IAS 38: Configuration and Customization Costs in a Cloud Computing Arrangement

Extract, IFRS® Discussion Group Report on the Meeting – May 20, 2021

The IFRS® Interpretations Committee (the Interpretations Committee) received a submission about a customer's accounting for costs of configuring or customizing the supplier's application software in a Software as a Service (SaaS) arrangement.

In the fact pattern described in the submission:

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's 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 customizing the supplier's application software to which the customer receives access. The request describes configuration and customization as follows:

   i.   Configuration involves settings 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. Customization involves modifying the software code in the application or writing additional code. Customization generally changes, or creates additional, functionalities within the software.

c) The customer receives no other goods or services.

In analyzing the submission, the Interpretations Committee considered:

   a) whether, applying IAS 38 *Intangible Assets*, the customer recognizes an intangible asset in relation to configuration or customization of the application software.

   b) if an intangible asset is not recognized, how the customer accounts for the configuration or customization costs.

The Interpretations Committee discussed these issues at its December 2020 and March 2021 meetings. Subsequently, the Interpretations Committee published an agenda decision in April 2021.

The Group considered the analysis included in this agenda decision as summarized below and discussed the application of this agenda decision in Canada.

Issue 1: Does the customer recognize an intangible asset in relation to configuration or customization of the application software?

Analysis

- The customer recognizes an item as an intangible asset when the customer 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 notes that an asset is a resource controlled by the customer and paragraph 13 of IAS 38 specifies that the customer 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 Interpretation Committee submission, the supplier controls the application software while the customer only has access. The assessment of whether configuring or customizing software results in an intangible asset for the customer depends on the nature and output of the configuration or customization performed.

- The Interpretations Committee observed that, in the SaaS arrangement described in the submission, the customer often would not recognize an intangible asset because it does not control the software being configured or customized and those configurations or customizations do not create a resource controlled by the customer that is separate from the software.

- The Interpretations Committee noted that 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 recognize the additional code as an intangible asset, the customer assesses whether the additional code is identifiable and meets the recognition criteria in IAS 38.

The Group's Discussion

Group members agreed with the analysis.

Some Group members highlighted that cloud computing arrangements often include multiple elements that need to be closely examined by the customer. For example, a cloud computing arrangement may include tangible elements like the supporting infrastructure and intangible elements such as software. In these cases, the customer should assess whether it controls the individual elements to determine whether an intangible asset should be recognized.

The Group then considered other arrangements where the control assessments are more complex compared to the fact pattern contemplated in the agenda decision. Several Group members noted that in some cases, the customer may have the ability to take possession of the supplier's software and host the software in a third-party's cloud environment or on its own infrastructure. In other cases, a customer may develop additional programs and software modules to integrate its own system with the supplier's system and database, which can be separated from the supplier and applied to another cloud environment or to its own system. These Group members noted in these

cases, it is important to understand the customer's rights in the arrangements. They also thought that a customer's right to possess the supplier's software or the underlying codes for software modules and the right to transfer the software to another environment are relevant factors to consider when assessing control.

A few Group members viewed the underlying economics between a customer owning the software license and accessing the software in a SaaS arrangement to be similar. Therefore, they noted that the different accounting treatments on the configuration and customization costs may not reflect the similar economics. One Group member thought that this concern may be more effectively addressed through a future standard-setting project. Another Group member highlighted that the Interpretations Committee's March 2019 agenda decision on "Customer's right to receive access the supplier's application software hosted on the cloud" provides useful guidance to help customers assess whether the cloud computing arrangement contains a software asset.

Issue 2: If an intangible asset is not recognized, how does the customer account for the configuration or customization costs?

Analysis

- If the customer does not recognize an intangible asset in relation to configuration or customization of the application software, the customer recognizes the costs as an expense when it receives the configuration or customization services. In assessing when to recognize the costs as an expense, IAS 38 requires the customer to determine when the supplier performs the configuration or customization services in accordance with the contract to deliver those services.

- IAS 38 does not provide guidance on the identification of services the customer receives and determining when the supplier performs those services. The Interpretations Committee observed that IFRS 15 *Revenue from Contracts with Customers* includes requirements associated with identifying promised goods or services in a contract with a customer. For the fact pattern described in the submission, the requirements in IFRS 15 provide guidance on determining when the supplier performs the configuration or customization services in accordance with the contract to deliver those services.

- If the contract specifies that the application software supplier also performs the configuration or customization service, then the customer applies paragraphs 69 and 69A of IAS 38 and determines when the supplier performs those services in accordance with the contract to deliver them.

    i. If the services the customer receives are distinct, then the customer recognizes the costs as an expense when the supplier configures or customizes 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 recognizes the costs as an expense when the supplier provides access to the application software over the contract term.

- If the contract to deliver the configuration or customization services to the customer is with a third-party supplier, the customer applies paragraphs 69 and 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 recognizes the costs as an expense when the third-party supplier configures or customizes the application software.

- If the customer pays the supplier of the configuration or customization services before receiving those services, it recognizes the prepayment as an asset.

The Group's Discussion

Some Group members observed that using IFRS 15 to determine whether the supplier performs configuration or customization services may be a change in approach for many entities. In these cases, the customer may need to evaluate its contract review process and procedures to incorporate this step when assessing at what point these implementation costs are recognized as an expense.

A few Group members noted the inconsistent accounting outcomes for the same implementation services performed by the third-party vendor or the cloud supplier. The implementation costs paid to a third-party vendor are expensed as incurred. However, if the same implementation services are performed by the cloud supplier, the implementation costs are combined with the cloud supplier's hosting fee when the services are not distinct. While acknowledging this inconsistency, some Group members observed that it is uncommon in practice for the cloud supplier to perform the implementation services. These Group members noted that companies often use internal IT teams to configure and customize the application software. In addition, one Group member commented that internal costs account for most of the implementation costs, comparing to the cost incurred on external consultants and software suppliers.

One Group member commented that when a customer pays a third-party to customize the supplier's software, the customer should consider whether it controls certain elements in the cloud computing arrangement. For example, a third-party vendor could have created a separate software asset that is controlled by the customer.

Issue 3: When should the agenda decision be applied?

The Group's Discussion

Several Group members said that "sufficient time" required to implement this agenda decision depends on a company's own facts and circumstances. They noted that the effort required to complete the implementation of the agenda decision will impact what represents "sufficient time".

A representative of the Canadian Securities Administrators commented that entities that have not yet implemented this agenda decision should consider applying the requirements in paragraph 30 of

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to disclose information on the expected timing and the possible impact that applying this agenda decisions will have on their financial statements.

The Group's discussion of the three issues raises awareness about the Interpretations Committee's agenda decision on the accounting for configuration or customization costs in a cloud computing arrangement. No further action was recommended to the AcSB.