



## Alerte de votre conseiller – IFRS

Point de vue sur les IFRS – Coûts de configuration ou de personnalisation dans un accord d'infonuagique

Novembre 2021

### Aperçu

L'équipe IFRS de Grant Thornton International a publié *IFRS Viewpoint – Configuration or customisation costs in a cloud computing arrangement* (en anglais seulement).

La série *IFRS Viewpoint* fournit des informations sur l'application des IFRS dans des situations complexes. Chaque édition mettra l'accent sur un aspect des normes dont l'application est difficile ou pour lequel il existe peu de directives.

Cette édition présente des indications sur la comptabilisation des coûts de configuration ou de personnalisation du logiciel d'application d'un fournisseur dans le cadre d'un accord de type logiciel-service.

### Problématique

L'International Financial Reporting Interpretations Committee (IFRIC) a reçu une demande concernant la manière dont un client doit comptabiliser les coûts de configuration ou de personnalisation du logiciel d'application d'un fournisseur dans le cadre d'un accord de type logiciel-service. Une grande diversité de pratiques s'est développée, et l'IFRIC a déterminé qu'il était à propos de publier une décision à cet égard dans le cadre de son programme de travail.

L'IFRIC a déterminé qu'il existe déjà suffisamment de lignes directrices dans les normes comptables pertinentes et que, par conséquent, aucune modification des normes comptables n'était nécessaire. La justification de cette conclusion, qui fait partie de l'interprétation des IFRS, est exposée dans la décision rendue dans le cadre du programme de travail de l'IFRIC.

### Ressource

Le document *IFRS Viewpoint – Configuration or customisation costs in a cloud computing arrangement* est joint à la présente *Alerte de votre conseiller*.



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Traduction : en cas de divergence, la version originale anglaise a préséance.

# IFRS Viewpoint

## Configuration or customisation costs in a cloud computing arrangement

### What's the issue?

The International Financial Reporting Interpretations Committee (IFRIC), received a request addressing how a customer should account for costs of configuring or customising a supplier's application software in a Cloud Computing or Software as a Service (SaaS) arrangement. Significant diversity in practice had developed and the IFRIC determined it was appropriate for an agenda decision to be issued.

The IFRIC determined sufficient guidance exists within the relevant accounting standards and therefore no amendments to accounting standards were required. The rationale for arriving at this conclusion, which forms part of the interpretation of IFRS, is set out in the agenda decision.

Our 'IFRS Viewpoint' series provides insights from our global IFRS team on applying IFRS in challenging situations. Each edition will focus on an area where the Standards have proved difficult to apply or where there is a lack of specific guidance.

#### Relevant IFRS

IAS 38 'Intangible Assets'

IFRS 15 'Revenue from Contracts with Customers'

IAS 36 'Impairment of Assets'

IAS 8 'Accounting Policies, Change in Accounting Estimates and Errors'

IAS 1 'Presentation of Financial Statements'



# What is cloud computing?

Cloud computing is a confusing term that can be interpreted in a variety of ways, with differing consequences. Generally, computing arrangements can be broken into three broad categories.

## Software Agreement Categories

Licensed software on premise

Licensed software off premise

Software as a service

In the first two categories, a license to use the software as the purchaser sees fit is typically granted. This includes an ability to choose where and how the software operates, and whether it operates at all. In the first category, the software operates in environments owned and operated by the entity acquiring the license – for instance, a local operating system on a desktop computer. In the second category, the purchaser has chosen (but not been forced) to operate the software in a third party’s environment. This may be selected to operate an ERP or other business critical platform on the basis of guaranteed uptime, distributed backups, and guarantees of otherwise unavailable levels of data security.

In the third category – widely described as SaaS (software as a service) – the purchaser has been granted a right to access software and use it for their purposes. No right to transfer the software to another platform or to control the method of operation of the software is granted beyond what is contractually agreed.

