

Accounting for cloud infrastructure subscription costs

Should cloud infrastructure subscription costs be capitalised?

In deciding whether cloud infrastructure subscription costs under a cloud computing arrangement should be capitalised, Statutory Boards should first assess whether the contract with the supplier governing this cloud computing arrangement contains a lease in the scope of SB-FRS 116.

Evaluating whether a cloud computing arrangement contains a lease

A Statutory Board should apply the principles in SB-FRS 116 to evaluate whether the cloud computing arrangement includes the right to use an asset e.g. underlying servers or software, for which it has the right to *obtain substantially all the economic benefits from use* of the asset and the *right to direct the use* of the asset *throughout the period of use*.

i. **Is there an identified asset?**

A Statutory Board should consider if there is an identified asset in this cloud computing arrangement e.g. server or software. An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time an asset is made available for use by the Statutory Board.

ii. **Does supplier have substantive rights to substitute identified asset throughout period of use?**

Even if an asset is specified, a Statutory Board should consider if it has a right to use the identified asset. There is no right to use the identified asset if the supplier of the identified asset has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive if both the following conditions exist:

- a. The supplier has practical ability to substitute alternative assets throughout the period of use e.g. Statutory Board cannot prevent supplier from substituting the server/software and alternative servers/software are readily available to the supplier or could be sourced by the supplier within a reasonable period of time; and
- b. The supplier would benefit economically from the exercise of its right to substitute the asset e.g. the economic benefits associated with substituting the server/software are expected to exceed the costs associated with substituting the server/software.

A Statutory Board's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception of the lease, are not

considered likely to occur e.g. introduction of new technology not substantially developed at inception of contract, agreement by future customer to pay an above market rate for use of the asset, a substantial difference between the Statutory Board's use of the asset or performance of the asset, and the use or performance of the asset considered likely at inception of the contract.

If the asset is located at the Statutory Board's premises, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset.

The supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the Statutory Board from having the right to use the identified asset.

If the Statutory Board cannot readily determine whether the supplier has a substantive substitution right, the Statutory Board shall presume that any substitution right is not substantive.

iii. **Does Statutory Board have right to obtain substantially all economic benefits from use of the asset throughout the period of use?**

A Statutory Board should consider whether it has the right to obtain substantially all the economic benefits from using the underlying asset throughout the period of use e.g. by having exclusive use of the underlying server or software throughout the period of use.

iv. **Does Statutory Board, supplier or neither party have right to direct how and for what purpose the asset is used throughout period of use?**

A Statutory Board should also consider whether it has the right to direct how and for what purpose the underlying asset is used throughout the period of use, or whether it has the right to operate the underlying asset (or direct others to operate the underlying asset in a manner that it determines) throughout the period of use without the supplier having the right to change those operating instructions. The Statutory Board should also consider if it designed the underlying asset (or specific aspects of the underlying asset) in a way that predetermines how and for what purpose the underlying asset will be used throughout the period of use.

If the Statutory Board's assessment based on the above principles is that the cloud computing arrangement contains a lease of an underlying asset, the Statutory Board should identify and separate the lease and non-lease components of the contract, and allocating the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.

If the cloud subscription costs relate to payments for the lease of the underlying asset (i.e. lease component) e.g. the underlying asset in the cloud computing arrangement is the cloud software, then the Statutory Board should capitalise the cloud subscription costs in accordance with the rules in SB-FRS 116. If the cloud subscription costs relate to the non-lease components of the contract e.g. if the underlying asset in the cloud computing arrangement is not the cloud software and cloud software is consumed as a service, then the cloud subscription costs should be expensed off.

Statutory Boards should discuss and agree with your auditors on the accounting treatment for cloud computing arrangements, including such cloud infrastructure subscription costs, with reference to the contract with your supplier and the principles in SB-FRS 116.