EITF Issue 17-A, Issue Summary No. 1, Supplement No. 3

Appendix B

1. The purpose of this appendix is to provide Task Force members with an analysis of the characteristics of a CCA and whether under those characteristics CCAs would meet the definition of a lease.

2. A contract is or contains a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The asset can be identified by being explicitly or implicitly specified; but even if it is specified, the customer does not have the right to use an identified asset if the supplier has a substantive substitution right. A customer has the right to control the use of an identified asset when it has both the right to obtain substantially all the economic benefits from the use of the identified asset, and the right to direct the use of that identified asset.

3. Judgement is necessary to apply the definition of a lease to a CCA and the key determinant about whether a CCA would meet the definition of a lease under Topic 842 often will be whether the underlying software element of a CCA meets the conditions to be an identified asset. The staff's research indicated that SaaS arrangements are structured as either a "single instance" software or as a "multi-tenant" software. Single instance SaaS arrangements include a specific instance of the software for each customer. Customers with single-instance software are able to change the "code" of the software to meet their needs, even though that code resides on the vendor's servers. A multi-tenant SaaS arrangement refers to a software architecture in which a single instance of software runs on a server and serves multiple customers. However, every customer has dedicated access to that instance of software, which includes the customer's specific data, configurations, functionality, and user management settings. Even though many customers use single instance software, each customer's data and configurations are isolated and remain invisible to other customers. In multi-tenant software, there are varying degrees to which the core application is designed to be shared across customers. On one end of the spectrum, the database structure and all other layers of the software are shared. On the other end of the spectrum, only the underlying infrastructure is shared. Customers with multi-tenant software are not able to customize the shared "code" for their own use but can apply specific configuration settings to meet their own needs.

4. The use of single instance software or multi-tenant software is dependent on the business strategy of each vendor. Multi-tenant software can be economical because software development and maintenance costs are shared, but it can only be configured and not customized. With multi-tenant software, the vendor only has to make updates once. With

single-tenant software, the vendor has to change multiple instances of the software in order to make updates.

5.	Based on the technical structure of these cloud arrangements, the software element of a CCA potentially may meet the conditions to be an identified asset in accordance with Topic 842. Paragraphs 842-10-15-9 through 15-10 state:

> An asset typically is identified by being explicitly specified in a contract. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the customer.
>
> Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:
>
>> a. The supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting an asset, and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time).
>>
>> b. The supplier would benefit economically from the exercise of its right to substitute the asset (that is, the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

In addition, paragraph 842-10-15-16 states:

> A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building or a segment of a pipeline that connects a single customer to the larger pipeline). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

6.	In SaaS arrangements, the contract generally identifies whether the company uses multi-tenant software or single instance software, but it generally does not explicitly identify a specific instance of the software that will be used. Even if the contract identified the specific instance of the software in a multi-tenant arrangement, the customer would not be able to identify whether that instance was being used by others due to the intangible nature of software.

7.	For single instance software, the asset typically would be implicitly specified, and therefore would meet the conditions to be an identified asset, because a software instance is needed to fulfill the contract at commencement and the supplier generally would not have a substantive substitution right (considering the significance of configuration costs incurred by customers, it is not likely that the benefits of substituting the instance of the software, assuming the supplier has a substitution right, would exceed the costs associated with substituting the customer's instance of the software).

8. For multi-tenant software, the staff believes that the analysis requires significant judgment and will depend on the specific facts and circumstances of the arrangement considering the varying degrees of multi-tenant software arrangements. Because the customer may have access to the software that includes its specific configurations and uses its specific data and no other customer can access the customer's configurations or data, some may view this as an indication that there is an identified asset comprising the customer's configurations and some portion of the software code. Effectively, the customer has the exclusive use of the configured software instance because the configuration is specific to the customer and cannot be used by the vendor or another customer. In addition, the configuration costs are often significant. While the vendor could offer the customer's configuration to another customer, those configurations likely would not fit another customer's specific needs. But others may think that there is not an identified asset because the instance of the software that the customer has access to is not physically distinct (it is shared with other users) and the capacity portion of the software used by one customer typically would not represent substantially all of the capacity of the software hosted by the vendor. In addition, since the vendor has the ability to offer one customer's configuration to other customers and the fact that another customer may choose the same configurations as other customers indicates that the customer does not have the exclusive use of the configured software.

9. Once one has determined that a CCA is based on an identified asset, it is likely that the CCA would meet the definition of a lease. This is because, considering the reasons leading one to believe that there is an identified asset, only the customer can obtain substantially all of the economic benefits from the configured software, and the customer has the right to direct the use of the identified asset. The customer decides whether to use the configured software, and if the customer decides to use it, when to use it, how long to use it, and where to use it. However, some believe that the customer does not have the ability to direct the use of the identified asset because the vendor could shut down the service, although CCAs usually include service-level guarantees that state how often the service can be down.

10. In summary, judgment would be needed to determine whether a CCA is or contains a lease (ignoring the scope exception in Topic 842) and the evaluation would depend on the specific facts and circumstances of the arrangement. The staff also notes that not all SaaS products are complex. Some work "out of the box," so different facts may result in different conclusions as to whether there is an identified asset in a CCA.