The IFRIC agenda decision issued in March 2021 relates to this third category SaaS.

### Owned

Owned software is able to be controlled by the purchaser – including selection of updates and hardware.

### Right of access

Software with a right of access is unable to be controlled by the purchaser – the provider chooses hardware, application of updates, etc., within limits of contract.

### Hosted

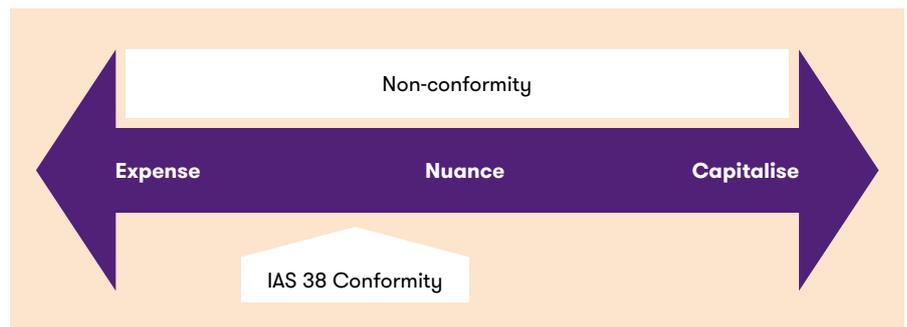
A hosted environment is one where the purchaser does not control the hardware upon which the software operates.

# What was the diversity in practice?

In its consultation on the issue, the IFRIC identified various approaches to customisation and configuration costs for cloud computing arrangements were utilised by companies depending on internal policy. These policies varied from expensing all costs in full to capitalisation of all costs in full, with most entities taking a more nuanced approach in their capitalisation policy and differentiating between expenditure with different underlying fact patterns.

In its agenda decision, the IFRIC determined a nuanced approach indicating IAS 38 'Intangible Assets' was appropriate depending on the facts and circumstances of the projects undertaken and the rights and obligations of the entity as it relates to the individual elements of the projects.

Many entities will find their historic policies, though nuanced, will not conform to the principles as described by the IFRIC.



## Example 1a: Strict expense policy

An entity has a strict policy – any expenditure related to a potential intangible asset is expensed without application of IAS 38 to the transaction. Such transactions are non-compliant with IAS 38 on the basis a transaction that was an intangible asset was expensed.

The accounting standards do not permit overly conservative accounting policies.

## Example 1b: Strict capitalisation policy

An entity has a strict policy – any expenditure related to a potential intangible asset is capitalised without application of IAS 38 to the transaction. Such transactions are non-compliant with IAS 38 on the basis a transaction that was not an intangible asset was capitalised.

The accounting standards do not permit overly aggressive policies.

## Example 1c: Capitalisation per the conceptual framework

An entity has established a policy that requires the recognition of an asset per the requirements of IAS 38. Where an IAS 38 asset does not exist, it applies the Conceptual Framework for Financial Reporting ('CF') and recognises certain elements of expenditure as an 'Other Asset' amortised over the life of the SaaS agreement.

IAS 38 requires expenditure that does not qualify for capitalisation to be expensed. The CF cannot override what is specifically set out in an International Accounting Standard.

# What does the agenda decision require?

The agenda decision requires management to capitalise those elements of expenditure that meet the definition of an intangible asset as defined by IAS 38 and recognise any additional amounts as an expense as the entity benefits from the expenditure – either by applying IAS 38 or applying another accounting standard.

The agenda decision clarified:

- the nature of expenditure that met the definition of an intangible asset
- the methods of differentiating between intangible assets and expenses, and
- the pattern in which the entity benefits from expenditure that does not qualify as an intangible asset.



# Intangible asset vs expense

The IFRIC identified the disparity in practice was caused in part by confusion over the definition of an intangible asset and whether costs incurred met the criteria to be recognised as an intangible asset.

