performs* the service. It also links that explanation to the definition of control in paragraph 606-10-25-25 [33]. A principal directs the use of the other party's services to fulfill, or partially fulfill, its performance obligation to the customer.

31. Together with other amendments proposed below, the proposed amendment also would *help* to explain how "inventory risk" (one of the indicators in paragraph 606-10-55-39 [B37]) can apply to some services. For example, an entity may have a risk substantially the same as inventory risk with respect to services if it has committed to obtain those services before obtaining a customer to whom the entity will transfer its right to those services.

Amendment 3

32. At the May 2015 IASB meeting, the IASB tentatively decided not to change the indicators in paragraph 606-10-55-39 [B37]. The potential changes that were discussed at that meeting were principally whether to eliminate some of the indicators. Since that meeting, the staff have conducted additional outreach with stakeholders that suggests some amendments to the indicators of a nature other than deletion could be useful in (a) making clear that the indicators support (or assist in) the evaluation of control in accordance with paragraph 606-10-25-25 [33] (rather than, for example, override or replace the evaluation of control in that context) and (b) helping entities to understand how those indicators assist in that evaluation.

33. The staff think the following amendments to the indicators would substantially accomplish the goals in (a) and (b) in paragraph 32 above:

    (a) First, each indicator should include some explanatory language as to how the indicator supports the control evaluation in accordance with paragraph 606-10-25-25 [33]. This is because the indicators are substantially unchanged from previous revenue guidance, under which they support a different principle (that of whether the entity has the significant risks and rewards of being a principal). In addition, previous U.S. GAAP includes explanatory guidance for each indicator, explaining how it supports the existing principle. Therefore, many stakeholders are of the view that it is necessary to provide additional guidance as to how the indicators relate to the application of the *new* control principle. History matters such that it would be useful to help stakeholders apply largely unchanged indicators to a new principle.

    (b) Second, in order to clarify that the principle for this guidance is that an entity is a principal if it controls the specified good or service before it is transferred to the customer (and is *not* a principal if it does not), the indicators should be reframed so as to provide evidence of when an entity controls a specified good or service, rather than indicators of when the entity is an agent. This would involve a relatively minor change to paragraph 606-10-55-37 [B37], but feedback from some stakeholders suggests that it would have a disproportionate effect on enhancing understanding of the control evaluation. To some stakeholders, if the principle for the guidance is that a principal obtains control a specified good or service before it is transferred to the customer, the indicators should support that question, not its converse. The presence of the indicators in the converse contributes to how some have interpreted the guidance; that is, that the indicators constitute a separate or additional evaluation, rather than existing to support a single, control evaluation.

(c) Third, the fourth indicator ("The entity's consideration is in the form of a commission") is not useful to answering the question of whether an entity has the ability to direct the use of, and obtain substantially all the remaining benefits from, the specified good or service. Some stakeholders think that retaining indicators that do not readily link to the control principle in paragraph 606-10-55-37 [B35] confuses the fact that the evaluation is one based on control. To those stakeholders, it suggests that there is either a different, or another, principle to consider. A more useful indicator of when an entity controls a specified good or service before it is transferred to a customer would be when the entity provides a significant service of integrating the goods or services that comprise the specified good or service for which the customer contracted (for example, the inputs to a combined, single performance obligation such as in Example 46 in Topic 606/IFRS 15). The staff think this is a strong indicator of when an entity is a principal for a specified good or service and could be helpful in applying the control principle if it is included in the guidance.

(d) Fourth, the guidance should clarify that both (i) the indicators are not an all-inclusive list (that is, in order to clarify that they merely *assist in* the evaluation of control) and (ii) one or more of the indicators may be more or less persuasive to the control evaluation in different contracts. This would both ensure that the focus of the principal versus agent assessment is on the control principle, with the indicators merely supportive thereof, and clarify that no indicator is "stronger" than another in all circumstances. This is an important clarification for entities applying U.S. GAAP that have been conditioned under Subtopic 605-45 to view the first and second indicators in paragraph 606-10-55-39 [B37] as the most important – "stronger" indicators. This could be accomplished with a minor modification to the lead-in to the indicators.

