STAFF PAPER

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Project	Revenue from Contracts with Customers		
Paper topic	Principal versus agent considerations—issues emerging from TRG discussions		
CONTACT(S)	Raghava Tirumala	rtirumala@ifrs.org	+44 (0)20 7246 6953
	Henry Rees	hrees@ifrs.org	+44 (0)20 7246 6466

Purpose of the paper

1. The purpose of this paper is to obtain input and direction from the IASB on one of the issues highlighted during the discussions of the Revenue Transition Resource Group (TRG)—assessing whether an entity is a principal or an agent in the context of the recognition of revenue.

2. This paper accompanies FASB Memo No.1: *Gross Versus Net Revenue Reporting: Research Update*—that memo has been distributed to IASB members and should be read in conjunction with this paper.

Staff analysis

Background

3. When a party other than the entity is involved in providing goods or services to a customer, the new revenue Standard requires the entity to identify whether it is:

   (a) the principal in the transaction (recognising the gross amount of consideration for the goods or services transferred); or

   (b) the agent (recognising the fee or commission to which it is entitled).

4. The new revenue Standard includes guidance to help an entity assess whether it is the principal or agent.

5. At its July 2014 meeting, the TRG considered the following two issues, which are set out in the FASB memo:

   (a) **Issue 1:** Implementation questions about the principal versus agent guidance in paragraphs B34–B38 of IFRS 15 *Revenue from Contracts with Customers*.

   (b) **Issue 2:** Estimating the gross revenue if the entity is the principal but is unaware of amounts being charged directly by an intermediary to the transaction.

6. TRG agenda paper 1 (click the link to access the paper) sets out the TRG discussion on these issues.

Overview of accompanying FASB memo No.1

7. In the FASB memo, the FASB staff are seeking input and direction from the FASB on whether and how to address the principal versus agent issues identified. The paper is a research paper. Accordingly, it does not ask the FASB to make decisions to amend (or not amend) the new revenue Standard in this respect.

8. The FASB memo not only discusses issues relating to the new revenue Standard, but also issues that have arisen relating to the existing US GAAP guidance on principal versus agent. Indeed, as noted in the FASB memo, most of the implementation questions that exist regarding the principal versus agent assessment did not arise as a result of the new revenue Standard.

9. In saying that, the FASB memo highlights that some additional questions have arisen as a result of the guidance in the new revenue Standard. In addition, it notes that many US stakeholders think that the new revenue Standard does not do much to alleviate the judgement and complexity that can arise when applying the existing US GAAP guidance on principal versus agent.

10. Because of the issues identified in both existing US GAAP as well as the new revenue Standard, the FASB memo discusses possible paths that the FASB might take to improve the existing guidance as well as the guidance in the new revenue Standard.

The principal versus agent guidance in IAS 18

11. IAS 18 *Revenue* was amended in 2009 to include principal versus agent guidance (see paragraph 21 in the Illustrative Examples). The guidance is related to, but less detailed than, the guidance in existing US GAAP (eg the indicators are not weighted and there are no illustrative examples). It is based on a risks and rewards principle with five indicators. These indicators served as the basis for the indicators in the new revenue Standard.

12. Based on our outreach, it would appear that there are fewer questions about the guidance in IAS 18 compared with existing US GAAP. Nonetheless, we understand that the requirements can sometimes necessitate entities making difficult judgements particularly in newer business models, in part because some of the indicators become less relevant in those models. However, issues have not been raised at regular meetings that IASB members and staff have with regulators, accounting firms and others.

Issue 1: Implementation of the principal versus agent guidance in IFRS 15

The issues emerging from TRG discussions

13. Paragraph B34 of IFRS 15 sets out the principle for determining whether an entity is a principal or an agent, as follows:

> B34 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 (ie the entity is a principal) or to *arrange* for the other party to provide those goods or services (ie the entity is an agent). [emphasis added]

14. Paragraphs B35–B37 of IFRS 15 then explain that (a) an entity assesses whether it provides, or arranges for another party to provide, the goods or services by assessing

whether it *controls* those goods or services before the transfer; and (b) provides some indicators to help make that control assessment, as follows:

B35 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 recognises revenue in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred.

