



Exposure Draft

Proposed Draft Guideline

Accounting Standards for Private Enterprises

Customer's Accounting for Cloud Computing Arrangements

March 2022

COMMENTS TO AcSB MUST BE RECEIVED BY
JUNE 20, 2022

We value your input and look forward to your feedback on this Exposure Draft. Comment on this document by uploading your response letter via this [online form](#). Please address your response to:

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This Exposure Draft reflects proposals made by the Accounting Standards Board (AcSB). Individuals and organizations are invited to send written comments on the Exposure Draft proposals. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

Comments are most helpful if they relate to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Exposure Draft should clearly explain the problem and include a suggested alternative, supported by specific reasoning. All comments received by the AcSB will be available on the website shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly within the response.

HIGHLIGHTS

The Accounting Standards Board (AcSB) proposes, subject to comments received following exposure, to issue a new ACCOUNTING GUIDELINE (AcG) 20, "Customer's Accounting for Cloud Computing Arrangements," in Part II of the CPA Canada Handbook – Accounting. This new Guideline would also apply to not-for-profit organizations (NFPOs) using the standards in Part III of the Handbook, as relevant.

The proposed Guideline would clarify how existing Sections in Part II of the Handbook should be applied to account for cloud computing arrangements. The proposed Guideline would also provide a simplified approach to ease the accounting requirements for such arrangements and address other issues that stakeholders have raised. These issues include concerns that the accounting outcome for expenditures on implementation activities in a certain situation does not reflect the economic benefits an enterprise receives over time and that there are insufficient disclosures regarding the accounting for cloud computing arrangements.

BACKGROUND

With the evolution of technology and the need for remote access, enterprises are increasingly entering into cloud computing arrangements. Stakeholders have informed the AcSB that there is diversity in the accounting for these arrangements. In addition, stakeholders have expressed concerns with the accounting outcome for expenditures on implementation activities in an arrangement that is a service contract and the complexity involved in applying existing guidance.

In response to stakeholder input, the AcSB undertook a project to address the financial reporting issues related to cloud computing arrangements. The Board decided to address the issues through an Accounting Guideline because it thinks having the guidance in one location would be simpler for stakeholders and the guidance is specific to cloud computing arrangements. Accounting Guidelines are a primary source of generally accepted accounting principles. They set out how existing Sections shall be applied in specific cases or the Board's conclusions on other particular issues of concern with respect to financial reporting.

Main features of the Exposure Draft

The proposed Guideline:

- clarifies that an enterprise may determine a method on a rational and consistent basis for allocating arrangement consideration to significant separable elements in a cloud computing arrangement;
- clarifies that an enterprise applies GOODWILL AND INTANGIBLE ASSETS, Section 3064, to account for the significant elements, unless the elements are tangible assets or rights to use tangible assets;
- provides an optional simplification approach to permit an enterprise to expense as incurred the expenditures related to the elements in a cloud computing arrangement within the scope of Section 3064;
- provides factors to assist an enterprise that does not apply the simplification approach in applying the control principle in Section 3064 for determining whether the cloud computing arrangement includes a software intangible asset; and
- provides an accounting policy choice to either:
 - apply an exception to capitalize directly attributable expenditures on implementation activities when the arrangement is a software service (i.e., when no intangible asset exist) and to present such costs as prepaid expenses; or
 - continue to expense as incurred such expenditures in accordance with existing requirements in Section 3064.

To improve the quality and consistency of disclosures, the proposed Guideline would require an enterprise to disclose information on how the cloud computing arrangement is accounted for in its financial statements. Specific disclosure requirements are described.

Illustrative Examples are provided to assist financial statement preparers in applying the proposed Guideline.

The proposed Guideline would apply for fiscal years beginning on or after January 1, 2023, with early application permitted. Enterprises would apply the proposed Guideline retrospectively to cloud computing arrangements that exist on or after the beginning of the earliest period presented in the financial statements in which the enterprise first applies the Guideline.

Consequential amendments

Consequential amendments are proposed to ACCOUNTING CHANGES, Section 1506, and to Section 3064 in Part II of the Handbook.

Plans for finalizing the proposed Guideline

The AcSB will deliberate the proposals considering comments received. As part of its deliberation process, the Board will consult its [Private Enterprise Advisory Committee](#) and [Not-for-Profit Advisory Committee](#) (Advisory Committees). The Private Enterprise Advisory Committee assists the Board in maintaining and improving accounting standards for private enterprises. The Not-for-Profit Advisory Committee provides input on circumstances unique to NFPOs when applying the potential Guideline.

The AcSB will provide updates about its deliberations in its decision summaries and on the [Cloud Computing Arrangements](#) project page.

Once it has completed its deliberation process and its due process procedures for finalizing a Guideline, the AcSB plans to issue AcG-20 in Q4 2022 if no significant changes are required.¹

Comments requested

Comments are most helpful if they relate to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposed Guideline in this Exposure Draft should clearly explain the problem and include a suggested alternative, supported by specific reasoning.

While the AcSB welcomes comments on all aspects of the proposed Guideline in this Exposure Draft, it particularly welcomes comments on the questions listed below:

1. This Guideline considers that an enterprise would be able to apply professional judgment to its facts and circumstances to determine the significant separable elements in a cloud computing arrangement and to allocate the arrangement consideration to such elements (see paragraphs 20-30 in the Basis for Conclusions).
 - (a) In a situation when a vendor provides software access and performs activities to implement the software, do you find it challenging to account for the software access separate from the other activities performed by the vendor? If so, please explain why.

¹ Refer to the "Due Process Specifically Related to Domestic Standards" in the [AcSB Standard-Setting Due Process Manual](#).

- (b) The Board decided not to provide guidance in determining significant separable elements in a cloud computing arrangement (see paragraphs 20-26 in the Basis for Conclusions). However, it has discussed some factors that may help an enterprise in determining such elements in a cloud computing arrangement (see paragraph 25 in the Basis for Conclusions).
 - i. Would including these factors in the Guideline be helpful?
 - ii. Are there other factors that you currently consider in your analysis when determining the goods or services you receive from your vendor in a cloud computing arrangement?
 - (c) The Board also decided not to prescribe a method to allocate arrangement consideration to significant separable elements in a contract (see proposed paragraphs 7-9 of AcG-20). Do you agree with the Board's decision? If not, why not and what method do you think the Board should prescribe?
2. Do you agree that an optional simplification approach should be provided so an enterprise is permitted to expense as incurred the expenditures related to the elements in a cloud computing arrangement within the scope of Section 3064 (see proposed paragraphs 10-11 of AcG-20)? If not, why not?
 3. For an enterprise that does not apply the simplification approach, the Board proposes an accounting policy choice to apply an exception to capitalize directly attributable expenditures on implementation activities when the cloud computing arrangement is a software service or to continue with existing requirements to expense as incurred. The exception applies to expenditures that do not meet the definition of an intangible asset on a stand-alone basis.
 - (a) Do you agree with providing an exception to capitalize expenditures on implementation activities that are directly attributable in preparing the software service for its intended use (see proposed paragraph 23(b) of AcG-20)? If not, why not?
 - (b) Do you agree that an enterprise should be provided with a choice to expense as incurred or to apply the exception to capitalize directly attributable expenditures on implementation activities when the cloud computing arrangement is a software service? If not, why not?
 4. The Board proposes to present as prepaid expenses capitalized expenditures on implementation activities using the proposed exception in paragraph 23(b) of AcG-20. Such capitalized expenditures shall be expensed on a straight-line basis over the expected period of access of the software service by the enterprise.
 - (a) Do you agree that such capitalized expenditures should be presented as prepaid expenses (see paragraph 30 of AcG-20)? If not, why not?
 - (b) Do you agree that the factors proposed in paragraph 25 of AcG-20 are sufficient to assist an enterprise in determining the expected period over which the capitalized expenditures should be expensed? If not, what other factors would you suggest?
 5. The Board proposes factors an enterprise should consider in applying the control criterion in Section 3064 for purposes of determining whether a cloud computing arrangement includes a software intangible asset (see proposed paragraphs 16-18 of AcG-20).
 - (a) Do you agree that the control criterion of an intangible asset is satisfied when an enterprise has the contractual right to obtain the software without significant penalty and it is feasible for the enterprise to run the software on its own or a third party's infrastructure? If not, why not?
 - (b) Do you agree that an enterprise may consider other factors such as exclusive rights or decision-making rights in relation to the software in determining whether it controls the software in the cloud computing arrangement? If not, why not?
 6. Do you agree with the proposed disclosure requirements (see proposed paragraphs 31-33 of AcG-20)? If not, why not?

