accounting guideline
AcG-20
Customer's accounting for cloud computing arrangements

Basis for Conclusions

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PURPOSE AND SCOPE

1 This Guideline provides guidance on:

(a) accounting for a customer's expenditures in a cloud computing arrangement; and

(b) determining whether a software intangible asset exists in the arrangement.

2 GOODWILL AND INTANGIBLE ASSETS, Section 3064, sets out the general principles governing the recognition, measurement, presentation and disclosure of goodwill and intangible assets.

3 This Guideline does not address expenditures on tangible elements of a cloud computing arrangement. Elements that are tangible assets are dealt with elsewhere in other Sections:

(a) property, plant and equipment (see PROPERTY, PLANT AND EQUIPMENT, Section 3061); and

(b) right to use a tangible asset (see LEASES, Section 3065).

4 Cloud computing is the on-demand delivery of computing resources over the internet or a private network. Computing resources include software, servers, data storage, networking capabilities and more. There are different types of delivery models that describe the combination of computing resources a vendor provides such as Software as a Service (SaaS). The way computing resources are delivered is referred to as the deployment model. A deployment model is the computing environment in which the computing resources reside, such as a cloud-based, on-premises or hybrid environment.

5 With the introduction of cloud computing arrangements, the purchase of a software license has started to shift toward paying a subscription fee to access the software. The subscription fee enables the customer to access the software residing on the vendor's cloud environment during the arrangement term. The vendor's cloud environment provides the infrastructure to support the running of the software, including providing the latest software updates.

6 An enterprise may enter into a multiple-element arrangement with a vendor that includes a software element, a hardware element and implementation activities. An enterprise may incur expenditures that relate to activities performed by internal personnel or third parties to implement the software in the arrangement.

RECOGNITION AND MEASUREMENT

7 Arrangement consideration is allocated at the inception of the cloud computing arrangement to all significant separable elements. As specified in paragraph 3, tangible elements such as hardware are outside the scope of this Guideline.

8 For example, licensing the software or subscribing for access to the software (software element) is typically a significant separable element in a cloud computing arrangement, particularly when implementation activities are performed by a third-party vendor or by the enterprise itself. However, an enterprise should consider if there are factors that may indicate the software element is not a separable element from the implementation activities. Factors to be considered include, but are not limited to, the following:

(a) The vendor does not sell to other customers the licensing of the software or subscription for accessing the software separately from the implementation activities.

(b) Only the vendor, or a third-party vendor that is subcontracted by the vendor, is capable of performing the implementation activities for the software.

9 An enterprise shall determine a method for allocating arrangement consideration on a rational and consistent basis for purposes of accounting for when it receives the goods or services.

10 This Guideline does not prescribe the method to allocate the arrangement consideration to meet the objective in paragraph 9. An enterprise may consider, but is not required, to adapt the methods in REVENUE, Section 3400, to perform this allocation.

Simplification approach

11 An enterprise is permitted to apply a simplification approach to account for expenditures in a cloud computing arrangement within the scope of this Guideline. In applying this approach, the expenditures in the arrangement shall be treated as the supply of services. The enterprise shall recognize the expenditures related to the elements in the cloud computing arrangement within the scope of this Guideline as an expense as incurred. Guidance on recognition of an expense is provided in GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.52-54. In particular, these paragraphs indicate the following:

(a) In the case of the supply of services, the enterprise recognizes the expenditure as an expense when it receives the services.

(b) Recognizing a prepayment as an asset is not precluded when payment for the delivery of the services has been made in advance of the enterprise receiving the services.

12 The simplification approach is an accounting policy that shall be applied consistently to expenditures in all cloud computing arrangements. In making this accounting policy choice, an enterprise need not meet the criterion in ACCOUNTING CHANGES, paragraph 1506.06(b).

13 An enterprise that does not apply the simplification approach shall apply:

(a) paragraphs 14-20 to determine if a software element is a software intangible asset or a software service;

(b) paragraphs 21-29 to all other elements within the scope of this Guideline (e.g., implementation activities or other intangible items such as those internally generated); and

(c) paragraphs 30-34 for the presentation requirements related to paragraphs 13(a) and (b).

Software intangible asset

14 A software element in the arrangement is recognized as a software intangible asset if it meets the definition of an intangible asset and the recognition criteria in accordance with GOODWILL AND INTANGIBLE ASSETS, Section 3064.

