

STAFF PAPER

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Paper topic	Initial consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the customer's accounting in cloud computing arrangements. The submitter asks how the customer applies IFRS Standards in accounting for fees paid to the supplier to access the supplier's application software running on the supplier's cloud infrastructure.
2. The objective of this paper is to:
 - (a) provide the Committee with a summary of the matter;
 - (b) present our research and analysis; and
 - (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:
 - (a) background information;
 - (b) summary of outreach;
 - (c) staff analysis; and
 - (d) staff recommendation.

4. There are two appendices to this paper:
 - (a) Appendix A—proposed wording of the tentative agenda decision; and
 - (b) Appendix B—submission.

Background information

5. This background information is based on the original submission supplemented by further information obtained from the submitter.

Types of arrangements

6. There are various types of cloud computing arrangements. However, the submission focusses on Software as a Service (SaaS) arrangements. In such arrangements the capability provided by the supplier (the cloud service provider) to the customer is to access the supplier's application software¹ running on the supplier's cloud infrastructure. The cloud infrastructure is a collection of hardware and software including network, servers, operating systems, storage, and individual software capabilities.

7. In these arrangements, the customer generally does not take possession of the software. Instead it accesses the software on an as-needed basis over the internet or via a dedicated line. The customer does not manage or control the underlying cloud

¹ Application software (app or application for short) is any program, or group of programs, that is designed for the end user. This contrasts with system software, which is mainly involved with running the computer.

infrastructure with the possible exception of customer-specific software configuration settings.

8. Contracts are often for an initial non-cancellable period (for example, two years), with options within the contracts for the customer to extend them. The contracts often include other services, such as technical support, implementation, data migration, business process mapping, training, and project management. The fees are generally paid on a monthly or yearly basis and are all inclusive, meaning they cover the right to access the software as well as these other services. For simplicity, the submission focusses only on:
 - (a) the customer's access to the supplier's application software without these other products and services; and
 - (b) the fees paid to the supplier for the customer's access to the supplier's application software.

9. The submission considers three fact patterns with differing customer rights relating to the software:
 - (a) a right to access non-dedicated application software running on non-dedicated infrastructure/hardware (Scenario X).
 - (b) same as Scenario X, except the customer also has a right to possess a copy of the application software (Scenario Y).
 - (c) same as Scenario X, except the customer specifies particular application software configurations (Scenario Z). Such configurations might range from basic to significant. To illustrate:
 - (i) Basic or standard configurations—such as a customer responding to standard configuration questions or inputting data into pre-existing fields. For example, an individual using a smart phone app may be required to answer standard configuration questions such as preferred language, whether to allow the app to track the phone's location, whether to allow the app access to other phone contacts, etc. (Scenario Z(i))
 - (ii) Significant configurations—such as modifications to the software to meet the customer's requirements. For example,

financial accounting application software might require configuration to facilitate a unique group organisation structure, chart of accounts, approval requirements for journal entries, etc. In some cases the customer may undertake the configuration whereas in other cases the supplier may configure the software for the customer based on the customer's input. In some cases, configuration might be viewed as so significant that it is akin to software development/customisation unique to the customer. (Scenario Z(ii))

Questions submitted

10. The submitter asks about the following requirements in IFRS Standards:
- (a) **Definitions.** How to apply the definitions of an intangible asset and a lease in IAS 38 *Intangible Assets* and IFRS 16 *Leases* in the context of these arrangements?
 - (b) **Scope.** How to apply the scope paragraphs in IAS 38 and IFRS 16, in particular distinguishing between 'leases of intangible assets' and 'rights held by a lessee under licensing agreements' in paragraphs 3(e) and 4 of IFRS 16 (and paragraph 6 of IAS 38)?
 - (c) **Measurement.** How to measure the liability related to the acquisition of an intangible asset if the customer accounts for the arrangement applying IAS 38?
11. Appendix B to this paper reproduces the submission, which provides the submitter's analysis of applying IFRS Standards to the scenarios set out in paragraph 9 of this paper.

Summary of outreach

Outreach process

12. To gather information about accounting for SaaS arrangements, we sent requests to members of the International Forum of Accounting Standard-Setters, securities regulators, and large accounting firms.
13. The request asked those participating to provide information based on their experience about:
 - (a) the prevalence of SaaS arrangements, including the different scenarios set out in paragraph 9 of this paper, and any variations of these scenarios; and
 - (b) the current accounting for these arrangements and whether they think such practice is likely to be affected by the new IFRS Standards that have been issued, but are not yet in effect.
14. We received fifteen responses—five from large accounting firms, seven from national standard-setters, two from organisations representing groups of regulators and one from a Committee member. The views received represent informal opinions, rather than formal views of those responding.

Findings from outreach

15. Most respondents said SaaS arrangements are common, noting Scenarios X and Z (both Z(i) and (ii)) as the most common. A few respondents said Scenario Y is common. However, most noted Scenario Y is less common than the other scenarios, or is rare. One respondent said, in Scenario Z(ii), there is more likely to be a right to possess a copy of the software (Scenario Y) than Scenarios X and Z(i). Many respondents said they expect cloud computing arrangements to increase in the foreseeable future. Some respondents gave examples of variations of SaaS arrangements, including:
 - (a) those in which the application software is hosted on private cloud infrastructures (ie that infrastructure supports only one customer) rather than public cloud infrastructures;

- (b) hybrid arrangements, which combine both public and private cloud infrastructures allowing data and application software to be shared between them; and
- (c) arrangements in which the supplier's application software is hosted on a third party's cloud infrastructure.