To assist with this confusion, the IFRIC identified two general ‘buckets’ of implementation cost incurred in a cloud computing arrangement:

- configuration costs, and
- customisation costs.

Configuration costs were defined as ‘involving the setting of various ‘flags’ or ‘switches’ within the application software, or defining values or parameters, to set up the software’s **existing code** to function in a specified way’. Customisation was defined as ‘involving **modifying the software code** in the application or writing additional code. Customisation generally changes, or creates additional, functionalities within the software.’ (emphasis added).

An intangible asset is recognisable when it has the following characteristics:

- the asset is **separable and transferable** from the entity, or arises from **contractual or other legal rights**
- the asset is a resource **controlled** by the entity, and
- the entity has the power to obtain economic benefits flowing from the resource and restrict the access of others to those benefits.

From the above, the IFRIC communicated it is typical the software underlying a cloud computing arrangement is not transferred to a customer, and the setting of flags (ie configuration) in third party software does not provide a separable and transferable, or contractual, right to an asset as no asset that is separate from the software has been created.

The IFRIC also addressed the potential for customisation costs to meet the definition of an intangible asset. The IFRIC identified in certain situations, customisation costs **may** be required to be capitalised. This will be applicable where the entity has engaged resources (internal or external) to create software to which the entity retains intellectual property rights. We note this is generally not the case where code is created for operation ‘in the cloud’ as such additional enhanced functionality generally remains the property of the third part cloud computing provider.

Configuration involves using existing code.

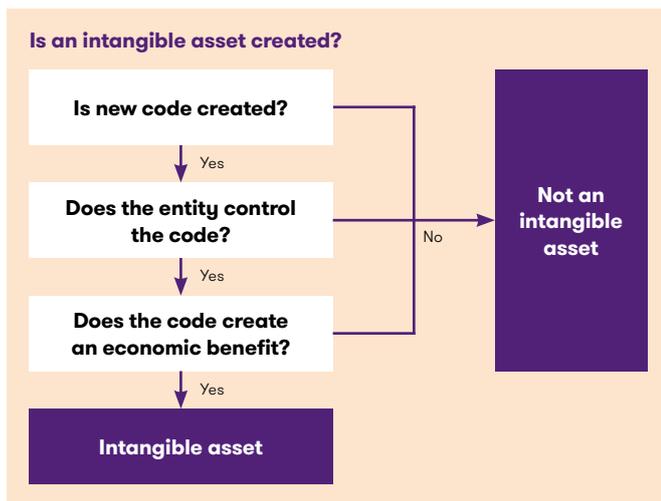
Customisation modifies or adds new code.

An intangible asset requires a legal right being assigned (a license) or the right to transfer ownership (copyright) that the entity controls.

The entity must, through the exercise of its rights, be able to prevent others from accessing the benefits of the asset.

### When is an intangible asset most likely to be created?

An intangible asset is most likely to be created where the entity is investing in specific technology to bridge a gap in capability – and rights to that investment are retained by the entity. Generally, the rights related to technology developed by a supplier where the supplier also provides the platform will not vest with the customer. Specific negotiation is generally required to retain the rights to the developed software, often at increased cost. The transfer of rights may also be incomplete as the software may also be developed using intellectual property which is retained by the counterparty.

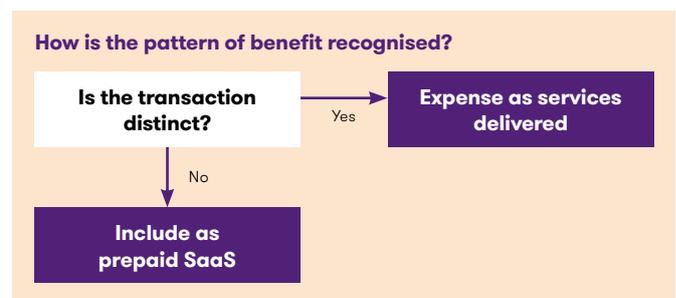


Notwithstanding this, there are certain hypothetical examples where an intangible asset may be created:

- development of a legacy platform/SaaS integration, or
- modification of systems in order to utilise SaaS output.

