IFRIC Update March 2021

IFRIC *Update* is a summary of the decisions reached by the IFRS Interpretations Committee (Committee) in its public meetings.

The Committee met on 16 March 2021, and discussed:

Committee's tentative agenda decisions

- Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)—Agenda Paper 3
- Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32 *Financial Instruments: Presentation*)—Agenda Paper 4

Agenda decisions for Board consideration

- Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 *Intangible Assets*)—Agenda Paper 2

Other matters

- Work in Progress—Agenda Paper 5

Addendum to IFRIC *Update*—Committee's agenda decisions

- Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 *Intangible Assets*)—Agenda Paper 2

Related information

IFRS Foundation work plan

Interpretations Committee page

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Committee's tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add standard-setting projects to the work plan. The Committee will reconsider these tentative decisions, including the reasons for not adding standard-setting projects, at a future meeting. The Committee invites comments on the tentative agenda decisions. Interested parties may submit comments on the open for comment page. All comments will be on the public record and posted on our website unless a respondent requests confidentiality and we grant that request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. The Committee will consider all comments received in writing up to and including the closing date; comments received after that date will not be analysed in agenda papers considered by the Committee.

Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)—Agenda Paper 3

The Committee received a request about how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments. In the fact pattern described in the request:

a. the lessee operates in a jurisdiction in which VAT is charged on goods and services. A seller includes VAT in an invoice for payment issued to a purchaser. In the case of leases, VAT is charged when an invoice for payment is issued by a lessor to a lessee.
b. the applicable legislation:
    i. requires a seller to collect VAT and remit it to the government; and
    ii. generally allows a purchaser to recover from the government VAT charged on payments for goods or services, including leases.
c. because of the nature of its operations, the lessee can recover only a portion of the VAT charged on purchased goods or services. This includes VAT charged on payments it makes for leases. Consequently, a portion of the VAT the lessee pays is non-refundable.
d. lease agreements require the lessee to make payments to the lessor that include amounts related to VAT charged in accordance with the applicable legislation.

The request asked whether, in applying IFRS 16, the lessee includes non-refundable VAT as part of the lease payments for a lease.

Outreach conducted by the Committee provided limited evidence:

a. that non-refundable VAT on lease payments is material to affected lessees; and
b. of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

The Committee has therefore not [yet] obtained evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32 *Financial Instruments: Presentation*)—Agenda Paper 4

The Committee received a request about the application of IAS 32 in relation to the reclassification of warrants. Specifically, the request described a warrant that provides the holder with the right to buy a fixed number of equity instruments of the issuer of the warrant for an exercise price that will be fixed at a future date. At initial recognition, because of the variability in the exercise price, the issuer in applying paragraph 16 of IAS 32 classifies these instruments as financial liabilities. This is because for a derivative financial instrument to be classified as equity, it must be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments (‘fixed-for-fixed condition’). The request asked whether the issuer reclassifies the warrant as an equity instrument following the fixing of the warrant’s exercise price after initial recognition as specified in the contract, given that the fixed-for-fixed condition would at that stage be met.

The Committee observed that IAS 32 contains no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument’s contractual terms are unchanged. The Committee acknowledged that similar questions about reclassification arise in other circumstances. Reclassification by the issuer has been identified as one of the practice issues the Board will consider addressing in its Financial Instruments with Characteristics of Equity (FICE) project. The Committee concluded that the matter described in the request is, in isolation, too narrow for the Board or the Committee to address in a cost-effective manner. Instead, the Board should consider the matter as part of its broader discussions on the FICE project. For these reasons, the Committee [decided] not to add a standard-setting project to the work plan.

Agenda decisions for Board consideration

Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 *Intangible Assets*)—Agenda Paper 2

The Committee considered feedback on the tentative agenda decision published in the December 2020 IFRIC *Update* about how a customer accounts for costs of configuring or customising the supplier's application software in a Software as a Service arrangement.