Some respondents suggested that the Committee also consider other cloud computing arrangements, such as infrastructure as a service (IaaS) arrangements and platform as a service (PaaS) arrangements.

16. Regarding the accounting treatment, many respondents said customers assess these arrangements to determine whether they create an intangible asset and/or lease component. If not, customers account for the arrangements as service contracts. Many respondents said customers generally account for SaaS arrangements as service contracts because it is difficult to demonstrate that the customer controls an intangible asset or the right to use an identifiable asset (lease). Some said, depending on the type of contract, some customers recognise an intangible asset for the right to access the software and others account for the arrangements as service contracts.
17. Some respondents said determining the appropriate accounting for these arrangements can be difficult because of the lack of specific requirements in IFRS Standards. Some respondents said a customer has an intangible asset only if the customer is able to possess and run the software on its own servers (Scenario Y), regardless of the extent of customer configuration. However, other respondents said the customer has an intangible asset in other circumstances, for example, when there are significant customer configurations (Scenario Z(ii)). Some respondents said it is unclear how customers should account for other fees (which can be significant), for example, fees for the customisation and implementation of the software. They suggested it would be helpful for the Committee to also address the accounting treatment for these other fees.²

² In April 2015, the US Financial Accounting Standards Board (FASB) issued ASU 2015-05, which provides guidance about a customer's accounting for fees paid in a cloud computing arrangement. Following this, several stakeholders contacted the FASB requesting additional guidance on the accounting for costs of implementation activities performed in a cloud computing arrangement that is a service contract. The FASB has a current project

18. Some respondents said in the absence of specific requirements in IFRS Standards, customers might, or currently do, consider US GAAP (eg ASU 2015-05). Accounting Standards Update (ASU) 2015-05 provides guidance for customers about whether a cloud computing arrangement includes a software licence. Applying ASU 2015-05:³
- (a) if a cloud computing arrangement includes a software licence, then the customer accounts for the software licence element of the arrangement consistent with the acquisition of other software licences.
 - (b) if a cloud computing arrangement does not include a software licence, the customer accounts for the arrangement as a service contract.

Consistent with this, some respondents said if a cloud computing arrangement includes a software licence, then the customer has an intangible asset.

19. In commenting on whether they think the current accounting for these arrangements is likely to be affected by the new IFRS Standards:
- (a) some respondents said they think IFRS 16 may affect the way customers account for these arrangements. However, others said they think it would not have any effect.
 - (b) some respondents suggested that IFRS 15 *Revenue from Contracts with Customers* might affect the way that customers account for these arrangements. This is because IFRS 15 contains specific application guidance on licensing arrangements and customers might consider the requirements in IFRS 15 when assessing, for example, the timing of when the customer obtains control of its right to access the supplier's software.

Staff analysis

20. We think we can address the questions raised by the submitter and the appropriate accounting for SaaS arrangements by considering the following three questions:

to address the resulting diversity in practice for such implementation costs and issued a proposed ASU in March 2018.

³ Paragraph 42 of this paper considers the requirements in ASU 2015-05 further.

- (a) are rights to access software within the scope of IAS 38 or IFRS 16 from the customer's perspective?
- (b) do SaaS arrangements create an intangible asset for the customer?
- (c) if the customer has an intangible asset, how should the customer measure that intangible asset and any liability related to its acquisition?

Are rights to access software within the scope of IAS 38 or IFRS 16?

The question

21. In considering which IFRS Standards apply to these arrangements, the submitter asks for clarity as to the distinction between 'rights held by a lessee under licensing agreements' and 'leases of intangible assets' referred to in paragraphs 3(e) and 4 of IFRS 16 respectively. The submitter also says some think the scope exclusion in paragraph 3(e) of IFRS 16 applies only to the licensing agreements specified in that paragraph, and not to licensing agreements for software.

IFRS requirements

22. Paragraph 6 of IAS 38 states the following:
- 6 Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are within the scope of this Standard and are excluded from the scope of IFRS 16.
23. Paragraphs 3(e) and 4 of IFRS 16 state the following:
- 3 An entity shall apply this Standard to all leases, including leases of *right-of-use assets* in a *sublease*, except for....
 - (a) ...
 - (e) rights held by a lessee under licensing agreements within the scope of IAS 38 *Intangible Assets* for such items as motion

picture films, video recordings, plays, manuscripts, patents and copyrights.

- 4 A lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 3(e).

Staff analysis

24. Paragraph 6 of IAS 38 includes within the scope of IAS 38 all rights held by a lessee under licensing agreements, and not just the examples specified. This is because that paragraph includes the wording ‘such as’, meaning ‘for example’. The requirements in paragraph 6 of IAS 38 are not new. Before IFRS 16, IAS 17 *Leases* and IAS 38 included identical scope paragraphs to those reproduced in paragraphs 22-23 of this paper.
25. Paragraph 3(e) of IFRS 16 simply replicates the requirement in IAS 38 for clarity (as the scope paragraphs of IAS 17 had done). Paragraph 4 of IFRS 16 reflects the Board’s decision to allow, but not require, the application of IFRS 16 to any other leases of intangibles. Paragraph BC71 of the Basis for Conclusions accompanying IFRS 16 explains the Board’s decision in this respect:
- BC71 ...The IASB acknowledged that there is no conceptual basis for excluding leases of intangible assets from the scope of IFRS 16 for lessees. However, the IASB concluded that a separate and comprehensive review of the accounting for intangible assets should be performed before requiring leases of intangible assets to be accounted for applying the requirements of IFRS 16. Many stakeholders agreed with this approach.
26. Neither IAS 38 nor IFRS 16 define ‘licensing agreement’. A business definition of a ‘licensing agreement’ is ‘written contract under which the owner of a copyright, know how, patent, servicemark, trademark, or other intellectual property, allows a licensee

to use, make, or sell copies of the original'⁴ Furthermore, paragraph B52 of IFRS 15 provides the following explanation of a 'licence':

