



ASPE Accounting Insights Accounting Guideline 20 (AcG-20)

Customer's accounting for cloud computing arrangements

Introduction

With the continuous evolution of technology, the number of organizations transitioning from on-premise technology to cloud computing arrangements has increased rapidly. Cloud computing has many benefits, including increased scalability, higher system availability, disaster recovery optionality, and much more.

The accounting treatment related to cloud computing arrangements can be complicated, as the arrangements may have multiple elements with different accounting treatments such as internal use software, service agreements, or leases. The associated costs with implementing cloud computing software are often significant and the accounting outcomes can have a material impact on an entity's financial results.

To provide additional guidance on the accounting for cloud computing arrangements, the Accounting Standards Board ("AcSB") issued a new accounting guideline, AcG-20 *Customer's Accounting for Cloud Computing Arrangements* (the "Guideline") on November 15, 2022. The Guideline provides guidance on how expenditures such as implementation costs should be accounted for as well as determining whether an intangible exists in a cloud computing arrangement.

This publication highlights key accounting requirements for various cloud computing arrangements as required by the Guideline.

Identification of significant elements

The first step in assessing the accounting of a cloud computing arrangement is to identify the separate significant elements within the arrangement, which can include:

- Tangible elements: Accounted for in accordance with Section 3061 *Property, plant and equipment* and Section 3065 *Leases*
- Intangible elements: Recorded in accordance with the Guideline
- Implementation activities: Recorded in accordance with the Guideline

Note: AcG-20 does not determine a specific method to allocate the costs among the significant elements but suggests stakeholders consider the methods in Section 3400 Revenue, to ultimately ensure a consistent and rational allocation approach.

Accounting for costs associated with cloud computing arrangement

An entity is permitted to adopt the simplification approach on the expenditures incurred. Under the simplification approach, all costs associated with the cloud computing arrangement that is within the scope of the Guideline are expensed as incurred. The simplification approach is an accounting policy choice that should be applied consistently to expenditures in all cloud computing arrangements.

Alternatively, an entity can also choose not to apply the simplification approach, which allows for certain eligible costs within the scope of the Guideline to be capitalized on the balance sheet.

The accounting treatment for each element of a cloud computing arrangement under each approach is detailed in the table below:

Significant element	Entity adopts the simplification approach	Entity does not adopt the simplification approach
Tangible elements	All costs allocated to the tangible elements are recorded in accordance with Section 3061 and Section 3065.	
Intangible elements	All costs allocated to intangible elements in the contract are to be expensed as they are incurred.	<p>Costs incurred in the cloud computing arrangement are assessed to see if they meet all the criteria to be recognized as intangible assets, per Section 3064 <i>Goodwill and intangible assets</i>, as detailed below:</p> <ul style="list-style-type: none"> • <i>Identifiable and result of a past transaction</i>: Generally, cloud computing arrangements meet this criterion, as they arise from contractual rights which have been obtained and are identifiable; • <i>Future economic benefits flow to enterprise</i>: The arrangements can vary in types of benefits (client resource management, financial reporting efficiencies etc.) but generally allow entities to obtain some future economic benefit from the arrangement; • <i>Control</i>: Determine if the entity has a contractual right to obtain the software without significant penalty (not incurring significant costs and without significant decrease in utility or value) and if it is feasible for an enterprise to run the software on its own or third party's infrastructure. Control can also be achieved in case of exclusive rights to use the software and decision-making rights to change how and for what purpose the software is used. <p>If any of the above criteria is not met, the element is classified as a <i>software service</i> and the expenditure allocated to this element shall be expensed as incurred. Typically, if an organization only has the right to receive access to an application software in the future this is neither a lease, nor an intangible asset, but rather a service the customer receives over the contract term.</p>