7. Do you agree with the proposed effective date of fiscal years beginning on or after January 1, 2023, with earlier application permitted (see proposed paragraph 34 of AcG-20)? If not, why not?
8. Do you agree with the transition provision to require an enterprise to apply the Guideline retrospectively, but only to cloud computing arrangements that exist on or after the beginning of the earliest period presented in the financial statements in which the enterprise first applies the Guideline (see proposed paragraph 35 of AcG-20)? If not, why not?
9. The illustrative examples are intended to show the application of the Guideline.
 - (a) The fact pattern used in both Illustrative Examples 1 and 2 includes an assumption that the services provided by the vendor for implementing the software are received prior to the commencement of accessing the software. Do you think this assumption is reasonable? If not, please describe the types of implementation services that would be received during the period when an enterprise is already accessing the software.
 - (b) Another assumption in the fact pattern is about the availability of information to allocate arrangement consideration. Would you be able to obtain pricing information from your vendor or from other sources such as through vendor quotations to assist in allocating the arrangement consideration to the goods or services you receive in a cloud computing arrangement?
 - (c) Illustrative Example 1 demonstrates the application of the Guideline when an enterprise chooses to apply the simplification approach. Illustrative Example 2 demonstrates the application of the Guideline when an enterprise does not apply the simplification approach. Are the examples helpful? If not, can you provide a fact pattern that is typical of what vendors offer in a cloud computing arrangement?

The deadline for providing your comment letter to the AcSB is June 20, 2022. We value your input and look forward to your feedback on this Exposure Draft. Comment on this document by uploading your response letter via this [online form](#).

PROPOSAL

ACCOUNTING GUIDELINE AcG-20, CUSTOMER'S ACCOUNTING FOR CLOUD COMPUTING ARRANGEMENTS

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PURPOSE AND SCOPE

- 1 This Guideline provides guidance on:
 - (a) accounting for a customer's expenditures in a cloud computing arrangement; and
 - (b) determining whether a software intangible asset exists in the arrangement.
- 2 GOODWILL AND INTANGIBLE ASSETS, Section 3064, sets out the general principles governing the recognition, measurement, presentation and disclosure of goodwill and intangible assets.
- 3 This Guideline does not address expenditures on tangible elements of a cloud computing arrangement. Elements that are tangible assets are dealt with elsewhere in other Sections:
 - (a) property, plant and equipment (see PROPERTY, PLANT AND EQUIPMENT, Section 3061); and
 - (b) right to use a tangible asset (see LEASES, Section 3065).
- 4 Cloud computing is the on-demand delivery of computing resources over the internet or a private network. Computing resources include software, servers, data storage, networking capabilities and more. There are different types of delivery models that describe the combination of computing resources a vendor provides such as Software as a Service (SaaS). The way computing resources are delivered is referred to as the deployment model. A deployment model is the computing environment in which the computing resources reside, such as a cloud-based, on-premises or hybrid environment.
- 5 With the introduction of cloud computing arrangements, the purchase of a software license has started to shift toward paying a subscription fee to access the software. The subscription fee

enables the customer to access the software residing on the vendor's cloud environment during the arrangement term. The vendor's cloud environment provides the infrastructure to support the running of the software, including providing the latest software updates.

- 6 An enterprise may enter into a multiple-element arrangement with a vendor that includes a software element, a hardware element and implementation activities. An enterprise may incur expenditures that relate to activities performed by internal personnel or third parties to implement the software in the arrangement.

RECOGNITION AND MEASUREMENT

- 7 Arrangement consideration is allocated at the inception of the cloud computing arrangement to all significant separable elements. For example, licensing the software or subscribing for access to the software (software element) is typically a significant separable element in a cloud computing arrangement. As specified in paragraph 3, tangible elements such as hardware are outside the scope of this Guideline.

- 8 An enterprise shall determine a method for allocating arrangement consideration on a rational and consistent basis for purposes of accounting for when it receives the goods or services.

- 9 This Guideline does not prescribe the method to allocate the arrangement consideration to meet the objective in paragraph 8. An enterprise may consider, but is not required, to adapt the methods in REVENUE, Section 3400, to perform this allocation.

Simplification approach

- 10 An enterprise is permitted to apply a simplification approach to account for expenditures in a cloud computing arrangement within the scope of this Guideline. Applying this approach, the enterprise shall recognize the expenditures related to the elements in the cloud computing arrangement within the scope of this Guideline as an expense as incurred. Guidance on recognition of an expense is provided in GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.52-54. In particular, these paragraphs indicate the following:
- (a) In the case of the supply of goods, the entity recognizes such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognizes the expenditure as an expense when it receives the services.
 - (b) Recognizing a prepayment as an asset is not precluded when payment for the delivery of the goods or services has been made in advance of the enterprise receiving the goods or services.

- 11 The simplification approach is an accounting policy that shall be applied consistently to expenditures in cloud computing arrangements. In making this accounting policy choice, the entity need not meet the criterion in ACCOUNTING CHANGES, paragraph 1506.06(b).

- 12 An enterprise that does not apply the simplification approach shall apply:
- (a) paragraphs 13-19 to determine if a software element is a software intangible asset or a software service; and
 - (b) paragraphs 20-28 to all other elements within the scope of this Guideline (for example, implementation activities or other intangibles such as those internally generated).

Software intangible asset

- 13 A software element in the arrangement is recognized as a software intangible asset if it meets the definition of an intangible asset and the recognition criteria in accordance with GOODWILL AND INTANGIBLE ASSETS, Section 3064.
- 14 The definition of an intangible asset requires the software element to be identifiable, be controlled by the enterprise and have future economic benefits that would flow to the enterprise

(see GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.11-.17). A software element normally meets the identifiable criterion because it would arise from contractual rights (see paragraph 3064.12(b)). The software element normally also meets the future economic criterion because of the benefits that would flow to the enterprise from the use of the software (see paragraph 3064.17).

- 15 An enterprise controls the software element if it has the power to obtain the future economic benefits flowing from the software and to restrict the access of others to those benefits (see GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.13).
- 16 A software element is controlled by the enterprise if it has the contractual right to obtain the software without significant penalty and it is feasible for the enterprise to run the software on its own or on a third party's infrastructure.
- 17 For purposes of the guidance in paragraph 16, the phrase "without significant penalty" contains two distinct concepts:
- (a) the ability to take delivery of the software without incurring significant cost; and
 - (b) the ability to use the software separately without a significant diminution in utility or value.
- 18 An enterprise may control the software element based on factors other than or in addition to paragraph 16. Other factors that indicate control include, but are not limited to, the following:
- (a) Exclusive rights to use the software or ownership of the intellectual property for customized software (i.e., the vendor cannot make the software available to other customers).
 - (b) Decision-making rights to change how and for what purpose the software is used throughout the period of use (e.g., the enterprise can decide on how and when to update or reconfigure the software).

Software service

- 19 A software element in the arrangement that does not meet the definition of an intangible asset and the recognition criteria in accordance with GOODWILL AND INTANGIBLE ASSETS, Section 3064, is a software service. An enterprise pays a subscription fee to access the software. The fee allocated to the software service shall be expensed as incurred (see paragraphs 3064.52-54 for guidance on recognition of an expense).

Implementation activities

- 20 An enterprise may incur expenditures to implement the software in the arrangement. Examples of implementation activities include:
- (a) integration;
 - (b) customization or coding;
 - (c) configuration;
 - (d) data conversion;
 - (e) testing;
 - (f) training; and
 - (g) business process reengineering.

This list of examples is not exhaustive.

- 21 An enterprise that recognizes a software intangible asset in accordance with paragraphs 13-18 shall capitalize as part of the cost of the asset expenditures on implementation activities that are directly attributable to preparing the asset for its intended use in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.25-.30. Subsequent measurement of the software intangible asset will be accounted for in accordance with Section 3064, which involves amortization and testing for impairment.

