



## STAFF PAPER

December 2020

## IFRS® Interpretations Committee meeting

<b>Project</b>	<b>Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38)</b>		
<b>Paper topic</b>	Initial Consideration		
<b>CONTACT</b>	Wei Shun Tan	<a href="mailto:wtan@ifrs.org">wtan@ifrs.org</a>	+81 (0) 3 5205 7282
	Jawaid Dossani	<a href="mailto:jdossani@ifrs.org">jdossani@ifrs.org</a>	+44 (0) 20 7332 2742

This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (Committee) and does not represent the views of the International Accounting Standards Board (Board), the Committee or any individual member of the Board or the Committee. Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Decisions by the Board are made in public and reported in IASB® *Update*. Decisions by the Committee are made in public and reported in IFRIC® *Update*.

## Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the customer's accounting for costs of configuring or customising the supplier's application software in a Software as a Service (SaaS) arrangement. The submitter asked whether the customer recognises such costs as: (a) an intangible asset, (b) a prepayment asset, or (c) an expense when incurred.
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 a standard-setting project to the work plan.

## Structure of the paper

3. This paper includes the following:
  - (a) background information (paragraphs 5–9);
  - (b) outreach and additional research performed (paragraphs 10–20);

- (c) staff analysis (paragraphs 21–53); and
  - (d) staff recommendation (paragraphs 54–55).
4. There are three appendices to this paper:
- (a) Appendix A—proposed wording of the tentative agenda decision;
  - (b) Appendix B—submission; and
  - (c) Appendix C—Agenda Decision [Customer’s Right to Receive Access to the Supplier’s Software Hosted on the Cloud \(IAS 38 Intangible Assets\)](#) (March 2019).

## Background information

5. In March 2019 the Committee finalised an agenda decision [Customer’s Right to Receive Access to the Supplier’s Software Hosted on the Cloud \(IAS 38 Intangible Assets\)](#). In that agenda decision, the Committee concluded that a contract that conveys to the customer only the right to receive access to the supplier’s application software in the future is a service contract.<sup>1</sup>
6. The submission outlines the following fact pattern:
- (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 in the future—ie the customer does not receive a software asset but, instead, receives a service of having access to the supplier’s application software.
  - (b) The customer incurs upfront costs of configuring or customising the supplier’s application software to which it receives access<sup>2</sup>. The submission describes configuration and customisation as follows:

---

<sup>1</sup> Appendix C to this paper reproduces the March 2019 agenda decision for ease of reference.

<sup>2</sup> For simplicity, the rest of this paper refers to these costs as configuration or customisation costs.

- (i) Configuration: Typical configuration relates to the setting of various ‘flags’ or ‘switches’ within the software, or defining certain values or parameters, to implement a particular set-up for the software’s existing functionality. Configuration does not involve the modification or writing of additional software code, but rather involves setting up the software’s existing code to function in a particular way.
  - (ii) Customisation: Typical customisation involves modifying existing software code in the application or writing additional code. The effect of significantly altering or adding software code is generally to change, or create additional, functionalities within the software.
- 7. The submission also excludes from the scope of the question costs related to training, data migration and conversion, development of interfaces with existing systems and additions to existing systems. The submitter says there is no diversity in the accounting for these costs.
- 8. The submission outlines the following views for the customer’s accounting of configuration or customisation costs:
  - (a) View 1: recognise the costs as an intangible asset;
  - (b) View 2: recognise the costs as a prepayment asset; and
  - (c) View 3: recognise the costs as an expense when incurred.
- 9. Appendix B to this paper reproduces the submission and explains the rationale for each of the three views.

## **Outreach and additional research performed**

### ***Outreach***

- 10. We sent an information request to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms. The submission was also made available on our website.

11. The request asked those participating to provide information based on their experience on the following:
- (a) whether it is common for entities to incur material amounts of configuration or customisation costs;
  - (b) if a customer pays configuration or customisation costs to the supplier of the application software (supplier), whether it is possible to identify such costs separately from other fees and costs payable to the supplier as part of the SaaS arrangement;
  - (c) how customers that incur material amounts of configuration or customisation costs account for those costs; and
  - (d) whether the accounting for configuration or customisation costs differs depending on whether those costs are paid to the supplier or to a third-party.
12. We received 14 responses—five from large accounting firms, seven from national standard-setters and two from organisations representing groups of securities regulators. The views received represent informal opinions, rather than formal views of those responding.

*Is it common for entities to incur material amounts of configuration or customisation costs?*

13. Many respondents said it is common for entities in Canada, France, Germany, Hong Kong, Israel and the United States to incur material amounts of configuration or customisation costs. A few respondents said they received mixed feedback about whether entities in Australia, Japan and Malaysia incur material amount of such costs.
14. A few respondents said entities enter into SaaS arrangements more frequently than in the past; the existence of material amount of such costs could therefore become more prevalent in the future.

