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Gross vs. Net – Clarity on Services, Credit Risk, and Indicators

The IASB and FASB held joint board meetings on December 16, 2015 to discuss comments received by the public on the proposed guidance on Principal versus Agent Considerations (Reporting Revenue Gross versus Net). The Boards largely approved the proposed amendments with few changes. We have included highlights from the meetings below.

In an arrangement where two or more entities provide goods or services to a customer, the proposed standard states that the principal (i.e., the entity recognizing revenue gross) must control the good or service before it provides the good or service to the customer. In contrast, the agent (i.e., the entity recognizing revenue net) merely arranges for the goods or services to be provided. In these cases the agent is never deemed to control the good or service.

Some respondents suggested that it can be tricky to map a control assessment against the indicators for principal/gross accounting provided in the proposed standard. Certain respondents also had difficulty evaluating when or if an entity controls services (and certain intangible goods) when transferred to the customer.

Unit of Account

The Boards first confirmed that the unit of account to which the principal vs. agent guidance is applied is the distinct good or service or distinct bundle of goods and services, not the performance obligation itself.

Control and Indicators

The Boards attempted to clarify the relationship between the definition of control and the principal/gross indicators set forth in the new standard, noting that assessment of who has control prior to transfer to the customer is most important. The proposed standard suggests the following – indicating that the entity controls and is therefore principal when 1) the entity is responsible for fulfilling the good or service; 2) the entity has inventory risk (see discussion below regarding control of services); 3) the entity has discretion in establishing pricing (although the agent may in certain cases also have pricing discretion).

The Boards reiterated that the indicators for principal/gross accounting are intended to support the control assessment rather than override it and that some indicators may be more persuasive than others in certain cases. That being said, the Boards did not differentiate between “strong” or “weak” indicators. This may be for some issuers a point of departure from current GAAP where stronger and weaker indicators were often considered.

The Boards also noted that an entity is often the principal if it performs a significant integration service, directing the use of input goods and services to produce a combined output to the customer. The joint staff members suggested that the final standard may clarify this point further.

Finally, the Boards agreed to remove credit risk as an indicator, noting in part that credit risk is evaluated earlier when determining whether a contract exists.



Services

Respondents had expressed some confusion in applying the principal vs. agent guidance to services. In particular, some questioned how an entity could control a service before the service is transferred to the customer, because a service only exists at the moment it is delivered. The Boards affirmed that an entity can control the “right to the good or service” before it transfers that right to the customer. Such examples of services controlled by a principal before transfer to a customer may include 1) an airline ticket as a right to fly rather than the flight itself or 2) a right to provide cleaning services where the principal directs a third party cleaning service to act on its behalf.

Based on the Boards discussions, it is unclear whether the final standard will further clarify the distinction between a specified good or service and a “right to a specified good or service”.

Next Steps

The Boards suggested that there would be no additional meetings on the proposed guidance before a final Accounting Standard Update is issued.

We will continue to monitor and keep you posted. Please do not hesitate to contact us with any questions or comments.

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