STAFF PAPER

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Project	**FASB/IASB Joint Transition Resource Group for Revenue Recognition**		
Paper topic	Gross versus Net Revenue: Amounts Billed to Customers		
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Purpose

1. Some stakeholders informed the staff that there may be multiple interpretations of the application of the guidance in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, and IFRS 15 *Revenue from Contracts with Customers* (collectively referred to as the "new revenue standard") in determining whether to present certain items billed to customers as revenue or as a reduction of costs. Examples of those amounts billed to customers include shipping and handling fees, reimbursements of other out-of-pocket expenses, and taxes or other assessments collected from customers and remitted to governmental authorities for which explicit guidance in U.S. GAAP was superseded by the new revenue standard. This paper includes a summary of the potential implementation issue that stakeholders have reported to the staff related to these items. The staff plans to ask the members of the FASB-IASB Joint Transition Resource Group for Revenue Recognition for their input about the potential implementation issue.

Accounting Guidance

2. Under the new revenue standard, entities will apply the principles described below to determine whether to include certain amounts billed to customers in revenue.

Core Principle

3. Paragraph 606-10-05-3 (IFRS 15, paragraph IN7) states that the core principle of the new revenue standard is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Promises in Contracts with Customers

4. Paragraph 606-10-25-17 (IFRS 15, paragraph 25) states that performance obligations do not include activities that an entity must undertake to fulfill a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

Determining the Transaction Price

5. Paragraph 606-10-32-2 (IFRS 15, paragraph 47) states that an entity should consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).

Principal versus Agent Considerations

6. Paragraphs 606-10-55-36 through 55-40 (IFRS 15, paragraphs B34-B38) include items an entity should consider in determining whether it is the principal in providing a good or a service to a customer or whether it is an agent of another entity. Under this guidance, an entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for the other party to provide those goods or services (that is, the entity is an agent).

7. An entity should determine who controls the goods or services before the transfer to the customer. A principal controls the goods or services before they are transferred to customers. When an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred.

8. In contrast, an entity is an agent if its 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 recognizes 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.

9. Paragraph 606-10-55-39 (IFRS 15, paragraph B37) includes the following indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer):

   (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.

Potential Implementation Issue Reported by Some Stakeholders

Issue: How should entities determine the presentation of amounts billed to customers under the new revenue standard?

10. The guidance on transaction price in paragraph 606-10-32-2 (IFRS 15, paragraph 47) states that the transaction price should *exclude* “amounts collected on behalf of third parties.”[1]

11. Conversely, if an entity is *not* collecting an amount *on behalf of* a third party (for example, on behalf of a government or another service provider), that amount should be included in the transaction price. Sometimes it may not be entirely clear whether or not the amounts are collected on behalf of third parties. In those cases, some stakeholders have expressed the view that an entity should apply the principal-agent framework in the new revenue standard to determine whether it is merely a conduit for the amounts collected or whether it is the principal with respect to the obligation. An entity could use the principal-agent framework to help it to determine whether the customer is compensating the entity for a cost it incurred to provide a good or service (that is, as a principal) or, instead, whether the entity is arranging for the customer to pay its (the customer’s) obligation to another party (that is, acting as an agent).

12. The principal versus agent implementation guidance assists an entity in determining whether the nature of its promise is a performance obligation to provide the specified goods or services itself or to arrange for another party to provide services. For items such as shipping and handling fees and other out-of pocket expenses, this guidance is applicable because those costs are incurred by the entity as part of satisfying a performance obligation. Since taxes and other assessments are generally an obligation to a governmental authority, rather than to a customer, the principal versus agent guidance is applied by analogy.

13. Below are some considerations about how stakeholders note that the principal versus agent guidance could be applied in determining how to present some common amounts billed to customers.

    (a) *Shipping and handling fees*—In determining whether it is a principal or an agent for shipping and handling, an entity might consider whether:

[1] Under existing IFRS (IAS 18, paragraph 8), amounts collected on behalf of third parties are excluded from revenue.

(i) The entity is responsible for directly providing or for procuring the service (including supplier selection).

(ii) The entity has discretion in setting the price charged for the shipping and handling to the customer (for example, entities often charge customers more or less than the costs incurred).

(iii) The entity's profit or loss on the shipping and handling is not fixed (if the entity has pricing discretion, the margin the entity earns, or incurs in the case of providing free or significantly discounted shipping and handling, is variable).

(iv) The entity bears the credit risk with respect to those fees. For example, if the entity is providing the shipping and handling services itself or if it is responsible for payment to the shipping provider regardless of its ability to collect the shipping and handling fees billed to the customer.