B52 A licence establishes a customer's rights to the intellectual property of an entity. Licences of intellectual property may include, but are not limited to, licences of any of the following:

- (a) software and technology;
- (b) motion pictures, music and other forms of media and entertainment;
- (c) franchises; and
- (d) patents, trademarks and copyrights.

27. Considering the descriptions set out in paragraph 26 above, we think all leases of software would result in rights being held by a lessee under licensing agreements, ie we cannot think of an example of a lease of software that would be covered by paragraph 4 of IFRS 16, rather than paragraph 3(e) of IFRS 16.

Staff conclusion

28. We think therefore that rights to access software are within the scope of IAS 38, and not IFRS 16 (because 'leases' of software are excluded from the scope of IFRS 16).
29. Note: The analysis in paragraphs 21-27 is to explain only why we think we can disregard IFRS 16 when considering the accounting for SaaS arrangements. These paragraphs do not consider whether SaaS arrangements meet the definition of a licensing agreement.

⁴ Taken from www.businessdictionary.com

Do SaaS arrangements create an intangible asset for the customer?

The question

30. The submitter observes that SaaS arrangements would be likely to meet the identifiability and future economic benefits elements of the definition of an intangible asset. However, the submitter questions how to assess the control element and asks whether the ‘underlying resource’ in paragraph 13 of IAS 38 would be:
- (a) the customer’s right to access the supplier’s software; or
 - (b) the application software itself.

IFRS requirements

31. Paragraph 8 of IAS 38 defines an intangible asset as ‘an identifiable non-monetary asset without physical substance’. For the customer to have an intangible asset, the SaaS arrangement would need to give rise to:
- (a) an asset, defined as ‘a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity’ (paragraph 8 of IAS 38 and 2010 *Conceptual Framework for Financial Reporting*);
 - (b) that is identifiable, ie is separable or arises from contractual or other rights (paragraph 12 of IAS 38).
32. Paragraph 13 of IAS 38 states the following:
- 13 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law...

Staff analysis*What is meant by ‘underlying resource’ in paragraph 13 of IAS 38?*

33. There are no requirements on what constitutes a resource in IAS 38 or in the 2010 *Conceptual Framework for Financial Reporting*. However, because an asset is defined as ‘a resource controlled by an entity...’, we think ‘underlying resource’ in paragraph 13 of IAS 38 is simply referring to the asset that an entity would recognise as an intangible asset. In other words, we read paragraph 13 of IAS 38 as follows: an entity controls an asset if the entity has the power to obtain the future economic benefits flowing from that asset and to restrict the access of others to those benefits.
34. We further observe that the second sentence of paragraph 13 of IAS 38 refers to control of the ‘future economic benefits from an intangible asset’ rather than ‘future economic benefits flowing from the underlying resource’, which supports our analysis in paragraph 33 above.
35. Consequently, in considering whether the right to access the software creates an intangible asset, the customer assesses whether it controls the right to access the software, rather than assessing whether it controls the underlying software. We observe that many contract-based intangible assets are rights to use a particular asset, rather than the underlying asset itself, for example, licensing agreements and use rights.⁵

Does the customer control the right to access the supplier’s software?

36. We observe that the customer’s right to access the supplier’s application software is:
- (a) a non-monetary resource without physical substance;
 - (b) from which future economic benefits are expected to flow to the customer (for example, through increases in revenues or reductions in production costs); and
 - (c) that is identifiable, because it arises from contractual rights.

⁵ Paragraph IE34 of the Illustrative Examples accompanying IFRS 3 *Business Combinations* lists these and other examples of contract-based intangible assets.

37. The outstanding element in assessing whether the arrangement includes an intangible asset is whether the customer controls the right to access the supplier's software, ie whether it has the power to obtain the future economic benefits flowing from that right and to restrict the access of others to those benefits (paragraph 13 of IAS 38). We have considered Scenarios X, Y and Z (as described in paragraph 9 of this paper) below. (Note we have considered Scenario Y last in the ordering of the scenarios below because Scenario Z(i) is similar to Scenario X and, based on our outreach, Scenario Y appears to be less common than Scenarios X and Z.)