B36 An entity is an agent if the entity's performance obligation is to arrange for the provision of goods or services by another party. When an entity that is an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the other party to provide its goods or services. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

B37 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.

15. Paragraphs 13–18 of the FASB memo highlight a number of questions that have arisen with respect to this guidance:

(a) Stakeholders have different views about whether control is always the basis for determining whether an entity is the principal or agent. This difference of views mainly arises because of differing interpretations of the relationship between control and the indicators in paragraph B37 of IFRS 15:

(i) Some think that control is the basis used to determine whether an entity is a principal or an agent and that the indicators in paragraph B37 complement the assessment of control.

(ii) Others think that an entity can still be a principal even if it does not control the goods or services before transfer. They interpret the new revenue Standard to say that, first, an entity assesses whether it controls the goods or services before transfer. If it does not, it then uses the indicators in paragraph B37 (which they view as unrelated to control) to assess whether it might still be the principal in the transaction, even though it does not control the goods or services before transfer.

(b) Some stakeholders also question how to weight or apply the indicators if a transaction is such that the indicators contradict each other.

16. The FASB memo also notes that the TRG discussions have highlighted that the principal versus agent guidance is generally easier to apply to transactions for tangible goods (eg the transfer of an item of property, plant and equipment) as opposed to

services and transactions for virtual or intangible goods (eg the transfer of a virtual online game or a right to a meal in a restaurant). It is the latter transactions that have gained greater prominence in some markets. Consequently, it appears that there are greater implementation challenges arising than were anticipated when the requirements were first developed and exposed for comment. 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 the new revenue Standard.

Staff analysis of the requirements in the new revenue Standard with respect to the issues raised

The principle in paragraph B34 and control

17. The principle for determining whether an entity is a principal or an agent, set out in paragraph B34 of IFRS 15, is clear. That principle is based on determining whether the nature of an entity's promise is a performance obligation 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).

18. Control is intertwined with that principle. As noted in the FASB memo, the staff think that in order for an entity to provide a good or service, it must first control that good or service. In our view, it would appear difficult to *provide* a good or service to a customer if the entity does not first have that good or service to provide. For this reason, the staff think that the Boards intended that control before transfer would be the determining factor when assessing whether an entity is a principal or an agent. If an entity controls a good or service (for example, by obtaining control of the rights to the good or service) before that good or service is transferred to the customer, it is a principal. If the entity does not control the good or service before transfer, it is an agent and, thus, *not* a principal.

19. The Boards' considerations in this respect, and the intertwined relationship between assessing control and the principal versus agent principle in paragraph B34, are explained in the Standard and basis as follows:

(a) Paragraph B35 of IFRS 15 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’. Paragraph B37 states that ‘…an entity is an agent (and therefore does not control the good or service before it is provided to a customer)…’.

(b) Paragraph BC380 states that ‘A principal controls the goods or services before they are transferred to a customer. Consequently, the principal’s performance obligation is to transfer those goods or services to the customer…In contrast, an agent does not control the goods or services before they are transferred to a customer. The agent merely facilitates the sale of goods or services between a principal and the customer. Consequently, an agent’s performance obligation is to arrange for another party to provide the goods or services to the customer.’

20. Some might suggest that the inclusion of the principle in paragraph B34 (ie that an entity determines whether it *provides*, or *arranges* for another party to provide, goods or services to the customer) as well as control (as set out in paragraph B35) creates confusion. It might appear that two different principles apply when assessing whether an entity is a principal or an agent.

21. The staff understand that this may be confusing but, nonetheless, highlight the explanation in paragraph BC380 of IFRS 15 that explains the intertwined relationship between these two concepts—ie (a) an entity cannot be the party that *provides* the good or service without controlling it before transfer, and (b) an entity cannot be the party merely *arranging* for another party to provide the good or service if it controls that good or service before transfer.

