STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	Principal versus Agent: Software Reseller (IFRS 15)	
Paper topic	Initial consideration	
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission asking whether, in applying IFRS 15 *Revenue from Contracts with Customers*, a reseller of software licences is a principal or agent.

2. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure of the paper

3. This paper includes the following:

   (a) background information (paragraphs 5–7);

   (b) outreach (paragraphs 8–9);

   (c) staff analysis and conclusion (paragraphs 10–40); and

   (d) analysis of whether to add a standard-setting project to the work plan (paragraphs 41–44).

4. There are three appendices to the paper:

   (a) Appendix A—proposed wording of the tentative agenda decision;

   (b) Appendix B—submission; and

   (c) Appendix C—paragraphs 27–30 of IFRS 15.

Background information

The fact pattern

5. Appendix B to this paper reproduces the submission, including details about the fact pattern. We have summarised the main facts considered in our analysis based on that fact pattern:

   (a) the reseller has distribution agreements with a range of software manufacturers. Each distribution agreement:

      (i) gives the reseller the right to grant (sell) the manufacturer's standard software licences to customers;

      (ii) requires the reseller to provide pre-sales advice to each customer—before the sale of the software licences—to identify the type and number of software licences that would meet the customer's needs;

      (iii) makes the reseller liable for damages to the software manufacturer if, for example, the customer—acting on the reseller's advice—purchases an insufficient number of software licences; and

      (iv) provides the reseller with discretion in pricing the software licences for sale to customers.

   (b) the nature of the pre-sales advice depends on the customer's needs—the advice might include, for example, checking whether the preferred licensing solution is most advantageous for the customer considering its infrastructure and needs. If the customer decides:

      (i) not to purchase software licences, it pays nothing.

(ii) to purchase software licences, the reseller negotiates the selling price with the customer, places an order with the software manufacturer on behalf of the customer (and pays the manufacturer), and invoices the customer for the agreed price.

(c) the software manufacturer provides the customer with the standard software licences ordered—issued in the customer's name—via a software portal and with the key necessary for activation. The software manufacturer enters into an agreement with the customer, which specifies:

(i) the customer's right to use the software;

(ii) a warranty covering the software's functionality; and

(iii) the term of the software licence and general pricing (the pricing structure provides the reseller with discretion in pricing the licences).

(d) if the reseller advises the customer to order an incorrect type or number of software licences (that fail to meet the customer's needs), the customer may not accept the licences. The reseller is unable to return unaccepted licences to the software manufacturer or sell them to another customer—the reseller is therefore liable if the customer does not accept ordered licences. Under civil law in the reseller's jurisdiction, the reseller is also liable for damages in the event of providing wrong advice with respect to the properties of the items purchased and other circumstances relevant to the customer.

The question

6. The submitter asks whether—in the fact pattern described—the reseller is a principal or agent with respect to the standard software licences provided to the customer.

7. The submission excludes from the scope of the question after-sales services the reseller provides to the customer. The submitter says such services are distinct from other promises in the contract.

Outreach

8. The purpose of any outreach we perform is mainly to understand whether the matter raised has widespread effect and has, or is expected to have, a material effect on those affected.

9. We decided not to perform outreach on this submission because we obtained information about the widespread and material effect of the matter raised from other sources:

   (a) the submitter provided us with publicly available financial statements of resellers in various jurisdictions and, through informal discussions with stakeholders, we are aware that fact patterns similar to that described in the submission are common in the software sector.

   (b) we are aware from the Board's work in developing IFRS 15 and the clarifications to IFRS 15 (issued in 2016)—and from informal discussions with stakeholders on IFRS 15 implementation—that principal versus agent considerations are frequently discussed in practice. We understand that the recognition of revenue as a principal or agent has a material effect on many entities affected.

Staff analysis

10. Assessing whether an entity is a principal or agent has historically proven to be a difficult assessment in some situations, and in particular in the context of contracts that involve intangible goods or services. The assessment depends on the specific facts and circumstances, which can include consideration not only of the terms and conditions of the contract between the entity and the customer, but also of any contract between (a) the entity and another party involved in providing the goods or services, and (b) the other party and the customer. Contracts or circumstances that might appear similar (or the same) may not be so when all relevant facts and circumstances are considered.

11. IFRS 15 contains requirements that specify how to determine whether an entity is a principal or agent—those requirements in paragraphs B34–B38 set out a framework for how an entity makes the determination. Paragraphs B34 and B34A state:

> B34. When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by the other party (ie the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 27–30). …
>
> B34A. To determine the nature of its promise (as described in paragraph B34), the entity shall:
>
> (a) identify the specified goods or services to be provided to the customer…; and
>
> (b) assess whether it controls (as described in paragraph 33) each specified good or service before that good or service is transferred to the customer.

12. In analysing the question submitted, we have therefore considered:

(a) how to identify the specified goods or services to be provided to the customer by considering the requirements in IFRS 15 for identifying performance obligations (see paragraphs 13–26 of this paper); and

(b) how to assess whether the reseller controls each specified good or service before that good or service is transferred to the customer (see paragraphs 27–37 of this paper).

Identifying the specified goods or services to be provided to the customer

What IFRS 15 says

13. Paragraph B34 states that a specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. The first step in identifying each distinct good or service is to assess the goods or services promised in the contract with the customer. In this respect, paragraph 24 states:

> A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the performance obligations identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.

14. Having assessed the goods or services promised in the contract with the customer, an entity then identifies—applying paragraphs 27–30—each distinct good or service (or distinct bundle of goods or services) to be provided to the customer. Appendix C to this paper reproduces paragraphs 27–30 of IFRS 15.

Applying the applicable requirements to the fact pattern submitted

Assessing the goods or services promised in the contract

15. In the fact pattern submitted, the contract with the customer includes an explicit promise to transfer a specified type and number of standard software licences to the customer.[1] The contract does not explicitly promise to provide pre-sales advice to the customer; however, the submitter's view is that the contract includes an implicit

[1] The contract with the customer also includes an explicit promise to transfer after-sales services to the customer. As noted in paragraph 7 of this paper, the submitter says those after-sales services are distinct. Consequently, we have not considered those services in analysing whether the reseller is a principal or agent for the sale of the standard software licences.

promise to transfer such a service to the customer. Appendix B to this paper includes arguments in support of this view.

16. We disagree. Based on our understanding of the facts, in our view the pre-sales advice—while important—is not an implicit promise in the contract. This is because, at the time of entering into the contract with the customer, there is no valid expectation of the customer that the reseller *will* transfer a consulting service to the customer. At the time of entering into that contract, the reseller has already provided the advice. That advice might have influenced the customer's decision to order a particular type and number of software licences. However, at that time of entering into the contract with the customer, there is no further advice to be provided by the reseller to the customer (other than as part of the after-sales services), and the advice already provided will not—and cannot—be transferred to the customer after contract inception.

17. In reaching this view, we note our understanding that the pre-sales advice relates to advising the customer on the type and number of standard software licences to order. If the customer decides not to order any software licences, the reseller and the customer do not enter into a written contract and the customer pays nothing.

18. In the fact pattern described in the submission, we therefore conclude that the promised goods in the contract with the customer are the standard software licences. The software licences therefore represent the specified good to be provided to the customer, as described in paragraph B34A(a).

Liability for damages in the event of wrong advice—is it a promised service?

19. In the fact pattern submitted, under civil law the reseller is liable for damages in the event of providing wrong advice to the customer with respect to the properties of the items to be purchased and other circumstances relevant to the customer. In the submitter's view, this provides evidence that the pre-sales advice is a consulting service implicitly promised in the contract with the customer.