34. As described and explained in the paragraph above, Amendment 3 would result in changes to the guidance in paragraph 606-10-55-39 [B37] similar to the following:

> Indicators that an entity ~~is an agent (and therefore does not control~~ controls the specified good or service before it is ~~provided~~ transferred to ~~a~~the customer~~)~~ include, but are not limited to, the following, each of which may be more or less persuasive to the control evaluation depending on the nature of the specified good or service and the terms of the contract:
>
> (a) ~~Another party~~ The entity is primarily responsible for fulfilling the contract, including the acceptability of the specified good or service (that is, the entity fulfills the contract itself or directs the other party to provide the

specified good or service on behalf of the entity in order to fulfill the entity's performance obligation to the customer).

(b) The entity ~~does not have~~ has inventory risk before or after the goods have been ordered by a customer, during shipping or on return (for example, the entity obtains or commits to obtain control of the specified good or service before obtaining a contract with a customer involving the transfer of control of that good or service, or accepts responsibility for damaged or returned inventory)~~;~~.

(c) The entity ~~does not have~~ has discretion in establishing the price~~s~~ for ~~other party's~~ the specified good~~s~~ or service~~s~~ (for example, if the entity sets the price the customer must pay for the specified good or service, this may indicate the entity, rather than the other party, directs the use of the good or service)~~;~~.

(d)~~ the entity's consideration is in the form of a commission; and~~ The entity provides a significant service of integrating other goods or services into the specified good or service for which the customer contracted (that is, the entity controls the specified good or service before it is transferred to the customer because it first controls the component goods or services by directing their use to create the specified good or service).

(e) The entity is ~~not~~ exposed to credit risk for the amount receivable from ~~a~~the customer ~~in exchange for~~ that relates to the other party's goods or services. If an entity is required to pay the other party involved in providing the specified good or service regardless of whether and when it obtains payment from the customer, this may indicate that the entity is directing the other party to provide its good(s) or service(s) to the customer on the entity's behalf.

Amendment 4

35. At the May 2015 IASB-only meeting, the IASB tentatively decided to amend Examples 45–48 accompanying IFRS 15, and to include some additional examples, to clarify the application of the principal versus agent guidance.

36. The staff think that the IASB should reaffirm that decision, while the FASB should similarly decide to amend the existing principal versus agent examples in Topic 606 and include some additional examples. The revisions to the existing examples would align with Amendments 1-3 of the staff proposal, and all of the illustrative examples (revised and additional) would be drafted to align with the objectives for the amendments (that is, (a) – (c) outlined in paragraph 23). In particular, the staff think this should include the following:

    (a) Clearly link the principal versus agent conclusion to the notion of control in paragraph 606-10-25-25 [33];

    (b) Identify the specified good or service in each example; and

    (c) Demonstrate that the indicators merely *support* the control principle, which, depending on the example, might result in none, or only some, of the indicators being relevant to the principal versus agent assessment. That is, revisions to the existing examples and the additional examples should be drafted so as to be consistent with the view that the indicators *support* the control evaluation (rather than *define* that evaluation). Those examples should also demonstrate that different indicators will be more or less relevant in different scenarios.

37. Appendix A includes *preliminary* thinking as to how two of the existing examples in Topic 606/IFRS 15 might appear subsequent to revision. It also includes preliminary thinking as to two additional examples that the staff would intend to consider for inclusion in any proposed ASU/Exposure Draft.

Options Considered but Rejected

38. The March 2015 FASB Memo No. 1 included discussion of a number of potential amendments that might be made to the principal versus agent considerations guidance in Topic 606/IFRS 15. One alternative discussed in that memo was to use a principle other than control for the principal versus agent assessment. That alternative principle would have assessed whether an entity was a principal or an agent based on its exposure to potential profits or losses from transferring the good or service to the customer. That alternative was rejected by the staff and not formally proposed as an alternative in this agenda paper based on the following:

    (a) Feedback from stakeholders that suggested the alternative principle would not be better, or easier to apply, than the control principle in Topic 606/IFRS 15. Outreach suggested this alternative principle might have unintended consequences and may be more complex to apply than control-based guidance (with improvements to the guidance presently in Topic 606/IFRS 15 such as that proposed by the staff herein).

    (b) Concerns that it might not be possible to retain converged, or even substantially converged, principal versus agent guidance if either Board elected to adopt an alternative principle to the principle presently included in Topic 606/IFRS 15.