The relationship between control and the indicators in paragraph B37

22. The TRG discussions also indicate that some of the confusion regarding the principal versus agent guidance relates to the relationship between the indicators of control in paragraph B37 of IFRS 15 and assessing control itself. This confusion, at least in part, relates to the fact that the indicators have been carried forward from IAS 18 and Topic 605, both of which had a different principle (based on risks and rewards) from that in IFRS 15.

23. The staff think that the Boards included the indicators within the new revenue Standard to help an entity determine whether it controls a good or service before transfer in scenarios when the assessment of control might be difficult. Accordingly, the Boards intended that the indicators would support the application of the principles in paragraph B34–B36 of IFRS 15—they do not override those principles nor should they be viewed in isolation. In other words, an entity should not conclude that it is the principal based only on an assessment of the indicators in paragraph B37 and, yet, determine that it does not control the goods or services before transfer.

24. Paragraph BC382 explains the Boards' considerations in this respect. It notes that 'the boards included indicators in paragraph B37 of IFRS 15 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'. The indicators in paragraph B37 are similar to those in IAS 18 (which, as noted above, includes a risks and rewards principle). Nonetheless, as explained in paragraph BC382, the indicators 'have a different purpose than previous revenue recognition requirements in that they are based on the concepts of identifying performance obligations and the transfer of control of goods or services'. Accordingly, the staff think that the Boards anticipated that the conclusions about principal versus agent under IFRS 15 could be different from those reached under existing requirements.

25. As noted in the FASB memo, some have suggested that the indicators are confusing because they do not directly answer the question of whether an entity controls goods or services before transfer (ie whether the entity has the ability to direct the use of, and obtain the benefits from, the goods or services before transfer). However, the staff think that the indicators were never intended to be factors that give an entity control—the intention was that they would be helpful because, if an indicator or indicators exist, then it is likely that the entity has control of the good or service before transfer. For example, if an entity is primarily responsible for fulfilling a contract or the entity has inventory risk, then neither of those factors give the entity the ability to direct the use of, or obtain the benefits from, a good promised in the contract before transfer. Nonetheless, if either or both of those factors exist, then it is likely that the entity also has the ability to direct the use of, and obtain the benefits from, the good before transfer.

26. The staff think that this relationship between the principle and accompanying indicators within the principal versus agent guidance is similar to the relationship between the principle and accompanying indicators in other parts of IFRS 15. For example, paragraph 33 of IFRS 15 includes the principle of control and paragraph 38 specifies indicators of the transfer of control. If an entity has a right to payment for an asset, or has transferred the significant risks and rewards of ownership of an asset (two of the indicators in paragraph 38), then it is likely that the entity has transferred control of the asset to the customer. Nonetheless, neither the obligation to pay nor having the significant risks and rewards of ownership directly provide the customer with the ability to direct the use of, and obtain the benefits from, the asset.

Identifying an entity's promise in the contract

27. The TRG discussions also indicate that the principal versus agent guidance in both existing Standards and the new revenue Standard can be difficult to apply to transactions for virtual or intangible goods. Those types of transactions are becoming increasingly common in particular markets.

28. As discussed later in the paper under 'possible ways forward for the IASB', the staff think that it may be helpful to explore possible ways to clarify the guidance in, or add examples to, IFRS 15, in particular for these types of transactions.

29. Nonetheless, and as mentioned in the FASB memo, the staff note the importance of appropriately identifying an entity's promise in a contract when assessing whether it is a principal or an agent. Doing so, we think, will be helpful in transactions for services or intangible goods. For example, as explained in BC381 and illustrated in Example 47, consider a travel agent that provides a ticket to an end customer. The ticket clearly gives rise to a performance obligation for the airline to provide a flight. But for the travel agent, being the principal would mean providing a *right* to a flight (ie a ticket) rather than providing the flight itself. Therefore, the travel agent would evaluate whether its performance obligation is a promise to provide a right to a flight or whether it is arranging for the airline to provide the flight. In other words, the fact that the travel agent will not provide the flight itself is not a relevant consideration. Instead, in assessing whether it is a principal or an agent, the travel agent would

evaluate whether it controls the right to a flight before that right is transferred to the customer.

