

## STAFF PAPER

September 2018

IFRS<sup>®</sup> Interpretations Committee meeting

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|--------------------|---|--|--------------------|
| <b>Project</b>     | <b>Cloud computing arrangements</b>                       |  |                    |
| <b>Paper topic</b> | Updated proposed wording of the tentative agenda decision |  |                    |
| <b>CONTACT(S)</b>  | Michelle Fisher   | <a href="mailto:mfisher@ifrs.org">mfisher@ifrs.org</a> | +44(0)20 7246 6918 |

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1. This addendum to Agenda Paper 5 sets out updated proposed wording of the tentative agenda decision to reflect the discussions at the Committee's meeting on 11 September 2018.
2. The paper includes both:
  - a. a clean version of the updated proposed tentative agenda decision (pages 2-4 of this paper); and
  - b. a mark-up version showing changes from that proposed in Agenda Paper 5 (pages 5-7 of this paper).

**Proposed wording of the tentative agenda decision (updated)****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 cloud computing (SaaS) arrangements. Specifically the request asked about 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 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 for the customer, the customer assesses whether it obtains control of an intangible asset.

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 term ‘underlying resource’ in paragraph 13 of IAS 38 refers to the resource that an entity would recognise as an intangible asset if and when it has control of that resource (and subject to the recognition criteria in paragraph 21 of IAS 38).

The Committee observed that there is a range of SaaS arrangements, and the customer’s assessment of whether it obtains control of an intangible asset will depend on the terms and conditions of the particular arrangement. Nonetheless, in circumstances in which the contract gives the customer a right to access the supplier’s application software over the contract period, at contract inception the customer obtains only the right to receive access in the future in exchange for cash. In other words, the customer does not obtain control of the right of access at contract inception but, instead, obtains a right to access application software controlled by the supplier over the contract period. Consequently, in these circumstances the customer would not recognise an intangible asset for the right to access the supplier’s application software.

In other circumstances however, the customer might obtain rights beyond a right of access that create an intangible asset for the customer. For example, as part of the SaaS arrangement the customer might obtain rights that give it the ability to direct the use of the application software, giving it the power to obtain the future economic benefits flowing from it and restrict the access of others to those benefits. In these circumstances, the customer would have an intangible asset for the right to use the application software.

#### ***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 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 would consider 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 previous Committee 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 fees paid to access the supplier's application software in SaaS arrangements. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

## Mark-up of proposed wording of the tentative agenda decision (updated)

### **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 (SaaS) arrangements. Specifically the request asked about 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 for the customer, the customer assesses whether it obtains control of ~~has an intangible asset 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 if and when it has control of that resource (and subject to the recognition criteria in paragraph 21 of IAS 38). 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, and the customer’s assessment of whether it obtains control of an intangible asset 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 contract gives 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,~~ at contract inception the customer obtains only the right to receive access in the future in exchange for cash. In other words, the customer does not obtain control of the right of access ~~a resource~~ at contract inception ~~that it controls.~~ but, instead, it has obtained a right to access ~~the~~ application software ~~in the future~~ controlled by the supplier over the contract period. Consequently, in these circumstances the customer’s would not recognise an intangible asset for the right to access the supplier’s 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 however, the customer might obtain rights beyond a right of access that create an intangible asset for the customer. For example, as part of the SaaS arrangement ~~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~~ might obtain rights that give it the ability to direct the use ~~the copy~~ of the application software ~~as it wishes~~ , giving it the power to obtain the future economic benefits flowing from it

(~~subject to copyright restrictions~~) and, ~~through possession~~, restrict the access of others to the those benefits ~~from that particular copy~~. In these circumstances, the customer would have an intangible asset for the right to use the application software ~~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 would consider 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~~ previous 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~~ fees paid to access the supplier's application software in SaaS arrangements. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.