*Is it possible to identify configuration or customisation costs separately from other fees and costs?*

15. Many respondents said entities are generally able to identify and distinguish configuration or customisation costs separately from other fees and costs payable to the supplier. However, some respondents said judgement might be required and, in particular circumstances, it can be challenging to identify such costs separately from other fees and costs payable to the supplier. For example, a few respondents said identifying such costs could be difficult when the supplier issues a single invoice for all services performed or when the payment for all services in a contract (including customisation or configuration as well as access to the supplier's application software) is spread evenly over the contract period.

#### *Accounting treatment*

16. Respondents commented as follows on the accounting treatment applied:
- (a) two respondents said entities usually recognise configuration or customisation costs as an asset (one of these respondents said entities recognise either an intangible asset or a prepayment asset and the other said entities recognise a non-current asset).
  - (b) two respondents said entities generally expense such costs when incurred;
  - (c) many respondents said all three views described in the submission (see paragraph 8 of this paper) are applied in accounting for such costs. Some of these respondents said the differing reporting practices could result from different facts and circumstances. For example, in considering how to account for such costs, entities often consider whether:
    - (i) the costs are material;
    - (ii) the costs meet the definition of an intangible asset and the recognition criteria in IAS 38;
    - (iii) the costs can be identified separately from the SaaS arrangement; and/or
    - (iv) the related services have been performed.

- (d) two respondents said in the absence of specific requirements in IFRS Standards, some entities refer to US GAAP requirements and, applying those requirements, generally recognise such costs as a prepayment asset.<sup>3</sup>

*Does the accounting treatment depend on the service provider?*

17. Six respondents said the accounting for configuration or customisation costs does not differ depending on whether the costs are paid to the supplier or a third-party.
18. Three respondents said the accounting for such costs varies depending on who performs the service. They said entities generally recognise a prepayment asset if the service is performed by the supplier. However, if the service is performed by a third-party (or is performed internally), entities generally either recognise the costs as an expense when the service is performed or recognise an asset. One respondent said the accounting should not differ, but it had nonetheless observed different reporting practices.
19. Some other respondents also observed different reporting practices depending on who performs the service. For example:
- (a) a few respondents said while most entities do not account for configuration or customisation costs differently depending on who performs the service, they were aware of a few cases in which the accounting differed.
  - (b) one respondent said in some jurisdictions the costs are more likely to be recognised as an intangible asset rather than as a prepayment asset when paid to a third-party. However, in other jurisdictions, the accounting does not differ regardless of who performs the service.

---

<sup>3</sup> In August 2018 the US Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-15, which provides guidance on the customer’s accounting for implementation costs incurred in a hosting arrangement that is a service contract. Applying ASU 2018-15, the customer applies the guidance in Subtopic 350-40 to determine which implementation costs related to the service contract to capitalise as an asset and which costs to expense—applying this guidance, the customer (a) capitalises costs for implementation activities in the application development stage (depending on the nature of the costs); (b) expenses the capitalised implementation costs over the term of the hosting arrangement; and (c) presents capitalised implementation costs in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented.

### ***Additional research performed***

20. In addition to the outreach above, we used the financial search engine, AlphaSense, to search for disclosures in publicly available financial statements about the accounting for configuration or customisation costs incurred by customers in a SaaS arrangement. While we found financial statements of suppliers that disclose information about configuration and/or customisation services performed, we were unable to find any financial statements of customers that disclose their accounting for configuration or customisation costs.

### **Staff analysis**

21. The submitter asked about how the customer accounts for configuration or customisation costs in the SaaS arrangement described in the submission. In analysing this matter, we considered:
- (a) whether, applying IAS 38, the customer recognises configuration or customisation costs as an intangible asset? (Question I); and
  - (b) how the customer accounts for such costs if it does not recognise an intangible asset (Question II)?

### ***Question I: Does the customer recognise configuration or customisation costs as an intangible asset?***

22. In the fact pattern described in the submission, the SaaS contract conveys to the customer the right to receive access to the supplier’s application software in the future—ie the customer does not receive a software asset (neither a software intangible asset nor a software lease—see Appendix C) at the contract commencement date but, instead, receives a service of having access to the supplier’s application software. Although the customer’s right to receive access to the software does not result in the recognition of a software asset, we considered whether, applying IAS 38, the configuration or customisation costs result in an intangible asset that the customer would recognise.

*Applicable requirements in IAS 38*

23. Paragraph 18 states:

The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

- (a) the definition of an intangible asset (see paragraphs 8–17);  
and
- (b) the recognition criteria (see paragraphs 21–23).

