Cloud computing: The impact of recent PSA Handbook changes on accounting for implementation costs

Extract, PSA Discussion Group Report on the Public Meeting – November 10, 2022

The submission asked the Group to consider whether implementation costs related to cloud computing arrangements that are service arrangements should be capitalized or expensed under PSAS in light of the recent guidance issued by PSAB and other standard setters. For example:

- PSAB issued PSG-8, which opens the door to recognizing purchased intangibles in public sector financial statements.
- The IFRS Interpretations Committee (IFRIC) the released an agenda decision (March 2021) on accounting treatment of costs of configuring or customizing a supplier's application software in a cloud computing arrangement that is a service arrangement.[1]
- PSAB's International Strategy is now in effect. The implementation of this strategy included the amending of Section PS 1150, *Generally Accepted Accounting Principles*, to position IPSAS as the first accounting framework for public sector entities to consult in situations not covered by primary sources of GAAP or for assistance in applying primary sources of GAAP to specific circumstances, when a public sector entity chooses to look outside the PSA Handbook for additional guidance.
- The Financial Accounting Standards Board issued ASU 2018-15 (Customer's accounting for implementation costs incurred in a cloud computing arrangement that is a service) effectively aligning the accounting for implementation costs for hosting arrangements, regardless of whether they convey a license to the software or represent a service arrangement.
- The Canadian Accounting Standards Board (AcSB) issued the Exposure Draft in March 2022 proposing the issuance of Accounting Guideline (AcG) 20, *Customer's Accounting for Cloud Computing Arrangements*.[2] The Guideline would apply to private sector entities following accounting standards for private enterprises (ASPE) and private sector not-for-profit organizations following accounting standards for not-for-profit organizations.

Cloud computing arrangements are becoming more prevalent in the public sector and involve significant investment. As noted during previous Group meetings (October 2015 and July 2020) PSAS do not directly address the questions of:

- accounting for payments made to a cloud computing provider for the underlying cloud computing arrangement; or
- accounting for related implementation costs.

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[1] IASB, "IFRIC Update March 2021." See "Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 31 Intangible Assets) – Agenda Paper 2", published in April 2021, for full details of the agenda decision.

[2] AcG-20 was issued to Part II of the CPA Canada Handbook and released on November 15, 2022.

Issue 1 – Considering the recent changes to accounting frameworks, how should a customer account for implementation costs incurred in a cloud computing arrangement that is a service under PSAS?

The Group was asked to consider whether all implementation costs should be capitalized (View A) or expensed (View B).

Most Group members supported View B, and shared the following:

- The underlying cloud computing software would be controlled by the supplier, not by the customer (so it is not an asset of the customer). Implementation costs on their own do not provide future economic benefits; these only arise in conjunction with the software. As the software is controlled by the supplier, implementation costs cannot be capitalized on their own by the customer.
- There is no prevailing view from other standard setters as to the most appropriate accounting for these circumstances.
- Some Group members distinguished having the software on-premises versus in the cloud and what the implications of this distinction were for accounting purposes. They noted that while an on-premises system may be capitalized, it would be helpful for PSAB to provide further guidance on cloud computing arrangements. A Group member noted that the same level of service is provided to public sector entities for a cloud-based service, as it is for an on-premises application. The Group reflected on the following while discussing the implications of an on-premises software versus a cloud-based one:
  - Extensive upfront costs
  - Similar implementation costs
  - Platforms and solutions have evolved more toward cloud-based ones (on-premises solutions are becoming outdated)
  - Replacement of software assets and service-level contracts are becoming more complex
  - Technological advancements have outpaced the development of accounting standards
- Another Group member stated while it can be argued such costs should be capitalized, current PSAS guidance explicitly prohibits accounting for developed or inherited intangibles as assets and so implementation costs for cloud computing arrangements need to be expensed.
- A practical and preferred approach would be to capitalize and amortize implementation costs related to cloud computing arrangements that are a service. However, public sector entities must adhere to current standards. The implicit approach given the current PSAS guidance is to expense such costs as they are incurred.

A few Group members raised concern with having to expense implementation costs related to cloud computing arrangements that are a service, as this may result in skewing the financial position of many public sector entities. Also, some Group members thought that the implementation costs have a value on their own. They gave examples where municipalities incur significant implementation costs involving cloud computing arrangements. Expensing such costs, rather than capitalizing and amortizing them over the period of the contract, poses a challenge to how to reflect such costs in financial statements and to explain them to council and to citizens.

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One Group member supported View A, providing an example where a software provider would no longer support the on-premises software system. A significant investment was required to upgrade the system to a cloud-based one. In this instance, it was determined to capitalize the cloud-based enterprise finance system and amortize such costs over the period of the contract.

The Group discussed if conclusions on the views provided in the submission would depend on the nature of the implementation activities. Many Group members reflected that the concept of control would still be relevant as the cloud-based software is controlled by the supplier. So, if the customer does not control the future economic benefits without proprietary access to the software, there would still be the need to expense the implementation costs related to the cloud computing arrangement, unless some of those implementation costs met the definition of an asset in their own right.

One Group member noted that exceptions should be explored, referencing the AcSB's Exposure Draft for AcG-20,[3] which will form part of ASPE. Added similar flexibility and clarity on how to account for cloud computing arrangements and related implementation costs under PSAS would be welcomed.

The Group reflected on the recent decisions from other standard setters and noted that cloud computing has been discussed at prior Group meetings. The Group encouraged PSAB to address the concerns discussed by providing further clarity and guidance regarding intangibles in general and specifically cloud computing arrangements, as well as related implementation costs.

[3] The Exposure Draft explored:

- how existing Sections in ASPE should be applied when accounting for cloud computing arrangements;
- a simplified approach to ease the accounting requirements for such arrangements; and
- 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.