Scenario X

38. In Scenario X, the customer has the right to access non-dedicated application software without any configurations. We think there are two possible ways of considering whether the customer controls the right to access the software:
- (a) View 1: Once a contract is signed, all parties to that contract will have rights from that contract and it could be argued that each party controls its own specific rights. The customer has its own specific right of access to the software (unique login) and access to its own copy, or 'instance', of the supplier's software that contains the customer's data. The customer has the power to obtain future economic benefits from its specific right of access during the contract period. Through its unique login, the customer can restrict the access of others to those benefits during that period. Applying View 1, the customer controls its individual right to access the supplier's software and has an intangible asset.
 - (b) View 2: The customer does not receive a resource at contract inception that it controls. Instead it has received a right to access the software in the future, over the contract period. The supplier holds, manages and updates the software over that period and has not given up or transferred its own rights relating to the access and use of the software. Furthermore, the customer requires the supplier's ongoing hosting service to obtain benefits from access to the software and it benefits from ongoing updates to the software by the supplier. Consequently, it appears that the customer's right to access the software simply gives it the right to services in the future, as

for other similar service contracts (for example, 24-hour technical support services over the contract period). Applying View 2, the customer does not have an intangible asset for the right to access the supplier's software.

39. We support the analysis in View 2. Although the customer accesses its own copy, or instance, of the software, SaaS arrangements are different from a scenario in which the customer downloads its own copy of the software or receives a copy of software on a CD ROM. In the later scenario, the customer receives a copy of the software at inception of the contract. The customer can generally use that copy as it wishes to obtain future economic benefits flowing from it (subject to copyright and other restrictions in the software licence)—for example, the customer can decide on which machine to install the software, whether to install updates to the software, etc—and it can restrict the access of others to benefits from that particular copy of software through possession. The supplier has transferred control of that copy of the software by handing it over to the customer and the customer has an intangible asset.

Scenario Z

40. In Scenario Z, the customer has a right to access the supplier's application software and also specify particular configurations. We have the following views:
- (a) if there are only basic or standard configurations to the software (Scenario Z(i)), the arrangement is similar to Scenario X. In that case, we think the customer has not obtained anything at inception of the contract that it controls. Consequently, the customer does not have an intangible asset and, instead, accounts for the arrangement as a service contract (as explained above in paragraph 38(b) of this paper).
 - (b) if there are significant, non-standard, customer configurations to the software (Scenario Z(ii)), then arguably the customer has the right to access a unique type of software. In this case, the customer might be able to restrict the access of others (the supplier and other customers) to the benefits from rights to access the software. Customers are also more likely to seek to have greater control over their rights to access customised software, particularly if they have incurred significant fees for the customisation and implementation of that software. We think the following

are examples of circumstances that would influence whether the customer controls the right to access the software:

- (i) whether the customer has a right to possess a copy of the software (see paragraphs 41-42 of this paper), for example on termination of the contract, and also whether the customer has the ability to host the software without the supplier's infrastructure.
- (ii) whether the supplier can make the modified version of the software available to other customers or whether the modified version can be used only by that specific customer (either because this is specified in the contract or because of the nature of the customer-specific configurations).
- (iii) whether the software continues to be modified/updated by the supplier over the period of the contract, or whether the customer manages when the configured software is updated.
- (iv) whether the software is hosted purely on the supplier's cloud infrastructure, or whether the customer (or a third party) has any control over the infrastructure on which the software is hosted, for example see the variations outlined in paragraph 16 of this paper.

If configurations are significant, we think it is possible that the customer might have an intangible asset, depending on the particular terms and conditions of the arrangement.

Scenario Y

- 41. In Scenario Y, the customer has a right to possess a copy of the software. Based on our outreach, Scenario Y is common only in a few jurisdictions and may be more likely to arise in a scenario in which the software involves significant customer configurations (Scenario Z(ii)).
- 42. We observe that Scenario Y is similar to the scenario identified by the FASB in ASU 2015-05 (see paragraph 18 of this paper). Applying ASU 2015-05, a SaaS arrangement would only include a software licence if the following criteria are met:
 - (a) the customer has the contractual right to take possession of the software at any time during the hosting period without a significant penalty; and

- (b) it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

ASU 2015-05 states that hosting arrangements that do not meet both these criteria are service contracts and do not constitute a purchase of, or convey a licence to, software.

- 43. We think if a customer has a ‘genuine’ right to possess a copy of the software, this would be similar to the scenario in which a customer downloads its own copy of the software or receives a copy of software on a CD ROM (see paragraph 39 of this paper). To be a genuine right of possession, we think the right would have similar characteristics to those identified by the FASB in ASU 2015-05 (reproduced in paragraphs 42(a) and (b) above), ie no significant penalty and ability to host the software without the supplier’s infrastructure. In this case, we think the customer would be likely to control that particular copy of the software.

IFRS 15 requirements for licensing agreements

- 44. IFRS 15 contains specific application guidance on accounting for licensing arrangements from the supplier’s perspective.⁶ In particular, it contains application guidance on whether a licence transfers to a customer either at a point in time or over time, which requires the supplier to consider whether it provides the customer with either:
 - (a) a right to access the entity's intellectual property as it exists throughout the licence period (under this type of arrangement it is expected the supplier undertakes activities that significantly affect the intellectual property); or
 - (b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted.
- 45. Some respondents to our outreach observed that IFRS 15 might affect the way that customers account for SaaS arrangements because customers might consider the

⁶ See in particular paragraphs B52-B62 of IFRS 15.

requirements in IFRS 15 when assessing, for example, the timing of obtaining control of the right to access the supplier's software at a point in time or over time.