15 The definition of an intangible asset requires the software element to be identifiable, be controlled by the enterprise and have future economic benefits that would flow to the enterprise (see GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.11-.17). A software element normally meets the identifiable criterion because it would arise from contractual rights (see paragraph 3064.12(b)). The software element normally also meets the future economic criterion because of the benefits that would flow to the enterprise from the use of the software (see paragraph 3064.17).

16 An enterprise controls a software element if it has the power to obtain the future economic benefits flowing from the software and to restrict the access of others to those benefits (see GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.13).

17 A software element is controlled by the enterprise if it has the contractual right to obtain the software without significant penalty and it is feasible for the enterprise to run the software on its own or on a third party's infrastructure.

18 For purposes of the guidance in paragraph 17, the phrase "without significant penalty" contains two distinct concepts:

(a) the ability to take delivery of the software without incurring significant cost; and

(b) the ability to use the software separately without a significant diminution in utility or value.

19 An enterprise may control the software element based on factors other than or in addition to those in paragraph 17. Other factors that may indicate control include, but are not limited to, the following:

(a) Exclusive rights to use the software or ownership of the intellectual property for customized software (i.e., the vendor cannot make the software available to other customers).

(b) Decision-making rights to change how and for what purpose the software is used throughout the period of use (e.g., the enterprise can decide on how and when to update or reconfigure the software).

Software service

20 A software element in the arrangement that does not meet the definition of an intangible asset and the recognition criteria in accordance with GOODWILL AND INTANGIBLE ASSETS, Section 3064, is a software service. An enterprise pays a

subscription fee to access the software. The fee allocated to the software service shall be expensed as incurred (see paragraphs 3064.52-54 for guidance on recognition of an expense).

Implementation activities

21 An enterprise may incur expenditures to implement the software in the arrangement. Examples of implementation activities include:

(a) integration;

(b) customization or coding;

(c) configuration;

(d) data conversion;

(e) testing;

(f) training; and

(g) business process reengineering.

This list of examples is not exhaustive.

22 An enterprise that recognizes a software intangible asset in accordance with paragraphs 14-19 shall capitalize as part of the cost of the asset, expenditures on implementation activities that are directly attributable to preparing the asset for its intended use in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.25-.30. Subsequent measurement of the software intangible asset will be accounted for in accordance with Section 3064, which involves amortization and testing for impairment.

23 Expenditures on implementation activities may also give rise to a separate intangible asset. If the expenditures do give rise to a separate intangible asset, it shall be accounted for in accordance with GOODWILL AND INTANGIBLE ASSETS, Section 3064. For example, the expenditures to develop software code may give rise to an internally generated intangible asset. Such an asset shall be accounted for in accordance with an enterprise's accounting policy choice in paragraph 3064.40.

24 An enterprise that recognizes a software service in accordance with paragraph 20 shall make an accounting policy choice to either:

(a) expense the expenditures on implementation activities, other than those capitalized in accordance with paragraph 23, as incurred (see GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.52-54, for guidance on recognition of an expense); or

(b) capitalize the expenditures on implementation activities that are directly attributable to preparing the software service for its intended use as an asset.

This accounting policy choice shall be applied consistently. In making this accounting policy choice, the enterprise need not meet the criterion in ACCOUNTING CHANGES, paragraph 1506.06(b).

25 Expenditures on implementation activities capitalized in accordance with paragraph 24(b) shall be expensed using a straight-line method over the expected period of access to the software service by the enterprise, unless there is evidence that another method better reflects the pattern in which the enterprise expects to benefit from accessing the software. In that case, such expenditures shall be expensed using a method that reflects the pattern in which the enterprise expects to benefit from accessing the software. The method of expense and the expected period of access to the software service by the enterprise shall be reviewed on a regular basis.

26 Factors to be considered in determining the expected period of access to the software service by the enterprise include, but are not limited to, the following:

(a) The expectations regarding the period during and beyond the arrangement term that the enterprise plans to continue accessing the software service, provided there is evidence to support such expectations.

(b) Any clauses that may exist in the arrangement such as non-cancellable periods, renewal periods or termination clauses that would impact the expected period of access to the software service by the enterprise, provided there is reasonable assurance in the execution of such clauses.

(c) The effects of obsolescence, technology, competition and other economic factors that may limit the expected period of access to the software service by the enterprise.

27 Certain expenditures on implementation activities are not directly attributable to preparing the software intangible asset or software service for intended use and are recognized as an expense as incurred. Examples of expenditures that should be expensed as incurred include:

(a) research activities (see GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.37-.39); and

(b) training activities (see paragraph 3064.53(b)).