- 22 Expenditures on implementation activities may also give rise to a separate intangible asset. If the expenditures do give rise to a separate intangible asset, it shall be accounted for in accordance with GOODWILL AND INTANGIBLE ASSETS, Section 3064. For example, the expenditures to develop software coding may give rise to an internally generated intangible asset. Such an asset shall be accounted for in accordance with an enterprise's accounting policy choice in paragraph 3064.40.
- 23 An enterprise that recognizes a software service in accordance with paragraph 19 shall make an accounting policy choice to either:
- (a) expense the expenditures on implementation activities as incurred (see GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.52-54, for guidance on recognition of an expense); or
 - (b) capitalize the expenditures on implementation activities that are directly attributable to preparing the software service for its intended use as prepaid expenses.
- This accounting policy choice shall be applied consistently. In making this accounting policy choice, the entity need not meet the criterion in ACCOUNTING CHANGES, paragraph 1506.06(b).
- 24 Expenditures on implementation activities capitalized in accordance with paragraph 23(b) shall be expensed using a straight-line method over the expected period of access of the software service by the enterprise, unless there is evidence that another method better reflects the pattern in which the enterprise expects to benefit from accessing the software. In that case, such expenditures shall be expensed using a method that reflects the pattern in which the enterprise expects to benefit from accessing the software. The method of expense and the expected period of access of the software service by the enterprise shall be reviewed on a regular basis.
- 25 Factors to be considered in determining the expected period of access of the software service by the enterprise include:
- (a) the expectations regarding the period during and beyond the arrangement term that the enterprise plans to continue accessing the software service, provided there is evidence to support such expectations;
 - (b) any clauses that may exist in the arrangement such as non-cancellable periods, renewal periods or termination clauses that would impact the expected period of access of the software service by the enterprise; and
 - (c) the effects of obsolescence, technology, competition and other economic factors that may limit the expected period of access of the software service by the enterprise.
- 26 Certain expenditures on implementation activities are not directly attributable to preparing the software intangible asset or software service for intended use. For example, training activities are recognized as an expense as incurred (see GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.53(b)).
- 27 Expenditures on implementation activities capitalized in accordance with paragraph 23(b) shall be tested for impairment in accordance with the provisions of IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063, except for a not-for-profit organization in which such expenditures shall be tested for impairment in accordance with the provisions of INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4434.
- 28 An enterprise may incur subsequent expenditures to enhance the service potential of the software after the initial implementation of the software element. Service potential may be enhanced when there is an increase in the previously assessed service capacity, the life, useful life, or the expected period of access of the software service is extended, or the quality of the output is improved. Activities performed to maintain the expected service capacity of the software are maintenance activities, not enhancements. Expenditures that are:
- (a) directly attributable to enhancing the service potential of a software intangible asset are included in the carrying amount of the software intangible asset;

- (b) directly attributable to enhancing the service potential of a software service are capitalized as prepaid expenses only if an enterprise applies paragraph 23(b); and
- (c) maintenance activities are expensed as incurred irrespective of whether they relate to a software intangible asset or software service.

PRESENTATION

- 29 An enterprise shall present a software intangible asset and any directly attributable expenditures on implementation activities accounted for as part of the cost of such asset in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.90.
- 30 An enterprise shall present any expenditures on implementation activities accounted for in accordance with paragraph 23(b) as prepaid expenses. Prepaid expenses that do not meet the definition of a current asset in accordance with CURRENT ASSETS AND CURRENT LIABILITIES, paragraph 1510.03, shall be classified as long-term assets.

DISCLOSURE

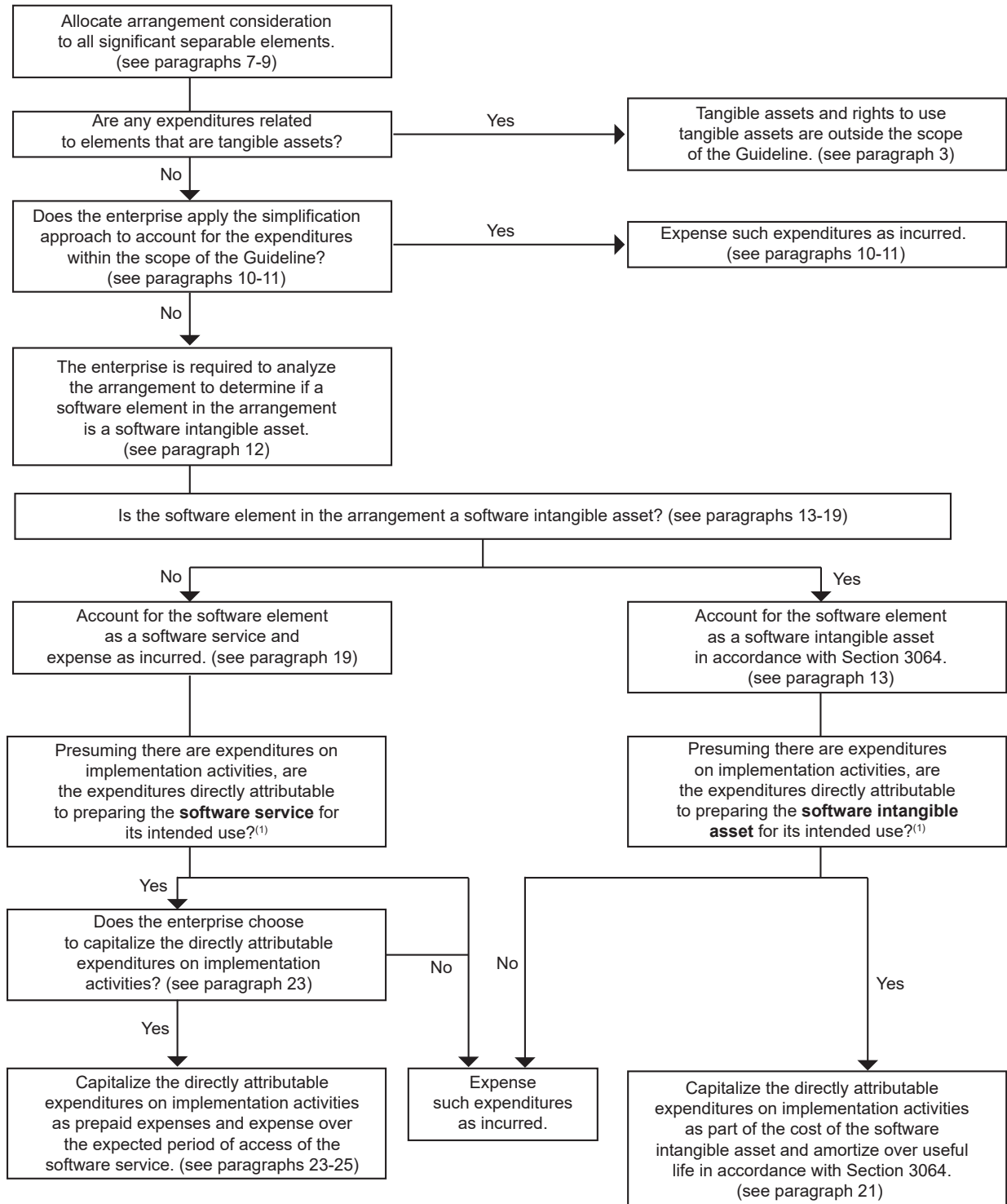
- 31 An enterprise that applies the simplification approach in paragraphs 10-11 shall disclose:
- (a) that fact; and
 - (b) the amount expensed for the period, including the caption in the income statement in which the expense is included.
- 32 An enterprise that does not apply the simplification approach in paragraphs 10-11 shall disclose the following:
- (a) for a software intangible asset, disclose information in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.91-.92 and 3064.94.
 - (b) for a software service, disclose:
 - (i) the amount expensed for the period, including the caption in the income statement in which the expense is included;
 - (ii) the policy followed to account for expenditures that are directly attributable to implementing the software service;
 - (iii) if directly attributable expenditures on implementation activities are capitalized, the net carrying amount capitalized as prepaid expenses and the method used to expense the prepaid expenses, including the expected period of access of the software service by the enterprise; and
 - (iv) for any impairment loss recognized on prepaid expenses in accordance with paragraph 27, the amount of the impairment loss, the caption in the income statement in which the impairment loss is included, and the facts and circumstances leading to the impairment.
- 33 In addition to the disclosures required by paragraphs 31 and 32, an enterprise shall disclose information in accordance with CONTRACTUAL OBLIGATIONS, Section 3280, regarding commitments to make expenditures on a cloud computing arrangement.

EFFECTIVE DATE AND TRANSITION

- 34 This Guideline applies to annual financial statements relating to fiscal years beginning on or after January 1, 2023. Earlier application is permitted.
- 35 An enterprise shall apply this Guideline retrospectively, but only to cloud computing arrangements that exist on or after the beginning of the earliest period presented in the financial statements in which the enterprise first applies the Guideline. The enterprise shall recognize the cumulative effect of initially applying the Guideline as an adjustment to the opening balance of retained earnings at the beginning of that earliest period presented.

DECISION TREE

This Decision Tree is illustrative only.



(1) An enterprise shall also consider paragraph 22 to determine whether any of the expenditures on implementation activities give rise to a separate intangible asset.

ILLUSTRATIVE EXAMPLES

This material is illustrative only.

These examples illustrate how the accounting treatment specified in this Guideline might be applied in a particular situation. Matters of principle relating to particular situations should be decided in the context of this Guideline.

APPLICATION OF GUIDELINE WHEN THE SIMPLIFICATION APPROACH IS APPLIED**Example 1**

Enterprise A chooses to apply the simplification approach in paragraphs 10-11 of the Guideline.