24. Accordingly, in assessing whether to recognise an intangible asset, a customer first considers whether an item meets the definition of an intangible asset. Paragraph 8 of IAS 38 defines an intangible asset as ‘an identifiable non-monetary asset without physical substance’. IAS 38 also defines an asset as ‘a resource (a) controlled by an entity as a result of past events; and (b) from which future economic benefits are expected to flow to the entity’.

25. Paragraph 12 states:

An asset is identifiable if it either:

- (a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
- (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

26. Paragraph 13 states:

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. ...

27. If a customer determines that an item meets the definition of an intangible asset, it then considers the recognition criteria in paragraphs 21–23. Paragraph 21 states:

An intangible asset shall be recognised if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- (b) the cost of the asset can be measured reliably.

*Application to configuration or customisation costs<sup>4</sup>*

28. The assessment of whether configuration or customisation costs results in an item that meets the definition of an intangible asset depends on the nature and output of the configuration or customisation performed.

29. In our view, the customer typically would not recognise an intangible asset for configuration or customisation of the supplier’s application software—this is because it would not have the power to obtain the future economic benefits flowing from the underlying resource (ie the software being configured or customised) and to restrict the access of others (including the supplier) to those benefits.

30. However, in a few situations (for example, when customisation results in writing additional code that is accessible only by the customer), the customer may have the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits—ie the customer might control the asset (for example, the additional code) that results from the configuration or customisation. In these situations, the customer would then assess whether that asset is identifiable and meets the recognition criteria in paragraphs 21–23 of IAS 38.

31. Whether the customer recognises an intangible asset in the situations described in paragraph 30 above depends on the applicable facts and circumstances. We note that:

- (a) configuration or customisation performed by either the supplier or a third-party would generally be identifiable—this is because it would arise from

---

<sup>4</sup> Our assessment is based only on the submitter’s description of configuration and customisation (see paragraph 6(b) of this paper).

contractual rights. If the configuration or customisation results in an item that meets the definition of an intangible asset, the customer would also apply paragraphs 25–32 of IAS 38—these paragraphs apply to intangible assets acquired separately (and not as part of a business combination). In particular, we note that paragraph 25 states:

... the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets.

- (b) if configuration or customisation is performed internally by the customer, the customer would also apply paragraphs 51–67 of IAS 38—these paragraphs apply to internally generated intangible assets.

***Question II: How does the customer account for configuration or customisation costs if it does not recognise an intangible asset?***

- 32. The following paragraphs consider how the customer accounts for configuration or customisation costs when it does not recognise an intangible asset in respect of those costs. As discussed in paragraph 29 of this paper, in our view the customer would typically not recognise an intangible asset in respect of configuration or customisation costs.
- 33. Paragraphs 68–70 of IAS 38 apply to expenditure on an intangible item. Paragraph 68 requires an entity to recognise expenditure on an intangible item as an expense when the expenditure is incurred unless it (a) forms part of the cost of an intangible asset that meets the recognition criteria; or (b) the item is acquired in a business combination and cannot be recognised as an intangible asset. Paragraphs 69–70 specify how an entity applies this requirement. These paragraphs state:
  - 69. In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. ... In the

case of the supply of services, the entity recognises the expenditure as an expense when it receives the services. ...

69A. ... Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver an advertisement to customers.

70. ...paragraph 68 does not preclude an entity from recognising a prepayment as an asset when payment for services has been made in advance of the entity receiving those services.

34. In the fact pattern described in the submission, the customer incurs the configuration or customisation costs to enhance the future economic benefits that will flow to it from access to the supplier's application software. The SaaS arrangement conveys to the customer the right to access that software and therefore is an intangible item. Consequently, when the customer does not recognise an intangible asset in respect of the configuration or customisation costs, in our view the requirements in paragraphs 68–70 of IAS 38 apply to those costs.

*Application of paragraphs 68–70 of IAS 38 to configuration or customisation costs*

35. Applying paragraph 69, the customer recognises the expenditure—the configuration or customisation costs—as an expense when it receives the related service. Paragraph 69A specifies that an entity receives a service *when that service is performed by a supplier in accordance with a contract to deliver the services to the entity*—and not necessarily when the entity benefits from that service. Accordingly, the customer considers when a supplier performs the service that relates to the configuration or customisation in accordance with the contract.
36. In a SaaS arrangement, a customer might often receive a bundle of services from the supplier—configuration or customisation services as well as access to the supplier's application software and possibly other services, such as training or data migration. In applying paragraphs 68–70, in our view it is first necessary for a customer to identify

which services it receives in exchange for amounts paid (or payable) and then assess when the supplier performs those services.