(b) *Other out-of-pocket expenses*—Shipping and handling fees are often a type of out-of-pocket expense. Therefore, the considerations summarized above for shipping and handling fees often would be similar to the considerations for other out-of-pocket expenses, except that in many arrangements, the entity is required to bill the customer for the amount incurred.

(c) *Taxes and other assessments remitted to governmental authorities*—In determining whether the entity is a principal or an agent with respect to taxes and other assessments, one or more of the following might indicate that the entity is the principal (and therefore that the entity would present the billings as revenue and the remittances as a cost).

(i) The entity is primarily responsible for fulfilling the obligation (that is, the entity is primarily responsible for the tax or other assessment). For example, U.S. telecommunications companies historically have been required to pay Universal Service Fund (USF) fees to the

U.S. Federal Communications Commission based on their revenues. They are responsible for that assessment regardless of whether they choose to seek full or partial reimbursement of that assessment through billings to their customers. In contrast, in some jurisdictions, the customer may be responsible for payment of sales (or use) taxes even though the jurisdiction may require the entity to collect the tax from the customer and remit the entire amount to the jurisdiction. If the entity (for example, an internet vendor) does not collect the tax, the customer may be responsible for remitting the applicable sales or use tax to the appropriate jurisdiction.

(ii) The entity has latitude with respect to the amount charged to the customer. Continuing with the examples above, entities that are required to collect sales tax from customers are required to do so at the amount owed to the jurisdiction and remit that amount to the jurisdiction, while U.S. telecommunications companies make their own decision about whether and how they recover the costs of their USF assessment from their customers.

(iii) The amount retained by the entity is *not* fixed. In the case of many sales taxes, the entity is required to remit what it collects and, therefore, its retention is fixed (at zero). Conversely, if the entity has discretion as to whether or how much it collects from the customer, then its margins on the tax or other assessment are not fixed and the price represents a business decision about the price customers will be willing to pay for its goods or services.

(iv) The entity has credit risk. If the entity is solely responsible for payment of the full tax or other assessment amount, regardless of whether it collects any amounts it has billed to its customers, it would have credit risk.

14. Other stakeholders have raised questions with respect to the guidance in paragraph 606-10-32-2 (IFRS 15, paragraph 47) that states that the transaction price should include only “the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.” Those stakeholders question whether there is, as a result of the definition of *transaction price*, a possible distinction between items such as reimbursements of out-of-pocket expenses or shipping and handling fees charged as part of fulfilling a promised good or service and collections for taxes or other assessments by governmental authorities.

15. Some assert that out-of-pocket expenses, including shipping and handling fees, are generally incurred by the entity in fulfilling its performance obligation(s) to the customer, and, therefore, the amounts billed to the customer represent consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. They assert that the fees are no different than the transaction price of a good representing “reimbursement” for the costs to produce that product (for example, the cost of each item of raw material, labor, depreciation on manufacturing equipment).

16. With respect to collections of taxes or other assessments, some stakeholders note that it is not clear whether those amounts represent consideration to which the entity expects to be entitled *in exchange for transferring promised goods or services to a customer*. In addition, they note that it can vary depending on the nature of the sales tax or other assessment from a governmental entity. Those billings may not relate to the entity’s fulfillment of a promised good or service. This may be evident in circumstances when the price of the good or service varies among jurisdictions by the statutorily mandated tax or assessment amount. For example, when a good is sold over the internet, a sales tax amount is added (or not added) at time of checkout based on where the customer resides. In addition, in some jurisdictions, certain types of entities might not be required to pay sales tax for certain products, while other types of entities are required to pay sales tax for the same products. In those examples, since the price variation is entirely attributable to the tax (and not attributable to any incremental performance), some assert that the tax amount should not be considered to be part of the consideration to which the entity is

entitled in exchange for transferring the promised good or service to the customer. Those amounts would, therefore, be excluded from revenue.

17. Other stakeholders assert that a principal-agent analysis of the nature described above is appropriate to determine whether those amounts should be considered part of the transaction price because an obligation *of the entity* to a governmental authority that is required in order for the entity to conduct business is no different than other costs of the entity that are paid with the proceeds from the entity's sales. For example, assume an entity sells a product to a customer for CU 100 and, as a direct result of that sale, owes a third party a sales commission of CU 10 and owes a governmental authority a tax on the transaction of CU 8. There appears to be no substantive difference between the third-party commission and the tax. The two costs were incurred as a direct result of the specific sale transaction, and neither the commission nor the tax provide any additional good or service to the customer beyond the product purchased.

Questions for the TRG Members
1. What are your views about the potential implementation issue included in this paper?
2. Are you aware of other interpretations for the issue that are not included in this paper?
3. Are there any related potential interpretation issues not included in this paper?