### Where an intangible asset does not exist: The pattern of benefit

Certain entities had identified an intangible asset did not exist for all or part of expenditure related to configuration and/or customisation of a cloud computing arrangement. Disparity in practice existed as to the recognition of expense in relation to this expenditure; certain entities recognising the expenditure as an expense when incurred, while others were recognising the expenditure as an ‘other asset’ and recognised the expenditure as an expense over the life of the cloud computing arrangement.



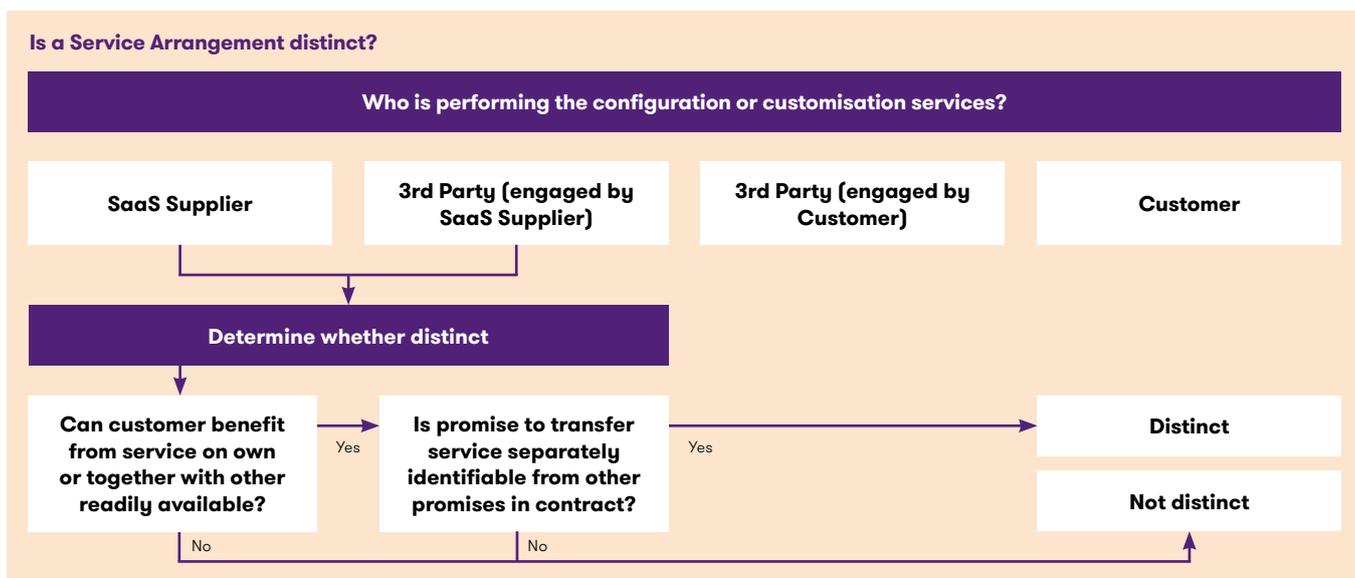
The IFRIC identified the deferring of expenditure over the life of the cloud computing arrangement is inappropriate as IAS 38 requires expenditure on services that is not capitalised be recognised as an expense when it receives the services. The judgements then applied by the entity relate to the timing and value of these non-qualifying services.

In arriving at this conclusion, the IFRIC considered the nature of SaaS arrangements and concluded they are, service arrangements as suggested by their name – Software as a Service. In a service arrangement, the benefit of the arrangement is generally received over the period of use of the service. As the period of use is generally the period of the contract, this is used as a proxy for the period of benefit.