Fact Pattern

On September 1, 20X2, Enterprise A enters into a non-cancellable SaaS arrangement with Provider B for a three-year term to access Provider B's Enterprise Resource Planning (ERP) software for an annual fee of \$40,000, payable at the end of each year. Access to Provider B's ERP software begins on April 1, 20X3, with the first annual fee due March 31, 20X4. After the three-year term, ongoing access is negotiable with Provider B. Considering the SaaS arrangement is critical to building its information technology capability and its most recent five-year strategic plan, Enterprise A expects to renew the arrangement with Provider B for an additional two years beyond the initial three-year term. Enterprise A has a December 31 year-end.

As part of the arrangement, Provider B agrees to perform various implementation activities to enable Enterprise A to access the ERP software. The contract specifies that Enterprise A will pay \$100,000 when Provider B completes all the implementation activities, which include:

- configuring the ERP software for it to be used as intended by Enterprise A (i.e., setting of flags and switches and setting the parameters of the software);
- purging Enterprise A's existing data;
- training of Enterprise A's employees;
- testing that the ERP software is performing as required; and
- customizing the ERP software code to generate certain management reports.

Key facts of the arrangement:

- Provider B expects to complete all the implementation activities by March 31, 20X3. All the implementation activities are expected to be performed evenly over a six-month period so that the ERP software will be implemented by March 31, 20X3.
- Provider B maintains and performs upgrades to the ERP software without Enterprise A's consent.
- Enterprise A does not have the right to obtain the ERP software developed by Provider B; it only has the right to access the ERP software.
- Enterprise A does not have the right to obtain the customized code developed by Provider B. The added management reports are available for Enterprise A to use when it receives access to Provider B's ERP software on April 1, 20X3.
- Provider B does not provide a detailed breakdown of the cost associated with each of the implementation activities.

Enterprise A has also obtained additional information through the vendor selection process:

- Other vendors provide access to a similar ERP software for an annual fee of \$40,000.
- Other vendors can also perform the required implementation activities to get the ERP software ready for use as intended by Enterprise A.
- Quotations obtained from other vendors contain more detailed pricing of their implementation activities and, overall, suggest that the implementation cost of \$100,000 represents competitive pricing in the market.

Analysis

Applying paragraphs 7-9 of the Guideline, Enterprise A considers the terms of the contract with Provider B and information from other vendor quotations. Enterprise A needs to allocate the total arrangement consideration to the significant separable elements in the arrangement.

Enterprise A first applies judgment and concludes that the access to Provider B's ERP software is a significant element separate from the implementation activities that will be performed by Provider B. The access to the Provider B's software will be received for at least three years pending renewal.

In accordance with the contract, Provider B will perform all the implementation activities from September 1, 20X2, to March 31, 20X3. Since the activities will be performed by Provider B evenly over the six-month period, Enterprise A expenses as incurred those activities evenly over that period.

Enterprise A then performs the allocation to the elements in the arrangement for the purpose of applying the simplification approach in paragraphs 10-11 of the Guideline to expense as incurred these expenditures. The contract consideration is allocated to each component based on the pricing specified in the contract with Provider B given these prices are competitive considering other vendor's pricing obtained during the vendor selection process.

Significant separable elements	Allocation
Software access (\$40,000 x 3 years)	\$120,000
Implementation activities	\$100,000
Total	\$220,000

Enterprise A recognizes the following:

- An expense of \$40,000 each year starting from April 1, 20X3 for the annual fee to access Provider B's ERP software. Since Enterprise A's fiscal year-end is December 31, it will recognize a prorated amount of \$30,000 for the nine-month access of the software in 20X3 (i.e., $\$40,000 \times 9/12$ months).
- An expense of \$100,000 relating to the implementation activities when it receives the services from Provider B. Because the implementation activities are performed evenly over the six-month period between September 1, 20X2 and March 31, 20X3, Enterprise A will recognize a prorated amount of \$50,000 (i.e., $\$100,000 \times 3/6$ months) in both 20X2 and 20X3.

Entries by Enterprise A*

For 20X2:

Dr.	Operating expenses	\$50,000	
Cr.	Accounts payable		\$50,000

To accrue and expense as incurred the expenditures on implementation activities performed by Provider B from September 1 to December 31, 20X2.

For 20X3:

Dr.	Operating expenses	\$50,000	
Dr.	Accounts payable	\$50,000	
Cr.	Cash		\$100,000

To expense as incurred the expenditures on implementation activities performed by Provider B from January 1 to March 31, 20X3, and to reflect the cash paid to Provider B.

Dr.	Operating expenses	\$30,000	
Cr.	Accounts payable		\$30,000

To accrue and expense as incurred the expenditure related to accessing Provider B's ERP software from April 1 to December 31, 20X3.

* This example assumes Enterprise A will continue to access the ERP software until March 31, 20X8, and will make the annual payments when due. However, the related entries are not shown.

APPLICATION OF GUIDELINE WHEN THE SIMPLIFICATION APPROACH IS NOT APPLIED

Example 2

This example uses the same fact pattern as Example 1, except Enterprise A chooses:

- (a) not to apply the simplification approach in paragraphs 10-11 of the Guideline; and
- (b) to apply the accounting policy described in paragraph 23(b) of the Guideline to capitalize expenditures on implementation activities that are directly attributable to preparing the software service for its intended use as prepaid expenses.

Analysis

Applying paragraphs 7-9 of the Guideline, Enterprise A considers the terms of the contract with Provider B and information from other vendor quotations. Enterprise A needs to allocate the total arrangement consideration to the significant separable elements in the arrangement.

Enterprise A first applies judgment and concludes that the access to Provider B's ERP software is a significant element separate from the implementation activities that will be performed by Provider B. The access to Provider B's software will be received for at least three years pending renewal.

In accordance with the contract, Provider B will perform all the implementation activities from September 1, 20X2 to March 31, 20X3 evenly over the six-month period. However, Enterprise A concludes that it needs to account for each activity performed by Provider B separately because it needs to determine which expenditures on implementation activities are directly attributable to preparing the software service for its intended use.

Enterprise A then performs the allocation to each of the elements in the arrangement. It considers that one method to allocate arrangement consideration is based on the stand-alone price. Given the prices in the contract with Provider B are competitive based on the pricing information obtained during the vendor selection process, Enterprise A uses other vendors' pricing information to estimate the stand-alone prices for the various implementation activities performed by Provider B.

Significant separable elements	Allocation
Software access (\$40,000 x 3 years)	\$120,000
Customized coding	\$40,000
Configuration	\$25,000
Purging existing data	\$15,000
Testing	\$10,000
Training	\$10,000
Total	\$220,000

Since Enterprise A chooses not to apply the simplification approach in paragraphs 10-11 of the Guideline, it applies paragraphs 13-19 of the Guideline to determine whether the software element in the arrangement is a software intangible asset or a software service:

- (a) Applying paragraphs 13-18 of the Guideline, Enterprise A assesses whether it has control of Provider B's ERP software. The key terms in the arrangement indicate that Enterprise A only has access to the ERP software. Enterprise A is not able to obtain the ERP software nor does it have exclusive rights or decision-making rights over the ERP software. Enterprise A concludes these terms indicate that it does not control the ERP software.
- (b) Applying paragraph 19 of the Guideline, Enterprise A concludes that the software element represents a software service.

Enterprise A then analyzes the accounting for expenditures on implementation activities:

- (a) Applying paragraph 23(b) of the Guideline, Enterprise A capitalizes expenditures on implementation activities that are directly attributable to preparing the software service for its intended use as prepaid expenses.²
- (b) Applying paragraph 22 of the Guideline, Enterprise A also considers whether any of the expenditures on implementation activities give rise to a separate intangible asset. Enterprise A's existing accounting policy in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.40, is to capitalize expenditures on internally generated intangible assets during the development phase.

Enterprise A recognizes the following:

- (a) Software access of \$40,000 each year for Provider B's ERP software. Applying paragraph 19 of the Guideline, this expenditure is expensed as incurred to reflect when Enterprise A receives the service to access the software over the arrangement term. Since Enterprise A's fiscal year-end is December 31, it will recognize a prorated amount of \$30,000 for the nine-month access of the software in 20X3 (i.e., $\$40,000 \times 9/12$ months).
- (b) Customized coding of \$40,000, configuration of \$25,000 and testing of \$10,000 (totaling \$75,000) are activities needed to prepare the software service for Enterprise A's intended use. Therefore, Enterprise A concludes that these are directly attributable expenditures.
 - i. Applying paragraph 22 of the Guideline, Enterprise A considers whether the development of the customized code qualifies as an internally generated intangible asset. Enterprise A notes that since it does not have control over this code, the code is not Enterprise A's internally generated intangible asset.
 - ii. Applying paragraphs 23(b) and 24 of the Guideline, Enterprise A will capitalize the expenditures related to coding, configuration and testing activities when they are received and expense

² If Enterprise A chooses the accounting policy in paragraph 23(a) of the Guideline to expense the expenditures on implementation activities as incurred, the accounting outcome for such expenditures will be the same as if an enterprise applies the simplification approach as illustrated in Example 1.

them over the expected period of access of the software service. Because the implementation activities are performed evenly over the six-month period between September 1, 20X2 and March 31, 20X3, Enterprise A will capitalize \$37,500 in 20X2 (i.e., $\$75,000 \times 3/6$ months) and the remaining \$37,500 in 20X3.