20. The reseller's potential liability for damage under civil law does not change our view as to whether the pre-sales advice is a promised service in the contract. However, the reseller may need to consider whether the legislation, itself, results in a promise to the customer. Based on our understanding of the fact pattern submitted, the legislation

does not provide the customer with a warranty in connection with the sale of a product (as described in paragraphs B28–B32) that could be considered to be part of the contract with the customer. Consequently, in our view the reseller would apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in accounting for its obligation arising from the legislation.

Assessing whether each promised good or service is distinct

21. Because we have concluded that there is only one specified good to be provided to the customer (other than the after-sales services that the submitter says are distinct), the reseller does not need to consider the requirements in paragraphs 27–30.

22. Nonetheless, in the light of the arguments provided in the submission (see Appendix B), we think it may be helpful to discuss some aspects of the application of paragraphs 27–30 (see Appendix C). For this purpose, paragraphs 23–25 below assume the promised goods and services in the contract comprise (a) the standard software licences; and (b) advisory services with respect to the type and number of licences ordered.

23. Applying paragraph 27, the reseller would assess whether:

    (a) the customer can benefit from the standard software licences either on their own or together with other resources that are readily available to the customer (ie the licences are capable of being distinct); and

    (b) the reseller's promise to transfer the standard software licences to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the licences is distinct within the context of the contract).

24. We would conclude that paragraph 27(a) is met—the licences are capable of being distinct. The licences are standard licences. Although the reseller does not sell the licences without providing advice, the software is functional on its own and the customer can benefit from it, for example, by installing the software on computers it owns or can readily purchase.

25. We would also conclude that paragraph 27(b) is met—the promise to transfer the licences is distinct in the context of the contract. The licences are standard licences—there is no transformative relationship between the advice and the software licences in

the process of fulfilling the contract. Although the customer benefits from the pre-sales advice and that advice may, for example, change the type or number of licences ordered by the customer, the advice does not transform the software licences themselves. In our view:

(a) the reseller is not providing a significant integration service (paragraph 29(a)). The entity has promised to provide pre-sales advice to the customer and then a specified type and number of standard software licences. The reseller has not promised to combine the advice and the licences in a way that would transform them into a combined output.

(b) the reseller's advice does not significantly modify or customise the software licences (paragraph 29(b)).

(c) the advice and the licences are not highly interdependent or highly interrelated (paragraph 29(c)). The reseller is, by contract, unable to provide the software licences to the customer without providing the pre-sales advice; however, the reseller would otherwise be able to fulfil its promise in the contract to provide the licences independently of providing the advice, and vice versa. The contractual requirement for the reseller to provide advice when it sells software licences to a customer does not change the assessment of whether the licences and the advice are distinct—this is because it does not change the characteristics of the licences or the advice themselves, nor does it change the reseller's promises to the customer.

26. Illustrative Example 11 accompanying IFRS 15 may be helpful to a reseller of software licences because it illustrates how promised software and related services may (or may not) be distinct.

Assessing whether the reseller controls each specified good or service before that good or service is transferred to the customer

What IFRS 15 says

27. 'An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer' (paragraph B35). 'An entity that is an agent does not control the specified good or service provided by another party before that good or

service is transferred to the customer' (paragraph B36). To determine whether it is a principal or agent, an entity therefore assesses whether it controls each specified good or service before that good or service is transferred to the customer (paragraph B34A(b)).

28. With respect to control, paragraph 33 states:

> Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.
> …

29. Paragraph B35A sets out the circumstances in which an entity is a principal:

> When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:
>
> (a) a good or another asset from the other party that it then transfers to the customer.
>
> (b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.
>
> (c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services (see paragraph 29(a)) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which includes goods or services from other parties) and directs their use to create the combined output that is the specified good or service.

30. The Board noted in paragraph BC382 that the nature of the entity's promise may not always be readily apparent. For that reason, paragraph B37 includes indicators to help an entity determine whether it is a principal or agent:

> B37. Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal (see paragraph B35)) include, but are not limited to, the following:
>
> (a) the entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications). 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.
>
> (b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). For example, if the entity obtains, or commits itself to obtain, the specified good or service before obtaining a contract with a 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 discretion in establishing the price 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 and obtain substantially all of the remaining benefits. 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.
>
> B37A. The indicators in paragraph B37 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.

31. The Board explained in paragraph BC385H that:

> The indicators (a) do not override the assessment of control; (b) should not be viewed in isolation; (c) do not constitute a separate or additional evaluation; and (d) should not be considered a checklist of criteria to be met, or factors to be considered, in all scenarios. Considering one or more of the indicators will often be helpful and, depending on the facts and circumstances, individual indicators will be more or less relevant or persuasive to the assessment of control.

Applying the applicable requirements to the fact pattern submitted

32. In paragraphs 15–18 of this paper, we concluded that the specified good to be provided to the customer is the standard software licences. In assessing whether the reseller controls the software licences before they are transferred to the customer, the reseller therefore applies paragraph B35A(a)—it assesses whether it obtains control of the licences from the software manufacturer that it then transfers to the customer. In the light of our conclusions in paragraphs 15–18 of this paper with respect to the specified good or service, paragraphs B35A(b) and B35A(c) are not applicable.

Assessing whether the reseller obtains control of the licences from the software manufacturer that it then transfers to the customer

33. An entity controls a good when it has the ability to direct the use of, and obtain substantially all the remaining benefits from, the good. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, the good.

34. In the fact pattern submitted, the question is whether the reseller obtains control of the standard software licences from the manufacturer that it then transfers to the customer. Can the reseller—even if only momentarily before their transfer to the customer—direct the use of the software licences and obtain substantially all the remaining benefits from them?

35. The answer to that question very much depends on the specific facts and circumstances:

    (a) in some situations, it may be clear that a reseller obtains control of standard software licences from the manufacturer that it then transfers to a customer. For example, this would be the case if the reseller purchases or controls a pool of standard software licences—or controls the master key to issue and activate software licences—before entering into contracts with customers. In these situations, the reseller has the ability to direct the use of the software licences by deciding whether to use them to fulfil a contract with a customer and, if so, which contract to fulfil. The reseller also has the ability to obtain the remaining benefits by either selling the licences and obtaining the proceeds from sale or, instead, using the licences itself. Illustrative Example 47 accompanying IFRS 15 illustrates this type of situation for a contract to provide airline tickets to a customer.

    (b) in some situations, it may be clear that a reseller does *not* obtain control of standard software licences from the manufacturer. For example, this would be the case if (a) the licences exist (or are created) only at the time that they are transferred to the customer by the manufacturer, (b) the reseller neither purchases, nor commits itself to purchase, licences before they are sold to customers, and (c) the reseller has neither responsibility for unaccepted or returned licences nor responsibility for the software's functionality (the customer would contact the manufacturer for any follow-up help and support).

36. However, in other situations, the nature of the reseller's promise may not be readily apparent—it may not be clear that a reseller obtains (or does not obtain) control of standard software licences before they are transferred to a customer, and the indicators in paragraph B37 may be relevant to the assessment. In those situations, no one factor or indicator is likely to be determinative of whether the reseller is a principal or

agent—the assessment of control is a holistic one considering all relevant facts and circumstances.

37. In the fact pattern submitted, consideration of the indicators in paragraph B37 may be relevant to the assessment of whether the reseller obtains control of the standard software licences. In that respect, we observe:

(a) the software licences—issued in the name of the customer—exist only after the reseller places an order with the software manufacturer and the software manufacturer issues the licences to the customer. The software manufacturer is responsible for issuing the licences and for the software's functionality and has discretion to accept or reject the customer's order—the software manufacturer is therefore responsible in those respects for fulfilling the promise to provide the licences to the customer (paragraph B37(a)).