39. Other potential amendments to the principal versus agent guidance that were discussed at the March 2015 joint meeting were not further considered in this agenda paper. This was either (i) because of additional staff consideration as to their viability or benefit or (ii) as a result of feedback from stakeholders since the March 2015 joint meeting.

Staff Recommendations

40. The staff recommend the Boards adopt the joint staff proposal, which, as noted above, the staff view as a package of amendments that should be adopted

together. The staff do not think that there is any package of amendments that would eliminate the complex judgments that can arise in some cases in assessing whether an entity is a principal or an agent. However, based on the feedback received from stakeholders, the staff think that the amendments proposed herein will make the guidance more understandable and easier to apply, as well as lead to more *consistent* application. Furthermore, the staff also think that the staff proposal substantially resolves the key issues that stakeholders have raised about the principal versus agent guidance in Topic 606/IFRS 15.

41. Paragraphs 45-51 of this paper provide further explanation about the IASB staff recommendation, in the light of the IASB's tentative decisions at its May 2015 meeting.

FASB Staff Recommendations

42. Consistent with the overall joint staff recommendation above, the FASB staff recommend that the FASB add a project to its technical agenda to revise the principal versus agent considerations guidance in Topic 606. In requesting that the FASB add this project to its technical agenda, the FASB staff think that the FASB should be aware that its staff view the package of amendments in the staff proposal to be the minimum necessary to address the needs of U.S. stakeholders. Similar to the IASB staff's recommendations discussed below, the FASB staff recommendations are being made with the goal of retaining converged guidance with the IASB. If the FASB were considering this project separately from the IASB, the FASB staff would continue to recommend a control principle for the principal versus agent evaluation, but would likely recommend some additional improvements and clarifications that stakeholders have communicated would also be useful, but are not *essential*. In other words, while the IASB staff, as outlined in paragraphs 46-51, are recommending additional improvements and clarifications than what those staff members would propose if the IASB was considering this issue on its own, the FASB staff are *not* recommending some

improvements or clarifications they would propose if the FASB were not considering this together with the IASB.

43. The FASB staff further recommend that the FASB authorize its staff at this meeting to draft a proposed ASU based on the staff proposal for vote by written ballot.

44. The staff think the Board should designate a comment letter period of approximately, but not less than, 45 days for this proposed ASU. The staff think the amendments that would be included in the proposed ASU are clarifications such that a more lengthy comment letter period is not necessary. The staff also think that, as implementation of Topic 606 is ongoing, enacting final changes in as timely a manner as possible is preferable. However, given the importance of this guidance to many stakeholders, the staff think a comment letter period shorter than 45 days may not give entities enough time to fully consider the changes. Therefore, the FASB staff think a comment letter period of approximately, but no less than, 45 days is a reasonable middle-ground between providing adequate time for consideration of the proposals and moving to enact changes to Topic 606 in a timely manner.

IASB Staff Recommendation

45. As noted in the Staff Analysis section of this paper, the IASB's tentatively decided at its May 2015 meeting to adopt what this paper describes as Amendments 2 and 4 of the joint staff proposal.

46. In the light of those decisions, the IASB staff think that the IASB has two alternatives:

    (a) Retain its May 2015 tentative decisions, without proposing any further amendments to the principal versus agent guidance in IFRS 15.

(b) In addition to its May 2015 tentative decisions, adopt Amendments 1 and 3 in this paper, and thereby adopt the entire package of amendments that represents the joint staff proposal in this paper.

47. Regarding Amendment 1 (refer to paragraph 27 of this paper), the IASB tentatively decided in May not to amend the application guidance in this respect. This is because:

(a) The proposed guidance (which largely points to other relevant parts of Topic 606/IFRS 15) is already within Topic 606/IFRS 15, although not within the principal versus agent guidance; and

(b) The IASB concluded that clarity in terms of the steps to be taken could be achieved by amending and adding to the illustrative examples. That is, the examples could be amended to illustrate that, as a first step, an entity should identify the specified good or service (and those examples include scenarios in which the specified good or service is a right and scenarios in which the specified good or service is a bundle of goods or services that are not distinct from each other). Then, as a second step, the entity would determine whether it is a principal or an agent by applying the control principle as defined in paragraph 606-10-25-25 [33] to that specified good or service.