- iii. Applying paragraph 25 of the Guideline, Enterprise A estimates the expected period of access of the software service to be five years, starting on April 1, 20X3. This expected period is based on management's expectations to continue accessing the software for an additional two years beyond the initial three-year term given the SaaS arrangement is a critical part of Enterprise A's strategic plan. Enterprise A also considered factors such as potential changes in technology that may limit the expected period of access of Provider B's ERP software when determining the expected period. Overall, Enterprise A concludes five years is a reasonable period based on its analysis. Since Enterprise A's fiscal year-end is December 31, it expenses on a straight-line basis \$11,250 of the capitalized expenditures in 20X3 (i.e., $\$75,000 \div 5$ years $\times 9/12$ months).
- (c) Training of \$10,000 and purging of existing data of \$15,000 (totaling \$25,000) are not directly attributable to preparing the software service for Enterprise A's intended use. Applying paragraph 26 of the Guideline, these expenditures are expensed as incurred when Provider B completes the performance of the training and purging data activities. Because the implementation activities are performed evenly over the six-month period between September 1, 20X2 and March 31, 20X3, Enterprise A will recognize a prorated amount of \$12,500 (i.e., $\$25,000 \times 3/6$ months) in both 20X2 and 20X3.

Entries by Enterprise A**

For 20X2:

Dr.	Prepaid expenses	\$37,500	
Cr.	Accounts payable		\$37,500

To accrue and capitalize expenditures that are directly attributable in preparing the software service for use (i.e., customized coding, configuration, and testing activities) from September 1 to December 31, 20X2.

Dr.	Operating expenses	\$12,500	
Cr.	Accounts payable		\$12,500

To accrue and expense as incurred the expenditures related to training and purging data from September 1 to December 31, 20X2.

For 20X3:

Dr.	Operating expenses	\$30,000	
Cr.	Accounts payable		\$30,000

To accrue and expense as incurred the expenditure related to accessing Provider B's ERP software from April 1 to December 31, 20X3.

Dr.	Prepaid expenses	\$37,500	
Cr.	Accounts payable	\$37,500	
Cr.	Cash		\$75,000

To capitalize expenditures that are directly attributable in preparing the software service for use (i.e., customized coding, configuration, and testing activities) from January 1 to March 31, 20X3, and to reflect the cash paid to Provider B.

Dr.	Operating expenses	\$12,500	
Cr.	Accounts payable	\$12,500	
Cr.	Cash		\$25,000

To expense as incurred the expenditures related to training and purging data from January 1 to March 31, 20X3, and to reflect the cash paid to Provider B.

Dr.	Operating expenses	\$11,250	
Cr.	Prepaid expenses		\$11,250

To expense on a straight-line basis the capitalized expenditures over the expected period of access of the software service of five years, prorated to reflect the period from April 1 to December 31, 20X3.

** This example assumes that Enterprise A will continue to access the ERP software until March 31, 20X8, will make the annual payments when due and expense the capitalized expenditures on a straight-line basis over five years. However, the related entries are not shown. Enterprise A shall apply paragraph 24 of the Guideline to review the method of expense and expected period of access of the software service on a regular basis. It shall also apply paragraph 27 of the Guideline to test for impairment of expenditures on implementation activities that are capitalized in accordance with paragraph 23(b) of the Guideline.

CONSEQUENTIAL AMENDMENTS TO ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES IN PART II OF THE CPA CANADA HANDBOOK – ACCOUNTING

The following significant consequential amendments to Part II of the Handbook have been identified. Additional text is denoted by underlining and deleted text by strikethrough.

GOODWILL AND INTANGIBLE ASSETS, Section 3064

PURPOSE AND SCOPE

- .04 Standards for the recognition, measurement, presentation and disclosure of tangible capital assets are provided in PROPERTY, PLANT AND EQUIPMENT, Section 3061. Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a license or patent) or film. In determining whether an asset that incorporates both intangible and tangible elements is to be accounted for under Section 3061 or as an intangible asset under this Section, an entity uses judgment to assess which element is more significant. For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset (see also ACCOUNTING GUIDELINE AcG-20, Customer's Accounting for Cloud Computing Arrangements).

ACCOUNTING CHANGES, Section 1506

- .09 *An enterprise may change the following accounting policies without meeting the criterion in paragraph 1506.06(b):*
- (a) *to consolidate subsidiaries, to account for them using the cost or equity method (see SUBSIDIARIES, Section 1591);*
 - (b) *to account for investments subject to significant influence using the cost or equity method (see INVESTMENTS, Section 3051);*
 - (c) *to account for interests in jointly controlled enterprises using the cost or equity method or by accounting for rights to the individual assets and obligations for the individual liabilities, in accordance with INTERESTS IN JOINT ARRANGEMENTS, Section 3056;*
 - (d) *to capitalize or expense expenditures on internally generated intangible assets during the development phase (see GOODWILL AND INTANGIBLE ASSETS, Section 3064);*
 - (e) *to measure a defined benefit obligation for defined benefit plans in which an actuarial valuation for funding purposes (funding valuation) is required to be prepared to comply with legislative, regulatory or contractual requirements using an actuarial valuation prepared for accounting purposes (accounting valuation) or the most recently completed funding valuation (see EMPLOYEE FUTURE BENEFITS, Section 3462);*
 - (f) *to account for income taxes using the taxes payable method or the future income taxes method (see INCOME TAXES, Section 3465);*
 - (g) *to initially measure the equity component of a financial instrument that contains both a liability and an equity component at zero (see FINANCIAL INSTRUMENTS, Section 3856);*
and
 - (h) *to determine the cost of agricultural inventories using full cost or only input costs (see AGRICULTURE, Section 3041);* and
 - (i) to account for expenditures in a cloud computing arrangement using the simplification approach or the accounting policy to expense or capitalize expenditures that are specific to implementation activities, in accordance with ACCOUNTING GUIDELINE AcG-20, Customer's Accounting for Cloud Computing Arrangements.

BASIS FOR CONCLUSIONS

Introduction

1. In March 2020, the AcSB considered its priorities related to projects for its domestic accounting standards. Based on input from its [Private Enterprise Advisory Committee](#) and [Not-for-Profit Advisory Committee](#) (Advisory Committees), the Board decided to add accounting for cloud computing arrangements from a customer's perspective to its workplan. The Board performed research to understand various cloud computing arrangements in practice and sought input to understand the accounting issues encountered by stakeholders and the usefulness of information provided to users in financial statements.
2. When it started the Cloud Computing Arrangements project, the AcSB heard from stakeholders two main financial reporting concerns:
 - (a) Expensing expenditures on implementation activities when the software in the cloud computing arrangement is not an enterprise's asset does not reflect the economic benefits an enterprise receives over time from implementing the software for use. Such expenditures can be quite significant.
 - (b) Determining the accounting for cloud computing arrangements involves a complex analysis, which can be difficult and costly to do for some private enterprises and not-for-profit organizations (NFPOs).
3. Through its research on this project and input from its Advisory Committees, the AcSB became aware of other financial reporting issues stakeholders encountered when accounting for cloud computing arrangements. These issues are as follows:
 - (a) Lack of clarity as to which Section applies to a cloud computing arrangement, leading to the possible use of FINANCIAL STATEMENT CONCEPTS, Section 1000, to determine if an asset exists or GOODWILL AND INTANGIBLE ASSETS, Section 3064, to determine if an intangible asset exists in the arrangement.
 - (b) The control principle in Section 3064 is challenging to apply in practice, especially for smaller private enterprises and NFPOs that may not have the time and resources to analyze if the arrangement contains an intangible asset.
 - (c) Allocating arrangement consideration to elements in a cloud computing arrangement may be difficult to do when the information is not provided by the vendor.
 - (d) Lack of guidance to account for subsequent changes to the software in a cloud computing arrangement (e.g., accounting for software upgrades and additional software modules).
 - (e) Insufficient disclosures for users to understand how the cloud computing arrangement is accounted for in the enterprise's financial statements. The lack of information provided to users affects the analysis of key ratios such as earnings before interest, tax, depreciation and amortization (EBITDA) and net income, and the understanding of cash flow impact.
4. The AcSB also considered the work of other standard setters. For example:
 - (a) U.S. Financial Accounting Standards Board (FASB) issued amendments in 2015 and 2018 to address the customer's accounting for fees paid in a cloud computing arrangement and implementation costs when the arrangement is a service contract.³

³ Accounting Standards Update No. 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*; and Accounting Standards Update No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*.

