

STAFF PAPER

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Project	Revenue from Contracts with Customers		
Paper topic	Principal versus agent considerations—issues emerging from TRG discussions		
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Purpose of the paper

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1. The purpose of this paper is to discuss possible actions that the IASB could take to resolve the issues emerging from the discussions of the Revenue Transition Resource Group (TRG) in relation to the application guidance on ‘Principal versus agent considerations’ in IFRS 15 *Revenue from Contracts with Customers*.
2. The paper is structured as follows:
 - (a) Background
 - (b) Summary of staff recommendations
 - (c) Issues emerging from TRG discussions
 - (d) Staff analysis of the guidance on principal versus agent considerations in IFRS 15
 - (e) Possible approaches to clarifying the issues
 - (f) Staff recommendations and questions for the IASB

Background

3. When a party other than the entity is involved in providing goods or services to a customer, IFRS 15 requires the entity to determine whether it is:
- (a) the principal in the transaction (recognising as revenue the transaction price allocated to the entity's performance obligation of providing the specified goods or services to the customer); or
 - (b) the agent (recognising as revenue the fee or commission for arranging for the other party to provide goods or services to the customer).

Paragraphs B34–B38 of IFRS 15 include guidance to help an entity make that determination.

4. At its July 2014 meeting, the TRG ([Agenda Paper 1](#)) considered the following two issues relating to principal versus agent considerations:
- (a) Issue 1: Implementation questions about the requirements in paragraphs B34–B38 of IFRS 15 (discussed later in this paper); and
 - (b) Issue 2: Estimating gross revenue if the entity is the principal but is unaware of amounts being charged by an intermediary to the transaction.
5. These two issues were discussed jointly by the IASB and the FASB at the March 2015 meeting. At that meeting, the staff provided the Boards with an update about the ongoing work on principal versus agent considerations. The IASB [Agenda Paper 7E](#) and the FASB [Memo No.1](#) for the March 2015 meeting provide some additional background on those issues.
6. The IASB decided at that meeting that it would not undertake standard setting with respect to Issue 2. Regarding Issue 1, the IASB decided that it would focus its ongoing work on exploring:
- (a) whether there are some amendments that could be made to IFRS 15 at this time that might be helpful to clarify the existing thought process; and/or
 - (b) whether adding one or two illustrative examples might be helpful in addressing some of the issues raised.

7. Consequently, this paper focuses on Issue 1—determining whether an entity is a principal or an agent. It explores whether any clarifications to the application guidance or illustrative examples on principal versus agent considerations could help address the issues raised. We note that much of the analysis regarding Issue 1 in Agenda Paper 7E of the March 2015 meeting has been included within this paper to ensure a complete and logical flow of analysis on the topic.
8. At this meeting, we are asking the IASB to make tentative decisions on Issue 1. We plan to discuss this issue together with the FASB at a future joint meeting.

Summary of staff recommendations

9. We recommend:
 - (a) proposing amendments to the application guidance in IFRS 15, along the lines set out in paragraphs 58 of this paper, and also proposing corresponding amendments to Examples 45–48 of IFRS 15.
 - (b) clarifying the application of the control principle to services provided by another party by either amending the application guidance in IFRS 15 or alternatively adding an illustrative example.

Issues emerging from TRG discussions

10. Paragraph B34 of IFRS 15 sets out the principle for determining whether an entity is a principal or an agent, as follows:

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 the other party to provide those goods or services (ie the entity is an agent).
[Emphasis added]
11. Paragraphs B35–B37 of IFRS 15 then explain that (a) an entity determines whether it provides, or arranges for another party to provide, the goods or services

by assessing whether it controls those goods or services before transfer; and (b) provides some indicators to help make that control assessment, as follows:

- B35 An entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer. However, an entity is not necessarily acting as a principal if the entity obtains legal title of a product only momentarily before legal title is transferred to a customer. An entity that is a principal in a contract may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf. When an entity that is a principal satisfies a performance obligation, the entity recognises revenue in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred.
- B36 An entity is an agent if the entity's performance obligation is to arrange for the provision of goods or services by another party. When an entity that is an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the other party to provide its goods or services. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.
- B37 Indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer) include the following:
- (a) another party is primarily responsible for fulfilling the contract;
 - (b) the entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping, or on return;

- (c) the entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited;
- (d) the entity's consideration is in the form of a commission; and
- (e) the entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services.

12. The following questions (explained in detail in the FASB memo of the March 2015 meeting) have arisen with respect to the above requirements:

- (a) Stakeholders have differing views about whether control is always the basis for determining whether an entity is a principal or an agent. This arises mainly because of differing interpretations of the relationship between control and the indicators in paragraph B37 of IFRS 15:
 - (i) Some think that control is the basis used to determine whether an entity is a principal or an agent and that the indicators in paragraph B37 complement the assessment of control.
 - (ii) Others think that an entity can be a principal even if it does not control the goods or services before transfer. They interpret the new revenue Standard to say that, first, an entity assesses whether it controls the goods or services before transfer. If it does not, it then uses the indicators in paragraph B37 (which they view as unrelated to control) to assess whether it might still be the principal in the transaction, even though it does not control the goods or services before transfer.
- (b) Some stakeholders also question how to weight or apply the indicators if a transaction is such that the indicators contradict each other.