(b) under the terms of the contract between the reseller and the software manufacturer, the reseller has the right to grant (sell) the software licences to customers. The reseller is the party that engages with the customer both before and after the software licences are transferred to the customer, taking responsibility for unaccepted licences (see bullet (c))—the reseller is therefore responsible in those respects for fulfilling the promise to provide the licences to the customer (paragraph B37(a)).

(c) the reseller does not purchase or control a pool of software licences before entering into the contract with the customer and cannot, for example, direct the software licences to another customer or use the licences itself. The reseller therefore does not have inventory risk before the licences are transferred to the customer but, in the event of non-acceptance by the customer, has inventory risk after transfer. The reseller is liable for any licences ordered that the customer does not accept (paragraph B37(b)).

(d) the reseller has discretion in establishing the price for the licences (paragraph B37(c)). Whether pricing discretion is more or less relevant to the assessment of control depends on, for example, the market for the software licences. Because the software licences are standard licences, the reseller may, in fact, have little discretion in pricing the licences—for example, this might be the

case if the customer is able to purchase those licences from other resellers (obtaining similar pre-sales advice).

Staff conclusion

38. Based on our analysis in paragraphs 10–37 of this paper, in the fact pattern described in the submission the reseller determines the nature of its promise (and thus whether it is a principal or agent) by:

    (a) first identifying the specified goods or services to be provided to the customer (paragraph B34A(a)) applying paragraphs 22–30 of IFRS 15. We conclude that, in the fact pattern submitted, the specified good to be provided to the customer is the standard software licences.

    (b) then assessing whether it obtains control of the software licences from the manufacturer that it then transfers to the customer (paragraph 35A(a)) applying paragraph 33 of IFRS 15. The reseller might consider the indicators in paragraph B37 of IFRS 15 in assessing control.

39. The fact pattern submitted is highly specific. Our understanding is that, although similar, not all software reseller contracts are the same. What might appear to be small or subtle differences in the specific facts and circumstances could change the conclusion when applying the requirements on principal versus agent considerations in IFRS 15. Determining whether the reseller obtains control of the software licences would require knowledge and consideration of the terms and conditions of the contracts between the reseller and the customer, the reseller and the software manufacturer and the software manufacturer and the customer, as well as other factors such as the market for the software licences.

40. For these reasons, in our view it would be inappropriate for us (the staff) or the Committee to conclude on whether, in the fact pattern submitted, the reseller is a principal or agent. It is generally not the Committee's role to provide answers to highly-specific fact patterns. There may be little benefit for stakeholders around the world when the answer very much depends on the specific facts and circumstances and there is a risk that stakeholders might inappropriately analogise to the conclusion when the facts are similar but not the same. There is also a risk that, if open to

answering highly-specific questions, the Committee might inadvertently undermine the appropriate use of judgement that is required when applying the principles-based framework in IFRS Standards. More specifically, in the context of principal versus agent considerations, the Board acknowledged that the assessment of whether an entity is a principal or agent might require judgement, in particular when the specified good or service is intangible. The Board developed the framework in paragraphs B34–B38 of IFRS 15 to ensure that entities apply a consistent approach to principal versus agent considerations. That framework—and the requirements within it—do not however remove the need for judgement in some situations, having appropriately considered and applied the requirements.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the application of the requirements in IFRS 15, outlined in paragraphs 10–37 of this paper? Our analysis is summarised in paragraphs 38–40 of this paper.

Whether to add a standard-setting project to the work plan

Staff analysis and conclusion

41. Paragraph 5.16 of the IFRS Foundation *Due Process Handbook* states that the Committee decides to add a standard-setting project to the work plan only if, among other things, the principles and requirements in IFRS Standards do not provide an adequate basis for an entity to determine the required accounting.

42. Based on our analysis in paragraphs 10–40 of this paper, we conclude that this criterion is not satisfied—the principles and requirements in IFRS 15 provide an adequate basis for a reseller to determine whether, in the fact pattern described in the submission, it is a principal or agent for the standard software licences provided to a customer.

Staff recommendation

43. For the reason described in paragraph 42, we recommend that the Committee not add a standard-setting project to the work plan. We recommend that the Committee instead publish a tentative agenda decision that sets out the applicable requirements in IFRS 15 and explains how a reseller might apply those requirements to the sale of standard software licences to a customer. In our view, the tentative agenda decision would be helpful in explaining how to 'walk through' the applicable requirements.

44. Appendix A to this paper sets out the proposed wording of the tentative agenda decision. In our view, the proposed tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Standards.[2]

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision in Appendix A to this paper?

[2] Paragraph 8.4 of the *Due Process Handbook* states: 'Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'

Appendix A—proposed wording of the tentative agenda decision

Principal versus Agent: Software Reseller (IFRS 15 *Revenue from Contracts with Customers*)

The Committee received a request asking whether, in applying IFRS 15, a reseller of software licences is a principal or agent. In the fact pattern described in the request:

a. the reseller has a distribution agreement with a software manufacturer that:

   i. gives the reseller the right to grant (sell) the manufacturer's standard software licences to customers;

   ii. requires the reseller to provide pre-sales advice to each customer—before the sale of the software licences—to identify the type and number of software licences that would meet the customer's needs; and

   iii. provides the reseller with discretion in pricing the software licences for sale to customers.

b. the nature of the pre-sales advice varies depending on the customer's needs. If the customer decides:

   i. not to purchase software licences, it pays nothing. The reseller and the customer do not enter into an agreement.

   ii. to purchase a specified type and number of software licences, the reseller negotiates the selling price with the customer, places an order with the software manufacturer on behalf of the customer (and pays the manufacturer), and invoices the customer for the agreed price.

c. the software manufacturer provides the customer with the software licences ordered—issued in the customer's name—via a software portal and with the key necessary for activation. The software manufacturer and the customer enter into an agreement specifying the customer's right to use the software, a warranty covering the software's functionality and the term of the licence.

d. if the reseller advises the customer to order an incorrect type or number of software licences (that fails to meet the customer's needs), the customer may not accept the

licences. The reseller is unable to return unaccepted licences to the software manufacturer or sell them to another customer.

Applicable requirements in IFRS 15—Principal versus agent considerations

Paragraphs B34–B38 set out a framework to determine whether an entity is a principal or agent. When another party is involved in providing goods or services to a customer, an entity determines whether the nature of its promise is a performance obligation to provide the specified goods or services itself (the entity is a principal) or to arrange for those goods or services to be provided by the other party (the entity is an agent).

To determine the nature of its promise, paragraph B34A requires an entity to:

a. identify the specified goods or services to be provided to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (paragraph B34); and

b. assess whether it controls each specified good or service before that good or service is transferred to the customer.

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer (paragraph B35). An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer (paragraph B36).

Identifying the specified goods or services to be provided to the customer

The first step in identifying each distinct good or service (or distinct bundle of goods or services) is to assess the goods or services promised in the contract with the customer. A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the contract may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer (paragraph 24).

Having assessed the goods or services promised in the contract with the customer, an entity then identifies—applying paragraphs 27–30—each distinct good or service (or distinct bundle of goods or services) to be provided to the customer.

Assessing whether an entity controls each specified good or service before that good or service is transferred to the customer

When another party is involved in providing goods or services to a customer, paragraph B35A sets out the circumstances in which an entity is a principal—one of which is when the entity obtains control of a good or another asset from the other party that it then transfers to the customer. Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset; control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset (paragraph 33).