48. For those reasons, the IASB staff think that Amendment 1 is not essential. Nonetheless, for the reasons noted in paragraph 28 of this paper, we think it would be helpful to include this guidance within the section of the application guidance that sets out principal versus agent considerations. We also think that there is relatively little risk of unintended consequences because the proposed additional guidance would simply refer to other relevant parts of IFRS 15—that is, it would not introduce new language. Accordingly, we recommend adopting Amendment 1 in this paper.

49. Regarding Amendment 3 (refer to paragraph 34 of this paper), the IASB also discussed and decided not to propose amendments to the indicators in paragraph 606-10-55-39 [B37] in May 2015. In doing so, the IASB noted that the indicators should not override the assessment of control, be viewed in isolation, nor be considered a checklist of criteria to be met, or factors to be considered, in all scenarios. It also noted that one or more of the indicators can often be helpful in assessing control and, depending on the particular facts and circumstances, differing indicators can be more or less relevant to that control assessment. For these reasons, the IASB decided that there was no need to amend the indicators in paragraph 606-10-55-39 [B37]. Instead, the IASB could provide clarity as to the interaction between the control principle and the indicators within the illustrative examples. That is, in each example, the analysis could be amended to illustrate that an entity considers only those indicators that are relevant and helpful to the assessment of control given the particular facts and circumstances, and also that the ultimate conclusion as to whether the entity is a principal or an agent is based on assessing control as defined in paragraph 606-10-25-25 [33] (having considered the relevant indicators). For example, Example 46 (set out in the appendix to this paper) could be amended to illustrate that only the indicators in (a), (c), and (e) of paragraph 606-10-55-39 [B37] are relevant and helpful when assessing control; Example 47 (also set out in the appendix to this paper) could be amended to illustrate that the indicators in (b) and (c) in paragraph 606-10-55-39 [B37] are most relevant and helpful when assessing control.

50. In proposing to add explanatory text to link each of the indicators to control, Amendment 3 goes beyond what the IASB staff think is needed to clarify the interaction between the indicators and the control principle. We think that this clarity can be achieved within the examples. There is a risk of further questions arising in relation to the additional explanations that would be included as part of the authoritative text. Accordingly, if considering this in isolation, we would not recommend adopting Amendment 3 in this paper. Nonetheless, we view retaining

guidance on principal versus agent considerations that is converged with the FASB as being particularly important. Consequently, on balance, we recommend that the IASB also adopt Amendment 3 in this paper, if the FASB decides to adopt that proposal.

51. The IASB staff would intend to include any proposed amendments to the principal versus agent guidance within the single Exposure Draft of proposed clarifications to IFRS 15, which the IASB plans to publish before the end of July 2015.

Questions 1-8: Principal versus Agent Considerations

Questions for the FASB:

1. Does the FASB want to add a project to its technical agenda to amend the principal versus agent consideration guidance in Topic 606?

2. Does the FASB want to adopt the package of amendments characterized as the staff proposal in the analysis above?

[**Questions 3-7 are applicable to a single proposed ASU that would include (a) the principal versus agent improvements described in this memo and (b) the estimating gross revenue improvements described in FASB Memo No. 3**]

3. Does the FASB think all relevant issues have been deliberated?

4. Have the FASB members received sufficient information and analysis to make informed decisions on those issues?

5. Subject to what the FASB learns from comment letters and other stakeholder outreach, do the expected benefits of the proposed changes justify the costs?

6. Should the FASB staff proceed to drafting a proposed ASU for a vote by written ballot?

7. If the FASB answers question #6 in the affirmative, what comment letter period does the FASB want to provide?

Questions for the IASB:

8. Does the IASB agree:

(a) to retain its tentative decisions at its May 2015 meeting (described as Amendments 2 and 4 in this paper)?

(b) to adopt Amendment 1 (paragraph 27 of this paper) and Amendment 3 (paragraph 34 of this paper)?

Appendix A – Revised and Additional Principal versus Agent Examples

A1. These examples represent preliminary staff thinking only, and are subject not only to the Boards' decisions, but additional revision by the Board members and staff during the drafting process.

