

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. if the customer decides:
 - i. to buy no software licences, it pays nothing. The reseller and the customer do not enter into an agreement.
 - ii. to buy 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).

Paragraph B34A states that determining the nature of its promise 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 the specified goods or services to be provided to the customer 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 provide 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. Such indicators include, but are not limited to: (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).

Applying 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 the customer includes an explicit promise to provide 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 the contract with the customer. At the time of entering into the contract with the 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 the contract with the customer, there is no valid expectation of the customer that the reseller will transfer a good or service to the customer other than the standard software licences.

Accordingly, the Committee concluded that, in the fact pattern described in the request, the promised goods in the reseller's contract with the customer are the standard software licences. Because the standard software licences are the only promised goods in the contract with the customer, they are distinct goods to be provided to the customer. 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 before they are transferred 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.

If—after applying the principles and requirements on control in IFRS 15—it is unclear whether the reseller is a principal or agent, the reseller considers the indicators in paragraph B37 in assessing whether it obtains control of the standard software licences from the software manufacturer before they are transferred to the customer. 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 for 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 before and after the software licences are provided 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 obtain a pool of 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 provided to the customer but then has inventory risk until the customer accepts the licences (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 Committee observed that the conclusion as to whether the reseller is a principal or agent depends on the specific facts and circumstances, including the terms and conditions of the relevant contracts. The reseller would apply judgement in making its overall assessment of whether it is a principal or agent—including considering the relevance of the indicators to the assessment of control and the degree to which they provide evidence of control of the standard software licences before they are transferred to the customer—within the context of the framework and requirements set out in paragraphs B34–B38 of IFRS 15.

The Committee also observed that the reseller would disclose (a) material accounting policy information in accordance with IAS 1 *Presentation of Financial Statements*, and (b) information required by IFRS 15, including about its performance obligations (paragraph 119) and the judgements made in applying IFRS 15 that significantly affect the determination of the amount and timing of revenue from contracts with customers (paragraph 123).

The Committee concluded that the principles and requirements in IFRS Accounting 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.