Paragraph B37 sets out indicators to help an entity determine whether it is a principal or agent, which comprise (a) primary responsibility for fulfilling the promise to provide the specified good or service; (b) inventory risk before the specified good or service has been transferred to the customer or after transfer of control to the customer; and (c) discretion in establishing the price for the specified good or service. The indicators 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, and different indicators may provide more persuasive evidence in different contracts (paragraph B37A).

Application of IFRS 15 to the fact pattern described in the request

Identifying the specified goods or services to be provided to the customer

In the fact pattern described in the request, the reseller's contract with a customer includes an explicit promise to transfer a specified type and number of standard software licences to the customer.

The Committee observed that the pre-sales advice the reseller provides—under the distribution agreement between the software manufacturer and the reseller—is not an implicit promise in a contract with a customer. At the time of entering into a contract with a customer, the reseller has already provided the advice. There is no further advice to be provided by the reseller and the advice already provided will not be transferred to the

customer after contract inception. Consequently, at the time of entering into a contract with a customer, there is no valid expectation of the customer that the reseller will transfer a good or service to the customer.

Accordingly, the Committee concluded that, in the fact pattern described in the request, the promised goods in a contract with a customer are the standard software licences. Those licences are therefore the specified goods to be provided to the customer as described in paragraph B34A(a).

Assessing whether the reseller controls the standard software licences before they are transferred to the customer

In the fact pattern described in the request, the reseller assesses whether it obtains control of the standard software licences from the software manufacturer that it then transfers to the customer. That assessment of control requires consideration of the specific facts and circumstances, which include the terms and conditions of the contracts between the reseller and the customer, the reseller and the software manufacturer and the software manufacturer and the customer.

In assessing control, the reseller might consider the indicators in paragraph B37. In the fact pattern described in the request, the Committee observed that:

a. the software licences provided to the customer exist only after the reseller places an order with the software manufacturer and the software manufacturer issues the software licences in the customer's name. The software manufacturer is responsible for the software's functionality as well as issuing and activating the licences. The software manufacturer is therefore responsible in those respects for fulfilling the promise to provide the licences to the customer (paragraph B37(a)).

b. the reseller is the party that engages with the customer both before and after the software licences are transferred to the customer, taking responsibility for unaccepted licences. The reseller is therefore responsible in those respects for fulfilling the promise to provide the licences to the customer (paragraph B37(a)).

c. the reseller does not control a pool of standard software licences before entering into the contract with the customer and cannot, for example, direct the software licences to another customer. The reseller therefore has no inventory risk before the licences are

transferred to the customer but, in the event of non-acceptance by the customer, has inventory risk after transfer (paragraph B37(b)).

d. the reseller has discretion in establishing the price for the software licences (paragraph B37(c)). Pricing discretion may be less relevant to the assessment of control if, for example, the market for the software licences is such that the reseller, in effect, has limited flexibility in establishing the price.

The fact pattern described in the request is highly specific. In the light of the specific facts and circumstances, the Committee observed that it is not in a position to conclude on whether the reseller is a principal or agent. The reseller would make that assessment within the context of the framework and requirements set out in paragraphs B34–B38 of IFRS 15.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for a reseller to determine whether—in the fact pattern described in the request—it is a principal or agent for the standard software licences provided to a customer. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—submission

B1. We have reproduced the submission below and in doing so deleted details that would identify the submitter of this request.

IFRS IC Potential Agenda Item Request

We kindly request the IFRS Interpretations Committee (hereinafter referred to as the "Committee") to examine the following issue in connection with the application of IFRS 15 with regard to the distinction between the principal and the agent.

1. Problem

The submission deals with the question whether, when software licences are sold by third parties, i.e. by IT service providers or IT system houses, the respective third party is to be classified as principal or agent. Doubts arise especially with respect to contract models in which the third party is a value-added reseller and directly performs complex and extensive consulting services in advance within the scope of the contractually agreed performance (so-called indirect contract models).

The question is especially whether the pre-sales consulting to be performed in the indirect contract model and the sale of a software licence represent goods and services in the meaning of IFRS 15.29 (c), which are highly interdependent or highly interrelated. While the affected value-added resellers of the entire IT industry usually assume that a significant integration service is on hand – which would imply classification as principal – [another party] published indications to be used for the assessment, which imply that in general, the goods and services are separable.

The distinction made between the role of the principal and that of the agent of an entity has significant consequences for the presentation of the revenue in the income statement.

For value-added resellers, it is therefore important to have a clear, reliable procedure.

2. Fact Pattern

The fact pattern is as follows:

(1) The volume licence is the typical licence model in the B2B segment. A customer who obtains a volume licence acquires the software and, via the licence contract, the right to

use a certain number of copies without obtaining a physical storage medium. The software is usually made available via a software portal. The software activation takes place by means of a key; however, a volume licence programme does not require the customer to use a new key for every activation, but only a single (corporate) key for the activation of all installed software products.

(2) Regardless of the licence model, the software manufacturer enters a contract with the end customer.

(3) In the context of the sales partnership, the IT service providers in the indirect contract model act as value-added resellers who create combined products that include their own services and sell these to their customers as custom solutions.

(4) The distribution agreement between the value-added reseller and the software provider confers an enforceable right on the value-added reseller to grant software licences to his customers.

(5) The consulting service is a key element of the performance towards the customer**.** The obligations of the value-added reseller in this regard are governed primarily by the agreement between the value-added reseller and the software manufacturer and thus become an essential element of every contract between the value-added reseller and the customer. Furthermore, the value-added reseller undertakes to provide every new customer with "certified consulting" services upon registration on the official company website. Thus, every customer is entitled to qualified advice according to the terms and conditions of the respective partner agreement and can expect a performance package with these features.

(6) The combination of qualified pre-sales consulting with the software licence is what delivers the customer benefit in the form of a suitable, legally compliant software solution.

(7) By means of the pre-sales consulting, a customer-specific contract package is configured for the customer for a planning horizon of three years. The pre-sales consulting is not based on standard offers or assumptions, but rather on the precisely identified needs of the customer. Especially aspects such as its corporate goals and the derived IT strategy are taken into consideration. In most cases, the pre-sales consulting culminates in the conclusion of a contract that provides the customer with various upgrade options and maximum flexibility.

(8) The pre-consulting services may only be performed by duly trained and certified employees (licence consultants). Depending on the complexity of the case, several person-days are often required for this pre-sales consulting. Apart from the direct consulting overhead that arises from the performance of the pre-sales consulting, the value-added reseller is faced with substantial upfront investments.

(9) In the case of public RFP of public-sector clients, both the partner status and the consulting are often explicitly requested and are part of the conditions of the RFP. They are thus explicitly agreed. It is remunerated within the framework of the total price for the software solution advised. If the contract is not concluded, the remuneration does not apply.

(10) The partner agreement between the software manufacturer and the value-added reseller stipulate that vis-à-vis the customer, the value-added reseller has complete discretion in his pricing.

(11) The value-added reseller invoices the software licence to the customer and receives the remuneration for all his services exclusively via the margin between the purchase price and the selling price. This includes the procurement of the software licences from the manufacturer, the consulting service provided and the above-mentioned upfront investments.

(12) The value-added reseller is exposed to a special form of inventory risk, since in the event of mislicensing (i.e. where the type or number of software licences sold was not appropriate), he cannot return the licences to the software vendor or sell them to another customer.