Example 46—Specialized Equipment

46.1 An entity enters into a contract with a customer for equipment with unique specifications. The entity and the customer develop the specifications for the equipment, which the entity communicates to a supplier that the entity contracts with to manufacture the equipment. The entity also arranges to have the supplier deliver the equipment directly to the customer. Upon delivery of the equipment to the customer, the terms of the contract require the entity to pay the supplier the price agreed to by the entity and the supplier for manufacturing the equipment.

46.2 The entity and the customer negotiate the selling price, and the entity invoices the customer for the agreed-upon price with 30-day payment terms. The entity's profit is based on the difference between the sales price negotiated with the customer and the price charged by the supplier.

46.3 The contract between the entity and the customer requires the customer to seek remedies for defects in the equipment from the supplier under the supplier's warranty. However, the entity is responsible for any corrections to the equipment required resulting from errors in specifications.

46.4 ~~To determine whether the entity's performance obligation is to provide the specified goods or services itself (ie the entity is a principal) or to arrange for another party to provide those goods or services (ie the entity is an agent), the~~ The entity ~~considers~~ identifies the nature of ~~its promise~~ the specified good or service to be provided to the customer. The entity concludes that it has promised to provide the customer with specialized equipment.~~; however,~~ Although the entity has subcontracted the manufacturing of the equipment to the supplier, the entity concludes that the development of the specifications, the manufacturing of the equipment, and overall management of the contract are not distinct because they are not separately identifiable (that is, there is a single performance obligation). The entity provides a significant service of integrating those items into the combined output—the specialized equipment—for which the customer has contracted. Accordingly, the entity identifies the specified good to be provided to the customer as the specialized equipment.

46.5 In order to assess whether the entity's performance obligation is to provide the specialized equipment (that is, the entity is a principal) or to arrange for another party to provide the specialized equipment (that is, the entity is an agent), ~~determining whether~~ the entity determines whether it ~~obtains~~ controls ~~of~~ the specialized equipment before ~~control transfers~~ it is transferred to the customer ~~and whether the entity is a principal~~. As part of that evaluation, and to assist in the determination, the entity considers the following, relevant indicators ~~in~~ from paragraph 606-10-55-39 [B37] as follows:

(a) The entity is providing a significant service of integrating the development of the specifications, the manufacturing of the equipment, and overall management of the contract into the specialized equipment that is the specified good in this contract. Therefore, the entity is directing the use of the supplier's manufacturing services to create the specialized equipment.

(~~a~~b) The entity is primarily responsible for fulfilling the contract. Although the entity subcontracted the manufacturing, the entity is ultimately responsible for ensuring that the specialized equipment is transferred to the customer and meets the specifications for which the customer has contracted.

~~(b) the entity has inventory risk because of its responsibility for corrections to the equipment resulting from errors in specifications, even though the supplier has inventory risk during production and before shipment.~~

(c) The entity has discretion in establishing the selling price with the customer.~~, and the profit earned by the entity is an amount that is equal to the difference between the selling price negotiated with the customer~~

~~(d) the entity's consideration is not in the form of a commission.~~

(~~e~~d) The entity has credit risk for the amount receivable from the customer ~~in exchange for the equipment~~ that relates to the supplier's manufacturing services.

46.6 The inventory risk indicator in paragraph 606-10-55-39(b) [B37(b)] is not relevant in this example. The specialized equipment is manufactured only after the contract with the customer is obtained such that there is no risk that either entity will be unable to sell the equipment to a customer.

46.7 The entity concludes that ~~its promise is to provide the equipment to the customer~~ it controls the specialized equipment before the equipment is transferred to the customer. ~~On the basis of the indicators in paragraph B37 of IFRS 15, the entity concludes that it controls the equipment before it is transferred to the customer~~. In addition to the consideration of the indicators in paragraph 606-10-55-39 [B37], the entity notes that, although the supplier delivers the specialized equipment to the customer, the supplier has no ability to direct its use (that is, the supplier cannot decide to use the specialized equipment for another purpose or direct the good to another customer). The terms of the entity's contract with the supplier prevents the supplier from directing the use of the specialized equipment by specifying that the equipment must be delivered to the customer. Thus, the entity is a principal ~~in the transaction~~ with respect to providing the specialized equipment to the customer and recognizes revenue in the gross amount of consideration to which it is entitled from the customer in exchange for the specialized equipment.

