

Appendix Two: IFRIC agenda decisions in relation to SaaS arrangements

This appendix sets out the International Financial Reporting Interpretations Committee (IFRIC) agenda decisions published in 2019 and 2021. These agenda decisions provide authoritative guidance on how a customer accounts for configuration or customisation costs in relation to SaaS arrangements.

This appendix should be read in conjunction with the Treasury's guidance *Accounting for Software as a Service (SaaS) - Accounting guide for public sector entities, including implications on appropriations for departments (February 2022)*.

March 2019 IFRIC agenda decision

Customer's Right to Receive Access to the Supplier's Software Hosted on the Cloud (IAS 38 Intangible Assets)

The Committee received a request about how a customer accounts for a 'Software as a Service' cloud computing arrangement in which the customer contracts to pay a fee in exchange for a right to receive access to the supplier's application software for a specified term. The supplier's software runs on cloud infrastructure managed and controlled by the supplier. The customer accesses the software on an as needed basis over the internet or via a dedicated line. The contract does not convey to the customer any rights over tangible assets.

Does the customer receive a software asset at the contract commencement date or a service over the contract term?

The Committee noted that a customer receives a software asset at the contract commencement date if either (a) the contract contains a software lease, or (b) the customer otherwise obtains control of software at the contract commencement date.

A software lease

IFRS 16 *Leases* defines a lease as 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. Paragraphs 9 and B9 of IFRS 16 explain that a contract conveys the right to use an asset if, throughout the period of use, the customer has both:

- a. the right to obtain substantially all the economic benefits from use of the asset (an identified asset), and
- b. the right to direct the use of that asset.

Paragraphs B9–B31 of IFRS 16 provide application guidance on the definition of a lease. Among other requirements, that application guidance specifies that a customer generally has the right to direct the use of an asset by having decision-making rights to change how and for what purpose the asset is used throughout the period of use. Accordingly, in a contract that contains a lease the supplier has given up those decision-making rights and transferred them to the customer at the lease commencement date.

The Committee observed that a right to receive future access to the supplier's software running on the supplier's cloud infrastructure does not in itself give the customer any decision-making rights about how and for what purpose the software is used - the supplier would have those rights by, for example, deciding how and when to update or reconfigure the software, or deciding on which hardware (or infrastructure) the software will run. Accordingly, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the contract does not contain a software lease.

A software intangible asset

IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It notes that an asset is a resource controlled by the entity and paragraph 13 specifies that an entity controls an intangible asset if it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

The Committee observed that, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the customer does not receive a software intangible asset at the contract commencement date. A right to receive future access to the supplier's software does not, at the contract commencement date, give the customer the power to obtain the future economic benefits flowing from the software itself and to restrict others' access to those benefits.

Consequently, the Committee concluded that a contract that conveys to the customer only the right to receive access to the supplier's application software in the future is a service contract. The customer receives the service - the access to the software - over the contract term. If the customer pays the supplier before it receives the service, that prepayment gives the customer a right to future service and is an asset for the customer.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to account for fees paid or payable to receive access to the supplier's application software in Software as a Service arrangements. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

April 2021 IFRIC agenda decision

Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 Intangible Assets)

The Committee received a request about how a customer accounts for costs of configuring or customising a supplier's application software in a Software as a Service (SaaS) arrangement. In the fact pattern described in the request:

- a. a customer enters into a SaaS arrangement with a supplier. The contract conveys to the customer the right to receive access to the supplier's application software over the contract term. That right to receive access does not provide the customer with a software asset and, therefore, the access to the software is a service that the customer receives over the contract term.

- b. the customer incurs costs of configuring or customising the supplier's application software to which the customer receives access. The request describes configuration and customisation as follows:
 - i. configuration involves the setting of various 'flags' or 'switches' within the application software, or defining values or parameters, to set up the software's existing code to function in a specified way.
 - ii. customisation involves modifying the software code in the application or writing additional code. Customisation generally changes, or creates additional, functionalities within the software.
- c. the customer receives no other goods or services.