(13) Below, the question raised is demonstrated on the basis of [a particular software manufacturer's] volume licence models, as this vendor accounts for a significant share of the entire software trading business worldwide and has implemented a standardised, globally valid agreement framework with its partners, thereby establishing the precondition for an industry-wide comparison. However, the objective is not merely to assess [this particular software manufacturer] and its contract models. In fact, the contract models of virtually all vendors have a similar structure. Value-added resellers often maintain business relationships with a wide range of software vendors.

(14) A special feature of the contract programmes of this particular software manufacturer in the indirect model is that in the contractual relationship, the value-added reseller stands

between [software manufacturer] and the customer and is requested to place orders on behalf of the customer and administer purchases of the customer.

(15) In the relationship with [this particular software manufacturer], the role of the value-added reseller comprises the responsibility for the sales and the after-sales processes. In the relationship with the customer, the value-added reseller is the first point of contact for all questions. The value-added reseller is responsible both for the order process and for any licensing issues that arise after the conclusion of the order.

3. Issue

Should the value-added reseller in the indirect contract model be regarded as the principal or as the agent?

3.1. View 1: The Value-Added Reseller is the Principal

In application of IFRS 15.24, IFRS 15.27 and IFRS 15.29 (c) and additionally of IFRS 15.B35A (c) as well as of IFRS 15.B37 (a) to (c), this view is supported by the following:

3.1.1. Identification and Evaluation of the Promises

According to IFRS 15.24, the value-added reseller identifies the sale of a software licence as a promise in the customer contract. Moreover, the value-added reseller identifies the pre-sales consulting as an implicit promise to the customer pursuant to IFRS 15.24.

To fulfil that the good or service is **capable of being distinct** (according to IFRS 15.27 (a) in conjunction with IFRS 15.28), both identified promises would have to deliver benefits to the customer. Prior to every sale of a software licence, the value-added reseller is under the obligation to provide qualified advice, firstly due to a pre-contractual consulting obligation (see below) and secondly due to the partner agreement entered into. If this requirement is not complied with, the partner could lose his partner status and thus his authorisation to sell software licences. Thus, it is not possible to purchase a licence without the consulting service, as there is no market legalised by the software vendor. It would not be possible for the end customer to purchase licences without the consulting service. Even if another value-added reseller were to be selected, the respective value-added reseller would in turn have to perform his own consulting service.

For the evaluation of whether the promise to transfer the good or service is **distinct within the context of the contract** (IFRS 15.27 (b) in conjunction with IFRS 15.29), it is relevant that the

purchase of a licence within the scope of the indirect model represents the result of a consulting process that not only serves the identification of the "right" licence, but also influences the type of licensing. The pre-sales consulting service has a significant effect on the ensuing licensing solution, i.e. the licence greatly depends on the prior consulting service and vice versa.

For the customer, the purchase of software licences raises various questions concerning the scope of the rights of use of the licences. This includes aspects of strategic and operational software procurement and consulting services with respect to the contract and compliance. Consulting services are closely linked to the sale of the software products and are considered to be a material component of the performance obligation towards the customer. These pre-consulting services may only be performed by duly trained and certified employees (licence consultants). The certifications of the licence consultants must regularly be renewed. The required training measures involve high costs, regardless of the quantity sold.

Without such consulting, no customer benefit can be gained. Moreover, the opinion of the value-added resellers is that the promises cannot be separated, as such separation does not reflect the characteristics of the indirect contract model (nature of the promise). The value-added resellers are of the opinion that the inseparability of the performance is also supported by the Board's explanations in IFRS 15.BC116M. With the example of IFRS 15.BC112 (development of a product concept with subsequent manufacturing of prototypes), the Board shows that a combined end result can be achieved over more than one phase, one element or one unit. The performance in the example IFRS 15.BC112 is basically separable, but interdependent, and so are the pre-sales consulting and the subsequent software sale.

An appraisal under civil law also supports the view that the promises cannot be separated: According to general accepted legal principles, the combination of the pre-contractual consulting obligation with the subsequent conclusion of the contract is mandatory, as it refers to the contract to be concluded and has legal consequences for the subsequent contractual relationship (damages in the event of wrong advice). A seller has consulting obligations if he has undertaken to provide the buyer with advice with respect to the properties of the item to be purchased or other circumstances relevant for the buyer. Such obligations can be assumed explicitly or implicitly. The applicability of the seller's consulting obligation increases the more the buyer needs protection and the more expertise the seller claims to have. The value-added reseller's consulting obligation arises with the commencement of the professional advice and is documented at the latest when an offer is submitted. Provided that the other

preconditions are met, a breach of the consulting obligation results in a claim for damages. The party protected by the ancillary obligation is to be put in a position as if the obligation had been duly performed. Moreover, depending on the circumstances, the breach of ancillary obligations can institute a reason for rescission or termination of the contract.

Moreover, the uniform billing and the fact that the value-added reseller usually does not have a separate claim to remuneration underlines the nature of the combined integrated performance for the customer.

In summary, the following applies to the indirect contract model in the field of software licensing involving a value-added reseller (in accordance with IFRS 15BC116J et seq).

(1) The customer benefit only arises from the interaction or combination of the individual promises.
(2) From the perspective of the customer, the promise largely represents a single performance (= provision of a suitable and legally secure software solution).
(3) The consulting service directly and greatly influences the licence (and vice versa). Thus, consulting risks also give rise to licence risks. The value-added reseller bears the risk for the entire service package and may be held liable accordingly.
(4) The consulting thus has a significant impact on the customer benefit.

Against the backdrop of both the implicit and, in certain cases, the explicit obligation to provide such comprehensive consulting services, the value-added reseller comes to the conclusion that pre-sales consulting represents an implicit (significant) promise to the customer. The performance consists, not only of the sale of the standard software licence, but of a combined performance bundle comprising the standard software licence and the qualified consulting services of the value-added reseller. The customer-specific licensing concept establishes a transformative connection between the pre-sales consulting and the sale of the vendor's software licence. In this process, the customer's needs are fully taken into consideration. The responsibility for the transformation services lies with the value-added reseller alone.

3.1.2. Further Aspects – Regulations of IFRS 15.B35 et seq

Against the above-mentioned backdrop, the value-added reseller considers the criteria for the classification as a significant integration service (IFRS 15.B35A (c)) to be fulfilled, by way of

which the value-added reseller obtains the control before transferring the performance bundle to the customer.

Apart from the value-added reseller's original consulting service, this is also supported by the fact that due to his partner status and the associated distribution agreement, he holds overriding distribution rights of the vendors. The distribution agreement between the value-added reseller and the software provider confers an enforceable right on the value-added reseller to grant software licences to his customers. The software provider has granted the value-added reseller a right to use his IP (i.e. to sell licences for his IP), which is separated from the actual underlying software licences. In connection with the application of the control criteria to intangible goods and services, IFRS 15.BC385Q also indicates that the evaluation of the control should not merely take individual parts of the promise, but the entire promise into consideration. Therefore, the evaluation of the control should examine the combined output, and it must be determined whether the entity controls the combined output before it transfers it to the customer.

The classification as principal is supported by the other indicators of IFRS 15.B37:

- The value-added reseller is mainly responsible for fulfilling his obligation towards the customer, as he ensures the compatibility of the standard software license and the customer requirements.
- Moreover, the value-added reseller is free to determine the price for the combined performance obligation at his own discretion (see Fact Pattern, item 10).
- Furthermore, the value-added reseller is exposed to a special form of inventory risk with regard to the standard software licence, since in the event of non-acceptance by the customer, he cannot return it to the software vendor or sell it to another customer (see Fact Pattern, item 12).

