

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

FASB



SUBJECT

FASB CLARIFIES PRINCIPAL VERSUS AGENT CONSIDERATIONS UNDER TOPIC 606

SUMMARY

The FASB recently issued ASU 2016-08¹ to clarify the principal versus agent guidance within the new revenue standard. However, the core principle in Topic 606² is unchanged. The ASU is available [here](#), and becomes effective concurrently with the new revenue standard, i.e., in 2018 for public entities and 2019 for all other entities.

DETAILS

Background

Topic 606 contains guidance on principal versus agent assessments when a third party is involved in providing goods or services to a customer. It specifies that an entity is a principal, and thus records revenue on a gross basis, if it controls a good or service before transferring the good or service to the customer. An entity is an agent, and thus records revenue on a net basis, if it arranges for a good or service to be provided by another entity. The guidance contains indicators and examples to assist with the analysis.

In this context, the Joint Transition Resource Group deliberated certain implementation questions relating to the principal versus agent analysis, which led the FASB and IASB to clarify their new revenue standards.

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¹ *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*

² Revenue from Contracts with Customers

Main Provisions

ASU 2016-08 clarifies the principal versus agent implementation guidance in the following areas:

- ▶ Unit of account at which the principal/agent determination is made
- ▶ Applying the control principle to certain types of transactions
- ▶ The control principle and principal/agent indicators
- ▶ Examples

Unit of account at which the principal/agent determination is made

The amendments require an entity to determine whether it is a principal or an agent for each *distinct* good or service (or a distinct bundle of goods or services) to be provided to the customer, based on paragraphs 606-10-25-19 through 25-22. If a contract with a customer includes more than one distinct good or service, an entity could be a principal for some and an agent for others.³

As part of this assessment - determining whether the entity provides a distinct good or service (principal) or merely arranges for a third party to do so (agent) - the entity should assess whether it controls each good or service before it is transferred to the customer. That is, an entity can only be a principal if it controls the good or service beforehand.

Applying the control principle to certain types of transactions

The amendments illustrate how an entity that is a principal might apply the control principle to goods, services, or rights to services, when another party is involved in providing goods or services to a customer. Specifically, an entity that is a principal could obtain control of (a) a good or another asset from the other party that it then transfers to the customer, e.g., inventory; (b) a right to a service that will be performed by another party (e.g., a cleaning service), which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf; or (c) a good or service from the other party that it combines with other goods or services to provide the specified good or service to the customer (e.g., combining specialized equipment manufactured by a third party with the entity's project management service).

The control principle and principal/agent indicators

The amendments clarify that the purpose of certain specific control indicators⁴ is to support or assist in the assessment of whether an entity controls a specified good or service before it is transferred to the customer. They do not override the control principle.

The amendments provide more specific guidance of how the indicators should be considered, and also clarify that their relevance will vary depending on the facts and circumstances.

BDO Observation: The control indicators discussed in the amendments are similar to those in existing revenue recognition guidance. However, they serve a different purpose in ASC 606, namely to assist in identifying performance obligations and in assessing the transfer of control (instead of "risks and rewards"). Because of this difference, the FASB acknowledged that some principal versus agent conclusions could be different under ASC 606 than those reached under the previous revenue recognition guidance.⁵ As a result, companies will need to carefully consider whether they serve as a principal or an agent in each of their revenue streams involving a third party as part of applying ASC 606.

³ The FASB has a related project to clarify the guidance on identifying distinct goods or services, with a final ASU expected in the near term.

⁴ See paragraph 606-10-55-39.

⁵ See BC15 - BC20 of the ASU.

Examples

The ASU revises existing examples and adds two new ones to more clearly depict how the guidance should be applied.

EFFECTIVE DATE AND TRANSITION

The effective date and transition requirements for ASU 2016-08 are the same as the effective date and transition requirements of Topic 606, specifically:

Public business entities will adopt the standard for annual reporting periods beginning after December 15, 2017, including interim periods within that year. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year.⁶

All other entities will adopt the standard for annual reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. Early adoption is permitted as of either:

- ▶ An annual reporting period beginning after December 15, 2016, including interim periods within that year, or
- ▶ An annual reporting period beginning after December 15, 2016 and interim periods within annual reporting periods beginning one year after the annual period in which an entity first applies the new standard.

INTERNATIONAL CONVERGENCE

The International Accounting Standards Board is expected to release *Clarifications to IFRS 15*, which will contain substantially converged amendments of IFRS 15.

⁶ A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files or furnishes financial statements with or to the SEC have the same effective date as public business entities.

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