37. IAS 38 does not include requirements on the identification of the services received and the assessment of when the supplier performs those services. In the absence of specific requirements in IAS 38, the customer applies paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to develop and apply an accounting policy.

38. Paragraphs 10–11 of IAS 8 state:

10. In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant ...

(b) reliable ...

11. In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements in IFRSs dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*.

39. Applying paragraph 11(a), we first considered whether there are requirements in IFRS Standards dealing with similar and related issues.

*Requirements dealing with similar and related issues*

40. IFRS 15 *Revenue from Contracts with Customers* includes requirements that specify:

(a) when a service promised in a contract with a customer is distinct—ie the requirements in paragraphs 22–30 of IFRS 15 on identifying a performance obligation; and

(b) when a supplier transfers a service to a customer—ie the requirements in paragraphs 31–45 of IFRS 15 on the satisfaction of a performance obligation.

41. Because paragraph 69A of IAS 38 requires the customer to consider when a *supplier* performs a service in accordance with a contract to deliver the service, in our view the requirements in IFRS 15 discussed in paragraph 40 above include requirements dealing with similar and related issues to those considered by the customer when applying paragraph 69A of IAS 38. The section below discusses the application of those requirements to configuration or customisation costs.
42. IFRS 15 applies to contracts with customers from the perspective of the seller, and not to the customer’s accounting for goods or services received. In concluding that IFRS 15 includes requirements dealing with similar and related issues to those considered by the customer in a SaaS arrangement, we note that we are *not* saying that a customer would always look to IFRS 15 in the absence of specific requirements regarding a particular transaction. Rather, we have concluded that, in this instance, IFRS 15 includes requirements dealing with similar and related issues because the applicable requirements in IAS 38 require the customer to assess when the *supplier* has performed the services in accordance with the contract. In the absence of specific requirements in IAS 38 to make that assessment, our view is then that a customer applies requirements in IFRS 15 relating to identifying the services promised in the contract and when the supplier performs the services promised.

*Application of IFRS 15 to configuration or customisation costs*

*Identifying the services promised in the contract*

43. Paragraphs 22–30 of IFRS 15 include requirements on identifying performance obligations in a contract with a customer. Paragraphs 26–30 explain when a good or service promised in a contract is distinct, and therefore is generally accounted for separately from other goods or services in the contract. Paragraphs 27 and 29 state:

27. A good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) 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 (ie the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).

29. ... Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

- (a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.
- (b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.
- (c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently.

44. Examples 10–12 of the Illustrative Examples accompanying IFRS 15 may also be helpful in identifying the services received in a SaaS arrangement.

45. In our view, the requirements in IFRS 15 discussed above provide an adequate basis for the customer to identify the services it receives in a SaaS arrangement. This assessment would not differ depending on who provides the service—the supplier or a third-party. We acknowledge however that more judgement may be involved when the supplier in the SaaS arrangement configures or customises the application software. In that case, the customer would determine whether it receives a configuration or customisation service from the supplier that is distinct (and therefore separately identifiable from the service of receiving access to the supplier’s application software), or instead receives a combined service of access to configured or customised software. Important considerations in making this assessment might be whether the configuration or customisation could be performed by a third-party, whether the configuration or customisation significantly modifies or customises the customer’s right to access the supplier’s application software and whether the supplier would be able to fulfil its promise to provide access to the application software independently of its promise to configure or customise the software.

**When the supplier performs the services promised in the contract**

46. Having identified the service it receives in a SaaS arrangement, the customer then determines when the supplier performs that service in accordance with the contract (paragraph 69A of IAS 38). Paragraphs 31–45 of IFRS 15 include requirements that deal with when a supplier transfers a good or service to a customer.
47. Once the customer has identified the services it receives in exchange for configuration or customisation costs, we would expect the assessment of when the supplier performs the service in accordance with the contract—and thus when the customer recognises the configuration or customisation costs as an expense—to be straightforward. If the customer receives a configuration or customisation service that is:
- (a) distinct, the customer would recognise the configuration or customisation costs as an expense when the supplier configures or customises the application software.
  - (b) not distinct (and instead an inseparable part of its right to access the supplier’s application software), the customer would recognise the

configuration or customisation costs as an expense when the supplier provides access to the application software over the contract term. If in this case the customer pays the supplier before receiving the service by, for example, making an upfront payment, it would recognise the prepayment as an asset (paragraph 70 of IAS 38).