Under certain contract models, the software vender pays additional remuneration for the sale of licences. In this contract models, the customer usually requests comprehensive consulting within the scope of the tender process. Here too, a customer-specific licencing concept is on hand, in which all above-mentioned indicators for classification as principal are met. From the perspective of the value-added reseller, an additional remuneration by the vendor does not change the assessment of whether he acts as principal or agent.

This opinion of the value-added reseller is in accordance with the accounting and measurement principles of the software reseller industry, with which intensive interchange takes place with regard to this discretionary judgment.

3.2. View 2: The Value-Added Reseller is an Agent

This deviating interpretation of IFRS 15 does not assume the existence of a significant integration performance in the indirect business if the main purpose of the consulting service is to fulfil the licensing requirements of the software vendors.

[Revenue] from the sale of standard software licences must be presented on a net basis in accordance with IFRS 15.B36 (accounting as agent) if the consulting service performed in connection with the sale of the software is primarily aimed at the fulfilment of the software vendor's licensing requirements and does not represent any significant service of integrating the goods or services at the request of the customer in the meaning of IFRS 15.29. For the assessment of whether the consulting service could potentially be a significant integration service, the following aspects must also be taken into consideration: the proportion of the consulting overhead and the licence value; the primary interest of the software vendor in appropriate licensing, which is important for the amount of his income; the fact that (in certain contract models) the software vendor pays remuneration for the sale of a licence and the fact that the consulting service is performed prior to the submission of a quotation, i.e. even in cases in which the software sale does not materialise.

The view that a pure agency activity is on hand is supported by the fact that in the context of the sale of standard software licences in the indirect business, a direct contractual relationship is instituted between the customer and the software vendor in addition to the contractual relationship between the customer and the value-added reseller and until then, the value-added reseller does not control the software licence. In this context, the pre-sales consulting would be regarded as a pure sales service on the part of the value-added reseller.

[This] reasoning can be supported as follows:

- The consulting service of the value-added reseller aims primarily at the software vendor's interest in due licensing.
- Compared to the value of the standard software licence, the pre-sales consulting overhead and the gross margin usually accounts for a minor share.

- Pre-sales consulting is provided even in cases in which the sale ultimately does not materialise. Thus, pre-sales consulting services are offered even without remuneration.
- A customer who knows which contract model would be suitable and how many standard software licences he or she needs would not gain any added value from the pre-sales consulting.

From the perspective of the value-added resellers, the following points conflict with view 2:

The activities of the value-added reseller do not only primarily aim at the fulfilment of the software vendor's licensing requirements. Rather, according to the partner agreement with [a particular software manufacturer], the value-added reseller has assumed the contractual obligation to provide every customer with certified consulting services according to the terms and conditions of the partner agreement, and this involves substantial upfront expenses. From the customer perspective, this manifests the expectation of receiving the respective performance bundle (see Fact Pattern, items 5 and 8 above).

The value-added reseller is liable for his consulting services, as the pre-contractual consulting obligation also refers to the contract to be concluded and has legal consequences for the subsequent contractual relationship (damages in the event of wrong advice). These aspects of the legal relationships between the software vendor and the value-added reseller go far beyond a mere sales service. Thus, it is irrelevant that compared to the volume of the overall order, pre-sales consulting services usually account for a minor share or are performed even in the rare case that no contract is concluded.

As described in chapter 3.1.2 above, the distribution agreement between the value-added reseller and the software provider also confers an enforceable right on the value-added reseller to grant software licences to his customers (see also Fact Pattern, item 4). The software provider has granted the value-added reseller a right to use his IP (i.e. to sell licences for his IP), which is separated from the actual underlying software licences.

In view of the above reason, the value-added reseller considers the criteria for the classification as a significant integration service (IFRS 15.B35A (c)) to be fulfilled and assumes that he obtains the control before transferring the performance bundle to the customer.

After all, according to IFRS 15.B35A (c), the entity controls the inputs before the entity renders the combined performance. In the case of software sale, this means that the software licence is

controlled by the value-added reseller prior to the combination with pre-sales consulting services.

4. Summary

The assessment of the principal/agent issue when selling third-party software licences within the context of the indirect contract model depends on numerous factors.

Especially the complex and extensive pre-sales consulting plays a key role in assessing the principal/agent issue. In view of the explicit and/or implicit obligation to provide comprehensive consulting in the context of the indirect model, consulting can be assumed to be an implicit, or, depending on the contract model, in some cases also an external performance obligation towards the customer. Furthermore, the value-added reseller is liable for his pre-contractual consulting services upon conclusion of the contract.

Accordingly, the licence is not sold alone, but as a combined performance bundle consisting of the licence and the qualified advice of the value-added reseller (i.e. a customer-specific licensing solution) for which the value-added reseller is responsible. In the indirect contract model, there is a transformative connection between the mandatory pre-sales consulting and the sale of software licences. The goods and services are highly interdependent or highly interrelated.

Moreover, the regulations concerning the "significant service of integrating the goods or services" (IFRS 15.B35A (c)) and "primary responsibility" (IFRS 15.B37 (a)) support the view of the resellers that they gain the control before the performance bundle is transferred to the customer. The indicators "inventory risk" (IFRS 15.B37 (b)), "pricing" (IFRS 15.B37 (c)) and the "right to direct another party" (IFRS 15.B35A (b)) also support this statement.

Therefore, the value-added reseller is the principal in the indirect contract model and presents the entire trading revenue.

5. Reasons for the IFRS IC to address this issue

a. Is the issue widespread and has, or is expected to have, a material effect on those affected?

The issue concerns all IT service providers worldwide who sell software licences to B2B customers under indirect contracts. In the fiscal year 2020 (2019), the revenue from such contracts of six European companies of the peer group amounted to approximately €11 billion (€10 billion).

For these companies, some of which are listed at the stock exchange, it is vital to gain legal certainty with regard to the presentation of revenue.

b. Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?

Yes. The principal/agent assessment has a major impact on revenue – which is one of the most important performance indicators of an entity. An aligned procedure will improve the comparability of financial reporting.

c. Can the issue be resolved efficiently within the confines of IFRS Standards and the Framework?

Yes. Due to the existing uncertainties with regard to the interpretation, the case described needs to be evaluated by the Committee and can be resolved efficiently within the scope of the IFRS Standards and the Framework.

d. Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRS Standards?

Yes, the issue is narrow in scope and refers to the sale of software volume licenses. Thus, efficient processing is guaranteed.

e. Will the solution developed by the Interpretations Committee be effective for a reasonable time period? The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified.

In view of the stable business models of the affected IT service providers and the current developments in the field of cloud solutions and software as a service (SaaS), which are inherently even more consulting-intensive, the solution will remain effective for a reasonable time period.

Questions and answers about the fact pattern

Facts provided in the fact pattern within the submission	Questions
2: Regardless of the licence model, the software manufacturer enters a contract with the end customer.	Could you provide more information about the contract between the software manufacturer and end customer?

Could you provide more information about the contract between the software manufacturer and end customer?

Essentially, the contract between the software manufacturer and the end customer comprises the general terms and conditions of the software manufacturer and the signatures of the contracting parties. The general terms and conditions include, in particular, the rights to use the software license, the right to verification of the performance of the contract by the software manufacturer (compliance), e.g. correct number of licenses in use by the customer, the purely functional warranty by the software manufacturer as well as the term of the software licenses and the general pricing. This pricing structure provides that the value-added reseller is free in its pricing to the end customer.