46. We think that most SaaS arrangements, in particular Scenarios X, Z(i) and most Z(ii), would be arrangements in paragraph 44(a) of this paper from the supplier's perspective, ie they give the customer a right to access the supplier's software as it exists throughout the licence period. Consequently, the supplier would account for the transfer of the resource over time. Nonetheless, accounting for SaaS arrangements by the customer is outside the scope of IFRS 15 and customers are required to apply IAS 38, not IFRS 15. Therefore applying the requirements in IFRS Standards will not necessarily result in symmetrical accounting between the customer and supplier. However, IFRS 15 considers when control of a resource transfers from the supplier to the customer and IAS 38 considers if/when the customer obtains control of a resource. Consequently, some of the discussion in IFRS 15 may be helpful in determining when, applying IAS 38, the customer obtains control over a resource.

Staff conclusion

47. We think the assessment of whether the customer controls the right to access the supplier's software, and thus has a corresponding intangible asset, depends on the particular terms and conditions of the SaaS arrangements, and judgement is required. Nonetheless, in scenarios in which the customer only has a right to access the supplier's software with no or basic/standard configurations, we think the customer would not have an intangible asset for the right to access the software at inception of the contract. In these scenarios, the customer accounts for the arrangement as a service contract.
48. We think if the contract gives the customer a genuine right to possess the software, and the ability to host that software on its own (or a third party) server, the customer would be likely to control that copy of the software and would have a corresponding intangible asset applying IAS 38.

How does the customer measure the intangible asset and any liability related to acquisition of that intangible asset?

The question

49. The submitter suggests that if the SaaS arrangement creates an intangible asset within the scope of IAS 38, it might be difficult to measure that intangible asset and any related liability. For example, measurement questions may arise similar to those arising in accounting for a lease that IFRS 16 addresses, for example, what is the term of the arrangement, how to allocate payments to different components of the arrangement (ie the right of access versus other services), how to account for variable payments, etc.

Staff analysis

50. Based on our outreach and analysis above, we think in most SaaS arrangements the customer will not have an intangible asset for the right to access the supplier's software. Therefore, the possible measurement difficulties mentioned in paragraph 49 would not arise. Nonetheless, we have considered the comments raised by the submitter for those cases when the customer might recognise an intangible asset.
51. In the absence of specific requirements in IAS 38, the customer could look to other IFRS Standards dealing with similar and related issues (paragraph 10-11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). For example, IAS 38 does not specifically address separating components of a contract, when an intangible asset is only one such component. Nonetheless, paragraphs 13-14 of IFRS 16 provide requirements on allocating the consideration in a contract to different components of the contract. However, once separated, IAS 38 specifically requires an entity to initially measure an intangible asset at cost (paragraph 24 of IAS 38), provided the cost can be measured reliably (paragraph 21 of IAS 38).
52. The cost of the intangible asset, and any related liability, may be difficult to determine under SaaS arrangements because of uncertainty about the extent of future payments, for example because of contract extension options. However, this is not new. Contract extension options exist in other licensing arrangements within the scope of

IAS 38, and we are not aware that they have caused significant measurement difficulties in practice.

53. The Committee has previously discussed the accounting for variable payments to be made for the purchase of an item of property, plant and equipment or an intangible asset (that is not part of a business combination). At its March 2016 meeting, the Committee determined that this matter is too broad for it to address within the confines of existing IFRS Standards. Consequently, the Committee decided not to add this matter to its agenda and issued an agenda decision to that effect.
54. In response to feedback from the 2015 Agenda Consultation and the outcome of the Committee’s discussions, the Board has added a project to its research pipeline on variable and contingent consideration. At its February 2018 meeting, the Board asked the staff to carry out work over the following months to assess how broad that research project should be. We think that project may consider the more difficult questions about the measurement of some intangible assets and related liabilities, including, for example, arrangements like SaaS arrangements.

Staff conclusion

55. For the reasons outlined in paragraph 50-54 of this paper, we think the Committee should not opine upon the measurement of the intangible asset and any related liability for SaaS arrangements.

Question 1 for the Committee

Does the Committee agree with our analysis of the requirements in IFRS Standards, summarised in paragraphs 21-55 of this paper?

Staff recommendation—should the Committee add this matter to its standard setting agenda?

***Is it necessary to add to or change IFRS Standards to improve financial reporting?*⁷**

56. Based on our analysis, we think that the requirements in existing IFRS Standards provide an adequate basis for the customer to account for rights to access the supplier’s application software in SaaS arrangements.
57. We acknowledge that in some cases (for example, Scenario Z(ii)) there will be a need for judgement when determining whether a customer controls the right to access the supplier’s software. However, we think this judgement is applied considering the specific terms and conditions of each SaaS arrangement and IAS 38 provides a framework within which an entity’s management would apply this judgement (paragraphs 8-17 of IAS 38).

Staff recommendation

58. Based on our assessment of the Committee’s agenda criteria in paragraphs 5.16-5.17 of the Due Process Handbook (discussed in paragraphs 56-57 above), we recommend that the Committee does not add this matter to its standard-setting agenda.
59. Nonetheless, we recommend publishing an agenda decision that clarifies the following matters:
- (a) an entity reads paragraph 3(e) of IFRS 16 to cover all software licensing agreements and, thus, that an entity account for all rights to access or use software applying IAS 38, not IFRS 16;
 - (b) ‘underlying resource’ in paragraph 13 of IAS 38 refers to the asset that an entity would recognise as an intangible asset;
 - (c) whether the customer controls the right of access depends on the particular terms and conditions of the arrangement. However, simply having a right to

⁷ Paragraph 5.16(b) of the *Due Process Handbook*.

access the supplier's application software would not be sufficient to indicate that the customer controls a resource at contract inception that meets the definition of an intangible asset.