13. The TRG discussions also highlighted that the principal versus agent guidance is generally easier to apply to transactions for tangible goods (eg the transfer of an item of property, plant or equipment) as opposed to services and transactions for

virtual or intangible goods (eg the transfer of a virtual online game or a right to a meal in a restaurant). It is the latter transactions that have gained greater prominence in some markets. Consequently, it appears that greater implementation challenges are arising than were anticipated when the guidance was first developed and exposed for comment. These implementation challenges have led some to question whether control is the appropriate basis on which to assess whether an entity is a principal or an agent.

14. It is, however, noteworthy that the principal versus agent guidance was not raised as a significant area of concern in the feedback on the 2010 ED nor the 2011 ED, both of which included proposals that were largely the same as the guidance in IFRS 15.

Staff analysis of the guidance on principal versus agent considerations in IFRS 15

The principle in paragraph B34 and control

15. The principle for determining whether an entity is a principal or an agent, set out in paragraph B34 of IFRS 15, is clear. That principle is based on determining whether the nature of an entity's promise is a performance obligation to *provide* the specified goods or services itself (ie the entity is a principal) or to *arrange* for another party to provide those goods or services (ie the entity is an agent).
16. Control is intertwined with that principle. We think that in order for an entity to provide the specified good or service, it must first control that good or service (as defined in paragraph 33 of IFRS 15). In our view, it would appear difficult to *provide* the specified good or service to a customer if the entity does not first have (and control) that good or service to be provided. For this reason, we think that the Boards intended that control before transfer would be the determining factor when assessing whether an entity is a principal or an agent. If an entity controls the specified good or service before that good or service is transferred to the customer, it is a principal. If the entity does not control the good or service before transfer, it is an agent and, thus, *not* a principal.

17. Some might suggest that the inclusion of the principle in paragraph B34 (ie that an entity determines whether it provides, or arranges for another party to provide, goods or services to the customer) as well as control (as set out in paragraph B35) creates confusion. It might appear that two different principles apply when assessing whether an entity is a principal or an agent.
18. We understand that this may be confusing. Nonetheless, the guidance and the explanations in the Basis for Conclusions (paragraph BC380) highlight that this is not a two-step assessment, but rather a one-step assessment based on control. An entity is required to assess whether it controls the specified good or service before transfer to the customer in order to conclude upon the nature of its promise as a performance obligation to *provide*, or to *arrange* for the other party to provide, the specified good or service.

The relationship between control and the indicators in paragraph B37

19. The TRG discussions indicate that some of the confusion regarding the principal versus agent guidance relates to the relationship between the indicators of control in paragraph B37 of IFRS 15 and assessing control itself. This confusion, at least in part, relates to the fact that the indicators have been carried forward from IAS 18 and Topic 605, both of which had a different principle (based on risks and rewards) from that in IFRS 15. In addition, the structure of the analysis in Examples 45–48 accompanying IFRS 15 has added to the confusion regarding the application of the principal versus agent guidance.
20. We think that the Boards included the indicators within the new Standard to help an entity assess whether it controls a good or service before transfer in scenarios when the assessment of control might be difficult. Accordingly, the indicators are intended to support the application of the control principle in paragraphs B34–B36 of IFRS 15—they should neither override the control principle, be viewed in isolation, nor be considered a checklist of criteria to be met, or factors to be considered, in all scenarios. Consequently, an entity should not conclude that it is the principal based on an assessment of the indicators in paragraph B37 and, yet, determine that it does not control the goods or services before transfer.

21. As mentioned above, the principal versus agent assessment is based on assessing whether the entity controls the specified good or service before transfer to the customer, and the entity would use the indicators to help make that assessment when needed. We think that considering one or more of the indicators can often be helpful and, depending on the particular facts and circumstances, differing indicators can be more or less relevant to the principal versus agent assessment. For example:
- (a) considering inventory risk is often helpful and relevant when the promise to the customer is to provide a good (which could be a right to a good or service).
 - (b) considering primary responsibility for fulfilling the promise in the contract is often helpful and relevant when the promise to the customer is to provide a service.
 - (c) having pricing discretion can be relevant in some scenarios and less relevant in others (for example, pricing discretion is not particularly relevant when an agent has some pricing discretion but only to allow the agent to create a larger market for its services of arranging for other parties to provide goods or services to customers).
22. Paragraph BC382 explains the Boards' considerations in this respect. It notes that 'the boards included indicators in paragraph B37 of IFRS 15 to help an entity determine whether the entity controls the goods or services before transferring them and thus whether the entity is a principal or an agent'. The indicators in paragraph B37 are similar to those in IAS 18 (which, as noted above, are based on a risks and rewards principle). Nonetheless, as explained in paragraph BC382, the indicators 'have a *different purpose than previous revenue recognition requirements* in that they are based on the concepts of identifying performance obligations and the transfer of control of goods or services' [emphasis added]. Accordingly, we think that the Boards envisaged that the conclusions about principal versus agent under IFRS 15 could be different from those reached under existing requirements.
23. Some have suggested that the indicators are confusing because they do not directly answer the question of whether an entity controls the specified goods or

