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Ms Sue Lloyd
International Accounting Standards Board
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Dear Ms Lloyd

Tentative agenda decision: Customer's right to access the supplier's software hosted on the cloud (IAS 38 Intangible assets)

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (the Committee) tentative agenda decision *Customer's right to access the supplier's software hosted on the cloud (IAS 38 Intangible assets)* (IFRIC Update November 2018). We have consulted with, and this letter represents the views of, the KPMG network.

Overall we agree with the Committee's tentative decision not to add this issue to its standard-setting agenda. However, we disagree that the customer should refer to the guidance in IFRS 15 *Revenue from contracts with customers* as recommended in the tentative agenda decision. We explain our concerns, and include other detailed comments, in the appendix to this letter.

We hope you find this letter helpful. Please contact Brian O'Donovan at +44 (0) 20 7694 8871 if you wish to discuss any of the issues raised.

Yours sincerely

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Appendix

Relevance of IFRS 15 to accounting by the customer

The tentative agenda decision indicates that the guidance in paragraphs B58-B62 of IFRS 15 may be helpful in assessing whether the customer's rights are sufficient to give it the 'right to use' the supplier's software. This is the guidance that the supplier will use to assess whether its promise in granting a distinct licence is a promise to provide a 'right to access' or a 'right to use' its intellectual property.

We do not believe that the customer should generally apply this guidance, for the following reasons.

Firstly, under IFRS 15.B59A, software is an example of intellectual property that often has significant stand-alone functionality – i.e. a software licence is generally a 'right to use' licence under IFRS 15. Only in limited scenarios are the future updates so critical to the functionality of the software that a software licence is 'right to access' under IFRS 15 – e.g. anti-virus software. Therefore, if the customer applies the IFRS 15 licensing guidance, this will generally lead to the conclusion that it has a 'right to use' the supplier's software. This outcome is inconsistent with the direction of the tentative agenda decision that cloud arrangements often provide a right to receive access to the supplier's application software in the future.

Secondly, suppliers often recognise revenue from cloud arrangements over time because the software licence is not distinct from the hosting service under Step 2 of the IFRS 15 model – not because the nature of the supplier's promise is to provide a 'right to access' its intellectual property under paragraphs B58-B62 of IFRS 15. The tentative agenda decision does not discuss whether the software licence is distinct from the hosting service from the perspective of the supplier, or how the customer would assess whether the arrangement contains separate lease and non-lease components – e.g. by applying the guidance in IFRS 16.B32-33.

For these reasons, we recommend that the Committee reconsider the references in the tentative agenda decision to IFRS 15. In addition, we recommend that the tentative agenda decision avoid the terms 'right to access' and 'right to use', except when they are being used in their IFRS 15 sense (or IFRS 16 in the case of 'right to use').

Other comments on the tentative agenda decision

We have the following additional comments on the wording of the tentative agenda decision related to the discussion of IFRS 16 *Leases*.

- The tentative agenda decision states that the contract involves the use of 'cloud infrastructure' (which the agenda paper notes includes hardware) and may involve the use of 'a dedicated line'. The tentative agenda decision does not address whether the contract includes a lease of tangible assets, presumably because this was not the focus of the submission. We recommend that the tentative agenda decision state explicitly that it does not address whether the contract contains a lease of tangible assets.
- The tentative agenda decision discusses whether the contract contains a lease but does not identify what is the underlying asset in this analysis. Depending on the nature of the underlying asset, it may be clear there is no lease without having to consider which party takes the 'how and for what purpose decisions' – e.g. because there is no identified asset, or the customer does not obtain substantially all of the benefits. We recommend that the tentative agenda decision identify the underlying asset in the analysis and explain that there are a variety of reasons why the contract may not contain a lease.
- The tentative agenda decision states that 'a software lease is a licensing agreement within the scope of IAS 38'. The preceding text appears to equate the term 'licence' in IFRS 15 with the term 'licensing agreement' in IFRS 16.3(e) and IAS 38. We note that the standards were developed independently at different times, and use different terms; we are sceptical that the terms were intended to be equivalent. It is unclear whether the Committee's conclusion relates to the fact pattern under discussion, or is intended to apply more generally. We recommend that this is clarified.
- The tentative agenda decision does not refer to IFRS 16.4, under which the customer could elect not to apply IFRS 16 to a component of the contract that is found to contain a lease of an intangible asset. This election could simplify the customer's analysis and avoid the issue discussed above. We recommend it is added to the tentative agenda decision.

The tentative agenda decision concludes that IAS 38 is the relevant standard, however the analysis primarily relies on concepts in IFRS 16 and IFRS 15 to apply IAS 38. This highlights a broader issue with IAS 38 no longer being fit for purpose to address the increasing number of complex intangible asset arrangements due to digitalisation. We believe that the Board should consider a project on IAS 38.