28 Expenditures on implementation activities capitalized in accordance with paragraph 24(b) shall be tested for impairment in accordance with the provisions of IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063, except for a not-for-profit organization for which such expenditures shall be tested for impairment in accordance with the provisions of INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4434.

29 An enterprise may incur subsequent expenditures to enhance the service potential of the software after the initial implementation of the software element. Service potential may be enhanced when there is an increase in the previously assessed service capacity, an extension of the useful life or the expected period of access to the software service, or an improvement in the quality of the output. Activities performed to maintain the expected service capacity of the software are maintenance activities, not enhancements. Expenditures that are:

(a) directly attributable to enhancing the service potential of a software intangible asset are included in the carrying amount of the software intangible asset;

(b) directly attributable to enhancing the service potential of a software service are included in the carrying amount of the asset that was recognized in accordance with paragraph 24(b); and

(c) maintenance activities are expensed as incurred irrespective of whether they relate to a software intangible asset or software service.

PRESENTATION

30 An enterprise shall present a software intangible asset, including any directly attributable expenditures on implementation activities accounted for as part of the cost of such asset, in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.90.

31 An enterprise shall classify cash payments to acquire a software intangible asset, including any related directly attributable expenditures on implementation activities, as cash flows arising from investing activities in accordance with CASH FLOW STATEMENT, paragraph 1540.18(a).

32 An enterprise shall present any expenditures on implementation activities capitalized as an asset in accordance with paragraph 24(b) as a separate line item in its balance sheet (see BALANCE SHEET, paragraph 1521.04(r)). Such asset is for the implementation of a software service and shall be classified as long term, unless at the inception of the cloud computing arrangement the expected period of access to the software service is within:

(a) one year from the date of the balance sheet (see CURRENT ASSETS AND CURRENT LIABILITIES, paragraph 1510.03); or

(b) the normal operating cycle, when that is longer than a year (see paragraph 1510.03).

33 Expenditures on implementation activities that are expensed in accordance with paragraph 25 shall be presented in the same line item in the income statement as the expense for subscription fees for the software service.

34 An enterprise shall classify cash payments for a software service, including any related expenditures on implementation activities, as cash flows arising from operating activities in accordance with CASH FLOW STATEMENT, paragraph 1540.16(c).

DISCLOSURE

35 An enterprise that applies the simplification approach in paragraphs 11-12 shall disclose:

(a) that fact; and

(b) the amount expensed for the period, including the caption in the income statement in which the expense is included.

36 An enterprise that does not apply the simplification approach in paragraphs 11-12 shall disclose the following:

(a) for a software intangible asset, disclose information in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraphs 3064.91-.92 and 3064.94.

(b) for a software service, disclose:

  (i) the amount expensed for the period, including the caption in the income statement in which the expense is included;

  (ii) the policy followed to account for expenditures that are directly attributable to implementing the software service;

  (iii) if directly attributable expenditures on implementation activities are capitalized in accordance with paragraph 24(b), the net carrying amount capitalized and the method used to expense the capitalized amount, including the expected period of access to the software service by the enterprise; and

  (iv) for any impairment loss recognized in accordance with paragraph 28, the amount of the impairment loss, the caption in the income statement in which the impairment loss is included, and the facts and circumstances leading to the impairment.

37 In addition to the disclosures required by paragraphs 35 and 36, an enterprise shall disclose information in accordance with CONTRACTUAL OBLIGATIONS, Section 3280, regarding commitments to make expenditures on a cloud computing arrangement.

EFFECTIVE DATE AND TRANSITION

38 This Guideline applies to annual financial statements relating to fiscal years beginning on or after January 1, 2024. Earlier application is permitted.

39 An enterprise that applies the simplification approach in paragraphs 11-12 shall apply this Guideline retrospectively, in accordance with ACCOUNTING CHANGES, Section 1506.

