Principal versus agent: IASB to propose amendments to IFRS 15

What you need to know

- To clarify the principal versus agent application guidance in IFRS 15, the IASB has agreed to propose:
  - Amending the application guidance to clarify how to apply the control principle to services provided by another party
  - Amending related illustrative examples and including some additional examples to clarify how to apply the application guidance
  - The IASB will discuss the principal versus agent application guidance and these tentative decisions at a future joint meeting with the FASB.
  - Any changes to the standards will be subject to the Board’s due process procedures, including seeking public comment.

Highlights

At its May 2015 meeting, the International Accounting Standards Board (IASB or Board), decided to propose amendments to the application guidance and certain illustrative examples in its new revenue standard, IFRS 15 Revenue from Contracts with Customers, in relation to principal versus agent considerations. The IASB and US Financial Accounting Standards Board (FASB), which developed their new revenue standards jointly (together, the Boards), are expected to discuss the principal versus agent considerations, including the IASB’s tentative decisions, at a future joint meeting. The IASB will incorporate these tentative decisions in its exposure draft (ED) expected to be approved for issuance in June.

The IASB also considered the requirement in IFRS 15 to account for a series of distinct goods or services as a single performance obligation if specified criteria are met (the series requirement). In its May 2015 ED (May ED), the FASB asked its constituents whether this requirement should be changed to an optional practical expedient. However, the IASB agreed not to ask its constituents a similar question.

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1 Under US GAAP: Accounting Standards Update 2014-09, Revenue from Contract with Customers (largely codified in Accounting Standards Codification (ASC) 606)
Principal versus agent considerations
Under the new revenue standards, when a third party is involved in providing goods or services to a customer, the entity must determine whether its performance obligation is to provide the good or service itself (i.e., the entity is a principal) or to arrange for another party to provide the good or service (i.e., the entity is an agent). An entity makes this determination by evaluating the nature of its promise to the customer.² An entity is a principal (and, therefore, records revenue on a gross basis) if it controls the promised good or service before transferring it to the customer. An entity is an agent (and records as revenue the net amount it retains as a commission) if its only role is to arrange for another entity to provide the goods or services.

Because the identification of the principal in a contract is not always clear, the Boards provided the following non-exhaustive list of indicators that a performance obligation involves an agency relationship:³

- Another party has primary responsibility for fulfilling the contract
- The entity has no inventory risk before or after the goods have been ordered, during shipping or on return
- The entity does not have discretion to establish pricing for the other party’s goods or services (i.e., the benefit the entity can receive from those goods or services is limited)
- The entity’s consideration is in the form of a commission
- The entity is not exposed to credit risk for the amount receivable in exchange for the goods or services.

Interaction between control and the indicators
Discussions at the July 2014 IASB/FASB Joint Transition Resource Group for Revenue Recognition (the TRG) meeting highlighted that stakeholders are questioning how the above indicators interact with the requirement to consider whether the entity obtains control of a good or service before providing it to the end-customer. Some believe that control is the basis used to determine whether an entity is a principal or an agent and that the indicators complement this determination. Others believe that an entity first assesses whether it controls the goods or services before transfer. If it does not, only then does it consider the principal versus agent indicators to assess whether it is the principal in the transaction. Some have questioned whether the indicators should be weighted and how contradictory indicators should be considered.

At its May 2015 meeting, the IASB agreed that the determining factor would be whether the entity controls the goods or services before transfer. If the entity does not obtain control before transfer, it is an agent, not the principal. In reaching this conclusion, the Board considered the explanation in the Basis for Conclusions to the new revenue standards, which highlights that this is not a two-step process, but rather a single assessment based on control.⁴

The IASB also noted that the above indicators were included in IFRS 15 to help an entity assess whether it controls a good or service before transfer in situations where the assessment of control may be difficult.⁵ That is, the indicators support the assessment; they are not intended to be considered in isolation or viewed as a checklist. Furthermore, they need not be considered in all scenarios. As such, an entity should not conclude that it is a principal based on an assessment of the indicators, only to determine that it does not control the goods or services before transfer. Rather, if such indicators are present, an entity likely already has control.

² IFRS 15.B34
³ IFRS 15.B37
⁴ IFRS 15.BC380
⁵ IFRS 15.BC382
of a good or service before transfer. The Board also agreed with its staff that, while the indicators are similar to those currently included in IAS 18 Revenue and in US GAAP, they have a different purpose and, therefore, it is possible that conclusions about principal versus agent under IFRS 15 could be different from those reached today.

**Identifying the specified good or service**

Constituents have raised concerns with the principal versus agent application guidance, because it is difficult to determine which party controls an intangible good or service prior to its transfer to the customer and it is not always clear which party is the customer. For example, an online game developer’s customer may be the intermediary that hosts the game on its network or platform, or it may be the end-consumer. Judgement is needed to apply the above indicators to intangible goods or services because they may be more relevant in evaluating control over tangible goods. Judgement may also be needed when applying the indicators to a bundle of goods or services that are not distinct from each other.

Stakeholders also indicated that some of the challenges may be linked to identifying the specified good or service. For example, Example 47 in IFRS 15 illustrates a travel agent selling airline tickets to customers. In relation to that example, some have questioned whether the principal versus agent assessment is in respect of the flight or the ticket (which gives the right to fly).

The IASB agreed that appropriately identifying the specified good or service is important and will assist entities in determining whether they are the principal or agent in a transaction. The IASB agreed to propose amendments to Examples 45 – 48 of IFRS 15 and include some additional examples to clarify that, in order to determine the nature of its promise, an entity would:

- Identify the nature of the specified good or service to be provided to the customer (e.g., a right to goods or services or a bundle of goods or services)
- Assess whether it controls that specified good or service before it is transferred to the customer.

Furthermore, the IASB agreed to propose amendments to the application guidance to explain the application of the control principle in relation to services (i.e., what would be controlled if an entity is the principal providing a service).

**How we see it**

Under IAS 18, determining whether to present gross or net revenue for the sale of intangible goods or services is challenging and requires significant judgement.

Under IFRS 15, this determination will continue to be challenging. However, the Board’s decision to propose clarifications to the application guidance and illustrative examples would assist an entity in determining the nature of its performance obligation when other parties are involved in transferring the specified good or service to the customer.
**Series of distinct goods or services**
The new revenue standards require that a series of distinct goods or services be accounted for as a single performance obligation if they are substantially the same, have the same pattern of transfer and meet specified criteria. The determination of whether a single performance obligation is created by bundling non-distinct goods or services or through the application of the series requirement is important because the accounting treatment for the single performance obligation would vary when allocating variable consideration and when applying the contract modification and changes in transaction price requirements.

At the April 2015 TRG meeting, members questioned whether the fact that the series requirement is not optional negates the benefits that the Boards had intended. In discussing the series requirement at its May 2015 meeting, the IASB noted that the FASB has asked its constituents, in its May 2015 exposure draft, whether the series requirement should be changed to an optional practical expedient. However, the IASB agreed not to ask its constituents a similar question. The Board noted concerns that such an approach would represent a change to the standard, rather than a clarification of the requirements.

**Next steps**
The Board’s latest decisions are tentative and it will seek public comment on any changes it proposes. The IASB will also discuss the principal versus agent application guidance and its tentative decisions on that topic at a future meeting with the FASB.

In June 2015, the IASB plans to approve an ED for issuance that incorporates these tentative decisions together with those from the February and March 2015 joint Board meetings (on topics such as accounting for licences of intellectual property and identifying performance obligations) and any additional amendments it determines to be necessary.