The IFRIC further identified certain contracts will contain services that are separate to the underlying SaaS arrangement and able to be accounted for separately to the arrangement – services that are ‘distinct’ – and services that are unable to be separated from the arrangement – services that are ‘not distinct’.

Generally, services ‘not distinct’ are unable to be separated from the SaaS arrangement and recognised as an expense on the same pattern as the SaaS arrangement. However, services that are ‘distinct’ are recognised as the benefit is received. Refer to table on page 7.

Services provided by a third party are often distinct from the SaaS arrangement as per the definition of ‘distinct’ in IFRS 15 ‘Revenue from Contracts with Customers’, so judgement needs to be applied.



**What is meant by distinct?**

As identified on the previous page, the IFRIC has referenced concepts first introduced in IFRS 15 in providing guidance on the timing of expenditure for these services. Where the services are considered ‘distinct’ from other elements of the contract, they are addressed as a separate element and are expensed as and when the services are provided – typically in a relatively short time period. Where the services are not considered distinct from other elements of the contract – ie other performance obligations as defined by IFRS 15 – they are required to be bundled with those other elements and recognised as an expense in the same pattern as those other elements.

IFRS 15 defines a good or service as distinct if both of the following criteria are met:

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct), and
- 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).

Such determinations are widely covered in IFRS 15 guidance and as a result we will not expand in detail in this publication, other than to note the application of this guidance requires the customer to consider a transaction from the supplier’s perspective in addition to their own.

As noted above, services offered by a third party may or may not be distinct. If engagement is by the customer, they will be distinct as it demonstrates the SaaS platform is able to be benefited from without additional services by that supplier. If engaged by the SaaS supplier, they can be considered an extension of the SaaS supplier and IFRS 15 should be applied.

**Transactions with elements of both intangible asset and expense**

It will be common to encounter situations where a contract (or contracts) with a supplier will include elements that both do and do not meet the definition of an intangible asset – and also situations where a transaction with a supplier contains elements that both are and are not distinct from the underlying cloud computing arrangement.

The IFRIC did not provide additional guidance on the identification of value, however other guidance exists that is applicable in this instance – specifically, we recommend a relative-value approach be utilised for the elements identified.

# Error or change in policy?

The IFRIC has identified disparity in practice exists and has issued an agenda decision on the basis of clarifying which policies are acceptable. In our view, it is appropriate in this instance to consider the correction of any related recognition and measurement arising from the application of the agenda decision as a change in accounting policy as opposed to a restatement due to an error.

While the form of restatement of prior periods is similar, it is appropriate in this instance to refer to a change in policy as a result of the IFRIC agenda decision as opposed to a restatement due to a prior period error.

In the instance of a change in policy, the appropriate disclosures are described in IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' and include:

- the nature and change in accounting policy
- the reasons why applying the new accounting policy provides reliable and more relevant information
- for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
  - for each financial statement line item affected, and
  - if IAS 33 'Earnings per Share' applies to the entity, for basic and diluted earnings per share
  - the amount of the adjustment relating to periods before those presented, to the extent practicable, and

- if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

# When should the policy be implemented?

For certain entities, the adoption of the new policy will result in minimal impact as a result of known limitations in the volume of contracts within the scope of the IFRIC agenda decision.

For other entities, the impact will be broader and may require significant projects to be undertaken to obtain, collate, and make judgements on the underlying information. It is therefore generally accepted the agenda decision may require effort to determine the impact of the agenda decision and adjust the financial statements of an entity; it may also be appropriate for entities to expedite the adoption of a revised policy in response to the agenda decision.

A general expectation has been communicated that all entities will have adopted the new policy by 31 December 2021. We do note, however, that accuracy is paramount. While an entity should seek to expedite adoption, corporate governance will require appropriate controls to be implemented to ensure accuracy in adoption which may require a more deliberate approach to ensure material accuracy.

Our view is the adoption of an accounting policy is governed by IAS 8 which does not allow for an ‘incomplete’ adoption of a policy. Any adoption should be completed in a single step and not involve restatement over multiple periods.

