

**Accounting Standards Board of Japan (ASBJ)**

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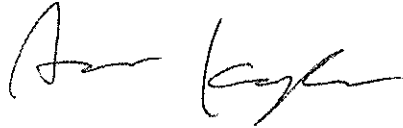
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**Re: Comments on *Principal versus Agent Considerations (Reporting Revenue Gross versus Net) - Revenue from Contracts with Customers (Topic 606)***

1. The Accounting Standards Board of Japan (the “ASBJ” or “we”) welcomes the opportunity to provide comments on the Financial Accounting Standards Board’s (the “FASB”) Proposed Accounting Standards Update (the “ED”) *Principal versus Agent Considerations (Reporting Revenue Gross versus Net) – Revenue from Contracts with Customers (Topic 606)*.
2. We understand that the ED proposes to clarify or amend some of the requirements in Topic 606 *Revenue from Contracts with Customers* in an attempt to address the concerns from US constituents. We support some of the proposals in the ED, because we find they would help entities to understand principles when implementing the requirements of Topic 606.
3. In addition, we greatly appreciate that the FASB and the International Accounting Standards Board (the “IASB”) have made a consistent proposal to revise the guidance for determining whether an entity is a principal or an agent. As the determination of whether an entity is a principal or an agent would have significant effects on the entity’s revenue amount recognized, we believe that it is highly desirable to maintain the proposed level of convergence when finalizing the Standard. At the same time, however, we believe that further improvement should be considered taking into account the importance of the determination.
4. For our comments on specific questions in the ED, please refer to the Appendix of this letter.
5. The ASBJ hopes that our comments will be helpful for the FASB’s future deliberations. If you have any questions, please feel free to contact us.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Atsushi Kogasaka', written in a cursive style.

Atsushi Kogasaka

Vice Chairman of the Accounting Standards Board of Japan

Chairman of the Technical Committee for Revenue Recognition in the ASBJ

## Appendix

### Comments on Specific Questions in the ED

**Question 1:** The proposed amendments to paragraph 606-10-55-36 clarify the unit of account (the “specified good or service”) at which an entity would determine whether it is a principal or an agent and clarify that an entity can be both a principal and an agent in a single contract. Would the proposed amendments improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

6. We agree with the proposed amendments to paragraph 606-10-55-36, because we believe that the proposal would be helpful for an entity to decide whether it controls a good or service in a contract before it transfers to the customer, whereby it is a principal or an agent.

**Question 2:** Paragraph 606-10-55-37A clarifies application of the control principle to certain types of arrangements by explaining what a principal controls before the specified good or service is transferred to the customer. Would the proposed amendments improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

7. Although we generally agree with the proposed amendments, we believe that further improvement should be made. The following paragraphs will explain our views as to how paragraph 606-10-55-37A of the ED could be amended.
8. On deliberating our comments on the ED, we found it difficult to understand the interaction between paragraph 606-10-55-37A (that explains when an entity obtains control of either a good or service, a right to service, the specified good or service to the customer) and paragraph 606-10-55-39 (that provides indicators for an entity to determine if it controls the specified good or service).
9. We find paragraph 606-10-55-37A (c) of the ED especially confusing, because the paragraph seems to explain that an entity controls the specified good or service when an entity provides a significant service of integrating goods or services provided by another party into the specified good or service that the customer has contracted, while not explaining if “significant service of integrating goods or

services” is intended to convey the same meaning of the term as used in paragraph 606-10-25-21 of Topic 606.

10. In addition, we are not sure if paragraph 606-10-55-37A(c) of the ED is intended to presume that an entity *always* controls the specified good or service when it provides a significant service of integrating goods or services provided by another entity, because the paragraph and the relevant Basis for Conclusions do not sufficiently explain how the provision of significant integration service should (or is likely to) satisfy the notion of ‘control’ set forth in Topic 606.
11. Accordingly, we suggest the FASB consider making the following changes to paragraph 606-10-55-37A of the ED:
  - (a) Clarifying the focus of the paragraph to be more in line with the intention of the paragraph. As we reviewed the paragraph, we find that there is a disconnect between the proposal and the reasons that the FASB proposes to add the paragraph (which we understand is to explain how the control principle could be applied to services to be provided to a customer.) Specifically, the second and third sentences of paragraph 606-10-55-37A (c) of the ED seems to provide guidance to determine *when* control is obtained as opposed to *how* control is obtained. In addition, some of the wordings (such as “another asset”) of paragraph 606-10-55-37A (a) are difficult to understand. It might be helpful if the FASB redraft paragraph 606-10-55-37A to better align it with the intended purpose.
  - (b) Relocating the essence of the second and third sentences of paragraph 606-10-55-37A (c) to paragraph 606-10-55-39 so as to better explain whether and how an entity obtains control of the specified good or service when the entity provides a significant service of integrating goods or services provided by another party. We think that there is a potential conflict between paragraphs 606-10-55-37A and 606-10-55-39 of the ED in terms of roles and contents, and relocating these sentences will make it easier for an entity to understand how to determine whether an entity controls the specified good or service before it is transferred to the customer.