- (b) The IFRS Interpretations Committee of the International Accounting Standards Board (IFRS Interpretations Committee) issued agenda decisions in 2019 and 2021, clarifying how a customer accounts for a Software as a Service (SaaS) cloud computing arrangement and the costs of configuring or customizing the software in the arrangement.⁴
5. Based on the information gathered, the AcSB decided that the project's objectives are to:
 - (a) address stakeholders' financial reporting concern of reflecting the economic benefits from implementing the software in a cloud computing arrangement that is a service contract;
 - (b) clarify the Sections to apply to account for cloud computing arrangements, including the disclosure requirements to improve information reported to users; and
 - (c) simplify the existing requirements to address some of the difficulties and challenges with accounting for cloud computing arrangements.
 6. In developing the proposed Guideline, the AcSB sought the advice of its Advisory Committees. These committees include financial statement users, auditors and preparers, with a range of backgrounds and experience from across Canada. Advisory Committee members include representatives from organizations of differing sizes and in a variety of industries.

Applicability to NFPOs

7. NFPOs apply the standards for private enterprises in Part II of the Handbook to the extent that Part II standards address topics not addressed in Part III of the Handbook. Except as otherwise noted:
 - (a) INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4434, directs NFPOs to apply Section 3064 in Part II of the Handbook; and
 - (b) TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4433, directs NFPOs to apply PROPERTY, PLANT AND EQUIPMENT, Section 3061, in Part II of the Handbook.
8. A simplified accounting approach for both tangible capital assets and intangible assets is currently available to small organizations if their average of annual revenues recognized in the statement of operations for the current and preceding period of the organization and any entities it controls is less than \$500,000 ("capital asset recognition exemption"). Eligible small organizations can continue to apply this capital asset recognition exemption and will not need to refer to Sections in Part II of the Handbook for topics specific to tangible capital assets and intangible assets.
9. In finalizing the Guideline and considering the feedback received, the AcSB will continue to consult its Not-for-Profit Advisory Committee on any unique considerations for NFPOs applying this Guideline.

Effects analysis

10. The proposed Guideline aims to:
 - (a) enhance the relevance of financial information provided by:
 - i. improving disclosures; and
 - ii. allowing for an exception to capitalize expenditures to implement a software in a cloud computing arrangement that is a service contract to reflect multi-year economic benefits; and
 - (b) reduce the cost of preparing financial statements by:
 - i. providing clear guidance on areas of concern identified by stakeholders and on Sections to apply; and
 - ii. permitting entities to expense as incurred the expenditures related to the elements in a cloud computing arrangement within the scope of Section 3064.

⁴ IFRIC Agenda Decision (published in April 2021 as an addendum to the March 2021 *IFRIC Update*): Configuration or Customisation Costs in a Cloud Computing Arrangement; and IFRIC Agenda Decision (published in the March 2019 *IFRIC Update*): Customer's right to receive access to the supplier's software hosted on the cloud.

11. In developing the proposed Guideline, the AcSB considered the consequences of applying the Guideline relative to the objective of financial statements and the benefit versus cost constraint. As described in FINANCIAL STATEMENT CONCEPTS, paragraph 1000.12, the purpose of financial reporting is to “communicate information that is useful to investors, creditors and other users in making their resource allocation decisions and/or assessing management stewardship.” Also, as described in paragraph 1000.13, the Board considers the benefit versus cost constraint, which states: “In developing accounting standards, the Board weighs the anticipated costs and benefits of its proposals in general terms to assess whether they are justified on cost/benefit grounds.”

Exception to capitalize expenditures on implementation activities that do not meet the definition of an asset

12. Based on research and input from the AcSB's Advisory Committees, some users find it helpful to understand if an enterprise has made investments to support cloud-based solutions as doing so may increase the value in merger and acquisition situations.
13. The AcSB's view is that if the enterprise does not control the software in the cloud computing arrangement, expenditures to implement the software do not form part of an intangible asset and the enterprise should expense those expenditures as incurred. However, the Board acknowledges there may be benefit for users to understand the multi-year economic benefit resulting from making significant investments to implement a cloud-based solution and understands preparers' concern for having to expense such costs in one period, particularly if such expenditures are significant. Therefore, the Board thinks developing an exception to the definition of an asset can be justified as the intent is to enable preparers to communicate information that is useful to their investors, members, contributors, creditors, and other users.

Applying an optional simplification approach to expense as incurred

14. The AcSB considered whether it was necessary to require an enterprise to perform an analysis to determine whether an intangible asset exists in a cloud computing arrangement. Based on research and input from its Advisory Committees, the Board understands that SaaS arrangements are more common in practice and the software element is not typically controlled by the enterprise. Furthermore, some users are indifferent on whether an intangible asset in the arrangement is recognized because they may exclude such asset from their decision-making process.
15. The AcSB recognizes there are small private enterprises and NFPOs for which performing this analysis would be difficult and costly. Given users' feedback, the Board decided to develop this optional simplification approach that permits an enterprise to expense as incurred the expenditures related to the elements in a cloud computing arrangement within the scope of Section 3064. If an enterprise applies this simplification approach, it is not required to perform an analysis to determine if an intangible asset exists in the cloud computing arrangement. The Board recognizes that optional application of the simplification approach affects comparability. However, the Board concluded that the cost/benefit considerations justified developing the simplification approach.

Conclusion on effects analysis

16. Having considered the effects of the proposed Guideline, the AcSB thinks that the proposals will result in improvements to the financial reporting of private enterprises and NFPOs.

Purpose and Scope

17. The AcSB considered whether to include the guidance through amendments to existing sections in Part II of the Handbook, or by issuing a Guideline. As described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, paragraph 1100.14, “Accounting Guidelines set out how existing Sections shall be applied in specific cases or the Board's conclusions on other particular issues of concern with respect to financial reporting.”

18. The AcSB proposes to issue a new Guideline because it thinks having the guidance in one location would be simpler for stakeholders. Furthermore, the Board was concerned that amending Section 3064 could lead to unintended consequences for the guidance to be applied to arrangements beyond cloud computing arrangements. Considering paragraph 1100.14, the Board thinks the guidance fits the description of an Accounting Guideline because it involves clarifying how existing Sections shall be applied to cloud computing arrangements and the Board's conclusions on specific financial reporting concerns.
19. The AcSB developed this Guideline to address the issues identified with accounting for a cloud computing arrangement, as noted in paragraphs 2-3. Specifically on which Sections to apply, the Board noted it is common for there to be multiple elements in a cloud computing arrangement. For example, an enterprise may acquire new hardware to run the software from the cloud computing arrangement. The Board decided to clarify that if any elements in the arrangement are tangible assets, they would be accounted for under Section 3061 or LEASES, Section 3065. Any remaining elements in the cloud computing arrangement that are not tangible in nature would be scoped within the proposed Guideline.

Recognition and measurement

20. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Therefore, the AcSB concludes that an enterprise should apply Section 3064 to account for elements in a cloud computing arrangement that are not tangible in nature. In the context of a cloud computing arrangement, if an element within the scope of Section 3064 does not meet the definition of an intangible asset, the expenditure to acquire it or generate it internally is recognized as an expense when it is incurred.
21. The AcSB observes that paragraphs 3064.52-54 provide guidance on the recognition of an expense under this Section. In the case of the supply of goods, an enterprise recognizes an expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognizes an expenditure as an expense when it receives the services. Paragraph 3064.53A goes into further details to assist an enterprise in determining when it has received the goods or services from the vendor. Therefore, the Board thinks that additional guidance is not needed in the Guideline in applying the requirement to expense as incurred given guidance already exists in Section 3064.
22. Based on the research performed, the AcSB noted that cloud computing arrangements typically include a software element and activities to implement the software. Therefore, these arrangements are usually multiple element arrangements. The Board observes that while guidance exists in Section 3064 to determine when goods or services are received, there is no specific guidance that deals with the identification of such goods or services in an arrangement from a customer's perspective.
23. The AcSB recognizes that from a vendor's perspective, there are extensive requirements in REVENUE, Section 3400, regarding evaluating all deliverables in an arrangement to determine whether they represent separate units of account. This evaluation is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction.
24. The AcSB had extensive discussions on whether the customer's accounting should be symmetrical to a vendor's accounting for the elements in the arrangement. For example, an enterprise should consider whether the deliverable(s) in the cloud computing arrangement have value to the customer on a stand-alone basis.
25. The AcSB also considered whether there are practical factors that would indicate the elements in the arrangement are always separate. For example, if an enterprise engages a third-party consultant to perform the implementation activities, the expenditures for such activities would always be separate from the software service offered by the vendor in the cloud computing arrangement. If the vendor

in the arrangement performs the implementation activities, an enterprise should consider whether such activities can only be performed by the vendor and not by other vendors or third-party consultants. The expenditures for the implementation activities are unlikely to be a separate element in the arrangement when such activities can only be performed by the vendor that offers the software service.