# Additional considerations

## Disclosure prior to adoption of new policy

IAS 8 does not address circumstances where the IFRIC has released an agenda decision that impacts an entity's choice of accounting policies and the entity is in the process of determining the impact of the change in policy. In such a situation, where an entity suspects the mandatory change in policy may be material to its financial statements, in our view it is appropriate for the entity to disclose sufficient information for users to understand the potential impact the change in policy may have on the financial statements. These disclosures are recommended to take a form similar to those described in IAS 8 and include:

- how the agenda decision impacts the entity
- whether the agenda decision has not been implemented as a change in policy, and
- known or reasonably estimable information relevant to assessing the possible impact that application of the change in policy will have on the entity's financial statements in the period of initial application.

We also recommend disclosures being applied by analogy, where IAS 8 requires disclosures of the following (or, if in brackets, analogising to):

- the title of the new International Accounting Standard (IFRIC agenda decision)
- the nature of the impending change or changes in accounting policy
- the date as at which it plans to apply the International Accounting Standard (IFRIC agenda decision) initially, and
- either:
  - a discussion of the impact the initial application of the International Accounting Standard (IFRIC agenda decision) is expected to have on the entity's financial statements, or
  - if the impact is not known or reasonably estimable, a statement to that effect.

**IAS 8 should be applied by analogy – including disclosure of potential impacts of the new policy.**

## Disclosure when there is adoption of the new policy

IAS 8 defines the required disclosures for entities that have implemented a new accounting policy in a period, and its requirements are as follows:

- the nature of the change in accounting policy
- the reasons why applying the new accounting policy provides reliable and more relevant information
- for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
  - for each financial statement line item affected, and
  - if IAS 33 applies to the entity, for basic and diluted earnings per share.

This will require the period of change in policy be calculated under both the historic and new policies

- the amount of the adjustment relating to periods before those presented, to the extent practicable, and
- if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of the condition and a description of how and from when the change in accounting policy has been applied.

**IAS 8 requires, in a change of policy, information for the current period be presented as complying with both policies (in the notes).**

### What is meant by ‘impracticable’?

In certain situations, it is impracticable for entities to obtain information in sufficient detail to determine the impact of historic transactions when applying a new policy. This situation may arise, for instance, where records are no longer retained by the entity.

In our experience, it is not unusual for information in records to be difficult to obtain – for instance, due to archiving. In such a situation, it is not ‘impracticable’ but ‘inconvenient’. An example of data that is ‘impracticable’ to obtain is given by IAS 8 as: “data [that] **may not have been collected** in the prior period(s)...”. (emphasis added). In our opinion, data that ‘may not have been collected’ is data that does not exist or was not retained – for instance, the number of simultaneous users where the fields were not added to a database. Data retained in invoice or other form that is not structured organised is data that is collected but not collated – such data is **not** impracticable to be obtained due to the ability to obtain the information with sufficient effort.

The Oxford Dictionary defines ‘Impracticable’ as ‘impossible to carry out, not feasible’.

We note ‘difficult’ or ‘expensive’ is not within the definition.

### Example 2a: Practicable

An entity has entered into contracts over a period of time that may give rise to an intangible asset. The entity has sufficiently detailed records of transactions entered into with third-party providers, however these are stored in hard copy in archive.

Accessing the information will be time consuming and incur a significant cost.

Accessing the information is practicable.

### Example 2b: Impracticable

An entity has undertaken significant investment in SaaS platforms, creating internally developed integrations with these platforms. The cost incurred was not monitored and supporting documentation does not exist.

It is impracticable for the entity to identify the value of intangible assets created as it relates to internal costs.

### Example 2c: Impracticable

An entity has undertaken significant investment in SaaS platforms, creating internally developed integrations with these platforms. The cost incurred was monitored via a detailed timekeeping system, however records are not retained past seven years in line with corporate governance requirements.