Example 47—Airline Ticket Broker

47.1 An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and must pay for those tickets regardless of whether it is able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance.

47.2 The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased; therefore there is no credit risk.

47.3 The entity also assists the customers in resolving complaints with the service provided by the airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

47.4 ~~To determine whether the entity's performance obligation is to provide the specified goods or services itself (ie the entity is a principal) or to arrange for another party to provide those goods or services (ie the entity is an agent), the entity considers the nature of its promise.~~

~~The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. In determining whether the entity obtains control of the right to fly before control transfers to the customer and whether the entity is a principal, the entity considers the indicators in paragraph B37 of IFRS 15 as follows:~~

~~(a) the entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.~~

~~(b) the entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.~~

~~(c) the entity has discretion in setting the sales prices for tickets to its customers.~~

~~(d) as a result of the entity's ability to set the sales prices, the amount that the entity earns is not in the form of a commission, but instead depends on the sales price it sets and the costs of the tickets that were negotiated with the airline.~~

In determining whether the entity is a principal or an agent, the entity observes that, with each ticket it commits to purchase from the airline, it obtains control of a right to a flight (in the form of a ticket) that is provided to the entity by the airline before transferring that right to one of its customers. The entity has the ability to direct the use of those rights by deciding whether to use the tickets to fulfill contracts with customers and, if so, which contracts they will fulfill. The entity also has the ability to obtain the remaining benefits from those rights either by reselling the tickets and obtaining the entirety of the proceeds from those sales or, alternatively, using the tickets itself.

47.5 Indicators (b) and (c) in paragraph 606-10-55-39 [B37] support the entity's conclusion that it controls a right to the flight before that right is transferred to the customer. The entity has inventory risk with respect to the tickets. This is *because* it has obtained those rights before obtaining a contract with a customer to transfer those rights (by committing to purchase the tickets, regardless of whether (i) it is able to obtain customers to whom to resell those tickets or (ii) it can obtain a favorable price for those tickets). The entity has sole discretion in establishing the price at which its customers may obtain the tickets that it controls. The entity also can decide, for example, to consume, rather than sell, its right to a flight (for example, use the ticket for its own personnel) if it is unable to obtain a favorable price from a customer.

47.6 The remaining indicators in paragraph 606-10-55-39 [B37] are either not relevant, or are not persuasive, to the analysis. There is no credit risk; the specified good or service in this contract is not a combined performance obligation for which a significant integration service is provided; and while the entity is primarily responsible for transferring its right to the customer, this is not a persuasive factor because the airline is primarily responsible for fulfilling the right embodied in the ticket.

47.7 ~~The entity concludes that its promise is to provide a ticket (ie a right to fly) to the customer. On the basis of the indicators in paragraph B37 of IFRS 15, the entity concludes that it controls the ticket before it is transferred to the customer.~~ ~~Thus~~ Therefore, the entity concludes that it is a principal in the transactions with the customers and recognizes revenue in the gross amount of consideration to which it is entitled in exchange for the tickets it ~~transferred~~ transfers to the customers.

New Example 1 —Office Maintenance Services

N1.1 An entity enters into a contract with a customer to provide office maintenance services. The entity and the customer define and agree upon the scope of the services and negotiate the price. The entity is responsible for ensuring that the services are performed in accordance with the terms and conditions in the contract.

N1.2 The entity regularly engages third party service providers to provide the office maintenance services. When the entity obtains the contract from the customer, the entity in turn enters into a contract with one of those service providers, directing the service provider to perform the specified services for the customer. The entity is obliged to pay the service provider even if the customer fails to pay.

N1.3 The entity observes that the specified services to be provided to the customer are the office maintenance services. The entity then concludes, consistent with paragraph 606-10-55-37 [B35], that it obtains control of a right to those services that will be performed by the third-party provider that it selects before those services are provided to the customer. The entity contracts with the service provider and directs the service provider to perform those services for the customer on its behalf in order to satisfy the entity's performance obligation to the customer.

N1.4 Some, but not all, of the indicators in paragraph 606-10-55-39 [B37] are relevant to the analysis in this example and support that the entity is directing the service provider to provide office maintenance services to fulfill the entity's performance obligation to the customer. In particular, the entity:

(a) Is primarily responsible for fulfilling the service to the customer, including having responsibility for the acceptability of the service (that is, the customer holds the entity responsible for fulfillment of the contract, regardless of whether the entity performs the services itself or engages a third-party service provider to perform the services).