### **Other considerations**

#### *Disclosure requirements*

48. Paragraphs 117–124 of IAS 1 *Presentation of Financial Statements* provide requirements for disclosures of accounting policies. In particular, these paragraphs state:
117. An entity shall disclose its significant accounting policies comprising:
- (a) ...
  - (b) the other accounting policies used that are relevant to an understanding of the financial statements.
119. In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. ...
121. An accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material. It is also appropriate to disclose each significant accounting policy that is not specifically required by IFRSs but the entity selects and applies in accordance with IAS 8.
49. We understand from outreach responses that customers incur material amounts of configuration or customisation costs, however our research of publicly available financial statements (see paragraph 20 of this paper) did not identify any disclosure

about the accounting for such costs. In our view it could be helpful if the Committee were to highlight existing disclosure requirements in this respect.

*Considering guidance in US GAAP*

50. As discussed in paragraph 16(d) of this paper, a few respondents to our outreach request said some entities refer to requirements in US GAAP when accounting for implementation costs associated with SaaS arrangements. Paragraph 12 of IAS 8 states:

In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.

51. We note that a customer applying IFRS Standards would not consider the requirements in US GAAP when accounting for configuration or customisation costs because, as explained in paragraphs 22–35 of this paper, IAS 38 includes requirements that specifically apply to the accounting for configuration or customisation costs. Paragraph 12 of IAS 8 applies only in the absence of IFRS requirements that specifically apply to a transaction, other event or condition.

**Staff conclusion**

52. Based on our analysis in paragraphs 21–51 of this paper, we conclude that in determining its accounting for configuration or customisation costs:
- (a) a customer considers whether, applying IAS 38, it recognises configuration or customisation costs as an intangible asset. The assessment of whether those costs result in an item that meets the definition of an intangible asset depends on the nature and output of the configuration or customisation performed. A customer typically would not recognise an intangible asset for configuration or customisation of the supplier’s application software

because it would not have the power to obtain the future economic benefits flowing from the underlying resource (ie the software being configured or customised) and to restrict the access of others (including the supplier) to those benefits.

- (b) if the customer does not recognise an intangible asset, it applies paragraphs 68–70 of IAS 38 in accounting for configuration or customisation costs.

Applying these paragraphs:

- (i) the customer recognises the costs as an expense when it receives the related service (paragraph 69 of IAS 38). Paragraph 69A specifies that an entity receives a service *when that service is performed by a supplier in accordance with a contract to deliver the service*. The customer therefore considers when a supplier performs the service that relates to the configuration or customisation in accordance with the contract.
- (ii) IAS 38 does not include requirements on the identification of the services received and the assessment of when the supplier performs those services. Applying paragraph 11(a) of IAS 8, the customer applies requirements in IFRS 15 that deal with similar and related issues in making that assessment—ie the requirements on identifying and satisfying performance obligations.
- (iii) if the customer receives a configuration or customisation service that is:
  1. distinct, the customer recognises the configuration or customisation costs as an expense when the supplier configures or customises the application software.
  2. not distinct (because the service is not separately identifiable from the customer’s right to access the application software), the customer recognises the configuration or customisation costs as an expense when the supplier provides access to the application software over the contract term. If the customer pays the supplier

before receiving the services, it recognises the prepayment as an asset (paragraph 70 of IAS 38).

- (c) applying paragraphs 117–124 of IAS 1, the customer discloses its accounting policy for configuration or customisation costs when that disclosure is relevant to an understanding of the customer’s financial statements.

### Question 1 for the Committee

1. Does the Committee agree with our analysis in paragraphs 21–51 of this paper regarding the application of the requirements in IFRS Standards to the fact pattern described in the submission? Our analysis is summarised in paragraph 52 of this paper.

### ***Should the Committee add a standard-setting project to the work plan?***

*Is it necessary to add to or change IFRS Standards to improve financial reporting?<sup>5</sup>*

53. Based on our analysis, we conclude that the principles and requirements in IFRS Standards provide an adequate basis for a customer to determine its accounting for expenditure on configuration or customisation of the supplier’s application software in a SaaS arrangement that conveys to the customer the right to receive access to the supplier’s application software in the future.

### **Staff recommendation**

54. Based on our assessment of the work plan criteria in paragraph 5.16 of the *Due Process Handbook* (discussed in paragraph 53 of this paper), we recommend that the Committee does not add a standard-setting project to the work plan. Instead, we recommend publishing a tentative agenda decision that outlines how a customer

---

<sup>5</sup> Paragraph 5.16(b) of the [Due Process Handbook](#)

accounts for expenditure on configuration or customisation of the supplier's application software in a SaaS arrangement as described in the submission.