26. After extensive deliberations, the AcSB decided not to provide guidance to assist an enterprise in determining the significant separable elements in a cloud computing arrangement based on these two points:
- (a) The purchase of multiple goods or services is not unique to cloud computing arrangements. There may be other situations in which an enterprise engages with a vendor for a bundle of goods or services to achieve its procurement requirements. In those situations, an enterprise has applied its professional judgement in assessing the contract to account for the goods or services purchased from the vendor.
 - (b) Explicitly requiring an enterprise to apply Section 3400 guidance in order to apply Section 3064 may introduce a level of complexity that results in a cost/benefit trade-off and lead to unintended consequences for other types of arrangements. In addition, the Board thinks the disclosures proposed in the Guideline would provide sufficient information for users to understand how a cloud computing arrangement is accounted for in an enterprise's financial statements, which would include explaining the significant elements in the arrangement.

Nevertheless, the Board intends to seek stakeholders' feedback to understand if an enterprise can apply professional judgment to determine the significant separable elements in a cloud computing arrangement with a vendor.

27. The AcSB notes that once an enterprise has determined the significant separable elements in the cloud computing arrangement, it would need to allocate the arrangement consideration to those elements. The Board understands from its Advisory Committees that sometimes it may be difficult to obtain pricing information of the various goods and services provided by the vendor in a cloud computing arrangement. Some enterprises may have this information, while others do not. As a result, allocating arrangement consideration to the different elements may be difficult and costly to do, especially for smaller private enterprises and NFPOs that do not have sufficient resources.
28. While the AcSB recognizes that there is also no guidance for allocating arrangement consideration from a customer's perspective, the concept of allocation exists in other Sections. For example:
- (a) PROPERTY, PLANT AND EQUIPMENT, Section 3061, acknowledges that the cost of an item of property, plant and equipment is made up of significant separable component parts. The cost is allocated to the component parts when practicable and when estimates can be made of the lives of the separate components.
 - (b) Section 3400 requires that arrangement consideration be allocated at inception of the arrangement to all deliverables on a relative stand-alone selling price basis.
29. However, the AcSB thought that since Section 3064 contains no specific requirements, an enterprise can determine a method for allocating arrangement consideration on a rational and consistent basis for purposes of accounting for when it receives the goods or services. The Board thinks that entities can adapt the methods in Section 3400 on allocating arrangement consideration to elements within the scope of the Guideline but did not propose this as a requirement.
30. To help an enterprise perform this allocation of arrangement consideration, the AcSB included illustrative examples in the proposed Guideline. The Board acknowledges there could be methods other than what is illustrated in the examples and an enterprise would use judgment to determine the method of allocation based on its own specific circumstances to apply the guidance in the proposed Guideline. For example, when an enterprise needs to assess whether implementation services received from the vendor are directly attributable to preparing the software for its use for capitalization purposes, it may require a more detailed allocation compared to an enterprise that applies the simplification approach and expenses as incurred the expenditures related to the elements in the arrangement.

Simplification approach

31. The AcSB considered the challenge that some stakeholders raised with respect to determining whether an intangible asset exists in the cloud computing arrangement, specifically applying the control principle in Section 3064.
32. The Advisory Committees observed that in practice, some enterprises consider the criteria in U.S. GAAP to determine if control of the software in a cloud computing arrangement exists. In most cases, enterprises determine it is rare to have control, particularly in SaaS arrangements. However, some enterprises, particularly smaller private enterprises and NFPOs, find it difficult and costly to analyze whether an intangible asset exists in the arrangement.
33. The AcSB notes that in Section 3064, an accounting policy choice exists either to capitalize expenditures on internally generated intangible assets during the development phase, or to expense such expenditures as incurred. This accounting policy choice is only available for internally generated intangible assets and was a simplification the Board provided when Part II of the Handbook was created.
34. Therefore, the AcSB decided to develop an optional simplification approach, similar to what exists for internally generated intangible assets, to permit entities to expense as incurred the expenditures related to the significant elements in the cloud computing arrangement. The Board recognizes this simplification approach would mean an enterprise could expense an intangible asset, whether separately acquired or internally generated, if it exists in a cloud computing arrangement. The Board's intention is that if an enterprise chooses to apply the simplification approach, this accounting policy would apply to expenditures in a cloud computing arrangement irrespective of an enterprise's existing accounting policy under paragraph 3064.40 relating to internally generated intangible assets.
35. The AcSB consulted its user members on its Advisory Committees. They noted that if there are sufficient disclosures to inform them how the cloud computing arrangement was accounted for in the financial statements, it is not imperative to their analysis to recognize an intangible asset when it exists in the arrangement.

Software intangible asset

36. For an enterprise that chooses not to apply the simplification approach, it will be required to analyze the cloud computing arrangement to determine if an intangible asset exists. The AcSB thought including guidance to help an enterprise assess whether the software element in the arrangement is a software intangible asset or a software service will reduce the cost of financial statement preparation. The Board decided to include factors relevant to cloud computing arrangements to assist an enterprise with applying the control principle in Section 3064. The Board developed these factors by considering the FASB and the IFRS Interpretations Committee's discussions on the topic of cloud computing arrangements.
37. The AcSB concluded that if an enterprise has the contractual right to obtain the software without significant penalty and it is feasible for the enterprise to run the software on its own or on a third party's infrastructure, the enterprise has control over the software and an intangible asset exists. The Board thinks that explaining the contractual right as the ability to obtain a copy of the intellectual property (software) rather than taking possession of the software as referred to in U.S. GAAP would help to clarify that the software does not have to reside on an enterprise's on-premises environment, but could reside on an off-premises environment as well. If such contractual right does not exist, the Board also thinks that an enterprise may control the software by considering other factors such as exclusive rights to use the software or decision-making rights over the software. The Board acknowledges these are not the only factors an enterprise considers in determining if the software is an intangible asset.

Software service

38. The AcSB concluded that if the software in the cloud computing arrangement is not an intangible asset, then the arrangement is a service contract. The proposed Guideline refers to the software in this situation as a software service.

Implementation activities

39. Currently in Section 3064, if the enterprise controls the software, the software will generally meet the recognition criteria of an intangible asset. Any directly attributable costs to implement the software can be capitalized as part of the cost of the intangible asset. The intangible asset will be accounted for in accordance with Section 3064.
40. One of the stakeholders' financial reporting concerns is the inability to capitalize costs incurred to implement the software in the cloud computing arrangement when the enterprise does not control the software. Many stakeholders observe that the economic benefits received over time from implementing a software provided by a vendor through a cloud-based deployment model are no different from the economic benefits received from implementing an on-premises software. Therefore, capitalizing expenditures on implementation activities and expensing over multiple periods better reflects the economic benefits an enterprise receives over time than expensing all in one period.

Developing an exception

41. The AcSB sought input from its user members on its Advisory Committees whether to develop an exception to capitalize expenditures on implementation activities incurred in a cloud computing arrangement that is a software service. Although lenders typically do not lend against intangible assets and exclude them from their decision-making process, some users observed that an enterprise's value may be higher if significant investments are made to support cloud-based solutions. The Not-for-Profit Advisory Committee noted that some funding from contributors may be for capital purposes, while other funding is for operating purposes.
42. The key focus for users is having sufficient disclosures to inform how the enterprise accounts for a cloud computing arrangement in the financial statements so that they can use the information to make necessary adjustments in their analysis. Improving disclosures to explain what amounts are expensed in the income statement or capitalized onto the balance sheet relating to a cloud computing arrangement is important. The AcSB understands that some NFPOs also provide other information to their contributors for special reporting purposes.
43. Considering the input, the AcSB decided to develop an accounting policy choice that would allow enterprises an exception to capitalize expenditures on implementation activities that are directly attributable to preparing the software for use when the enterprise does not control the software (i.e., a software service). If an enterprise does not choose to capitalize such expenditures, it will continue to expense as incurred according to existing guidance when the arrangement is a software service.
44. The Board decided this was an exception to the asset definition but was convinced by the feedback that expensing the expenditures on implementation activities in the period incurred may not always produce the most relevant information to users in the context of cloud computing arrangements. However, the Board does not intend for this exception to be used for arrangements beyond cloud computing arrangements.
45. Two AcSB members expressed concerns with developing this exception because the expenditures that would be capitalized do not meet the definition of an asset on a stand-alone basis. Since the software in the cloud computing arrangement is not controlled by the entity, it is a service contract. For these same Board members, they thought that any related expenditures incurred to implement the software service should be treated as a period expense.