(b) Establishes the price the customer will pay for the office maintenance services, regardless of what rate the entity is able to negotiate with one of its service providers.

(c) Has credit risk with respect to the consideration it expects to receive for the office maintenance services. The fact that the entity must pay the service provider in accordance with the terms of its contract with the service provider regardless of whether and when it obtains payment from the customer supports that the service provider is acting on behalf of the entity, rather than on its own behalf, and the entity is directing the service provider to provide the office maintenance services to the customer.

N1.5 The inventory risk indicator is not relevant to this example because no right to the office maintenance services exists before the contract with the customer is obtained by the entity. Only upon entering into the contract with the customer does the entity obtain a right to the service provider's office maintenance services, which it then directs to fulfill its contract with the customer. The integration service indicator is also not relevant to this example because the specified service in this contract is not a combined performance obligation for which a significant integration service is provided.

N1.6 Based on the analysis outlined above, the entity concludes that it is a principal in this example because it controls the specified office maintenance services before they are transferred to the customer and, consequently, recognizes revenue in the gross amount of consideration to which it is entitled in exchange for providing the office maintenance services to the customer.

New Example 2 —Retail Example

N2.1 An entity that is a retailer enters into a contract with a manufacturer to sell its product at its retail stores. The manufacturer provides quantities of the product for sale at the entity's stores (quantities as requested by the entity), but the entity does not take title to those products, except momentarily, at the point of sale of the product to a customer. The entity sets the price to the customer for the product with input from the manufacturer. The entity is not required to pay the manufacturer the price it has agreed in the contract until the product is sold to a customer. The entity's margin is the difference between the price at which it sells the product to the customer and the price it agreed to remit to the manufacturer when its sells the product.

N2.2 The entity concludes that it controls the products before they are transferred to customers based on the control principle in paragraph 606-10-25-25 [33] and, therefore, that it is a principal in the sales of the products to customers. The entity concludes that it controls the products before they are transferred to customers because, while the products are in its stores, it has the ability to direct their use. The terms of the contract are such that the entity can direct the use of the products in the same way that it can other goods for which it obtains title (and is obliged to pay) when the goods are delivered to the entity (for example, it can decide in which store or which part of its store the products are placed, and it can decide what price is charged - with some input from the manufacturer). Having delivered the products to the entity, the manufacturer cannot direct the products (located in the entity's stores) to another retailer or to any specific customer. The entity also has the ability to obtain substantially all the remaining benefits from the products, which are principally the potential cash flows from their sale. This is because the entity will obtain all of the cash flows from sale of the products. Accordingly, the entity obtains control of the products at the point that the products are delivered to its stores, which, in this case, does not coincide with the transfer of title to the products.

N2.3 The indicators in paragraph 606-10-55-39 [B37] do not persuasively affect the principal versus agent assessment in this example; the fact that the entity controls the products before they are transferred to the customers is clear from applying the principle in paragraph 606-10-25-25 [33]. Three of the indicators are not relevant in this example. The significant integration service indicator is not relevant because the specified good in this example is the product; there is no combined performance obligation. Similarly, the pricing indicator is not relevant because both parties have significant input into determining the retail price of the product. There is no credit risk in this example because the customer pays for the product in full at the time of sale.

N2.4 The remaining two indicators in paragraph 606-10-55-39 [B37] provide conflicting indications. Because the entity does not take title to, or agree to pay the manufacturer for, the manufacturer's products before they are transferred to the customer ("flash title" obtained only momentarily at the point of sale is not considered to be substantive), the manufacturer is the party that has inventory risk with respect to the products. In contrast, it is the entity that is primarily responsible for fulfilling the contract with the customer because it is the party that makes the product available for purchase by the customer in this transaction (by placing it in its store) and the party that the customer will hold responsible for the acceptability of the product (that is, the customer will expect the entity to grant a refund for a defective or otherwise returned product within a specified amount of time).

N2.5 Because the entity is a principal in the sales of the products, it recognizes revenue in the gross amount of consideration to which it is entitled in exchange for the products.