55. Appendix A to this paper sets out the proposed wording of the tentative agenda decision. In our view, the proposed tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Standards.<sup>6</sup>

### Questions 2 and 3 for the Committee

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

---

<sup>6</sup> Paragraph 8.4 of the *Due Process Handbook* states: 'Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'

## Appendix A—proposed wording of the tentative agenda decision

### **Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 *Intangible Assets*)**

The Committee received a request about the customer’s accounting for costs of configuring or customising the supplier’s application software in a Software as a Service (SaaS) arrangement. In the fact pattern described in the request:

- 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 for a specified term—that right to receive access does not provide the customer with a software asset at the contract commencement date and, therefore, the access to the software is a service that the customer receives over the contract term.
- b. the customer incurs upfront costs of configuring or customising the supplier’s application software to which it receives access. The request describes configuration and customisation as follows:
  - i. 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.
  - ii. Customisation involves modifying the software code in the application or writing additional code. Customisation generally changes, or creates additional, functionalities within the software.

In analysing the request, the Committee considered:

- a. whether, applying IAS 38, the customer recognises an intangible asset in relation to configuration or customisation of the application software (Question I)?
- b. if an intangible asset is not recognised, how the customer accounts for the configuration or customisation costs (Question II)?

#### **Does the customer recognise an intangible asset in relation to configuration or customisation of the application software (Question I)?**

Applying paragraph 18 of IAS 38, an entity recognises an item as an intangible asset when it 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 defines an intangible asset as ‘an identifiable non-monetary asset without physical substance’. IAS 38 notes that an asset is a resource controlled by an entity and paragraph 13 specifies that an entity controls an intangible 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 request, the supplier controls the application software to which the customer has access. The assessment of whether configuration or customisation of that software results in an intangible asset for the customer depends on the nature and output of the configuration or customisation performed. The Committee observed that, in the SaaS arrangement described in the request, the customer often would not recognise an intangible asset because it does not have the power to obtain the future economic benefits flowing from the software being configured or customised and to restrict others’ (including the supplier’s) access to those benefits. In some circumstances, 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, the customer assesses whether the additional code is identifiable and meets the recognition criteria in IAS 38 in determining whether to recognise the additional code as an intangible asset.

**If an intangible asset is not recognised, how does the customer account for configuration or customisation costs (Question II)?**

If the customer does not recognise an intangible asset in relation to configuration or customisation of the application software, it applies paragraphs 68–70 of IAS 38 to account for those costs. The Committee observed the following regarding the application of those paragraphs:

- a. The customer recognises the costs as an expense when it receives the configuration or customisation services (paragraph 69). Paragraph 69A specifies that ‘services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service...’. In assessing when to recognise the costs as an expense, IAS 38 therefore requires the

customer to determine when the supplier performs the configuration or customisation services in accordance with the contract to deliver those services.

- b. IAS 38 does not include requirements that deal with the identification of the services the customer receives and when the supplier performs those services in accordance with the contract. Applying paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the customer refers to, and considers the applicability of, the requirements in IFRS Standards that deal with similar and related issues. The Committee observed that IFRS 15 *Revenue from Contracts with Customers* includes requirements that suppliers apply in identifying the promised goods or services in a contract with a customer and when those promised goods or services are transferred to the customer. In the fact pattern described in the request, those requirements in IFRS 15 deal with issues similar and related to those faced by the customer in determining when the supplier performs the configuration or customisation services in accordance with the contract to deliver those services.
- c. In applying the requirements in IFRS 15 to determine when the supplier performs the configuration or customisation services in accordance with the contract:
- i. if the configuration or customisation services the customer receives are distinct, then the customer recognises the configuration or customisation costs as an expense when the supplier configures or customises the application software.
  - ii. if the configuration or customisation services the customer receives are not distinct (because those services are not separately identifiable from the customer's right to access the application software), then the customer recognises the configuration or customisation costs as an expense when the supplier provides access to the application software over the contract term. If the customer pays the supplier before receiving the services, it recognises the prepayment as an asset (paragraph 70 of IAS 38).

Applying paragraphs 117–124 of IAS 1 *Presentation of Financial Statements*, the customer discloses its accounting policy for configuration or customisation costs when that disclosure is relevant to an understanding of the customer's financial statements.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for a customer to determine its accounting for configuration or

customisation costs incurred in relation to the SaaS arrangement described in the request. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

## Appendix B—submission

B1. We have reproduced the submission below, and in doing so deleted details that would identify the submitter of this request.

### Potential Interpretations Committee agenda item request

This letter describes an issue that we believe should be added to the agenda of the IFRS Interpretations Committee. We have included a summary of the issue, diverse views, and an assessment against the Interpretations Committee criteria.

#### Issue

In its March 2019 decision on a *Customer's Right to Receive Access to the Supplier's Software Hosted on the Cloud (IAS 38 Intangible Assets)*, the Committee observed that a contract that conveys to the customer only the right to receive access to the supplier's application software in the future is a service contract – i.e. the customer does not receive a software asset. This letter addresses the accounting for costs incurred in relation to such a 'cloud service contract'.