services before transfer (ie whether the entity has the ability to direct the use of, and obtain the benefits from, the goods or services before transfer). However, we think that the indicators were never intended to be factors or criteria that directly give an entity control—the intention was that they would be helpful because, if an indicator or indicators exist, then it is likely that the entity also has control of the good or service before transfer. For example, if an entity is primarily responsible for fulfilling a promise in a contract or the entity has inventory risk, then neither of those factors directly give the entity the ability to direct the use of, or obtain the benefits from, a good promised in the contract before transfer. Nonetheless, if either or both of those factors exist, then it is likely that the entity also has the ability to direct the use of, and obtain the benefits from, the good before transfer. In other words, an entity would not typically be expected to undertake inventory risk or primary responsibility for fulfilling the promise in a contract without also having control over the good or service promised in the contract before transfer to the customer.

24. We think that this relationship between the principle and accompanying indicators within the principal versus agent guidance is similar to the relationship between the principle and accompanying indicators in other parts of IFRS 15. For example, paragraph 33 of IFRS 15 includes the principle of control and paragraph 38 specifies indicators of the transfer of control. If an entity has a right to payment for an asset, or has transferred the significant risks and rewards of ownership of an asset (two of the indicators in paragraph 38), then it is likely that the entity has transferred control of the asset to the customer. Nonetheless, neither the obligation to pay nor having the significant risks and rewards of ownership directly provides the customer with the ability to direct the use of, and obtain the benefits from, the asset.
25. This is also similar to the relationship between exposure to risk and rewards (variable returns) and control (of which power is an element) within IFRS 10 *Consolidated Financial Statements*. Paragraph B20 of IFRS 10 states that ‘having a large exposure to variability of returns is an indicator that the investor may have power. However, the extent of the investor’s exposure does not, in itself, determine whether an investor has power over the investee’.

The use of the indicators in paragraph 38 rather than the indicators in paragraph B37

26. Some have questioned why the indicators in the principal versus agent guidance (paragraph B37) are different from the indicators in the guidance on satisfying performance obligations (paragraph 38), noting that both sets of indicators relate to control. If the determining factor when assessing whether an entity is a principal or an agent is control (as defined in paragraph 33 of IFRS 15), then why create a new set of indicators?
27. We think that it is important to note that the indicators in paragraph 38 of IFRS 15 are indicators of the *transfer* of control. Paragraph 38 states that an entity considers those indicators ‘to determine *the point in time* at which a customer obtains control of a promised asset’ [emphasis added]. Accordingly, those indicators serve a different purpose than the principal versus agent indicators in paragraph B37. The indicators in paragraph 38 are not intended to indicate *whether* the customer obtains control of a promised asset—it is assumed that the customer will obtain control of the promised asset at some point—instead, they are intended to indicate *when* the customer has obtained control.
28. In contrast, the indicators in paragraph B37 are intended to indicate *whether* the entity controls a specified good or service before it is transferred to the customer.
29. In saying that, given that both sets of indicators relate to control, some of the indicators in paragraph 38 are somewhat similar to some of the indicators in paragraph B37. For example, inventory risk overlaps to some degree with having physical possession, or the significant risks and rewards of ownership, of an asset.

Identifying the specified good or service

30. We think that at least some of the perceived difficulty in applying the ‘control’ principle, in particular to virtual or intangible goods and services, is linked to the identification of the specified good or service to be provided to the customer. Specifically:
- (a) In the context of Example 47 in IFRS 15 (in which a travel agent sells airline tickets to customers), some stakeholders indicated that it is not

clear whether the control principle should be applied to the flight or the ticket (which provides the right to the flight). A similar question arises in Example 48 in IFRS 15 (in which an entity sells vouchers to meals at a specified restaurant). In that example, should the control principle be applied to the meal or the voucher (which provides the right to the meal)?

- (b) When a contract contains multiple goods or services, should the control principle be applied to each specified good or service in the contract or only to distinct bundles of specified goods or services? Similarly, should control be applied at the contract level or could an entity, within one contract, be a principal with respect to some specified goods or services and an agent with respect to others?

