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ACCOUNTING FOR CLOUD COMPUTING AND SaaS ARRANGEMENTS

The accounting for Cloud Computing arrangements by users can present challenges, to both determine the appropriate classification of the arrangement and accounting for the associated costs.

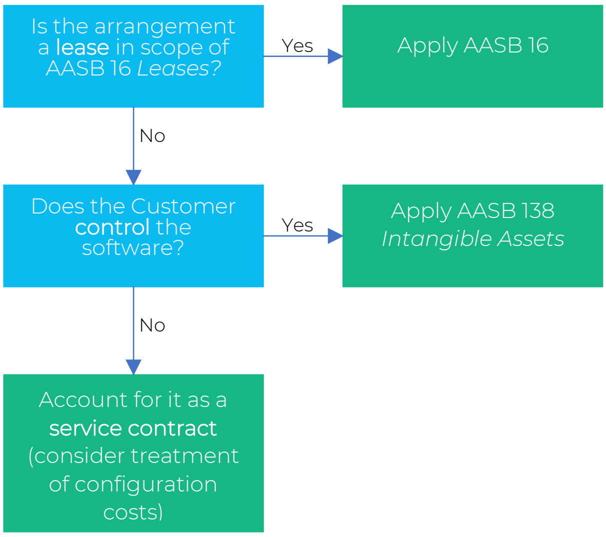
As technology continues to advance, existing accounting standards often lag in their requirements. The proliferation of Software as a Service (SaaS) and other Cloud computing arrangements has been no different. There is no specific accounting standard that directly applies to these arrangements by customers and instead existing standards are applied with significant judgements necessary. The issue was ultimately escalated to the IFRS Interpretations Committee (IFRIC) who considered the accounting for these arrangements in IFRIC Agenda decisions in March 2019 and March 2021.

WHAT ARE CLOUD COMPUTING OR SaaS ARRANGEMENTS?

Cloud computing or SaaS arrangements are when, rather than organisations purchasing software outright and installing it on their own machines, the software supplier instead hosts the software on their own systems and the customers log into the system via a browser. The customer organisations are still able to tailor the software to their own needs and configure it to meet their requirements. This can be done by selecting options within the software itself or by writing custom code. These SaaS arrangements are typically based on a subscription model and when the organisation stops paying their subscription, they will no longer have access to the SaaS system.

HOW SHOULD ORGANISATIONS ACCOUNT FOR CLOUD COMPUTING AND SaaS ARRANGEMENTS?

Organisations usually account for these transactions as service contracts and recognise the expense straight line as they access the service. However, there may be limited circumstances when other approaches might be required. IFRIC discussed this in their Agenda Decision in March 2019. The decision process an entity must undertake is as follows:



Is the arrangement in the scope of AASB 16 *Leases?*

For a SaaS arrangement to be in scope of AASB 16, the customer must have both:

- The right to obtain substantially all the benefit from use of the asset.
- The right to direct the use of the asset.

A typical SaaS arrangement does not give the customer this level of control to direct the use of the software, as the vendor, still owns the underlying software code and can and does provide access to the code to other customers concurrently. The vendor also still controls all decisions about how and when to upgrade the software as well as what hardware the software will run on etc. Accordingly, it is unlikely that SaaS arrangement will meet the definition of a lease.

Is the arrangement in the scope of AASB 138 *Intangible Assets?*

For similar reasons noted above, SaaS arrangements are unlikely to give customers control over the underlying software, as they cannot restrict other organisations from accessing the software as well and as such there is no intangible asset that the customer controls.

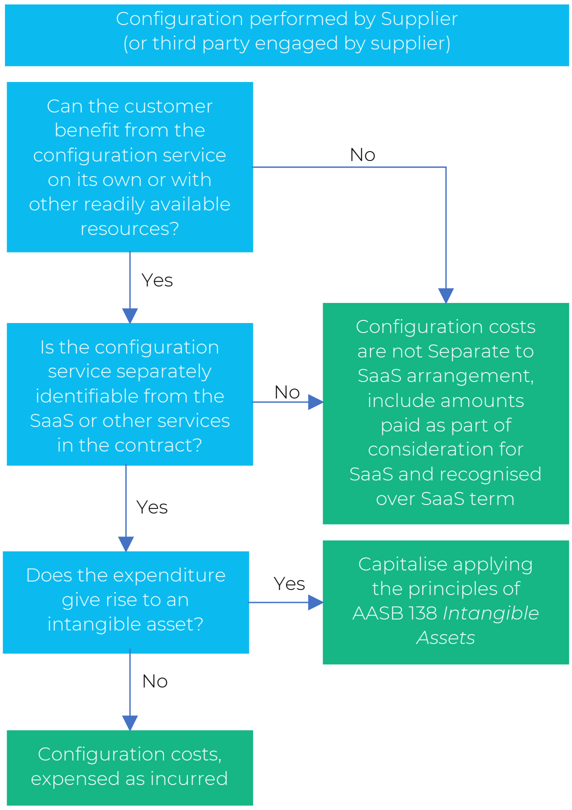
Hence, these arrangements are typically service contracts.