We have observed diverse views and practice on the emerging issue of whether up-front costs of configuring or customising<sup>7</sup> the supplier's software to which access is being granted, should be capitalised or not. These costs of preparing the software for its intended use can be considerable. This topic was identified as an application issue at the time of the previous Committee discussions but was not addressed for scoping reasons.

We have observed three different treatments of configuration/ customisation costs: 1) capitalised as an intangible asset under IAS 38; 2) capitalised as a prepayment for future services; or 3) expensed as incurred. For the purposes of analysing the acceptability of these three treatments, the discussion below first considers whether there is an intangible asset and then whether there is a prepayment for future services.

Note that there is a difference between IFRS and US GAAP requirements. Under US GAAP, such costs in a cloud service contract are capitalised to the same extent as if they were incurred in respect of a controlled software intangible asset. This may be a factor in the emerging diversity.

#### **Question 1: Are the costs of preparing the software for use capitalised under IAS 38 in a cloud service contract?**

##### **View 1: No, as there is no intangible asset**

In a cloud service contract the customer does not control the software intangible asset. Therefore, the requirements of paragraph 27–28 of IAS 38 do not apply and there is no basis to capitalise the directly attributable costs of preparing the software for its intended use under

---

<sup>7</sup> See Appendix 2 for further details on the meaning of configuration and customisation activities assumed herein.

IAS 38. That is to say, the access to the software is not an intangible asset, and so these costs cannot be the cost of any such intangible asset.

Nor can they be an intangible asset in their own right because they do not establish control of any asset that is separate from the access to the software under the service contract.

Under View 1, intangible asset treatment is ruled out.

**View 2: Yes, there is an asset of some kind and the costs of preparing the software for its intended use should be capitalised as an intangible**

The costs of preparing the software for its intended use enhance the entity's right to receive access to the software in the future. These costs give rise to future economic benefits (the definition of an asset in the Conceptual Framework) that will be consumed over the periods when the software is accessed and should therefore be capitalised as an asset. They are not tangible assets, and so they must be intangible assets.

Further, the economic substance of such costs is the same regardless of whether the customer obtains control of a software intangible asset or enters into a cloud service contract. Therefore, the accounting for these costs should be aligned – i.e. the costs should be capitalised.

**Question 2: If the costs do not give rise to an intangible asset, are they expensed as incurred or capitalised as a prepayment for future services?<sup>8</sup>**

**View 1 – Expensed as incurred because the service is received up-front**

Activities that prepare the software for its intended use are services. Under IAS 38.69, an entity recognises the expenditure as an expense when the services are received. IAS 38.69A clarifies that services are received when they are performed by a supplier in accordance with a contract to deliver them.

The services to prepare the software for its intended use are performed by the supplier up-front and the associated costs should be recognised when they are performed.

**View 2 – Prepayment for future services because the configured/customised software will be accessed in the future**

Although the supplier performs the service up-front, the customer receives the benefit of that service over the cloud contract term when it receives access to the software. The services are therefore received in the future and the costs should be capitalised as a prepayment asset.

---

<sup>8</sup> Note that Question 2 primarily arises when the activities are performed by the supplier of the cloud software. When the activities are performed up-front by internal company personnel it is not possible to argue that the entity receives services in the future.

**View 3 – An entity uses a consistent framework to determine whether the service is separate from the access to the software (expensed as incurred) or part of one combined service (prepayment for future services)**

An entity should assess the nature of the service to determine when it is received – i.e. is it separate from the service of receiving access to the software or is it part of one combined service?

There is no specific guidance in IFRS on how a customer identifies separate services within a contract that may contain multiple services. However, IFRS 15 and IFRS 16 address similar and related issues from the perspective of the supplier in a revenue contract and a lessee in a contract that is, or contains, a lease.

Considering the principles in those standards, services that are capable of being provided separately by another supplier that does not also provide the access to the cloud software – e.g. configuration services – are separate from the service of receiving access to the software and the associated costs should be expensed as incurred. Conversely, a service that could only be performed by the cloud vendor – e.g. customising the underlying software code – is not separate from the service of receiving access to the customised software and the associated costs should be capitalised as a prepayment asset.

We believe that the Interpretations Committee should address this issue because it could have a significant effect on the financial statements of entities across all industries as companies shift from on-premise to cloud computing arrangements. Unlike with some other matters of accounting diversity, capitalising or not capitalising costs significantly affects comparability and the decision-making of users. Our assessment of this issue against the agenda criteria is included in Appendix 1 to this letter.