31. The guidance on principal versus agent in paragraphs B34–B38 of IFRS 15 mainly relates to the application of Step 2 of the revenue recognition model, *Identify the performance obligations in the contract*. Appropriately identifying the specified good or service is an important step in appropriately identifying the nature of an entity’s promise as a performance obligation to provide, or arrange for another party to provide, that specified good or service. Doing so, we think, will be helpful in almost all transactions. Application of the control principle becomes easier if the ‘specified good or service’ is appropriately identified.

The specified good could be a right

32. Examples 47 and 48 in IFRS 15 illustrate that the specified good to be provided to the customer could be a right to a good or service. In Example 47, a travel agent provides customers with airline tickets. The airline ticket clearly gives rise to a performance obligation for the airline to provide a flight. But for the travel agent, being the principal would mean providing a right to a flight (ie a ticket) rather than providing the flight itself. Therefore, the travel agent would evaluate whether its performance obligation is a promise to provide a *right* to a flight or whether it is arranging for the airline to provide the right to the flight. In other words, the fact that the travel agent will not provide the flight itself is not a relevant consideration. Instead, in assessing whether it is a principal or an agent,

the travel agent would evaluate whether it controls the *right* to a flight before that right is transferred to the customer.

Example 1

An entity enters into a contract with customers to purchase advertising space on websites on behalf of those customers—the customers then place advertisements on the websites. The entity’s technology identifies the advertising space that is best suited to each customer’s needs, and purchases that advertising space only at the time that the right to place advertisements on the space is then transferred to the customers.

The entity identifies the specified good to be provided to the customer as the right to place advertisements on the advertising space—the provision of the right to the advertising space is the only promise in the contract with the customer.

The entity then concludes that it does not control the right to the advertising space before that right is transferred to customers. The entity concludes that it did not at any time have the ability to direct the use of the right to the advertising space—it does not purchase the right in advance of it being transferred to the customer and could not, for example, decide to use the advertising space for a purpose other than providing the customer with the right to that space.

In this example, some of the indicators in paragraph B37 might also be helpful in reaching this conclusion—for example, the entity is not primarily responsible for fulfilling the promise to the customer nor does it have any substantive inventory risk relating to the right to advertising space. The entity is responsible simply for ensuring that its technology functions as expected to arrange for the sale of rights to advertising space by website owners to customers.

Accordingly, the entity concludes that the nature of its promise is a performance obligation to arrange for website owners to provide advertising space to customers and, thus, that it is an agent.

The specified good or service is distinct from other goods or services

33. Similarly, we think that the specified good or service to which the control principle is applied should be a distinct good or service, or a distinct bundle of goods or services. If individual goods or services are not distinct from each other, then by definition they are not separately identifiable from each other.

Accordingly, we do not think that it would be appropriate or feasible to assess whether an entity controls goods or services that cannot be identified separately from other goods or services promised to the customer. Doing so would also appear to contradict Step 2 of the revenue recognition model.

34. Consequently, in contracts in which the good or service provided by the other party is an input that the entity obtains and then integrates with other promised goods or services to produce a combined output for which the customer has contracted, the entity assesses whether it controls the combined output before that output is transferred to the customer. In that scenario, the principal versus agent assessment would typically be straightforward. We would expect the entity to conclude that it is a principal. This is because the entity would have identified the combined output as the specified good or service and not the input provided by the other party. The entity, rather than the customer, controls the good or service provided by the other party, which it then uses to satisfy its performance obligation to the customer. The good or service provided by the other party would be a fulfilment cost to the entity.
35. Determining whether an entity is a principal or an agent for each distinct good or service (or distinct bundle of goods or services) also means that an entity could be a principal with respect to some specified goods or services in a contract with a customer, and an agent with respect to other specified goods or services in that contract. For example, a contract for recruitment services might provide the customer with access to a third party recruitment database as well as other recruitment services provided by the entity. Assuming that the access to the third party database and the other recruitment services are both distinct, and depending on the terms and conditions of the contracts, the entity could be a principal for the recruitment services that it provides to the customer and an agent relating to the access to the third party database.

Example 2 (similar to Example 46 in IFRS 15)

An entity enters into a contract with a customer for equipment with unique specifications. The entity and the customer develop the specifications for the equipment, which the entity communicates to a supplier that the entity contracts with to manufacture the equipment. The entity also arranges to have the supplier deliver the equipment directly to the customer.

The entity and the customer negotiate the selling price and the entity invoices the customer with 30-day payment terms. The entity is obliged to pay the supplier even if the customer fails to pay for any reason. The entity is also responsible for any corrections required to the equipment resulting from errors in specifications.

The entity identifies the specified good or service to be provided to the customer as the specialised equipment. Although the entity has subcontracted the manufacturing of the equipment to the supplier, the entity concludes that the development of the specifications, the manufacturing of the equipment, and the overall management of the contract are not distinct because they are not separately identifiable (ie there is a single performance obligation). The entity provides a significant service of integrating those items into the combined output—the specialised equipment—for which the customer has contracted.