Significant element	Entity adopts the simplification approach	Entity does not adopt the simplification approach	
Implementation activities Examples of eligible implementation costs: <ul style="list-style-type: none"> • Integration • Customization or coding • Configuration • Data conversion • Testing • Business process reengineering Examples of ineligible implementation costs: <ul style="list-style-type: none"> • Training • Research 	<p>All costs allocated to implementation activities are to be expensed as they are incurred.</p>	<p><i>Software intangible asset</i></p> <p>An enterprise that recognizes a software intangible asset 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.</p> <p>Expenditures on implementation activities may also give rise to a separate intangible asset, which shall be accounted for in accordance with Section 3064.</p>	<p><i>Software service</i></p> <p>An enterprise will have an accounting policy choice to either:</p> <ol style="list-style-type: none"> 1. Record the expenditures as expenses as they are incurred; or 2. Capitalize the expenditures on implementation activities that are directly attributable to preparing the software service for its intended use in a separate line item in the balance sheet. <p>Capitalized expenditures are expensed using the straight-line method over the expected access period of the contract (or other method that better reflects the benefits obtained by the entity). Such asset should also be tested for impairment, in accordance with Section 3063 <i>Impairment of long-lived assets</i> (or Section 4434 for non-for-profit organizations).</p>
Subsequent expenditures	<p>All subsequent costs incurred relating to a cloud computing contract are expensed as they are incurred.</p>	<p><i>Software intangible asset</i></p> <p>All subsequent costs incurred directly attributable to enhancing the service potential of an intangible asset are included in the carrying amount of the intangible asset.</p> <p>Maintenance activities not directly attributable to enhancing service potential of an intangible asset are expensed as incurred.</p>	<p><i>Software service</i></p> <ul style="list-style-type: none"> • When an entity elects to capitalize implementation activities, subsequent costs directly attributable to enhancing the service potential of a software service should also be capitalized. • Maintenance activities not directly attributable to enhancing service potential of a software service are expensed as incurred. • When an entity elects to expense implementation activities expenditures, subsequent expenditures are also expensed.

Effective date and transition

This Guideline applies to annual financial statements relating to fiscal years beginning on or after January 1, 2024. Earlier application is permitted. Upon transition, entities should apply the Guideline as follows:

- If the simplification approach is used, the Guideline should be applied retrospectively.
- If the simplification approach is not used, entities have an option to apply the Guideline either:
 - a. retrospectively; or
 - b. retrospectively for implementation activities incurred on or after the beginning of the earliest period presented in the financial statements in which the enterprise first applies the Guideline.

Differences between Accounting Standards for Private Enterprises (“ASPE”) and International Financial Reporting Standards (“IFRS”)

The recently issued Guideline results in certain differences in the application of ASPE and IFRS in connection with costs associated with cloud computing arrangements. In particular, there is a significant divergence in the accounting of implementation, configuration and customization costs.

ASPE	IFRS
An entity is permitted to apply a simplification approach to account for expenditures in a cloud computing arrangement. In applying the simplification approach, the expenditures in the arrangement shall be treated as the supply of services and expensed when the services are received.	No such approach under IFRS.
Eligible costs that are directly attributable to implementation activities can be either expensed or capitalized if an entity determines that it has entered into a software service arrangement. The software implementation asset is amortized over the expected access period of the contract. For an entity who has recognized a software intangible asset, eligible costs that are directly attributable to implementation activities should be capitalized as part of the cost of the asset. Expenditures on implementation activities may also give rise to a separate intangible asset.	Configuration and customization services conducted by a third party, employees or in-house contractors are expensed immediately as a service. If the configuration and customization services are (i) conducted by the service provider or a subcontractor of the service provider and (ii) the configuration and customization services are distinct, then the associated costs are expensed immediately as a service. If the configuration and customization services are (i) conducted by the service provider or a subcontractor of the service provider and (ii) the configuration and customization services are not distinct, then the associated costs can be recognized as a prepayment and expensed when the service provider provides access to the application software over the contract term.

Conclusion and next steps

The Guideline may change current accounting practices for cloud computing arrangements and is expected to impact entities of all sizes across all industries as entities embark on their finance transformation journey.

It should be noted that every cloud computing arrangement is unique. The analysis and determination of the appropriate accounting treatment of implementation expenditures could require significant judgment and often require a deep understanding of certain technical aspects of the arrangement.

Entities should develop and consistently apply an appropriate accounting policy for cloud computing arrangements and implementation costs and should be able to explain judgments made in applying its accounting policy. Set forth below are illustrative key activities that an entity may consider when adopting the Guideline:

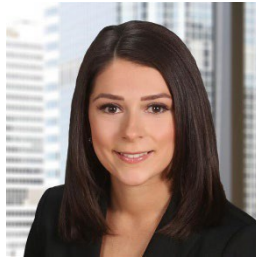
Key activities	Description
Scope and plan	<ul style="list-style-type: none"> Identify and inventory cloud computing arrangements and contracts that may be affected by the standard
Assess	<ul style="list-style-type: none"> Review existing accounting policies against the requirements of the Guideline to identify areas of adoption impact, including impact on financial statements, financial metrics, financial covenants, etc. Identify areas of judgments and policy choice
Quantify	<ul style="list-style-type: none"> Perform analysis to quantify adoption impact, including developing applicable judgment, estimates and policy choices
Sustain	<ul style="list-style-type: none"> Update or develop accounting policies and procedures, including controls, to comply with the requirements of the Guideline
Educate	<ul style="list-style-type: none"> Train all stakeholders (finance and operational personnel, shareholders, board of directors or equivalents, creditors, etc.) of the impact from the Guideline

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