40 An enterprise that does not apply the simplification approach shall apply this Guideline:

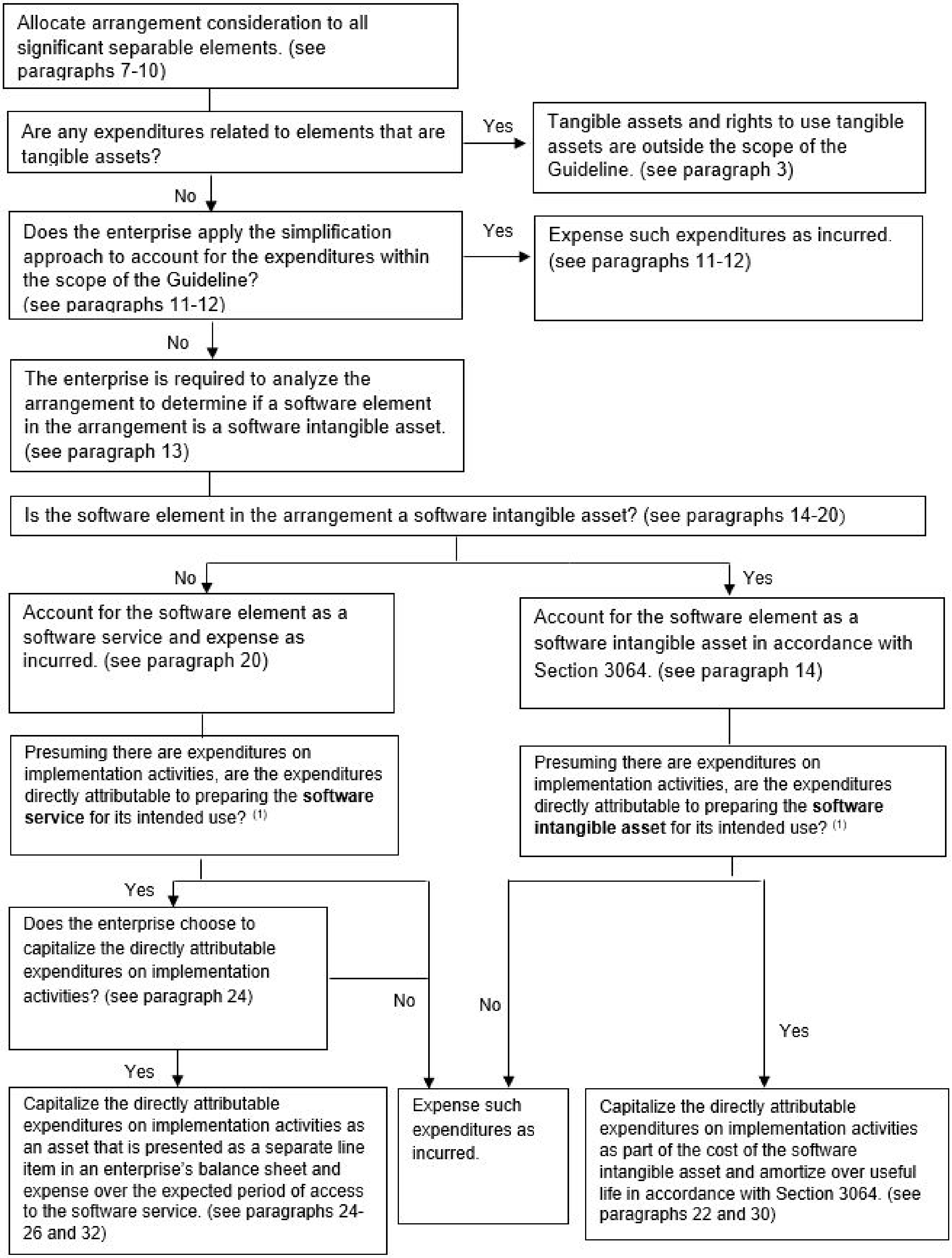
(a) retrospectively in accordance with ACCOUNTING CHANGES, Section 1506; or

(b) retrospectively only to expenditures on implementation activities incurred in a cloud computing arrangement on or after the beginning of the earliest period presented in the financial statements in which the enterprise first applies the Guideline. If the enterprise applies this transitional provision, it shall disclose that fact.

41 If an enterprise applies the transitional provision in paragraph 40(b), it is also required to apply the Guideline retrospectively to any previously recognized assets resulting from a cloud computing arrangement. Any adjustment to those assets in respect of applying the Guideline shall be recorded in opening retained earnings of the earliest period presented.

DECISION TREE

This Decision Tree is illustrative only.



(1) An enterprise shall also consider paragraph 23 to determine whether any of the expenditures on implementation activities give rise to a separate intangible asset.

ILLUSTRATIVE EXAMPLES

This material is illustrative only.

These examples illustrate how the accounting treatment specified in this Guideline might be applied in a particular situation. Matters of principle relating to particular situations should be decided in the context of this Guideline.

APPLICATION OF GUIDELINE WHEN THE SIMPLIFICATION APPROACH IS APPLIED

Example 1

Enterprise A chooses to apply the simplification approach in paragraphs 11-12 of the Guideline.