In addition, for example in the case of contracts with [a particular software manufacturer], the value-added reseller is named as a partner in the general terms and conditions and thus occupies the middle position between the software manufacturer and the end customer. According to the contract, the partner is a company authorized by [the particular software manufacturer] to sell licensed products to the customer. In the contractual relationship between the software manufacturer and the customer, the partner is commissioned by the customer to place orders on behalf of the customer and to manage purchases by the customer.

We would like to clarify that the role as a partner is by no means "limited to placing orders for the customer, managing purchases" as well as mediating ("establishing") a contractual relationship between end customers and the software manufacturer and bringing about follow-up orders. It is our clear understanding, as well as that of the entire industry, that the consulting services provided by a value-added reseller go beyond the simple brokerage service and rather focus on the provision of an integration service.

Facts provided in the fact pattern within the submission	Questions
4: The distribution agreement between the value-added reseller and the software provider confers an enforceable right on the value-added reseller to grant software licences to his customers.	1) Could you provide more information about the distribution agreement between the software manufacturer and reseller? 2) Does the reseller hold the master key to the software licence before any contract is signed with a customer? 3) Does the reseller have a pool of pre-purchased software licences? 4) Or instead does the reseller purchase software licences only after a contract with a customer is signed?

1) Could you provide more information about the distribution agreement between the software manufacturer and reseller?

The distribution agreement between the software manufacturer and the value-added reseller contains the general terms and conditions for resellers (partners) and the resulting distribution rights. The general terms and conditions include, in particular, the conditions under which the value-added reseller may sell the software licenses. The agreement also stipulates that the value-added reseller is responsible for both, the sales and after-sales process. In addition, the agreement stipulates that the value-added reseller must pay the software manufacturer for each license, even if a quantity is ordered that exceeds the customer's requirements. Furthermore, the agreement stipulates that the value-added reseller has full discretion in its pricing. In addition, the agreement stipulates that the value-added reseller must ensure that the customer has purchased a sufficient number of software licenses. In the event of incorrect licensing, the value-added reseller would be liable for damages.

The software manufacturer reserves the right to refuse a customer through the distribution agreement. From our point of view, this contractual clause is at best of a theoretical nature, since we are not aware of any case in which the software manufacturer has refused to accept a customer from the value-added reseller in recent decades. In the course of the business transaction, therefore, it is (in fact) the value-added reseller alone who decides on the acceptance of a customer. This results not least from the fact that the value-added reseller in the discussed model as a partner is the primary and in relation to the software manufacturer the only contact for the customer.

The value-added resellers therefore conclude that they have an overriding, enforceable right to grant licenses before individual software licenses are transferred to the customer. It is the value-added reseller's enforceable rights against the software vendor that give the value-added reseller the right to virtually instruct the software manufacturer to grant the software licenses. These rights exist before the customer places a license order. Therefore, the value-added reseller concludes that it controls the software licenses within the meaning of IFRS 15 before the software licenses are transferred to its customers.

2) **Does the reseller hold the master key to the software licence before any contract is signed with a customer?**
3) **Does the reseller have a pool of pre-purchased software licences?**
4) **Or instead does the reseller purchase software licences only after a contract with a customer is signed?**

According to IFRS 15.B35A(c), the entity normally controls the inputs before the entity provides the combined service consisting of pre-sales consulting and license. In the case of software sales, this means that the software license would have to be controlled by the value-added reseller prior to the combination.

The individual license right only arises after the order by the value-added reseller and the granting of the license by the software manufacturer. The value-added reseller does not keep licenses in stock, but orders the licenses only after the customer has placed an order. This is a more or less efficiently designed purchasing process that eliminates the classic risks of stockpiling. Nevertheless, the value-added reseller bears a special form of inventory risk with regard to the order, since in the event of incorrect licensing the customer does not accept (i.e pay for) the licenses and the value-added reseller has no right of return against the software manufacturer.

Furthermore, the value-added reseller holds distribution rights of the software manufacturer through the partner status and the associated distribution framework agreement. The master distribution agreement between the value-added reseller and the software vendor transfers an enforceable right to the value-added reseller to grant software licenses to its customers. The software provider has transferred to the value-added reseller a right to use its intellectual property - IP (i.e., to sell licenses to its IP) - this right is separate from the underlying software licenses themselves.

Furthermore IFRS 15.BC385Q specifies that the application of the control principle should not relate to individual parts of the performance obligations, but to the entire performance obligation. Rather, control should relate to the combined output and it should be determined whether the entity controls the combined output before it is transferred to the customer. Therefore, as already clarified, we do not consider the consideration of the transfer of the license in isolation to be appropriate.

Facts provided in the fact pattern within the submission	**Questions**
5: The consulting service is a key element of the performance towards the customer. 6: The combination of qualified pre-sales consulting with the software licence is what delivers the customer benefit in the form of a suitable, legally compliant software solution. 7: By means of the pre-sales consulting, a customer-specific contract package is configured for the customer for a planning horizon of three years. The pre-sales consulting is not based on standard offers or assumptions, but rather on the precisely identified needs of the customer.	1) Paragraph B34 of IFRS 15 states 'An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer.' Could you walk us through the thought process in determining that there is a distinct bundle of goods or services? 2) Could you describe the nature of the consulting service in more detail? What happens if the customer decides not to buy any software licences? Does the customer pay for the consulting services in that case? 3) Does the contract between reseller and customer involve changing or modifying the software licences?

1) Paragraph B34 of IFRS 15 states 'An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer.' Could you walk us through the thought process in determining that there is a distinct bundle of goods or services?

Refer to 3.1.1 Identification and measurement of promises from the enquiry to the IFRS Interpretations Committee 2021-05-10.

According to IFRS 15.24, the value-added reseller identifies the sale of a software licence as an explicit promise in the customer contract and the pre-sales consulting as an implicit promise to the customer.

To fulfil that the good or service is **capable of being distinct** (according to IFRS 15.27 (a) in conjunction with IFRS 15.28), both identified promises would have to deliver benefits to the customer separately. Prior to every sale of a software licence, the value-added reseller is obligated to provide qualified advice, firstly due to a pre-contractual consulting obligation arising from law (see below) and secondly due to the partner agreement entered into. If this requirement is not complied with, the partner could lose his partner status and thus his authorisation to sell software licences. Thus, it is not possible to purchase a licence without the consulting service, as there is no market legalised by the software manufacturer. It would not be possible for the end customer to purchase licences without the consulting service. Even if another value-added reseller were to be selected, the respective value-added reseller would in turn have to perform his own consulting service.

For the evaluation of whether the promise to transfer the good or service is **distinct within the context of the contract** (IFRS 15.27 (b) in conjunction with IFRS 15.29), it is relevant that the purchase of a licence within the scope of the indirect model represents the result of a consulting process that not only serves the identification of the "right" licence, but also influences the type of licensing. One type of licensing could be, for example, that the desired licence type can be used in the home office, while another cannot be used in the home office due to licensing limitations. The pre-sales consulting service has a significant effect on the ensuing licensing solution, i.e. the licence greatly depends on the prior consulting service and vice versa.

For the customer, the purchase of software licences raises various questions concerning the scope of the rights of use of the licences. This includes aspects of strategic and operational software procurement and consulting services with respect to the contract and compliance. Consulting services are closely linked to the sale of the software products and are considered to be a significant component of the performance obligation towards the customer. These pre-sales services may only be performed by duly trained and certified employees (licence consultants). The certifications of the licence consultants must regularly be renewed. The required training involve high costs, regardless of the quantity sold.