The entity then concludes that it controls the specialised equipment before the equipment is transferred to the customer. Although the supplier delivers the specialised equipment to the customer, the supplier has no ability to direct its use (ie the supplier cannot decide to use the specialised equipment for another purpose). The entity has prevented the supplier from directing the use of the specialised equipment by specifying that the equipment must be delivered to the customer to fulfil the promise in the contract.

In this example, the indicators in paragraph B37 might also be helpful in reaching this conclusion—for example, the entity (a) is primarily responsible for fulfilling the promise (to provide the specialised equipment) to the customer; (b) has discretion in establishing prices and is not paid a commission; and (c) has credit risk relating to the consideration it expects to receive for the specialised equipment.

Example 3

An entity enters into contracts with customers for a package of cloud services, including access to cloud platforms (owned and operated by third parties), network management services, and software tools to manage and optimise usage of the cloud. The entity enters into contracts with the third party cloud platform owners for the right to access the cloud platforms.

The entity identifies the specified service to be the package of cloud services. The terms and conditions of the contracts with customers and the third party

platform owners are such that the entity concludes that the access to the cloud platforms is not distinct from the other services being provided by the entity to the customer because it is not separately identifiable from those other services. The entity provides a significant service of integrating all of the goods and services being provided to the customer into a combined package of cloud services; each of the inputs is highly interrelated with each other. The contract with the customer contains a single performance obligation.

The entity then concludes that it controls the package of cloud services before it is transferred to the customer. The entity controls the right to access the cloud platforms and then directs the use of that right by integrating that access with the other goods and services in providing a package of cloud services to the customer.

In this example, some of the indicators in paragraph B37 might also be helpful in reaching this conclusion—for example, the entity (a) is primarily responsible for fulfilling the promise (to provide the package of cloud services) to the customer; (b) has discretion in establishing prices.

Control of a service

36. Some have raised concerns about the application of the control principle to services to be provided to a customer. They question how an entity (other than the service provider) could control a service before that service is transferred to the customer because a service comes into existence only at the moment that it is delivered. Thus, in their view, only the provider (or originator) of a service can control that service. For this reason, those stakeholders question the appropriateness of ‘control’ as the basis for determining whether an entity is a principal or an agent in service contracts.
37. We understand this concern but, nonetheless, think that the control principle can be applied in the context of assessing whether an entity is a principal or an agent when another party provides services.
38. Paragraph 33 of IFRS 15 states that:
- 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...

39. We think that an entity can control a service to be provided by another party when it controls the *right* to the specified services from the other party that will be provided to the customer. The entity then either transfers the *right* to the services to the customer or directs the other party to provide the services to the customer to satisfy the entity's performance obligation in the contract with the customer. Determining whether the entity controls the *rights* to the specified service requires careful consideration of the facts and circumstances in each case.
40. Based on the above, contracts involving services provided by another party in which the entity is a principal can be broadly categorised as follows:
- (a) First, contracts in which an entity provides the customer with a right to a future service to be provided by another party (eg the airline ticket in Example 47 of IFRS 15).
 - (b) Second, contracts in which the service provided by the other party is not distinct from other goods or services promised by the entity to the customer. The service is, therefore, part of a distinct bundle of goods or services that represents the entity's performance obligation to the customer (refer to Example 5 of this paper).
 - (c) Third, contracts in which an entity engages another party to provide the service to the customer on its behalf in satisfying its performance obligation (refer to Example 6 of this paper).
41. As explained in paragraphs 30–35 of this paper, we think that the determination of whether an entity is a principal or an agent in the first and second categories is more straightforward if the specified good or service is appropriately identified.
42. In relation to the first category of contracts, Examples 47 and 48 of IFRS 15 illustrate the determination of whether the entity is a principal or an agent. The specified good in these examples is the *right* to the service. In these contracts, the entity determines whether the rights exist before the customer obtains those rights and whether the entity controlled those rights before they are transferred to the

customer. We think that the application of the control principle is more straightforward in these contracts because *rights* to a service are akin to a good.

Example 4 (similar to Example 48 in IFRS 15)

An entity sells vouchers that entitle customers to future meals at specified restaurants. The entity does not purchase the vouchers in advance; instead it purchases vouchers only as they are requested by the customer. The entity sells the vouchers through its website.

The entity and the restaurants jointly determine the prices at which the vouchers will be sold to customers. The entity is entitled to 30 per cent of the voucher price when it sells the voucher.

The entity identifies that the specified good to be provided to the customer is not the meal but the voucher, which provides the right to a meal at specified restaurants.

The entity assesses whether it controls the vouchers before they are transferred to customers. The entity concludes that it did not at any time have the ability to direct the use of the vouchers—the rights are created only at the time that those vouchers are purchased by the customers and, thus, the rights do not exist before the customer purchases the vouchers. Thus the entity concludes that the nature of its promise is a performance obligation to arrange for the restaurants to provide vouchers to the customers.