Fact Pattern

On October 1, 20X4, Enterprise A enters into a non-cancellable SaaS arrangement with Provider B for a three-year term to access Provider B's Enterprise Resource Planning (ERP) software for an annual fee of $40,000, payable at the end of each year. Access to Provider B's ERP software begins on April 1, 20X5, with the first annual fee due March 31, 20X6. Although the arrangement does not include a clause related to renewal options, Enterprise A and Provider B have a mutual understanding that the agreement can be renewed near the end of the term at market price. Considering this mutual understanding and that the SaaS arrangement is a critical part of Enterprise A's five-year strategic plan in building its information technology capability, Enterprise A expects to renew the arrangement for an additional two years beyond the initial three-year term. Enterprise A has a December 31 year-end.

As part of the arrangement, Provider B agrees to perform various implementation activities to enable Enterprise A to access the ERP software. The contract specifies that Enterprise A will pay $100,000 when Provider B completes all the implementation activities, which include:

- configuring the ERP software for it to be used as intended by Enterprise A (i.e., setting of flags and switches and setting the parameters of the software);
- purging Enterprise A's existing data;
- training of Enterprise A's employees;
- testing that the ERP software is performing as required; and
- customizing the ERP software code to generate certain management reports.

Key facts of the arrangement:

- Provider B expects to complete all the implementation activities by March 31, 20X5. All the implementation activities are expected to be performed evenly over a six-month period so that the ERP software will be implemented by March 31, 20X5.
- Provider B maintains and performs upgrades to the ERP software without Enterprise A's consent.
- Enterprise A does not have the right to obtain the ERP software developed by Provider B; it only has the right to access the ERP software.
- Enterprise A does not have the right to obtain the customized code developed by Provider B. The added management reports are available for Enterprise A to use when it receives access to Provider B's ERP software on April 1, 20X5.
- Provider B does not provide a detailed breakdown of the cost associated with each of the implementation activities.

Enterprise A has also obtained additional information through the vendor selection process:

- Other vendors provide access to a similar ERP software for an annual fee of $40,000.
- Other vendors can also perform the required implementation activities to get the ERP software ready for use as intended by Enterprise A.
- Quotations obtained from other vendors contain more detailed pricing of their implementation activities and, overall, suggest that the implementation cost of $100,000 represents competitive pricing in the market.

Analysis

Applying paragraphs 7-10 of the Guideline, Enterprise A considers the terms of the contract with Provider B and information from other vendor quotations. Enterprise A needs to allocate the total arrangement consideration to the significant separable elements in the arrangement.

Enterprise A first applies judgment and concludes that the access to Provider B's ERP software is a significant element separate from the implementation activities that will be performed by Provider B. The access to Provider B's software will be received for at least three years pending renewal.

In accordance with the contract, Provider B will perform all the implementation activities from October 1, 20X4 to March 31, 20X5. Since the activities will be performed by Provider B evenly over the six-month period, Enterprise A expenses as incurred those activities evenly over that period.

Enterprise A then performs the allocation to the elements in the arrangement for the purpose of applying the simplification approach in paragraphs 11-12 of the Guideline to expense as incurred these expenditures. The contract consideration is allocated to each component based on the pricing specified in the contract with Provider B given these prices are competitive considering other vendor's pricing obtained during the vendor selection process.

Significant separable elements	Allocation

Software access ($40,000 × 3 years)	$120,000
Implementation activities	100,000
Total	**$220,000**

Enterprise A recognizes the following:

(a) An expense of $40,000 each year starting from April 1, 20X5 for the annual fee to access Provider B's ERP software. Since Enterprise A's fiscal year-end is December 31, it will recognize a prorated amount of $30,000 for the nine-month access of the software in 20X5 (i.e., $40,000 × 9/12 months).

(b) An expense of $100,000 relating to the implementation activities when it receives the services from Provider B. Because the implementation activities are performed evenly over the six-month period between October 1, 20X4 and March 31, 20X5, Enterprise A will recognize a prorated amount of $50,000 (i.e., $100,000 × 3/6 months) in both 20X4 and 20X5.

Entries by Enterprise A*

For 20X4:

Dr.	Operating expenses		50,000	
	Cr.	Accounts payable		50,000

To accrue and expense as incurred the expenditures on implementation activities performed by Provider B from October 1 to December 31, 20X4.

For 20X5:

Dr.	Operating expenses		50,000	
Dr.	Accounts payable		50,000	
	Cr.	Cash		100,000

To expense as incurred the expenditures on implementation activities performed by Provider B from January 1 to March 31, 20X5, and to reflect the cash paid to Provider B.

Dr.	Operating expenses		30,000	
	Cr.	Accounts payable		30,000

To accrue and expense as incurred the expenditure related to accessing Provider B's ERP software from April 1 to December 31, 20X5.