46. The AcSB also decided that the period over which the capitalized expenditures from applying the exception is expensed should be the expected period of access of the software service by the enterprise. The Board recognized that determining this expected period may require significant judgment. Therefore, the Board has developed some factors to assist an enterprise in this regard. These factors considered the concepts used in determining an intangible asset's useful life and the term of a lease while reflecting the common occurrence in practice that many cloud computing arrangements may have a term on a month-to-month basis or may not specify a term.
47. The AcSB's intent is that an enterprise can look beyond the arrangement term in determining the expected period of access of the software service. An enterprise should consider its plans for continuing to access the software service with the vendor, any clauses in the arrangement that would impact the expected period of access, and whether the effects of obsolescence, technology, competition and other economic factors may limit the expected period of access of the software service by the enterprise. The enterprise should consider what evidence it has to support its expectations (e.g., business plan showing the importance of the cloud computing arrangement in achieving its overall business objectives and how long the enterprise expects to engage the vendor for the software service).

Other matters

48. The AcSB thought it was important to clarify for an enterprise that does not apply the simplification approach, it would need to consider whether any elements in addition to the software element may give rise to other intangibles assets. For example, the Board is aware there could be a situation when a vendor develops additional software code that can be used by the customer in another cloud computing arrangement. In this situation, developing coding could give rise to a separate internally generated intangible asset. An enterprise would apply Section 3064, specifically paragraph 3064.40 as it relates to internally generated intangible asset, to determine whether recognition is required.
49. The AcSB is also aware through input from its Advisory Committees that there could be additional modules or upgrades to the software in the cloud computing arrangement. Section 3064 does not provide guidance on accounting for enhancements of an intangible asset. Paragraph 3064.20 indicates that the nature of an intangible asset is such that in many cases subsequent expenditures are likely to maintain the asset as opposed to add or replace part of the asset. Furthermore, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business.
50. The AcSB understands that in practice, some enterprises capitalize enhancements or upgrades to software if it results in additional functionality. Although paragraph 3064.20 indicates that most subsequent expenditures are likely to maintain the future economic benefits of the intangible asset, the Board thinks that software is like hardware where enhancements may occur and can be attributable. Therefore, the Board decided to incorporate the betterment guidance in Section 3061 into the proposed Guideline to assist enterprises in determining whether subsequent expenditures incurred in a cloud computing arrangement enhance the software intangible asset or software service.
51. With regard to testing for impairment, expenditures capitalized through applying the exception are tested for impairment in accordance with the provisions of IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063, which is the same for a software intangible asset that is subject to amortization in Section 3064. However, if an NFPO is applying this Guideline, it would test for impairment in accordance with the provisions of INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4434, as the Section contains guidance for recognizing write-downs of intangible assets for NFPOs.

Presentation

52. Currently in Section 3064, software meeting the definition of an intangible asset is presented as an intangible asset, including any directly attributable costs to prepare the software for use. The intangible asset is subject to amortization over its useful life. The amortization expense would not affect a key ratio, EBITDA.
53. The AcSB considered how to present expenditures capitalized using the exception it developed. The Advisory Committees expressed mixed views on presentation.

Presentation of capitalized expenditures using the exception

54. One view is to adopt an intangible asset presentation because it is consistent with how an enterprise will present expenditures on implementation activities if it controls the software. This view considers that the nature of such expenditures is the same regardless of whether the enterprise controls the software, and therefore, should be presented in the same manner. This presentation also makes it easier for users since the balance sheet impact from the cloud computing arrangement would be presented with other software within the intangible assets financial statement caption. The expensing of capitalized expenditures using the exception would also be presented as amortization expense, therefore not affecting a key ratio, EBITDA.
55. Another view is to adopt a prepaid expenses presentation because when the enterprise does not control the software in the cloud computing arrangements, the subscription fees paid to access the software are expensed as an operating expense. If expenditures capitalized using the exception are presented as prepaid expenses, these expenditures would also be expensed as an operating expense in the same manner as the subscription fees. The impact of both the subscription fees and the expenditures to implement a cloud computing arrangement that is a service contract would flow through the same income statement line item.
56. Furthermore, U.S. GAAP requires capitalized implementation costs incurred in a cloud computing arrangement that is a service contract be presented in the same line item as a prepayment of the fees for the associated hosting arrangement.
57. The AcSB also considered other presentation options, such as deferred charges, but noted that creating a new separate balance sheet caption outside what exists in BALANCE SHEET, Section 1521, may have unintended consequences.
58. The AcSB acknowledges there are merits to both intangible asset and prepaid expenses presentation. However, if the software itself is not presented as an intangible asset, it would be counterintuitive to present the related expenditures on implementation activities as an intangible asset. The Board thinks that since the nature of the cloud computing arrangement is a software service, presenting the related expenditures on implementation activities as prepaid expenses produces a more relevant income statement impact to align with where the subscription fees will be recognized.
59. The AcSB also considered current and non-current classification for prepaid expenses. Prepaid expenses that do not meet the definition of a current asset in accordance with CURRENT ASSETS AND CURRENT LIABILITIES, paragraph 1510.03, shall be classified as long-term assets.

Disclosure

60. The disclosure requirements in the proposed Guideline are consistent with the disclosure requirements in Section 3064 and CONTRACTUAL OBLIGATIONS, Section 3280.
61. The AcSB decided it was important to include disclosure requirements in the proposed Guideline, even if some requirements highlight what exists in other Sections. Users have noted that currently in practice, it is sometimes difficult to understand how a cloud computing arrangement is accounted for in an enterprise's financial statements.

62. In addition to highlighting existing disclosure requirements, the AcSB decided to require an enterprise that applies the simplification approach to disclose that fact. If an enterprise does not apply the simplification approach, it should disclose the accounting policy it chose to account for directly attributable expenditures on implementation activities for a software service. For an entity that chooses to capitalize such directly attributable expenditures on implementation activities, the enterprise should also disclose the balance sheet and income statement impact. This disclosure would be consistent with expenditures capitalized as part of a software intangible asset in Section 3064.

Effective Date and Transition

63. The AcSB plans to issue proposed AcG-20 into Part II of the Handbook in Q4 2022 if no significant changes are required to the proposed Guideline following stakeholders' feedback on the Exposure Draft.

64. Selecting an effective date for the proposed Guideline is an important step in the AcSB's due process. The Board recognizes the importance of this Guideline given cloud computing arrangements are becoming more prevalent in practice.

65. Considering the transitional provisions discussed below, the AcSB proposes AcG-20 to be effective for fiscal years beginning on or after January 1, 2023. The Board also proposes to permit earlier application. For example, this would permit:

- (a) private enterprises with a December 31 year-end to apply this Guideline to their 2022 financial statements; and
- (b) NFPOs with a March 31 year-end to apply this Guideline to their 2022-23 financial statements.

66. The AcSB has heard from its Advisory Committees that providing the option to apply the Guideline retrospectively or prospectively is important. Some enterprises may want to apply the Guideline retrospectively to capitalize expenditures previously expensed under existing guidance. However, other enterprises may want to apply the Guideline prospectively as it would be less costly. If the application of the Guideline is not expected to be significant, the benefits of retrospective application would not justify the costs.

67. The AcSB acknowledges that the proposed Guideline may result in some enterprises changing their accounting for cloud computing arrangements, which would increase the cost of financial reporting. However, the Board thinks that applying the proposed Guideline would result in improvements to financial reporting and that retrospective application would be useful since it would provide comparable information for the prior period.

68. The AcSB proposes that an enterprise apply the proposed Guideline retrospectively, but limit retrospective application to cloud computing arrangements that exist on or after the beginning of the earliest period presented.

Alternative view on Exposure Draft, “Customer’s Accounting for Cloud Computing Arrangements”

- AV1 Two AcSB members voted against the publication of the Exposure Draft, “Customer’s Accounting for Cloud Computing Arrangements.” Their rationale is articulated in paragraphs AV2-AV3.
- AV2 The two AcSB members disagreed with the Board’s proposal to develop an exception to capitalize directly attributable expenditures on implementation activities incurred in a cloud computing arrangement that is a software service and present such costs as prepaid expenses. They disagreed because such expenditures do not meet the definition of an asset in FINANCIAL STATEMENT CONCEPTS, Section 1000, and FINANCIAL STATEMENT CONCEPTS FOR NOT-FOR-PROFIT ORGANIZATIONS, Section 1001. An asset should not be recognized for expenditures related to implementing a software service that the entity does not control. These expenditures should be treated as a period expense.
- AV3 The two AcSB members also think that the benefit of the information communicated to users through capitalizing directly attributable expenditures on implementation activities as prepaid expenses does not justify creating an exception to the definition of an asset. Users, such as lenders, may have to adjust out the expenditures recognized as prepaid expenses each year when making lending decisions as opposed to making a one-time adjustment for the year in which such expenditures are recognized as a period expense. Therefore, these two Board members voted against the publication of the Exposure Draft.

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