60. Appendix A to this paper sets out the proposed wording of the tentative agenda decision.

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—proposed wording of the tentative agenda decision**Customer’s right to access supplier’s application software hosted on the supplier’s cloud infrastructure (IAS 38 *Intangible assets*)**

The Committee received a request about the customer’s accounting in Software as a Service (SaaS) cloud computing arrangements. Specifically the request asked how the customer applies IAS 38 and IFRS 16 *Leases* in accounting for fees paid to access the supplier’s application software running on the supplier’s cloud infrastructure. In these arrangements, the customer generally does not take possession of the software. Instead it accesses the software on an as-needed basis over the internet or via a dedicated line. The customer does not manage or control the underlying cloud infrastructure with the possible exception of customer-specific software configuration settings.

Scope of IAS 38 and IFRS 16

Paragraph 6 of IAS 38 includes within the scope of IAS 38 rights held by a lessee under licensing agreements; these rights are also excluded from the scope of IFRS 16 (paragraph 3(b) of IFRS 16). Consequently, the Committee concluded that rights to access or use software within SaaS arrangements are within the scope of IAS 38, and not IFRS 16.

Do these arrangements create an intangible asset for the customer?

The Committee observed that, in SaaS arrangements, the customer’s right to access the supplier’s application software is:

- a non-monetary resource without physical substance;
- from which future economic benefits are expected to flow to the customer (for example, through increases in revenues or reductions in future production costs);
and
- that is identifiable, because it arises from contractual rights.

Consequently, in assessing whether these arrangements create an intangible asset, the customer assesses whether it has a resource that it controls. Paragraph 13 of IAS 38 states that “An entity controls an asset if the entity has the power to obtain the future economic

benefits flowing from the underlying resource and to restrict the access of others to those benefits...”.

The Committee observed that the term ‘underlying resource’ in paragraph 13 of IAS 38 refers to the resource that an entity would recognise as an intangible asset. Consequently, in considering whether the right to access the software creates an intangible asset, the customer would assess whether it controls the right to access the software, rather than assessing whether it controls the underlying software.

The Committee observed that there is a range of SaaS cloud computing arrangements, with varying degrees of customer configuration. Ultimately, whether the customer controls the right to access the supplier’s application software will depend on the terms and conditions of the particular arrangement, and judgement may be required.

Nonetheless, in circumstances in which the customer has only a right to access the supplier’s application software over the contract period with no customer configurations, or only basic or standard configurations, the customer does not obtain a resource at contract inception that it controls. Instead it has obtained a right to access the application software in the future over the contract period. Consequently, the customer’s right to access the application software simply gives it the right to services in the future and the customer accounts for it as a service contract.

In other circumstances, the customer may obtain a resource at contract inception that it controls. For example, the customer may have the right to possess a copy of the application software and the ability to host that software without the services of the supplier (for example, host it on its own or third party infrastructure). In such circumstances, the customer may have the ability to use the copy of the application software as it wishes to obtain the future economic benefits flowing from it (subject to copyright restrictions) and, through possession, restrict the access of others to the benefits from that particular copy. In these circumstances, the customer would have a resource that it controls.

Measurement of the intangible asset and any related liability

The Committee observed that, if the customer has an intangible asset in a SaaS arrangement, paragraph 24 of IAS 38 requires the customer to measure the intangible asset initially at cost (assuming that the recognition criteria in paragraph 21 of IAS 38 are

met). IAS 38 does not explicitly specify how, when determining cost, an entity considers some of the terms and conditions that might exist in SaaS arrangements, for example variable payments or options to extend the contract. In the absence of specific requirements in IAS 38, an entity applies paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and reliable. In particular, the entity considers measurement requirements in other IFRS Standards dealing with similar and related issues. Furthermore, the Committee noted that in response to feedback from the 2015 Agenda Consultation and the outcome of the Committee’s discussions, the Board has added a project to its research pipeline on variable and contingent consideration.

The Committee concluded that the requirements in existing IFRS Standards provide an adequate basis for an entity to account for rights to access the supplier’s application software in SaaS arrangements. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Appendix B—submission

- B1. We have reproduced the submission below. We have deleted details that would identify the submitter.

Issue

- B2. In some cloud computing arrangements, the customer pays fees to the supplier to access and use the supplier's hardware and application software. There is no specific guidance in IFRS Standards that addresses the customer's accounting in such arrangements, although certain aspects of IFRS 16 *Leases* and IAS 38 *Intangible Assets* are relevant.
- B3. Without clear guidance in IFRS Standards on the accounting for these types of cloud computing arrangements, diversity could exist in practice when it comes to accounting for the fees paid to access and use a supplier's hardware and application software.

Fact patterns

- B4. Our IFRS Discussion Group (the Group) considered three fact patterns with different rights in a cloud computing arrangement:
- (a) a right to access and use non-dedicated supplier hardware and supplier application software (Scenario X).
 - (b) same as Scenario X except the customer has a right to possess a copy of the application software (Scenario Y).
 - (c) same as Scenario X except the customer specifies particular application software configuration settings (Scenario Z).