* This example assumes Enterprise A will continue to access the ERP software until March 31, 20Y0, and will make the annual payments when due. However, the related entries are not shown.

APPLICATION OF GUIDELINE WHEN THE SIMPLIFICATION APPROACH IS NOT APPLIED

Examples 2A and 2B

Enterprise A chooses:

(a) not to apply the simplification approach in paragraphs 11-12 of the Guideline; and

(b) to apply the accounting policy described in paragraph 24(b) of the Guideline to capitalize expenditures on implementation activities that are directly attributable to preparing the software service for its intended use.

Except for the accounting policy choices identified above, Example 2A uses the same fact pattern as Example 1. Example 2B continues with the fact pattern and includes an implementation of an additional software module to illustrate the application of paragraphs 23 and 29 of the Guideline to account for implementation activities after access to the software is obtained.

Example 2A

Analysis

Applying paragraphs 7-10 of the Guideline, Enterprise A considers the terms of the contract with Provider B and information from other vendor quotations. Enterprise A needs to allocate the total arrangement consideration to the significant separable elements in the arrangement.

Enterprise A first applies judgment and concludes that the access to Provider B's ERP software is a significant element separate from the implementation activities that will be performed by Provider B. The access to Provider B's software will be received for at least three years pending renewal.

In accordance with the contract, Provider B will perform all the implementation activities from October 1, 20X4 to March 31, 20X5 evenly over the six-month period. However, Enterprise A concludes that it needs to account for each activity performed by Provider B separately because it needs to determine which expenditures on implementation activities are directly attributable to preparing the software service for its intended use.

Enterprise A then performs the allocation to each of the elements in the arrangement. It considers that one method to allocate arrangement consideration is based on the stand-alone price. Given the prices in the contract with Provider B are competitive based on the pricing information obtained during the vendor selection process, Enterprise A uses other vendors' pricing information to estimate the stand-alone prices for the various implementation activities performed by Provider B.

Significant separable elements	**Allocation**
Software access ($40,000 × 3 years)	$120,000
Customized coding	40,000
Configuration	25,000
Purging existing data	15,000
Testing	10,000
Training	10,000
Total	**$220,000**

Since Enterprise A chooses not to apply the simplification approach in paragraphs 11-12 of the Guideline, it applies paragraphs 14-20 of the Guideline to determine whether the software element in the arrangement is a software intangible asset or a software service:

(a) Applying paragraphs 14-19 of the Guideline, Enterprise A assesses whether it has control of Provider B's ERP software. The key terms in the arrangement indicate that Enterprise A only has access to the ERP software. Enterprise A is not able to obtain the ERP software, nor does it have exclusive rights or decision-making rights over the ERP software. Enterprise A concludes these terms indicate that it does not control the ERP software.

(b) Applying paragraph 20 of the Guideline, Enterprise A concludes that the software element represents a software service.

Enterprise A then analyzes the accounting for expenditures on implementation activities:

(a) Applying paragraph 23 of the Guideline, Enterprise A considers whether any of the expenditures on implementation activities give rise to a separate intangible asset. Enterprise A's existing accounting policy in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.40, is to capitalize expenditures on internally generated intangible assets during the development phase.

(b) Applying paragraph 24(b) of the Guideline, Enterprise A capitalizes expenditures on implementation activities that are directly attributable to preparing the software service for its intended use. 1

(c) Applying paragraph 32 of the Guideline, Enterprise A presents such capitalized expenditures as an asset for implementation of software services, which is a separate line item in its balance sheet.

Enterprise A recognizes the following:

(a) Software access of $40,000 each year for Provider B's ERP software. Applying paragraph 20 of the Guideline, this expenditure is expensed as incurred to reflect when Enterprise A receives the service to access the software over the arrangement term. Since Enterprise A's fiscal year-end is December 31, it will recognize a prorated amount of $30,000 for the nine-month access of the software in 20X5 (i.e., $40,000 × 9/12 months).

(b) Customized coding of $40,000, configuration of $25,000 and testing of $10,000 (totaling $75,000) are activities needed to prepare the software service for Enterprise A's intended use. Therefore, Enterprise A concludes that these are directly attributable expenditures.

 (i) Applying paragraph 23 of the Guideline, Enterprise A considers whether the development of the customized code qualifies as an internally generated intangible asset. Enterprise A notes that since it does not have control over this code, the code is not Enterprise A's internally generated intangible asset.