**Question 3:** The proposed amendments to paragraph 606-10-55-39 provide indicators of when an entity controls the specified good or service before it is transferred to the

customer and, therefore, would be a principal. The amendments also clarify the relationship of each indicator to the control principle in paragraph 606-10-55-37. Paragraph 606-10-55-39A was added to explain that the indicators may be more or less relevant to the principal versus agent assessment depending on the nature of the arrangement and that different indicators may provide more or less persuasive evidence about whether the entity controls the specified good or service before it is transferred to the customer in different contracts. Would the proposed amendments improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

12. We do not think that the proposed amendments to paragraph 606-10-55-39 sufficiently improve the operability and understandability of the principal versus agent guidance in Topic 606. Therefore, we believe that further improvement should be made. The following paragraphs will explain our views as to how 606-10-55-39 of the ED could be amended.
13. We understand the FASB's intention to amend paragraph 606-10-55-39 of Topic 606 is to address questions regarding a relationship between the control principle and indicators set forth in the paragraph. However, we think that the proposed amendments to paragraph 606-10-55-39 in the ED may not have been sufficiently aligned with the notion of 'control' which is a key requirement of Topic 606. We worry that the proposed indicators may still be seen to have been derived from indicators which were understood to be indicators of 'risks and rewards' set forth in the previous revenue Standards (Topic 605).
14. As for the notion of 'control', paragraph 606-10-25-25 of topic 606 explains that for an entity to control an asset, the entity must have both (i) the ability to direct the use of the asset and (ii) the ability to obtain substantially all of the remaining benefit from the asset. Considering the fundamental importance of the notion, we believe that there should be a clearer link between the two factors of 'control' and relevant guidance to support an entity's judgment as to whether control exists. In order to accomplish the objective, we suggest the following changes to paragraph 606-10-55-39 of the ED:
  - (a) Explaining the two factors of the notion of 'control' explicitly;
  - (b) Replacing indicator (a) of paragraph 606-10-55-39 of the ED with two separate indicators;

- (c) Incorporating the essence of the second and third sentences of paragraph 606-10-55-37A (c) of the ED into the factors for the notion of 'control' (see paragraph 11 (b) of this letter.);
  - (d) Adding other indicators that would assist an entity to determine whether it controls the specified good or service to 606-10-55-39 of the ED;
  - (e) Expanding the explanations of the indicators, where they are deemed necessary or helpful; and
  - (f) Adding a new paragraph (paragraph 606-10-55-39B) to acknowledge that an entity is presumed not to control the specified good or service thus is an agent, unless the entity is able to demonstrate that it controls the specified good or service.
15. Although there is not a consensus among market constituents in Japan as to how to make wording changes to the proposals in the ED, as an example, alternative wordings may look like as follows (underlines and strikeouts are added by us from the proposal in the ED):

~~606-10-55-39 Indicators that an entity controls the specified good or service before it is transferred to the customer include, but are not limited to, the following:~~ In order for an entity to decide whether it is a principal or an agent, the entity shall assess whether it controls each specified good or service before it is transferred to the customer. In the assessment, the entity shall consider both (i) whether it has the ability to direct the use of the specified good or service and (ii) whether it has the ability to obtain substantially all of the remaining benefits from the specified good or service. Indicators that would assist the entity's determination include, but are not limited to, the following:

- a. Where an entity provides a service of integrating goods or services provided by another party into the specified good or service for which the customer has contracted, the entity's service of integrating goods or services involves a significant degree of transformation. In that case, the entity has the ability to control the specified good or service, because the other entity is considered to provide inputs to the specified good or service as a combined item before that good or service is transferred to the customer.
- b. The entity has inventory risk before the specified good or service has been transferred to a customer or after that transfer (for example, on return). ~~For example, if~~ The inventory risk encompasses the risk of incurring potential losses

from a loss or damage of inventories as well as those from a decay of unsold items. The degree of the inventory risk should be assessed based on its substance rather than solely based on a contractual arrangement between an entity and another party. If the entity obtains, or commits to obtain, the specified good or service before obtaining a contract with a—the customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.