Views and discussion

B5. Five issues were considered in the context of the three scenarios and can be categorized as follows:

Definitions How to apply the definitions of an intangible asset and a lease in the context of cloud computing arrangements.	Issue 1–Do the arrangements create intangible assets in the scope of IAS 38 <i>Intangible Assets</i> ?
	Issue 2–Do the arrangements or the components thereof meet the definition of a lease in IFRS 16 <i>Leases</i> ?
Scope How to apply the scope paragraphs in IAS 38 and IFRS 16, given the distinction between leases of intangible assets and rights held by a lessee under licensing agreements is unclear.	Issue 3–Does paragraph 3(e) of IFRS 16 only apply to the licensing arrangements listed therein, or does it apply broadly to all licensing arrangements including software licenses?
	Issue 4–Assuming paragraph 3(e) of IFRS 16 applies broadly to all licensing arrangements, how does an entity determine whether the arrangement contains a software license?
Measurement How to measure the liability related to the acquisition of an intangible asset if the cloud computing arrangement is accounted for under IAS 38.	Issue 5–If the arrangement includes an asset that is within the scope of IAS 38 and outside the scope of IFRS 16, how does an entity measure the asset and liability?

Issue 1: Do the arrangements create intangible assets within the scope of IAS 38?

- B6. The recognition criteria for an intangible asset (i.e., identifiability, control over a resource and existence of future economic benefits) need to be considered. Scenarios X, Y and Z would likely satisfy the identifiability and existence of future economic benefits criteria, but it is questionable whether the control criterion is satisfied.
- B7. Paragraph 13 of IAS 38 states in part that “[a]n entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.” The key issue in the case at hand is the identification of the “underlying resource”. If the underlying resource in the cloud computing arrangement is the customer’s right of access to, and use of, the hardware and application software, the customer has control as others are unable to utilize that customer’s specific right. However, if the underlying resource is the hardware and application software, the customer’s right of access and use may not satisfy the intangible asset definition’s control criterion, absent other arrangement features (e.g., hardware or application software wholly dedicated to the customer).
- B8. Based on existing guidance in IAS 38, there are diverse views regarding whether the underlying resource is the customer’s right of access and use or the hardware and application software.
- B9. Assuming that the underlying resource is the hardware and application software, paragraph 4 of IAS 38 applies, and an entity uses judgment to determine whether the software is an integral part of the hardware (i.e., whether this specific software is

required to operate the hardware). If it is not, the software is treated as an intangible asset and assessed separately from the hardware to determine if the control criterion is satisfied.

- B10. The non-dedicated hardware would fail the definition of control in all scenarios absent other arrangement features. However, the non-dedicated application software may satisfy the control definition in Scenario Y given the customer's right to possess a copy of the application software and restrict its access and use by others to benefit from that specific copy. For Scenario Z, the question is whether a right to access and use application software with customer-specific configurations is sufficient to satisfy the control criterion (i.e., create an identifiable version of the software to obtain future economic benefits and restrict the access of and use by others to those benefits).
- B11. The Group's discussion highlighted a challenge in applying the intangible asset definition, particularly with respect to the application of the control criterion.

Issue 2: Do the arrangements or the components thereof meet the definition of a lease in IFRS 16?

- B12. Paragraph 9 of IFRS 16 states in part that “[a] contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.”
- B13. In applying the lease definition, it is clearer that the identified assets in the cloud computing arrangement are the hardware and application software.
- B14. Group members agreed that there is no lease in Scenario X and there is no lease for the hardware component in Scenarios Y and Z.
- B15. For Scenario X, it is unlikely that the customer would have the right to obtain substantially all the economic benefits given the potential for others to use the same hardware and application software. Therefore, the arrangement is unlikely to meet the definition of a lease.
- B16. Similarly, for Scenarios Y and Z, it is unlikely that the hardware component would satisfy the lease definition given it is not dedicated to the customer. However, for Scenario Y, the right to possess a copy of the application software appears to provide the customer with the right to obtain substantially all the economics benefits from that copy of the application software and the right to direct its use. Based on paragraph B32 of IFRS 16, the application software should be assessed separately from the hardware. The customer's right to possess the application software may indicate that the customer could benefit from the software on its own or together with other available computing resources, and that the software is neither highly dependent on, nor highly interrelated with, the hardware in the contract (see paragraph 8 for a discussion of integral).
- B17. For Scenario Z, there is a question as to whether the customer-specific application software configuration settings create an identifiable version of the software that provides the customer with the right to obtain substantially all the economic benefits and the right to direct its use. In addition, in terms of applying paragraph B32 of IFRS 16, since the customer does not have the right to possess the application software, it is

unclear whether the software is considered highly dependent on, or highly interrelated with, the hardware in the arrangement.

Issue 3: Does paragraph 3(e) of IFRS 16 only apply to the licensing arrangements listed therein, or does it apply broadly to all licensing arrangements including software licenses?

- B18. Paragraph 3(e) of IFRS 16 states that the standard does not apply to “rights held by a lessee under licensing agreements within the scope of IAS 38 *Intangible Assets* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.” Further, IFRS 16 does not define the term “licensing arrangements”. Given the reference to lessee, this scope exclusion seems to indicate that IAS 38 is applied rather than IFRS 16 when a qualifying intangible asset is acquired but the arrangement also meets the definition of a lease.

View 3A – Paragraph 3(e) of IFRS 16 applies narrowly to the licensing arrangements listed therein.