ACCOUNTING FOR CONFIGURATION COSTS

Many different costs are incurred in setting up a Cloud computing or SaaS arrangement, well beyond the payment of the regular access payments to the supplier. It is important to assess each of these costs separately to determine whether or not they can be capitalised under AASB 138 as an intangible asset.

This analysis of costs is complicated where the organisation pays the supplier of the SaaS for these configuration services. This is because AASB 138 does not provide any guidance on how to separate services and the associated costs within a contract. IFRIC considered this issue and concluded on how and when to separate costs from the SaaS contract in their March 2021 Agenda Decision.

IFRIC determined that in lieu of any guidance in AASB 138, entities should instead apply the guidance in AASB 15 *Revenue from Contracts with Customers* paragraph 27 by analogy to determine whether the configuration services provided by the supplier are distinct from the SaaS service or not. That is, are they akin to separate performance obligations under AASB 15.



There are two decisions that need to be considered before it can be determined whether the Configuration service and the SaaS are distinct or not:

1. *Can the customer benefit from the configuration service and the SaaS separately on their own?*

Indicators that the organisation could benefit from purchasing either the SaaS or the configuration services on their own include:

- if the Supplier sells the SaaS without the configuration services; or
- the Configuration services could be purchased separately from an independent provider.

Both of these would indicate that the customer can benefit from the configuration and the SaaS separately.

2. *Can the Configuration service and the SaaS be separately identified in the context of this contract?*

AASB 15.29 discusses that performance obligations are not distinct within the context of a contract where:

- Significant service of integrating the different goods or services together
- One good or service significantly modifies the other.
- The goods or services are highly interdependent or highly interrelated.

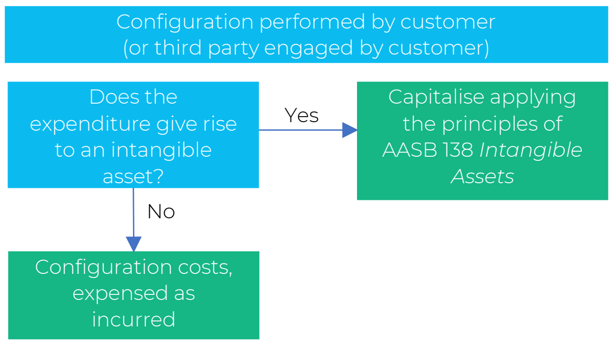
The customer is likely going to need to focus on the extent that the configuration services modifies the underly software of the SaaS, as this is typically the most relevant indicator in a software environment.

Significant judgement may be required to determine how much the configuration costs are actually modifying the software. Configurations that are just actually selecting different standard option in the software, or setting up your data in the software are less likely to significantly modify the actual software. Configurations that are writing custom code, to change the functionality of the software are more likely to be a significant modification.

If you answer No to either of these questions the configuration service is not distinct and separate from the SaaS service. As they are not distinct, all amounts paid, including any amounts identified on invoices as relating to the configuration service, are considered to be consideration paid for the SaaS. As consideration for the SaaS the amount should be recognised as the access to the SaaS is provided. Accordingly, if amounts are paid upfront in relation to configuration, this can be capitalised as a pre-paid expense and then released over the period of the SaaS arrangement.

Where the costs are not considered to be part of the costs of the SaaS arrangement, or where the organisation has undertaken the configuration work independently of the supplier, the organisation will have to apply the normal rules of AASB 138, to determine if the costs are able to be capitalised as intangible assets.

The key considerations at this point, will be whether the configuration work gives rise to a future economic benefit for the organisation, it is separately identifiable and that the organisation controls it.



Typical costs that may be incurred in setting up a cloud computing of SaaS system and there likely treatment as either expense (E) or capitalise (C) include:

Project initiation costs

- E — Product research and feasibility costs

Implementation Costs

- C — Software to allow existing systems to interface with SaaS
- E — Data conversion costs including reconciling between the old and new systems; inputting new data required by the SaaS; purging old data
- C — Updates to existing systems that enhance functionality of that system
- C — New Hardware
- ? — Configuration costs – see discussion above

Post Implementation Costs

- C — Development of user manuals and guidance materials
- E — Staff training
- E — Testing and ongoing maintenance
- E — Ongoing SaaS access fees

Further information

Accounting for Cloud Computing and SaaS arrangements can be complex and will require careful analysis of each of the underlying costs and service. For more advice or assistance please contact your local Moore Australia Advisor.