43. In the second category of contracts, the entity's performance obligation is to provide a bundle of goods or services, which includes the services provided by the other party. Accordingly, the services provided by the other party create an asset that the entity controls. The entity directs the use of this asset by integrating it with other promised goods or services to satisfy its performance obligation to the customer. Consequently, the services provided by the other party are costs to fulfil the entity's performance obligation.

Example 5 (similar to Example 10 in IFRS 15)

An entity, a contractor, enters into a contract to build a hospital for a customer. The entity is responsible for the overall management of the project and identifies various goods and services to be provided, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing. The entity engages a

number of subcontractors for the engineering, piping and wiring, and installation of equipment.

The entity identifies that the specified good to be provided to the customer is the hospital. The entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. The entity provides a significant service of integrating the goods or services (the inputs) into the hospital (the combined output) for which the customer has contracted.

The entity determines that its performance obligation is to provide the hospital and, thus, that it is the principal. The entity would be unable to provide the hospital to the customer if it did not control the various goods and services being provided by the subcontractors.

44. Determining whether an entity is a principal or an agent is more difficult in the third category of contracts. Having entered into a contract with a customer, the entity engages another party to satisfy all of a performance obligation within that contract on its behalf. In these contracts, we think that the entity would again assess whether it controls a right to the specified services as explained in paragraph 39 of this paper. An entity could control the right to the specified services by entering into a contract with the service provider (ie the other party that provides the service), and defining the services to be provided to the customer on the entity's behalf. The entity obtains the right to the services of the service provider, and then directs the service provider to provide the services to the customer to satisfy the entity's performance obligation. In this scenario, the entity would appear to be in no different a position than if it had fulfilled the contract using its own resources rather than engaging a service provider to do so. The entity obtains and uses the services from the service provider as the services are performed on its behalf in fulfilling its performance obligation with the customer. This is illustrated in the example below.
45. In other scenarios in which the specified services provided to the customer are provided by another party and the entity did not have the ability to direct those services, the entity would typically be expected to be an agent. In that scenario, the entity is likely to be simply facilitating (and arranging for) the provision of services by the service provider, rather than controlling the rights to the services that the entity then directs to the customer.

Example 6

An entity enters into a contract with a customer to provide office maintenance services. The entity and the customer define and agree the scope of the services and negotiate the price. The entity is responsible for ensuring that the services are performed in accordance with the terms and conditions in the contract.

The entity regularly engages third party service providers to provide the office maintenance services. When the entity obtains a contract from a customer, the entity in turn enters into a contract with one of these service providers directing the service provider to provide the specified services to the customer. The entity is obliged to pay the service provider even if the customer fails to pay for any reason.

The entity observes that the specified services to be provided to the customer are the office maintenance services that will be provided by the service provider. The entity then concludes that it controls the rights to the services of the service provider before those services are provided to the customer. The entity directs the service provider to provide those services to the customer on its behalf in satisfying its performance obligation to the customer. Thus, the entity concludes that it is the principal.

In this example, some of the indicators in paragraph B37 might also be helpful in reaching this conclusion—for example, the entity (a) is primarily responsible for fulfilling the promise (to provide the maintenance services) to the customer; (b) has discretion in establishing prices; and (c) has credit risk relating to the consideration it expects to receive for the office maintenance services.

Possible approaches to clarifying the issues***No standard-setting action***

46. The IASB could decide not to take any standard-setting action at this time with respect to principal versus agent considerations.

The control principle

47. As explained in paragraphs 15–18 of this paper, the guidance and the explanations in the Basis for Conclusions highlight that the determination of whether an entity is a principal or an agent is a one-step assessment based on the control principle.

An entity is required to assess whether it controls the specified good or service before transfer to the customer in order to determine the nature of its promise as a performance obligation to *provide*, or to *arrange* for the other party to provide, the specified good or service.

48. The Boards' considerations in this respect, and the intertwined relationship between assessing control and the principal versus agent principle in paragraph B34, are explained in the Standard and Basis as follows:

- (a) Paragraph B35 of IFRS 15 states that 'an entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer'. Paragraph B37 states that '...an entity is an agent (and therefore does not control the good or service before it is provided to a customer)...'
- (b) Paragraph BC380 states that 'A principal controls the goods or services before they are transferred to a customer. Consequently, the principal's performance obligation is to transfer those goods or services to the customer...In contrast, an agent does not control the goods or services before they are transferred to a customer. The agent merely facilitates the sale of goods or services between a principal and the customer. Consequently, an agent's performance obligation is to arrange for another party to provide the goods or services to the customer.'

The relationship between control and the indicators in paragraph B37

49. As explained in paragraphs 19–29 of this paper, the guidance and the explanations in the Basis for Conclusions highlight that the indicators in paragraph B37 are intended to be strictly 'indicators' of whether an entity controls the specified good or service before it is transferred to the customer. Paragraph B37 states 'Indicators that an entity is an agent (and therefore *does not control* the good or service...'¹ [emphasis added] Paragraph BC382 explains that 'the boards included indicators in paragraph B37 of IFRS 15 to help an entity determine whether the entity controls the goods or services before transferring them and thus whether the entity is a principal or an agent'.