- B19. Proponents of this view believe the scope exclusion is specific to those licensing arrangements listed in paragraph 3(e) of IFRS 16. All other licensing arrangements that qualify as intangible assets and meet the definition of a lease are not automatically scoped out of IFRS 16.
- B20. An entity has an accounting policy choice based on paragraph 4 of IFRS 16, which states “[a] lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 3(e).”

View 3B – Paragraph 3(e) of IFRS 16 applies broadly to all licensing arrangements.

- B21. Proponents of this view believe that the licensing arrangements in paragraph 3(e) of IFRS 16 are only examples, rather than an exhaustive list. They believe that all licensing arrangements that qualify as intangible assets and meet the definition of a lease are automatically scoped out of IFRS 16.

Issue 4: Assuming paragraph 3(e) of IFRS 16 applies broadly to all licensing arrangements, how does an entity determine whether the arrangement contains a software license?

- B22. For Scenario X, the analysis in Issue 2 would suggest that the arrangement does not meet the definition of a lease, therefore there is no scoping conflict between IFRS 16 and IAS 38.
- B23. However, for Scenarios Y and Z, the analysis suggests that the application software component may meet both the definition of an intangible asset and a separate lease component. If this is the case, an entity needs to consider whether such a software component constitutes a licensing arrangement to determine whether it is scoped out of IFRS 16 by paragraph 3(e) of the standard.

- B24. The term “licensing agreement” is used to determine when items that meet both the definition of a lease and an intangible asset are only with the scope of IAS 38. However, this term is not defined in existing IFRS Standards. This could lead to diversity in practice, depending on how the term is viewed.
- B25. One view is that to represent a licensing arrangement, the customer must have the right to possess a copy of the software. Under this view, the right to access and use the application software lease component would be considered a licensing arrangement in Scenario Y, and therefore, would be scoped out of IFRS 16. An alternate view is that licensing arrangement is considered broadly as a customer’s right to intellectual property. Under this view, there is little economic difference between Scenarios Y and Z. Therefore, the licensing arrangement should encompass the application software lease component in both scenarios.
- B26. As illustrated by the Group’s discussion, the issue of the lack of a definition for “licensing agreement” and the lack of guidance on when a licensing agreement exists is amplified by the ambiguity between paragraphs 3(e) and 4 of IFRS 16. Paragraph 3(e) of IFRS 16 explicitly scopes out certain items that meet the definitions of both a lease and an intangible asset. However, paragraph 4 of IFRS 16 indicates that an entity has a choice to apply IFRS 16 to other items outside paragraph 3(e) of IFRS 16 that also meet the definitions of both a lease and an intangible asset. The distinguishing factor between the two paragraphs is unclear, which makes it difficult to understand what the term “licensing arrangements” is intended to capture in paragraph 3(e) of IFRS 16.

Issue 5: If the arrangement includes an asset that is within the scope of IAS 38 and outside the scope of IFRS 16, how should an entity measure the asset and liability?

- B27. If the arrangement includes an asset that is within the scope of IAS 38 and outside the scope of IFRS 16, an entity would measure the asset at cost as prescribed by IAS 38 (i.e., its purchase price plus any directly attributable costs of preparing the asset for its intended use). However, there is some debate as to whether the notion of cost as defined in IFRS 16 would yield a better result given the asset to be recognized is similar to an IFRS 16 right-of-use asset. Cost under IFRS 16 includes the initial measurement of the lease liability (including payments made at or before the lease commencement date less incentives received), plus any initial direct costs and estimated asset retirement costs.
- B28. However, there are also many questions around how to measure the liability related to the acquisition of the intangible asset such as determining the term, which payments to include in the measurement of the liability, allocating payments to different components, etc. While there are many measurement issues similar to those encountered in an IFRS 16 lessee model, it is not clear whether it would be appropriate for an entity to apply the liability measurement guidance in IFRS 16 by analogy to the liability that arises from an arrangement wherein the related asset is recognized using an IAS 38 model.

Reasons for IFRIC to address the issue

B29. Below we have assessed the issue against the IFRIC agenda criteria:

Criteria	Assessment
1. Is the issue widespread and has, or is expected to have, a material effect on those affected?	The three issues (definitions, scope and measurement) are expected to be widespread as more entities have and are entering into cloud computing arrangements. As the costs associated with ongoing cloud computing solutions can be significant to an organization, there can also be a material effect on those affected.
2. Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?	Yes, financial reporting will be improved Our IFRS Discussion Group’s discussion highlights that existing guidance is insufficient to assist stakeholders in concluding which standard applies to a cloud computing arrangement. This insufficient guidance affects comparability because some entities may be capitalizing certain costs that others are expensing.
3. Can the issue be resolved efficiently within the confines of IFRS Standards and the Conceptual Framework for Financial Reporting?	All three issues can be resolved efficiently within the confines of IFRS Standards by expanding the guidance in IAS 38 and IFRS 16.
4. Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRS Standards?	All three issues are sufficiently narrow in scope. For the definitions issue, clarification is needed specifically around the application of the concept of control. The scoping issue is limited to clarifying the intent of the relevant specific paragraphs in IAS 38 and IFRS 16. For the measurement issue, the existing lessee model can be leveraged in designing a solution.
5. Will the solution developed by the Interpretations Committee be effective for a reasonable time period? The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified.	The solution will be effective for a reasonable period of time as cloud computing arrangements are only going to be more common based on the evolution of the digital environment.