



RSM INSIGHT: ACCOUNTING FOR CLOUD BASED SOFTWARE

by RSM IFRS Advisory Committee

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ACCOUNTING FOR CLOUD BASED SOFTWARE

Accounting for 'Software as a Service' cloud computing arrangements

Cloud computing solutions, often packaged as "Software as a Service – SaaS" arrangements, are commonly used due to their flexibility and scalability features. In a cloud computing arrangement, software is usually accessed through the internet, rather than on local servers. Such arrangements generally do not require customers to download or take possession of the underlying software. Instead, software is stored on cloud computing infrastructure that is managed by the software provider, and accessed on an as-needed basis, with software updates and maintenance services being managed by the software provider.

A recent IFRIC agenda decision has clarified some aspects of accounting for cloud-based SaaS arrangements.

Configuration or Customisation Costs in Cloud Computing Arrangements

In April 2021, the IFRS Interpretations Committee (IFRIC) issued a final agenda decision in relation to Configuration or Customisation Costs in a Cloud Computing Arrangement. The decision focused on the appropriate accounting treatment for configuration or customisation costs from cloud computing arrangements.

In the fact pattern described in the request a customer enters into a SaaS arrangement with a supplier. The contract conveys to the customer the right to access the supplier's application software over the contract term. That right to receive access does not provide the customer with a software asset. Therefore, the access to the software is a service the customer receives over the contract term. The customer incurs costs of configuring or customising the supplier's application software.

Configuration

Configuration involves the setting of various 'flags' or 'switches' within the application software, or defining values or parameters, to set up the software's existing code to function in a specified way.

Customisation

Customisation involves modifying the software code in the application or writing additional code. Customisation generally changes or creates additional functionalities within the software.

The IFRIC considered the following questions in analysing the request:

- a) Whether, applying IAS 38, the customer recognises an intangible asset in relation to configuration or customisation of the application software.
- b) If an intangible asset is not recognised, how does the customer account for the configuration or customisation costs.

When can an intangible asset be recognised?

The IFRIC decided that in the fact pattern described in the request configuration and customisation usually would not meet the definition of intangible assets under IAS 38 *Intangible Assets*.

In reaching this decision, the IFRIC noted that:

- If the customer does not control the software being configured or customised, it generally would not recognise an intangible asset because the configuration or customization activities do not create a resource controlled by the customer that is separate from the software.
- In some circumstances, the arrangements may result in additional code from which the customer has the power to obtain future economic benefits and to restrict others' access to those benefits. In this case, the customer might be able to recognise the additional code as an intangible asset depending on whether the additional code is separately identifiable and meets the recognition criteria in IAS 38.

Generally, cloud computing arrangements do not give rise to an intangible asset under IAS 38 as they do not give customers the power to control the cloud-based software to obtain the future economic benefits flowing from the asset, and to restrict the access of others to those benefits. Most cloud computing arrangements only provide customers with the right to access the software, and customers are not required to obtain software licences or take possession of the underlying software.

Configuration and customisation costs might be capitalised as intangible assets if an entity determines that it has control over a separate software intangible asset. A software intangible asset would exist if the following criteria (least but not limited to) are met:

- There was a contractual right to take possession of the software. The cloud-based software would be operated on the customer's own computer infrastructure or through a contract with a third party that is unrelated to the software provider.

- Exclusive right is granted to the customer and the software is not available to other customers.
- As part of customisation or configuration, additional software code was created, and controlled by the customer, which could be used separately from the underlying cloud -based software. We believe this is likely to be relatively rare in practice.

The assessment of whether configuration or customisation costs can be recognised as intangible assets for the customer depends on the nature and output of the software implementation performed. Judgement and detailed assessment are required for determining the appropriate accounting treatment based on all relevant facts and circumstances.

How to treat customisation and configuration costs?

The IFRIC also considered the accounting treatment of configuration or customisation costs under IAS 38 if an intangible asset is not recognised. The Committee observed that an entity should recognise the expenditure as an expense when it receives the services. This raises the question of when a customisation or configuration service is received.