It is impracticable for the entity to calculate the value of intangible assets created as it relates to costs incurred more than 7 years prior to transition to the new policy.

### Example 2d: Impracticable

An entity does not retain documentation for the legally required seven year period but for three years only. It is impracticable for the entity to calculate the value of intangible assets created as it relates to costs incurred more than three years prior to transition to the new policy.

### Example 2e: Impracticable

An entity stored its hard copy source documents in a container which was lost in a factory fire.

It is impracticable for the entity to calculate the value of intangible assets.

# Practical application – navigating the process

Developing a materially correct statement of financial position when addressing historic transactions can be difficult as it requires understanding:

- the period for which information is available
- the projects implemented, or being implemented, at a particular point in time
- the relative impact of historic transactions on the balance sheet and income statement for all periods presented in restated financial statements, and
- completing the above without the influence of hindsight.

## Capturing the required data

Where activity has been identified for assessment, it may be appropriate to involve expertise outside of the accounting function – for example, operations or information technology – in order to ensure data captured is correct and accurate. Additional complexity will arise in ensuring the information collected is auditable. As the totality of expenditure increases towards being material, the quality of information required to demonstrate the allocation of transactions or portions of transactions to either expenditure or intangible assets needs to be carefully assessed.

Ideally, each project would be considered as a series of sub-projects. Information that may be required to be captured includes:

- project name
- project sponsor
- project goal
- impacted systems
- developer (eg external provider, internal coders)
- assessment of whether any potential intangible assets exist
- assessment of whether any potential non-distinct expenditure exist
- references to supporting information (contracts, invoices, MSAs, etc)
- preparer of collated information
- reviewer of collated information (subject matter expert)
- reviewer of collated information (appropriately qualified finance professional)
- invoices associated
- total expenditure
- the related data points associated, including:
  - third party contracts
  - third party invoices
  - internally incurred costs (payroll, etc)
  - whether each element of expenditure qualified for capitalisation at the point in time
  - whether a non-capitalisable item is distinct or not from the underlying cloud computing arrangement, and
  - the value capitalised (or expensed) that will require reassessment.

By logging this information, management will then be able to demonstrate a clear understanding of the value received in exchange for the expenditure on the project. Management can then focus its attention on projects where additional judgement may be required to be applied. Information captured in this process may include:

- description of sub-projects
- systems impacted
- direct costs incurred on the sub-project
- discussion of the sub-project and the application of IAS 38
- expected useful life of the project (if capitalised), or
- contractual life of the cloud computing arrangement (if not distinct).

We recommend entities undertaking large numbers of cloud computing projects develop a robust, IAS 38 accounting policy and related decision templates to ensure full compliance with this Standard.

### **Navigating consequential accounting considerations**

While it can reasonably be expected for most entities, the value of qualifying projects that are not yet available for use may be immaterial, in certain situations – eg large scale implementations and integrations – material intangible assets may be recorded at a reporting date that are not yet in production. IAS 36 ‘Impairment of Assets’ requires intangible assets that are not yet available for use to be tested for impairment at least annually – including in the year of their acquisition.

Management should therefore ensure any material balances are tested for impairment as required by IAS 36.

### Calculating the impact

Calculating the impact of a change in accounting policy involves a full restatement of historic financial information presented in the financial statements – including restating historic results that are presented as adjustments to retained earnings.

This requires the entity to understand the financial statement impact for each period impacted – in other words as every period in which transactions impacted by the entity have occurred.

Understanding the nature of transactions and the expected maximum useful life of any intangible assets created will allow an entity to create a maximum period of look-back. This period of look-back may also be limited by data retention policies that have been in place.

### Materiality

Certain entities, by reference to their internal metrics, may determine the impact on the financial statements of the change in policy to be immaterial historically. While this may be true for internal reporting purposes – especially for entities whose internal performance measures are not impacted by the change in policy – it will not necessarily be true for all stakeholders, particularly those external to the entity. Generally, there is an expectation materiality should be measured based on the lens through which those external parties would view the financial statements.