The Committee reached its conclusions on the agenda decision. In accordance with paragraph 8.7 of the IFRS Foundation's *Due Process Handbook*, the Board will consider this agenda decision at its April 2021 meeting. Subject to the Board not objecting, the agenda decision will be published in April 2021 in an addendum to this IFRIC *Update*.

Agenda paper 2: Report to the Board

Respondents to the tentative agenda decision highlighted shortcomings in the requirements of IAS 38 in their application to intangible asset arrangements linked to digitalisation. The Committee suggested that the Board consider this feedback as part of its upcoming Agenda Consultation.

Other matters

Work in Progress—Agenda Paper 5

The Committee received an update on the current status of open matters not discussed at its meeting in March 2021.

Addendum to IFRIC Update—Committee's agenda decisions

Agenda decisions, in many cases, include explanatory material. Explanatory material may provide additional insights that might change an entity's understanding of the principles and requirements in IFRS Standards. Because of this, an entity might determine that it needs to change an accounting policy as a result of an agenda decision. It is expected that an entity would be entitled to sufficient time to make that determination and implement any necessary accounting policy change (for example, an entity may need to obtain new information or adapt its systems to implement a change). Determining how much time is sufficient to make an accounting policy change is a matter of judgement that depends on an entity's particular facts and circumstances. Nonetheless an entity would be expected to implement any change on a timely basis and, if material, consider whether disclosure related to the change is required by IFRS Standards.

The Committee discussed the following matters and decided not to add standard-setting projects to the work plan.

Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 *Intangible Assets*)—Agenda Paper 2

Published in April 2021[1]

The Committee received a request about how a customer accounts for costs of configuring or customising a 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 over the contract term. That right to receive access does not provide the customer with a software asset and, therefore, the access to the software is a service that the customer receives over the contract term.
b. the customer incurs costs of configuring or customising the supplier's application software to which the customer 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.
c. the customer receives no other goods or services.

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).

[1] In accordance with paragraph 8.7 of the *Due Process Handbook*, at its April 2021 meeting, the International Accounting Standards Board discussed, and did not object to, this agenda decision.

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 the entity 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 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 control the software being configured or customised and those configuration or customisation activities do not create a resource controlled by the customer that is separate from the software. In some circumstances, however, 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, in determining whether to recognise the additional code as an intangible asset, the customer assesses whether the additional code is identifiable and meets the recognition criteria in IAS 38.

If an intangible asset is not recognised, how does the customer account for the 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 that:

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 includes no requirements that deal with the identification of the services the customer receives in determining when the supplier performs those services in accordance with the contract to deliver them. Paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* require the customer to refer to, and consider 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. For 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. if the contract to deliver the configuration or customisation services to the customer is with the supplier of the application software (including cases in which the supplier subcontracts services to a third party), the customer applies paragraphs 69–69A of IAS 38 and

determines when the supplier of the application software performs those services in accordance with the contract to deliver them as follows:

   i. if the services the customer receives are distinct, then the customer recognises the costs as an expense when the supplier configures or customises the application software.
   ii. if the services the customer receives are not distinct (because those services are not separately identifiable from the customer's right to receive access to the supplier's application software), then the customer recognises the costs as an expense when the supplier provides access to the application software over the contract term.

d. if the contract to deliver the configuration or customisation services to the customer is with a third-party supplier, the customer applies paragraphs 69–69A of IAS 38 and determines when the third-party supplier performs those services in accordance with the contract to deliver them. In applying these requirements, the customer recognises the costs as an expense when the third-party supplier configures or customises the application software.
e. if the customer pays the supplier of the configuration or customisation services before receiving those services, it recognises the prepayment as an asset (paragraph 70 of IAS 38).

Paragraphs 117–124 of IAS 1 *Presentation of Financial Statements* require the customer to disclose its accounting policy for configuration or customisation costs when that disclosure is relevant to an understanding of its 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.