 (ii) Applying paragraphs 24(b) and 25 of the Guideline, Enterprise A will capitalize the expenditures related to coding, configuration and testing activities when they are received. Because the implementation activities are performed evenly over the six-month period between October 1, 20X4 and March 31, 20X5, Enterprise A will capitalize $37,500 in 20X4 (i.e., $75,000 × 3/6 months) and the remaining $37,500 in 20X5. Such capitalized expenditures will be expensed over the expected period of access to the software service.

 (iii) Applying paragraph 26 of the Guideline, Enterprise A estimates the expected period of access to the software service to be five years, starting on April 1, 20X5. This expected period is based on management's expectations to continue accessing the software for an additional two years beyond the initial three-year term. Management's expectation is supported by the fact that the SaaS arrangement has significant economic value to Enterprise A as it is a critical part to its strategic plan and there is a mutual understanding between Enterprise A and Provider B that the arrangement can be renewed at market price. Enterprise A also considered factors such as potential changes in technology that may limit the expected period of access to Provider B's ERP software when determining the expected period. Overall, Enterprise A concludes five years is a reasonable period based on its analysis. Since Enterprise A's fiscal year-end is December 31, it expenses on a straight-line basis $11,250 of the capitalized expenditures in 20X5 (i.e., $75,000 ÷ 5 years × 9/12 months).

(c) Training of $10,000 and purging of existing data of $15,000 (totaling $25,000) are not directly attributable to preparing the software service for Enterprise A's intended use. Applying paragraph 27 of the Guideline, these expenditures are expensed as incurred when Provider B completes the performance of the training and purging data activities. Because the implementation activities are performed evenly over the six-month period between October 1, 20X4 and March 31, 20X5, Enterprise A will recognize a prorated amount of $12,500 (i.e., $25,000 × 3/6 months) in both 20X4 and 20X5.

Entries by Enterprise A**

For 20X4:

Dr.	Asset for implementation of software services	37,500	
	Cr. Accounts payable		37,500

To accrue and capitalize expenditures that are directly attributable in preparing the software service for use (i.e., customized coding, configuration, and testing activities) from October 1 to December 31, 20X4.

Dr.	Operating expenses	12,500	
	Cr. Accounts payable		12,500

To accrue and expense as incurred the expenditures related to training and purging data from October 1 to December 31, 20X4.

For 20X5:

Dr.	Operating expenses	30,000	
	Cr. Accounts payable		30,000

To accrue and expense as incurred the expenditure related to accessing Provider B's ERP software from April 1 to December 31, 20X5.

Dr.	Asset for implementation of software services	37,500	
Dr.	Accounts payable	37,500	
	Cr. Cash		75,000

To capitalize expenditures that are directly attributable in preparing the software service for use (i.e., customized coding, configuration, and testing activities) from January 1 to March 31, 20X5, and to reflect the cash paid to Provider B.

Dr.	Operating expenses	12,500	
Dr.	Accounts payable	12,500	
	Cr. Cash		25,000

To expense as incurred the expenditures related to training and purging data from January 1 to March 31, 20X5, and to reflect the cash paid to Provider B.

Dr.	Operating expenses	11,250	
	Cr. Asset for implementation of software services		11,250

To expense on a straight-line basis the capitalized expenditures over the expected period of access to the software service of five years, prorated to reflect the period from April 1 to December 31, 20X5.

**This example assumes that Enterprise A will continue to access the ERP software until March 31, 20Y0, will make the annual payments when due and expense the capitalized expenditures on a straight-line basis over five years. However, the related entries are not shown. Enterprise A shall apply paragraph 25 of the Guideline to review the method of expense and expected period of access to the software service on a regular basis. It shall also apply paragraph 28 of the Guideline to test for impairment of expenditures on implementation activities that are capitalized in accordance with paragraph 24(b) of the Guideline.

Example 2B

Fact Pattern

On January 1, 20X6, nine months after it obtained access to Provider B's ERP software on April 1, 20X5, Enterprise A engaged Provider B to develop additional code for a human resources (HR) module. The HR module will cost $80,000.

This HR module can automate certain HR processes such as new employee onboarding, timesheet submission and vacation requests. Because of this improvement to the overall information technology (IT) capability, Enterprise A now expects to renew the arrangement with Provider B for an additional three years beyond the initial three-year term. This represents an additional year compared to the original estimate done in October 20X4 when the contract was signed with Provider B.