## Appendix 1

### Reasons for the Interpretations Committee to address the issues

- a) ***Is the issue widespread and has, or is expected to have, a material effect on those affected?*** Yes. This issue is relevant for all companies that are customers in cloud computing arrangements that are service contracts. This population of impacted entities is expected to continue to increase as more businesses shift towards cloud computing arrangements. The significance for affected entities will also increase as they migrate more of their existing systems to the cloud.
- b) ***Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?*** Yes. The issue affects whether implementation costs are expensed up-front or capitalised and amortised over a longer period. The comparability of financial statements would be improved if all customers in a cloud computing arrangement that is a service contract applied the same approach.
- c) ***Can the issue be resolved efficiently within the confines of IFRS Standards and the Conceptual Framework for Financial Reporting?*** Yes. It relates to the application of requirements in IAS 38 to specific transactions. We note that the Committee has previously issued an agenda decision in relation to other aspects of these specific transactions.
- d) ***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?*** Yes. It relates to the application of requirements in IAS 38 to specific transactions. We note that the Committee has previously issued an agenda decision in relation to other aspects of these specific transactions. We also note that the issue is widespread.
- e) ***Will the solution developed by the Interpretations Committee be effective for a reasonable time period?*** Yes. A project on IAS 38 is not currently on the IASB agenda. Although initial outreach by the Board in advance of the agenda consultation has indicated that some stakeholders may support a project on IAS 38, the timing and scope of any such project is unclear.

## Appendix 2

*Configuration* - Typical configuration services relate to the setting of various ‘flags’ or ‘switches’ within the software, or defining certain values or parameters, to implement a particular set-up for the software’s existing functionality. Configuration does not involve the modification or writing of additional software code, but rather involves setting up the software’s existing code to function in a particular way.

*Customisation* - Typically involves modifying existing software code in the application or writing additional code. The effect of significantly altering or adding software code is generally to change, or create additional, functionalities within the software.

For the sake of clarity, there are other up-front costs for which we believe there is no diversity in views and these are not the subject of this submission. For example:

- training, data migration and conversion (expensed); and
- the development of interfaces with existing systems (capitalised because they are intangible assets in their own right or additions to existing (own systems) intangible assets, assuming the other the criteria in IAS 38 are met).

**Appendix C— Agenda Decision Customer’s Right to Receive Access to the Supplier’s Software Hosted on the Cloud (IAS 38 Intangible Assets) (March 2019)**

The Committee received a request about how a customer accounts for a ‘Software as a Service’ cloud computing arrangement in which the customer contracts to pay a fee in exchange for a right to receive access to the supplier’s application software for a specified term. The supplier’s software runs on cloud infrastructure managed and controlled by the supplier. The customer accesses the software on an as needed basis over the internet or via a dedicated line. The contract does not convey to the customer any rights over tangible assets.

***Does the customer receive a software asset at the contract commencement date or a service over the contract term?***

The Committee noted that a customer receives a software asset at the contract commencement date if either (a) the contract contains a software lease, or (b) the customer otherwise obtains control of software at the contract commencement date.

***A software lease***

IFRS 16 *Leases* defines a lease as ‘a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration’.

Paragraphs 9 and B9 of IFRS 16 explain that a contract conveys the right to use an asset if, throughout the period of use, the customer has both:

- a. the right to obtain substantially all the economic benefits from use of the asset (an identified asset); and
- b. the right to direct the use of that asset.

Paragraphs B9–B31 of IFRS 16 provide application guidance on the definition of a lease.

Among other requirements, that application guidance specifies that a customer generally has the right to direct the use of an asset by having decision-making rights to change how and for what purpose the asset is used throughout the period of use. Accordingly, in a contract that contains a lease the supplier has given up those decision-making rights and transferred them to the customer at the lease commencement date.

The Committee observed that a right to receive future access to the supplier's software running on the supplier's cloud infrastructure does not in itself give the customer any decision-making rights about how and for what purpose the software is used—the supplier would have those rights by, for example, deciding how and when to update or reconfigure the software, or deciding on which hardware (or infrastructure) the software will run. Accordingly, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the contract does not contain a software lease.

### *A software intangible asset*

IAS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It notes that an asset is a resource controlled by the entity and paragraph 13 specifies that an entity controls an intangible 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.

The Committee observed that, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the customer does not receive a software intangible asset at the contract commencement date. A right to receive future access to the supplier's software does not, at the contract commencement date, give the customer the power to obtain the future economic benefits flowing from the software itself and to restrict others' access to those benefits.

Consequently, the Committee concluded that a contract that conveys to the customer only the right to receive access to the supplier's application software in the future is a service contract. The customer receives the service—the access to the software—over the contract term. If the customer pays the supplier before it receives the service, that prepayment gives the customer a right to future service and is an asset for the customer.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to account for fees paid or payable to receive access to the supplier's application software in Software as a Service arrangements. Consequently, the Committee decided not to add this matter to its standard-setting agenda.