

AN ALERT FROM THE BDO FINANCIAL SERVICES PRACTICE

BROKERAGE INSIGHTS

AICPA ISSUES NEW BROKER-DEALER REVENUE RECOGNITION IMPLEMENTATION ISSUE

SUMMARY

On March 1, 2017, the American Institute of Certified Public Accountants (AICPA) issued a working draft aimed at helping broker-dealers apply the new revenue recognition standard when accounting for the costs associated with underwriting services on either a gross (principal) or net (agent) basis.

The new working draft, [Issue #3-3: Principal vs. Agent: Costs Associated with Underwriting](#), is part of a [series](#) of revenue recognition implementation issues identified by the AICPA Brokers and Dealers in Securities Revenue Recognition Task Force. The task force was convened to assist the industry with implementing the [Accounting Standards Update \(ASU\) No. 2014-09](#), Revenue from Contracts with Customers. The new revenue standard is effective for calendar-year public companies in 2018.

The Principal vs. Agent working draft is open for public comment until May 1, 2017. Once finalized, the draft will be implemented in the ongoing revenue recognition guide developed by the task force.

This guidance from the AICPA is anticipated to have a limited impact on the brokerage industry's accounting standards.

Key Takeaways from *Issue #3-3: Principal vs. Agent: Costs Associated with Underwriting Guidance*

Underwriting syndicate members should evaluate whether they are principal or agent in providing underwriting services to the issuer in accordance with guidance in FASB ASC 606-10-55-36 through ASC 606-10-55-40. The lead underwriter and participating underwriters in an underwriting syndicate should conduct this analysis by assessing whether they have promised the issuer that they would provide the specified goods or services themselves (acting as principal) or arrange for them to be provided by the other party (acting as agent). This would include an assessment of whether they control the specified goods or services to be provided to the customer before these goods or services are transferred to the customer.

FASB ASC 606-10-55-37A indicates that when another party is involved in providing goods or services to a customer, an entity is defined as a principal if it obtains control of any one of the following: i) a good or asset from the other party that it then transfers to the customer; ii) a right to direct that party to provide one of its services to the customer on the entity's behalf; or iii) the opportunity to combine the other party's goods or services with other goods or services to the customer.



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FASB ASC 606-10-55-39 provides indicators that an entity controls the specified good or service. A lead underwriter could evaluate these as follows:

- ▶ Primary responsibility for fulfilling the contract: Each underwriting syndicate member is legally responsible to perform services for the issuer and is liable under the terms of the contracts. The lead underwriter, however, plays more of an agent role as it negotiates with the issuer on behalf of the entire syndicate.
- ▶ Inventory risk before or after the goods have been ordered, during shipping, or upon return: Each underwriting syndicate member is obligated to pay the service providers even if they do not perform as promised. The lead underwriter doesn't have inventory risk because it doesn't purchase the participating underwriters' services at any time, and so is indicative of an agent relationship.
- ▶ Discretion in establishing the price for the specified good or service: While the lead underwriter negotiates the agreements between the issuer and syndicate members, it doesn't necessarily have greater influence on pricing than the other syndicate members. Underwriting syndicate members also have limited discretion on pricing. Thus, lead underwriters and syndicate members can have either a principal or agent relationship in this case, depending on the scenario.

AICPA's Financial Reporting Executive Committee (FinREC) generally believes that the role of the underwriting syndicate members, including the lead and participating underwriters, is that of a principal because the underwriter obtains control of the services and combines them with other services when fulfilling its performance obligation. Thus, each underwriter should reflect their proportionate share of the underwriting costs on a gross basis in the statement of earnings in accordance with ASC 606-10-55-37B.

FinREC generally believes that the role of the lead underwriter with regard to services provided by the participating underwriters is that of an agent because the underwriter does not obtain control over the other syndicate members' services. Thus, the lead underwriter should record underwriting revenues net of revenues allocated to the participating members and expenses incurred net of the expenses that are allocated to the participating members in accordance with ASC 606-10-55-38.

FASB ASC 940-340-25-3 states that underwriting expenses incurred before the actual issuance of the securities shall be deferred.

FASB ASC 940-340-35-3 states that underwriting expenses deferred shall be recognized at the time the related revenues are recorded. In the event that a securities transaction is not completed, the entities involved shall write those costs off to expense.

Registered broker-dealers should be prepared to identify which role they are playing (lead or participating underwriter, or syndicate member) when working with issuers. They should also understand how each role will affect their financial reporting.

The AICPA has also issued for comment working draft [Issue # 3-3a: Costs Associated with Investment Banking Advisory Services](#). Comments on this working draft are also due May 1, 2017.

BDO's Financial Services practice stands ready to assist broker-dealers with understanding the new requirements and making the necessary adjustments to comply.

The BDO Revenue Recognition Resource Center can be accessed [here](#).

A special thank-you to Marcelo Suarez and Gani Lopez for their assistance with this article.

For more information about how your organization can incorporate the new AICPA broker-dealer revenue recognition implementation issue, contact

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