Identifying the specified good or service

50. As explained in paragraphs 30–35 of this paper, the application of the control principle is often more straightforward if the specified good or service to be provided to the customer is appropriately identified. We note, however, that the need to appropriately identify the specified good or service to be provided to the customer is not clearly evident from the guidance in paragraphs B34–B38.
51. Having said that, Examples 47 and 48 in IFRS 15 and the explanations in paragraph BC381 highlight that the specified good to be provided to the customer could be a right to a good or service.
52. Similarly, in situations in which the good or service provided by the other party is not distinct from other promised goods or services, we think that the guidance on identifying performance obligations should lead an entity to conclude that the principal versus agent assessment would be performed at the level of distinct goods or services (or a distinct bundle of goods or services). Paragraphs B34–B36 and BC381 also refer to determining the nature of an entity’s promise as a *performance obligation*, and refer to the principal or agent satisfying a *performance obligation*.

Control of a service

53. Paragraphs 36–45 of this paper explain the application of ‘control’ to services. We think that the specific issue highlighted in this respect is about the *application* of the definition of control rather than a *missing requirement* in the Standard.

Standard-setting needed

54. Alternatively, the IASB could conclude that it should undertake some standard-setting action to provide greater clarity about how to determine whether an entity is a principal or an agent. It could do so by clarifying the thought process (or steps to be taken) as well as some or all of the following aspects of the guidance:
- (a) Identifying the specified good or service;
 - (b) Control of a service in the context of the principal versus agent assessment; and

(c) Aligning the indicators in paragraph B37 more closely to the control principle.

55. It is important to note, however, that we think the Boards envisaged that the determination of whether an entity is a principal or an agent would require careful consideration of the facts and circumstances, and the exercise of judgement. We do not think that clarifying the guidance can or should remove the need for that careful consideration, nor can it remove the need to apply judgement. Nonetheless, we think that clarifying the existing guidance could help alleviate some of perceived difficulty in applying the guidance.

Identifying the specified good or service

56. As noted earlier in this paper, we think that the principal versus agent assessment (and the application of the control principle) becomes easier in many scenarios if an entity identifies the specified good or service appropriately.

57. The difficulty in applying the ‘control’ principle in particular to virtual or intangible goods and services, and the diversity in views expressed at the TRG meeting about the good or service to which the control principle is applied, might suggest that the guidance, examples and explanations in the Basis for Conclusions in IFRS 15 do not adequately emphasise the importance of identifying the specified good or service. Consequently, the IASB could clarify the thought process by specifically requiring an entity to identify the nature of the specified good or service before applying the control principle to that specified good or service.

58. We think that the clarification could be provided by including an additional paragraph along the following lines:

B34A To determine the nature of its promise (as described in paragraph B34), the entity shall:

- (a) identify the nature of the specified good or service to be provided to the customer. For example:
 - (i) the specified good could be a right to goods or services (see paragraph 26).
 - (ii) the specified good or service could be a bundle of goods or services that are not distinct from each other (see paragraphs 27-30).
- (b) assess whether it controls (as described in paragraph 33) the specified good or service before that good or service is transferred to the customer.

59. This additional paragraph would achieve the following:

- (a) It would provide a better framework (ie clarify the thought process) to be applied when assessing whether an entity is a principal or an agent.
- (b) It emphasises the importance of appropriately identifying the specified good (which could be a right) or service.
- (c) It clarifies that the principal versus agent assessment is made for each distinct good or service (or bundle of goods or services).
- (d) It emphasises that control (as defined in paragraph 33 of IFRS 15) is the determining factor when assessing whether an entity is a principal or an agent.

60. We do not think that this additional paragraph would change the conclusions already reached by the Boards on this topic because, in many respects, it simply points to other relevant parts of IFRS 15.

Control of a service in the context of the principal versus agent assessment

61. The IASB could clarify the application of control to services in the context of the principal versus agent assessment by providing an explanation of the scenarios in which a principal can control a service to be provided by another party.
62. Paragraph B35 of IFRS 15 explains that an entity that is a principal in a contract may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf. We think that, if the IASB wishes to clarify the guidance in this respect, an amendment to paragraph B35 could usefully explain the application of control to a service.
63. The explanation could be drafted along the following lines:

The entity that is a principal controls:

- (a) a good (eg a right) that it obtains from the other party that it then transfers to the customer;
- (b) a right to a service to be provided by the other party, which gives the entity the ability to direct the other party to provide that service to the customer on the entity's behalf in satisfying its performance obligation; or
- (c) a good or service that it then integrates with other goods or services into a bundle of goods or services that represents its performance obligation.