Without such consulting, no benefit can be gained by the customer. Moreover, the opinion of the value-added resellers is that the promises cannot be separated, as such separation does not reflect the characteristics of the indirect contract model (nature of the promise). The value-added resellers are of the opinion that the inseparability of the performance is also supported

by the Board's explanations in IFRS 15.BC116M. With the example of IFRS 15.BC112 (development of a product concept with subsequent manufacturing of prototypes), the Board shows that a combined end result can be achieved over more than one phase, one element or one unit. The performance in the example IFRS 15.BC112 is basically separable, but interdependent, and so are the pre-sales consulting and the subsequent software sale.

An appraisal under civil law also supports the view that the promises cannot be separated: According to general accepted legal principles in our jurisdiction, the combination of the pre-contractual consulting obligation with the subsequent conclusion of the contract is mandatory, as it refers to the contract to be concluded and has legal consequences for the subsequent contractual relationship (damages in the event of wrong advice). A seller has consulting obligations if he has undertaken to provide the buyer with advice with respect to the properties of the item to be purchased or other circumstances relevant for the buyer. Such obligations can be assumed explicitly or implicitly. The applicability of the seller's consulting obligation increases the more the buyer needs protection and the more expertise the seller claims to have. The value-added reseller's consulting obligation arises with the commencement of the professional advice and is documented at the latest when an offer is submitted. Provided that the other preconditions are met, a breach of the consulting obligation results in a claim for damages. The party protected by the ancillary obligation is to be put in a position as if the obligation had been duly performed. Moreover, depending on the circumstances, the breach of ancillary obligations can institute a reason for rescission or termination of the contract.

2) Could you describe the nature of the consulting service in more detail? What happens if the customer decides not to buy any software licences? Does the customer pay for the consulting services in that case?

The requested extensive consulting service can vary greatly depending on the customer. For example, the type and scope of the pre-sales consulting depend on whether an existing customer or a new customer is concerned and what the budget and IT needs of the customer are. In the pre-sales consulting, an individual contract package is configured for the customer for a planning horizon of three years. The pre-sales consulting is not about selling standard offers or assumptions, but is geared towards catering to the precisely identified needs of the customer. Especially aspects such as their corporate goals and the derived IT strategy are taken into consideration. Under ideal circumstances, the pre-sales consulting culminates in

the conclusion of a contract that provides the customer with various upgrade options and maximum flexibility.

Pre-sales consulting especially comprises the following activities:

- Check for possible licensing law changes by the licensor.
- Comparison of the current infrastructure with the preferred licensing.
- Determination of possible advantages of a cloud solution compared to on premise licensing.
- Checking whether a technologically newer solution is more advantageous for the customer than renewal of the existing license. This includes consideration of financial goals as well as technical possibilities and expectations of the customer.
- Checking whether the preferred license model can be used in the desired application area, e.g. home office, in terms of technical as well as licensing requirements.
- Calculation of the quantity structure also with regard to possible procurement advantages.

3) Does the contract between reseller and customer involve changing or modifying the software licences?

In the case of the indirect contract model discussed here, no material adjustments in the classic sense, such as programming, are provided.

We would like to refer to a statement in IFRS 15 that is important for value-added resellers. According to IFRS 15.BC107, an integration service is characterized by the fact that the risks arising from the transfer of the individual goods and services are not distinct, since the essential part of the performance promise to the customer is to ensure that the individual goods and services flow into the overall product, in our case "adequate license bundle". This idea of not distinct risk is taken up again in IFRS 15.BC108. According to this, risks are not distinct if the risk resulting from the integration is negligible. In the present facts, it is obvious in our view that risks from pre-sales consulting are directly reflected in the overall product "adequate license bundle" and are therefore by no means negligible.

At the same time, it should be noted that there is considerable scope for discretion in these paragraphs between the simple installation of software and the rather clear case of customizing. The necessity of the introduction of IFRS 15.29 itself as well as the remaining uncertainty, which IFRS 15.BC111 clearly expresses, indicate the necessity of exercising appropriate discretion on the diverse cases of practice.

We would like to emphasize once again that, particularly in the case of our transaction discussed here, the two elements of consulting services and license transfer are not distinct. The connecting link here is the customer's need for an IT solution, which is made up of an IT concept that is suitable for him and the transfer of the necessary licenses. This result is based on competent consulting by the value-added reseller. The type and number of software licenses is derived from this IT concept and is embedded in the overall result of an IT solution tailored to the specifics of the individual customer. It would lead precisely to a risk if the two elements were not transferred in a coordinated manner. The customer's needs would not be met if, for example, the consultation resulted in 500 licenses of a certain type being transferred, but ultimately only 250 were transferred. Conversely, the transfer of too many costly licenses would lead to the risk of incorrect licensing with recourse claims by customers. This again underlines the customer's interest in a total package - in the combined product.

Facts provided in the fact pattern within the submission	**Questions**
12: The value-added reseller is exposed to a special form of inventory risk, since in the event of mislicensing (i.e. where the type or number of software licences sold was not appropriate), he cannot return the licences to the software vendor or sell them to another customer.	1) In whose name are the software licences issued? 2) In the event of mislicensing, what happens to the software licences? Does the reseller have to pay the software manufacturer for the software licences?

1) In whose name are the software licences issued?

The software licences are issued by the software manufacturer to the end customer, i.e. in the end customer’s name.

2) In the event of mislicensing, what happens to the software licences? Does the reseller have to pay the software manufacturer for the software licences?

In the event of non-acceptance by the customer, the licences remain with the Value-added Reseller. He cannot return the software license to the software manufacturer or sell it to another customer so that he has to write them off to the profit or loss.

Nevertheless, the value-added reseller must pay the software manufacturer for its licenses.

Facts provided in the fact pattern within the submission	Questions
15: In the relationship with [the particular software manufacturer], the role of the value-added reseller comprises the responsibility for the sales and the after-sales processes. In the relationship with the customer, the value-added reseller is the first point of contact for all questions. The value-added reseller is responsible both for the order process and for any licensing issues that arise after the conclusion of the order.	1) Could you provide more information about the after-sales processes and licensing issues? 2) Who (software manufacturer or reseller) is responsible for making the software available to the customer and for any glitches in the software?

1) Could you provide more information about the after-sales processes and licensing issues?

As part of the after-sales process, the value-added reseller performs a yearly inventory of the software licenses for the software manufacturer only in the direct contract model which is not issued here. This service represents a separate performance obligation and is distinct.
The licensing issues essentially comprise technical and commercial services provided by the value-added reseller after the purchase. In particular, these are after-sales services, which essentially cover the handling of support issues and assistance with manufacturer software maintenance. These services are generally provided through the operation of a hotline, on-site support in the form of training courses. Within the scope of their design, these services result in independent usability in the form of customer services. Therefore, they are distinct from other performance obligations.

2) Who (software manufacturer or reseller) is responsible for making the software available to the customer and for any glitches in the software?

Although the software functionality is guaranteed by the software manufacturer, the value-added reseller is responsible for the correct granting of licenses. In the overall context of the discussed indirect model, the customer only gains his benefit from the combination of software (functionality), consulting and correct licensing, which is provided by the value-added reseller in the course of his ordinary business activities. The assumption of liability for the correct selection of licenses is not negligible from our customers' point of view. In fact, it is itself an essential component of the service, since companies would bear a considerable loss in the event of incorrect licensing under certain circumstances.

Appendix C—paragraphs 27–30 of IFRS 15

C1. Paragraphs 27–30 of IFRS 15 state:

> 27. A good or service that is promised to a customer is distinct if both of the following criteria are met:
>
> (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
>
> (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).
>
> 28. A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.
>
> 29. In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in

accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

(a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.

(b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.

(c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently.

30. If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.