It may therefore not be appropriate to consider transactions as ‘material’ or ‘immaterial’ by reference to purely internal metrics, but instead consider the impact on other metrics such as total assets or net profit after tax.

IAS 1 ‘Presentation of Financial Statements’ provides a comprehensive definition of ‘Material’.

#### Definition of materiality in IAS 1

“Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.”

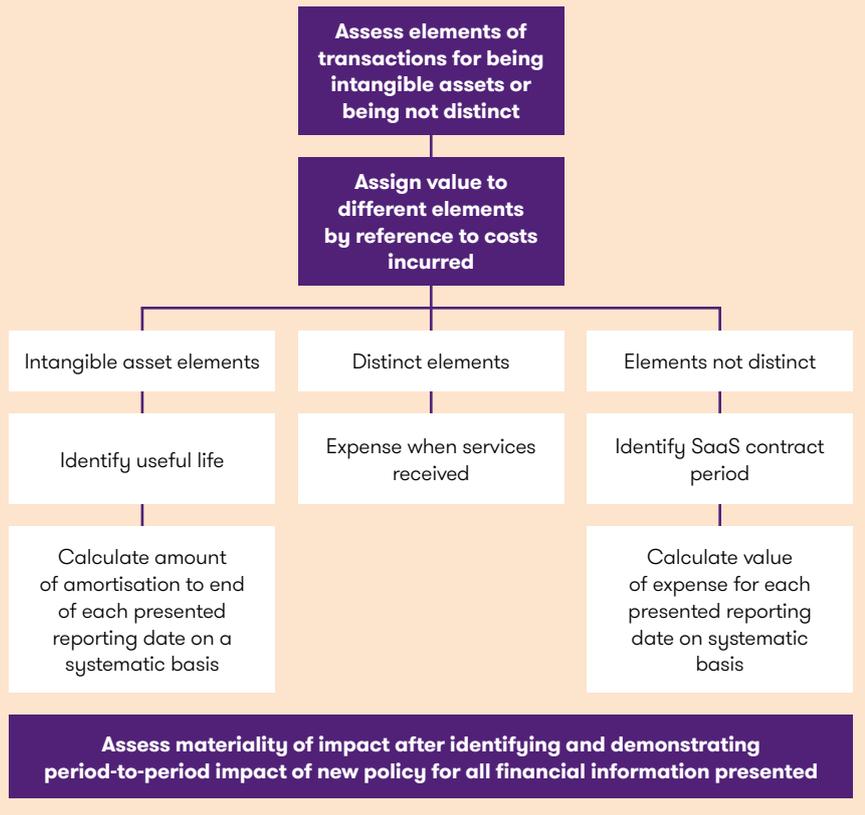
### Example 3

An entity has undertaken significant investment in SaaS platforms, creating internally developed integrations with SaaS platforms. All the cost incurred with third parties was expensed as incurred.

Certain projects completed 8 years prior to reporting date resulted in intangible assets as defined by IAS 38, however the relevant records were destroyed in accordance with corporate policy.

The entity is unable to calculate the impact of the change in policy for these historic transactions and therefore limit its look-back period to seven years.

## Identifying period-to-period impact



## Definition of distinct

An element of a transaction is distinct from (or capable of being distinct from) the underlying SaaS contract if the entity can benefit from either element of the contract without the other.

If a third party delivers a service, it cannot be included as a part of the SaaS contract and should be considered a 'Distinct element' in the flow chart.

## Definition of systematic

Generally, matching to the pattern of benefit received (eg relative volume or time based).

## How we can help

We hope you find the information in this IFRS Viewpoint helpful in giving you some insight into a complex IFRS area. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit [www.grantthornton.global/locations](http://www.grantthornton.global/locations) to find your local member firm.