64. Alternatively, given that this clarification is an *explanation* of the scenarios in which a principal can control a service, the IASB could decide to provide the clarification by including an additional example and including a discussion in the Basis for Conclusions.

Aligning the indicators in paragraph B37 more closely to the control principle

65. As explained in paragraph 21 of this paper, we think that considering the indicators can often be helpful when assessing whether an entity controls a specified good or service before it is transferred to the customer. Consequently, we would not recommend removing the indicators in paragraph B37.
66. Depending on the particular facts and circumstances, differing indicators can be more or less relevant to the assessment of control. In particular, the first three indicators in paragraph B37—primary responsibility for fulfilling the promise in the contract, inventory risk and discretion in establishing prices—are often useful and relevant. Similarly, in some scenarios, one or both of the remaining two indicators—consideration in the form of commission and exposure to credit risk—can also be helpful. Because the purpose of the indicators is to help when needed, some would suggest that there is no harm in retaining all five of the indicators in paragraph B37, even if some of those indicators are less relevant in particular scenarios.
67. In saying that, some question the usefulness of the commission and exposure to credit risk indicators for the following reasons:
- (a) it is more difficult to link (even indirectly) these indicators to control, in particular the commission indicator; and
 - (b) these indicators are often not particularly helpful or relevant in more difficult scenarios. For example, in many of the new economy transactions, the customer pays in advance or at the time that it obtains the specified good or service and, thus, there is no exposure to credit risk.
68. Consequently, the IASB could decide to delete one or both of those indicators.
69. Regarding the commission indicator (paragraph B37(d) of IFRS 15), we note that paragraph B36 of IFRS 15 states that ‘an entity that is an agent recognises revenue in the amount of any fee or *commission* to which it expects to be entitled in exchange for arranging for the other party to provide its goods or services’

[emphasis added]. Accordingly, if the IASB were to decide to delete the commission indicator, we do not think there would be any loss of guidance.

Staff recommendations and questions for the IASB

70. Having considered the wider implications about the risks of amending the Standard at this stage as discussed in Agenda Paper 7A of the February 2015 meeting, we recommend providing some clarifications with respect to the principal versus agent guidance.
71. The extent of the discussion at the TRG meeting on this issue and subsequent feedback that we received has highlighted that, at present, stakeholders are having difficulties in applying the guidance. Although most of the issues highlighted have arisen in the US because it appears that more of the difficult transactions to which the guidance applies occur in the US, we think that these clarifications would be equally useful for other jurisdictions. Consequently, we recommend proposing amendments to IFRS 15 in this respect.
72. Paragraphs 54–69 of this paper set out various clarifications that could be made. We think that all of these clarifications could be helpful. However, as a minimum, we recommend proposing amendments to the application guidance in IFRS 15, along the lines of what is set out in paragraph 58 of this paper, and also proposing corresponding amendments to Examples 45-48 of IFRS 15. We also recommend adding some illustrative examples.
73. We think providing a better framework as to the steps to be taken in applying the principal versus agent guidance (as proposed in paragraph 58 of this paper) would be particularly helpful for stakeholders, including when applying the guidance to many of the new economy transactions. In addition, we think that there is relatively low risk of unintended consequences from amending the guidance in this respect. This is because the amendments largely simply point to other relevant paragraphs of IFRS 15.
74. If the IASB decides not to amend the application guidance of IFRS 15 in this respect, we recommend amending the analysis in Examples 45-48 in any event—not to change the facts or conclusions but rather to change the wording of the

analysis in some respects. This is because the wording of the analysis in these examples has created some of the confusion regarding the application of the principal versus agent guidance. We think that the analysis within the examples could be improved in a number of respects. First, the analysis could be enhanced to emphasise the need to identify the specified good or service. Second, the conclusion that the entity controls or does not control the specified good or service could be more closely linked to the definition of control in paragraph 33 of IFRS 15. Third, the analysis in the examples of the indicators in paragraph B37 could be changed. The analysis of the indicators within the examples can be read to imply, incorrectly, that an entity must always assess the indicators and that the control conclusion is reached solely on the basis of the assessment of the indicators. We also recommend adding some illustrative examples.

Questions for the IASB

1. Does the IASB agree with the staff recommendation to propose amendments to the application guidance in IFRS 15, along the lines of those set out in paragraph 58 of this paper, to clarify the application of the principal versus agent guidance? Examples 45–48 accompanying IFRS 15 would also be amended accordingly and some additional examples included.
2. Does the IASB wish to propose amendments to the application guidance in IFRS 15, along the lines of those set out in paragraph 63 of this paper, to explain the application of the control principle in the context of services?
3. Does the IASB wish to propose to delete one or both of the commission indicator and exposure to credit risk indicator in paragraph B37 of IFRS 15?
4. If the IASB does not wish to amend the application guidance of IFRS 15, does the IASB agree to amend Examples 45–48 and include some additional examples to clarify the application of the principal versus agent guidance as described in paragraph 74 of this paper?