30. Again, the boards explained their considerations in this respect in paragraph BC381: ‘The boards observed that identifying an entity’s promise (ie the performance obligation) in a contract is fundamental to the determination of whether the entity is acting as a principal or an agent. This is because identifying the nature of the entity’s performance obligation is necessary for the entity to determine whether it controls the goods or services that have been promised before they are transferred to a customer.’

Other clarifications

31. The FASB memo suggests that it might be helpful to clarify the unit of account when identifying an entity’s promise in the contract.

32. The staff think that a clarification in this respect is unlikely to be needed. This is because paragraphs B34–B36 and BC381 indicate that the Boards intended the principal versus agent assessment to be made at the level of a performance obligation, rather than the individual goods or services within one performance obligation. These paragraphs refer to determining the nature of an entity’s promise as a performance obligation, and refer to the principal or agent satisfying a performance obligation.

Possible ways forward for the IASB

33. In many respects, the implementation questions highlighted in TRG discussions already existed before IFRS 15 was issued, and thus are not caused by IFRS 15. The principal versus agent guidance included in IFRS 15 built on the previous requirements in IAS 18 and, in our view, improved upon those requirements by having a clearer principle.

34. For this reason and on the basis of the analysis in this paper, the IASB could decide that no standard setting action is needed at this time. Instead, the discussion in this and any future paper could help to educate practice on how to interpret and apply the principal versus agent guidance.

35. In saying that, the IASB could also consider exploring either:

    (a) Making limited amendments to the guidance in IFRS 15 to clarify the thought process that is already embedded within the Standard; or

    (b) Adding one or two examples, to illustrate the application of the existing principles to some of the ‘new economy’ transactions discussed above to which it is more difficult to apply the guidance.

36. This would be consistent with some of the input we received from IFRS stakeholders on the TRG.

37. The FASB memo discusses two possible approaches for amending the new revenue Standard to clarify the guidance:

    (a) The first is to amend the guidance to make clear that the control premise is the determining factor when making the principal-agent assessment. The FASB staff indicate that, in their view, this would include substantive revisions to the indicators in paragraph B37 of IFRS 15 so that each of the indicators links to control.

    (b) The second is to restructure the principal versus agent guidance around a premise different from control (eg which party is most significantly exposed to profits or losses from fulfilling the promise to the customer).

38. The FASB staff note that the first of these approaches would represent less of a change to the new revenue Standard than the second because it retains control as the determining factor when assessing whether an entity is a principal or an agent. The IASB staff prefer that option and think it is more consistent with our suggestion above of clarifying the thought process embedded in the Standard. However, the extent of the change suggested in the FASB memo might be beyond what we think is needed at this stage. Nonetheless, if the IASB were to decide to explore clarifying IFRS 15 as discussed above, then the IASB staff would monitor any amendments that the FASB might develop with a view to maintaining consistency in outcomes as far as is possible.

Staff recommendation

39. The staff recommend doing more work to find out:

(a) whether there are some minor amendments that could be made to IFRS 15 at this time that might be helpful to clarify the existing thought process, and/or

(b) whether adding one or two illustrative examples might be helpful in addressing some of the issues raised.

Question: Implementation of principal versus agent guidance
Does the IASB agree with the staff recommendation to do some further work to explore possible clarifications that could be made to the principal versus agent guidance?

Issue 2: Estimating gross revenue as a principal

The issue emerging from the TRG discussions

40. Consider the following fact pattern.

> An entity sells goods to customers through intermediaries. According to the terms of the contract between the entity and the intermediaries:
>
> - the role of the intermediaries is to arrange for the entity to provide the goods to (end) customers, ie the intermediaries are agents of the entity; and
> - the intermediaries remit a net agreed amount per unit of the good to the entity for the goods sold by them.
>
> Further, the entity is unaware of the price charged by intermediaries to customers.

41. The questions discussed by the TRG about the above fact pattern are the following:

(a) Is the transaction price for the entity:

(i) the gross amount charged by the intermediaries to end customers; or

(ii) the net amount remitted by the intermediaries to the entity?