- c. The entity has a legal title to the specified good or service without granting substantive rights to other parties. If the entity has such a legal title, this may indicate that the entity has the ability to direct the use of the specified good or service. However, when it obtains the legal title only momentarily before the specified good or service is transferred to the customer, it does not necessarily control the specified good or service.
- d. The entity is primarily responsible for deciding the timing and manner in which the specified good or service is deployed as part of its sales activities. This typically includes the entity's ability to decide when and how it will allocate the specified good or service as part of its sales activities. If the entity is primarily responsible for making the decision, this may indicate that the entity has the ability to direct the use of that good or service.
- e.e. The entity has discretion in establishing prices for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.
- a.f. The entity is primarily responsible for ~~fulfilling promise to provide the specified good or service.~~ providing assurance that the specified good or service complies with an agreed-upon specification. This typically ~~includes responsibility for the acceptability of the specified good or service.~~ The entity's responsibility is typically demonstrated by its acceptance of the responsibility to replace or repair a defective good that it has provided to a customer or re-perform a service to a customer when the service is found not to be in compliant with the agreed-upon specification. If the entity is primarily responsible for ~~fulfilling the promise to provide the specified good or service,~~ this may indicate that the other party

~~involved in providing the specified good or service is acting on the entity's behalf. providing assurance that the specified good or service complies with an agreed-upon specification, this may indicate that the entity has the ability to obtain substantially all of the remaining benefits from the good or service before it is transferred to the customer.~~

~~d. Subparagraph superseded by Accounting Standards Update 2015-XX.~~

~~e.g. The entity is exposed to credit risk for the amount receivable from the customer in exchange for the specified good or service. For example, if the entity is required to pay the other party involved in providing the specified good or service regardless of whether it obtains payment from the customer, this may indicate that the entity is directing the other party to provide goods or services on the entity's behalf, exposed to substantial risks, and has the ability to obtain substantially all of the remaining benefits from the specified good or service before it is transferred to the customer. However, in some cases, an agent may choose to accept credit risk as part of its overall service of arranging for the provision of the specified good or service.~~

606-10-55-39A The indicators in paragraph 606-10-55-39 may be more or less relevant to the assessment of control depending on the nature of the specified good or service and the terms and conditions of the contract. In addition, different indicators may provide more persuasive evidence in different contracts.

~~606-10-55-39B Sometimes, the determination of whether an entity controls the specified good or service is equivocal, when another party is involved in providing the specified good or service to a customer by the entity. For example, as the degree of significance of an entity's additional service using good or service provided by another party becomes higher, the more likely that the entity concludes that it controls the specified good or service. However, unless the entity is able to demonstrate that the entity controls the specified good or service, there is a presumption that the entity does not control the specified good or service thus is an agent.~~

16. In addition, although we agree with the proposal to remove the indicator relating to a form of consideration (which corresponds to paragraph 606-10-55-39 (d) of Topic 606), we suggest that the FASB sufficiently explain why it is deleted. We understand that a form of consideration would not fit well in the context of the discussion as to whether 'control' exists or not; however, this indicator has been a good reference point in practice when determining whether an entity is a principal



or an agent, and it may continue to be the case in some practical applications of Topic 606. Therefore, it would be helpful if paragraph BC17 (c) of the ED could be redrafted to better communicate the reasons for deletion.

**Question 4:** Would the revisions to the principal versus agent illustrative examples (Examples 45 through 48) and the added illustrative examples (Examples 46A and 48A) improve the operability and understandability of the principal versus agent guidance in Topic 606? If not, please explain why and suggest alternatives.

17. Although we generally agree with revisions to the principal versus agent illustrative examples, we suggest that the FASB consider making additional conforming amendments to explanations in relevant Illustrative Examples (Examples 45 to 48A).
18. We have the impression that explanations given in these examples are somewhat random, in that some examples support the conclusion almost solely by reference to an entity's ability to direct the use of goods or services whereas others explain the conclusion by reference to two factors of 'control' more extensively. Although we generally agree with the conclusions in the examples themselves, we think that our proposal could help the FASB provide insights in a more consistent manner in the examples.