In the absence of any other specific guidance, the IFRIC noted that IFRS 15 *Revenue from Contracts with Customers* includes requirements that suppliers should apply in identifying the promised goods or services in a contract with a customer, which may be used in determining whether customisation or configuration services are a separate service for the purposes of recognising the expense.

Distinct vs. Not Distinct

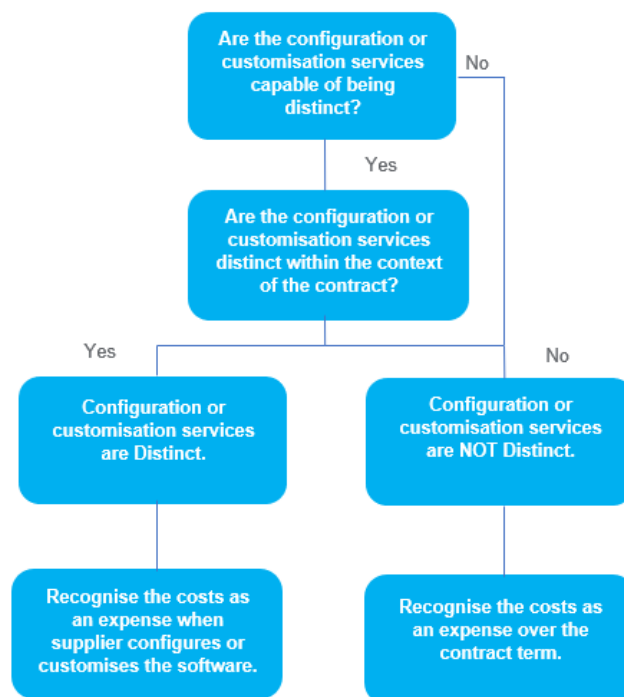
Under IFRS 15, goods or services that are promised to a customer are distinct if both of the following criteria are met:

- The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
- The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

In order to determine whether the configuration and customisation services are distinct, the two following criteria must be met:

- Being capable of being distinct.
- The services are distinct within the context of the contract.

If the configuration and customisation services fail to meet the above criteria as specified under IFRS 15, then the promised goods or services are not distinct.



In summary:

- If the configuration or customisation services are distinct, the costs should be recognised as an expense when the software provider configures or customises the software.
- If the configuration or customisation services are not distinct because they are not separately identifiable from the customers' right to receive access to the application software, the associated costs should be recognised as expense over the contract term of the software as a service arrangement.

In some cases, software may be significantly modified during the customisation. In our view, such a customisation service is generally not considered to be distinct and is not separately identifiable from the service of receiving access to the application software under the cloud computing arrangements. Therefore, the customer should recognise the associated expenses as and when the customer receives access to the customised application software over the contract term.

Significant judgement is required in assessing whether the configuration and customisation services are distinct, depending on the nature and output of the configuration or customisation performed in the cloud computing arrangements.

If the contract to deliver the configuration or customization services is with a third-party supplier, the customer determines when the third-party supplier performs the services applying the requirements in paragraphs 69-69A of IAS 38. The customer recognises the costs as an expense as and when the third-party supplier performs the services.

Implication

IFRIC final agenda decisions are authoritative IFRS pronouncements in many jurisdictions, and are referred to within IAS 8, meaning that compliance with IFRIC agenda decisions forms part of full compliance with IFRS.

Many businesses incur significant costs for software implementation, including configuration and customisation of cloud-based application software. Some entities may have capitalised implementation costs in relation to such SaaS arrangements prior to the finalisation of the IFRIC decision.

Previously capitalised cloud computing configuration or customisation costs may need to be expensed as services received. Any changes resulting from IFRIC agenda decisions would be accounted for as a change in accounting policy under IAS 8 and applied retrospectively. In addition, appropriate disclosures of the change are required under IAS 8.

Further Information

For further information about accounting for Cloud computing, please contact your local RSM adviser.

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