(b) If the transaction price is the gross amount charged by the intermediaries to end customers (which the entity is not aware of), should the entity estimate the gross consideration and recognise revenue accordingly? In that case, the difference between the estimated gross consideration and the net amount remitted by the intermediaries to the entity would be recognised as commission expenses.

42. Paragraphs 19–21 of the FASB memo explain the issue. The FASB memo notes that this issue arises under existing Standards. Currently, having concluded that the intermediary is an agent:

(a) some entities estimate and recognise as revenue the gross amount of consideration that end customers would remit to the intermediary; and

(b) other entities recognise as revenue the net amount that they receive from the intermediary.

43. Some TRG members highlighted that the new revenue Standard does not address the issue and some clarification would reduce diversity in practice.

Staff analysis of the requirements in the new revenue Standard with respect to the issue raised

44. Paragraphs BC379 and BC380 explain that, when another party is involved in providing goods or services to a customer, the purpose of assessing whether an entity is a principal or an agent is to identify the nature of the entity's promise (ie performance obligation). Having assessed the nature of its promise, the entity would then determine the consideration to which it expects to be entitled for fulfilling its promise by applying the general requirements in the Standard.

45. The staff think that the principal versus agent guidance mainly applies when an intermediary is assessing whether it is a principal or an agent. When an entity is the originator of a promised good or service to be transferred to an end customer, the principal versus agent guidance may only be relevant in helping to determine whether the entity's customer is the intermediary (if the intermediary is a principal) or the end customer (if the intermediary is an agent).

46. Consequently, although this issue was discussed by the TRG in the context of the principal versus agent guidance, the staff think that the issue is not specifically about that guidance. Rather, it is about the general requirements in the Standard, for example, for identifying performance obligations and determining the transaction price.

47. Based on discussions with some IFRS stakeholders, it would appear that this is not a significant issue, even under IAS 18, for a number of reasons:

    (a) The first is because it is limited to a narrow population of contracts. Typically, when an entity is the principal in a transaction (and thus is providing promised goods or services to an end customer), the entity would know the consideration being paid by the end customer and to which it is entitled. If the entity does not know the consideration to which it is entitled, we think it might raise a question as to whether the entity's customer is the intermediary in the transaction rather than the end customer (ie that the intermediary is a principal in providing the promised good or service to the end customer, and not an agent).

    (b) Even when this scenario does arise, we understand that entities are generally able to apply judgement and make estimates about the consideration to which they are entitled having all relevant facts and circumstances available to them.

    (c) We also understand that the situations in which a principal may be unaware of the amount charged by an agent to end customers are generally limited to goods or services for which margins are thin. In those situations, the ability of the agent to charge a different price to the end customers could be considered as affecting only the fee or commission income of the agent. In other words, the agent may be willing to forego a part of its fee or commission for business reasons.

FASB staff considerations

48. The FASB memo discusses four possible views that could arise in situations in which a principal is unaware of the gross consideration collected by an agent in the

transaction. Refer to paragraphs 53–58 of the FASB memo for the analysis of the four views. The FASB staff favour View D, which is to require an entity to recognise as revenue the net agreed amount that it receives from the intermediary that is acting as its agent.

49. The FASB staff think that View D may result in the outcome that is most appropriate and could be achieved through an amendment to the variable consideration guidance without amending the principal versus agent guidance in this regard.

Staff recommendation

50. As explained above, the staff think that the issue is not about the principal versus agent guidance in paragraphs B34–B38. The general guidance in IFRS 15 would assist an entity in determining the consideration to which it is entitled depending on the nature of its promise. Further, our understanding is that the situations in which the entity (a principal) is unaware of the gross consideration collected by an intermediary in the transaction are limited to a narrow population of contracts. The FASB memo also notes that this is a narrow-scope issue.

51. For the reasons noted above, the staff recommend that no further work is done on this issue at this time. Nonetheless, we will monitor any future decisions taken by the FASB in this respect.

Question: Estimating gross revenue as a principal
Does the IASB agree with the staff recommendation to not do any further work on this issue at this time?