Key facts of the HR module:

- Provider B expects to complete the development of the module by March 31, 20X6.
- Once the additional code is accepted by Enterprise A, Provider B will deploy the code to its cloud environment. However, Enterprise A does not have the right to obtain the code to the HR module.
- The module is only compatible with Provider B's ERP software and does not work with any other vendor's software.
- Similar to the ERP software, Provider B maintains and performs upgrades to the HR module without Enterprise A's consent.
- Provider B regularly develops modules for other customers to add to its ERP software.

Analysis

Since Enterprise A chooses not to apply the simplification approach in paragraphs 11-12 of the Guideline, Enterprise A first applies paragraph 23 of the Guideline and considers whether the expenditures to develop the HR module give rise to a separate intangible asset. Enterprise A's existing accounting policy in accordance with GOODWILL AND INTANGIBLE ASSETS, paragraph 3064.40, is to capitalize expenditures on internally generated intangible assets during the development phase.

Enterprise A determines that it does not have control of the HR module because it cannot obtain the code and run it on its own or another party's infrastructure. Furthermore, similar to the ERP software, Enterprise A also does not have exclusive or decision-making rights over the HR module.

Therefore, Enterprise A concludes that the additional HR module does not give rise to a separate intangible asset. Instead, developing the new module represents a subsequent implementation activity to Provider B's ERP software.

Enterprise A then applies paragraph 29 of the Guideline to analyze the accounting for the subsequent expenditures incurred to develop the HR module:

(a) As the HR module improves Enterprise A's overall IT capability and extends its expected period of access to Provider B's ERP software, Enterprise A concludes that the module is an enhancement to the ERP software service.

(b) Applying paragraph 29(b) of the Guideline, Enterprise A capitalizes expenditures that are directly attributable to enhancing the service potential of a software service as part of the carrying amount of the asset (i.e., implementation of software services).

Given the expected period of access to the software service is extended for one additional year, Enterprise A applies ACCOUNTING CHANGES, paragraph 1506.23, to recognize the impact as a change in an accounting estimate. Enterprise A will prospectively expense the cumulative expenditures capitalized over the remaining revised expected period of access to Provider B's software.

Enterprise A recognizes the following:

(a) HR module of $80,000 as part of the cost of the asset for implementation of software services.

(b) A revised annual expense of $24,750 relating to the cumulative amounts capitalized as an asset for implementation of software services. This amount is calculated as follows:

(i) $12,750 of expense relating to previously capitalized expenditures on implementation activities; 2 and

(ii) $12,000 of expense relating to the capitalized HR module. 3

Entries by Enterprise A***

For 20X6:

Dr.	Operating expenses		40,000	
	Cr.	Accounts payable		40,000

To accrue and expense as incurred the expenditure related to accessing Provider B's ERP software from January 1 to December 31, 20X6.

Dr.	Asset for implementation of software services		80,000	
	Cr.	Cash		80,000

To capitalize the HR module since it is a subsequent expenditure that enhances the service potential of the software service (i.e., Provider B's ERP software).

Dr.	Operating expenses		24,750	
	Cr.	Asset for implementation of software services		24,750

To expense on a straight-line basis the capitalized expenditures (both original and the new HR module) over the remaining expected period of access to the software service of five years and three months.

*** This example assumes that Enterprise A will continue to access the ERP software, including the new HR module until March 31, 20Y1 and will make the annual payments when due. However, the related entries are not shown. Enterprise A shall apply paragraph 25 of the Guideline to review the method of expense and expected period of access to the software service on a regular basis. It shall also apply paragraph 28 of the Guideline to test for impairment of expenditures on implementation activities that are capitalized in accordance with paragraph 24(b) of the Guideline.

Footnotes

1. If Enterprise A chooses the accounting policy in paragraph 24(a) of the Guideline to expense the expenditures on implementation activities as incurred, the accounting outcome for such expenditures will be the same as if an enterprise applies the simplification approach as illustrated in Example 1.

2. On January 1, 20X6, the carrying amount of the asset for implementation of software services is $63,750 ($75,000 - $11,250 from Example 2A). From January 1, 20X6 to March 31, 20X6, an additional expense of $3,750 is recognized ($63,750 ÷ 4.25 years remaining × 3/12 months), resulting in a carrying amount of $60,000. On April 1, 20X6, the remaining expected period of access to the software was revised to five years due to the addition of the HR module. Therefore, the revised annual expense is $12,000 ($60,000 ÷ 5 years), prorated to $9,000 ($12,000 × 9/12 months). Total expense for 20X6 reporting period is $12,750 ($3,750 + $9,000).

3. Annual expense for the HR module is $16,000 ($80,000 ÷ 5 years), prorated to $12,000 ($16,000 × 9/12 months) for the 20X6 reporting period.