In analysing the request, the Committee considered:

- a. whether, applying IAS 38, the customer recognises an intangible asset in relation to configuration or customisation of the application software (Question I).
- b. if an intangible asset is not recognised, how the customer accounts for the configuration or customisation costs (Question II).

Does the customer recognise an intangible asset in relation to configuration or customisation of the application software (Question I)?

Applying paragraph 18 of IAS 38, an entity recognises an item as an intangible asset when the entity demonstrates that the item meets both the definition of an intangible asset and the recognition criteria in paragraphs 21–23 of IAS 38. IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. IAS 38 notes that an asset is a resource controlled by an entity and paragraph 13 specifies that an entity controls an asset if it has 'the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits'.

In the fact pattern described in the request, the supplier controls the application software to which the customer has access. The assessment of whether configuration or customisation of that software results in an intangible asset for the customer depends on the nature and output of the configuration or customisation performed. The Committee observed that, in the SaaS arrangement described in the request, the customer often would not recognise an intangible asset because it does not control the software being configured or customised and those configuration or customisation activities do not create a resource controlled by the customer that is separate from the software. In some circumstances, however, the arrangement may result in, for example, additional code from which the customer has the power to obtain the future economic benefits and to restrict others' access to those benefits. In that case, in determining whether to recognise the additional code as an intangible asset, the customer assesses whether the additional code is identifiable and meets the recognition criteria in IAS 38.

If an intangible asset is not recognised, how does the customer account for the configuration or customisation costs (Question II)?

If the customer does not recognise an intangible asset in relation to configuration or customisation of the application software, it applies paragraphs 68–70 of IAS 38 to account for those costs. The Committee observed that:

- a. the customer recognises the costs as an expense when it receives the configuration or customisation services (paragraph 69). Paragraph 69A specifies that ‘services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service’. In assessing when to recognise the costs as an expense, IAS 38 therefore requires the customer to determine when the supplier performs the configuration or customisation services in accordance with the contract to deliver those services.
- b. IAS 38 includes no requirements that deal with the identification of the services the customer receives in determining when the supplier performs those services in accordance with the contract to deliver them. Paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* require the customer to refer to, and consider the applicability of, the requirements in IFRS Standards that deal with similar and related issues. The Committee observed that IFRS 15 *Revenue from Contracts with Customers* includes requirements that suppliers apply in identifying the promised goods or services in a contract with a customer. For the fact pattern described in the request, those requirements in IFRS 15 deal with issues similar and related to those faced by the customer in determining when the supplier performs the configuration or customisation services in accordance with the contract to deliver those services.
- c. if the contract to deliver the configuration or customisation services to the customer is with the supplier of the application software (including cases in which the supplier subcontracts services to a third party), the customer applies paragraphs 69–69A of IAS 38 and determines when the supplier of the application software performs those services in accordance with the contract to deliver them as follows:
 - i. if the services the customer receives are distinct, then the customer recognises the costs as an expense when the supplier configures or customises the application software.
 - ii. if the services the customer receives are not distinct (because those services are not separately identifiable from the customer’s right to receive access to the supplier’s application software), then the customer recognises the costs as an expense when the supplier provides access to the application software over the contract term.
- d. if the contract to deliver the configuration or customisation services to the customer is with a third-party supplier, the customer applies paragraphs 69–69A of IAS 38 and determines when the third-party supplier performs those services in accordance with the contract to deliver them. In applying these requirements, the customer recognises the costs as an expense when the third-party supplier configures or customises the application software.
- e. if the customer pays the supplier of the configuration or customisation services before receiving those services, it recognises the prepayment as an asset (paragraph 70 of IAS 38).

Paragraphs 117–124 of IAS 1 *Presentation of Financial Statements* require the customer to disclose its accounting policy for configuration or customisation costs when that disclosure is relevant to an understanding of its financial statements.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for a customer to determine its accounting for configuration or customisation costs incurred in relation to the SaaS arrangement described in the request. Consequently, the Committee decided not to add a standard-setting project to the work plan.