

Results of the AEG e-discussion on Follow-Up to Original and Copies: Treatment of Annual Licenses-to-Use

Introduction

1. The issues relating to the treatment of originals and copies were discussed by the AEG at its meeting held in December 2004. The AEG agreed that (a) copies generated for issue under licenses to use represent new production; (b) when they display the characteristics of fixed assets, copies issued under license to use should be recorded as gross fixed capital formation; (c) when a license to reproduce is issued under terms similar to an operational lease, the payments made are treated as payments for services; and (d) when the holder of an original divests itself of part or all of the responsibility to issue and service copies under licenses to use by means of a license to reproduce, this constitutes the sale of the corresponding part of the asset.

2. The AEG asked the Canberra II Group to recommend in which cases when payments for a license to use are made over several years represent the acquisition of an asset rather than a series of payments for services and the consequence for recording other transactions.

3. With respect to annual payments for licences to use software, two specific cases considered by the OECD Software Task Force were deliberated upon by the Canberra II Group at its meeting held in March-April 2005, namely:

(a) Sequences of regular (equal) annual payments

One particular and important type of transaction is when regular payments for a license-to-use are made annually. If the purchaser intends to use the software repeatedly in production until the end of its economic life then the treatment should follow that for a sequence of annual payments set out in (a) above. The full value of the software reproduction should be recorded as fixed capital formation in the first year of the acquisition of the software, with annual license payments corresponding to interest payments thereafter, following the usual national accounts rules for financial leases. Where this is not practical it is acceptable to capitalise the annual license payments as and when they occur.

(b) Sequence of annual payments (an initial payment followed by smaller "maintenance" updates)

These transactions should be interpreted as purchases of software copies in the first year and purchases of updates (improvements to the first version) in subsequent years. Making an initial payment for acquisition of the software, followed by a series of smaller "maintenance license" payments in subsequent years, is little different in practice from making one up-front payment for the software reproduction, and so the treatment should be, in practice, the same.

4. The Canberra II Group made the following recommendations to the AEG for its consideration:

- (i) If a copy (license-to-use) is acquired via regular annual payments, the payments should be recorded as finance lease transactions if it can be established that the purchaser intends to use the copy repeatedly in production until the end of its economic life. Intent can be determined if significant associated costs are incurred on acquisition. For example, for software, the costs involved in training or developing new systems based on the software. For other copies however establishing intent is likely to be less common, and
- (ii) The full value of the software reproduction should be recorded as fixed capital formation at the time of acquisition, with annual license payments corresponding to interest payments thereafter, following the usual national accounts rules for financial leases. When this is not practical it is acceptable to capitalise the annual licence payments as and when they occur and consumption of fixed capital in the same year.

Response received

5. The aforesaid recommendations of the Canberra II Group were referred (document no. SNA/M1.05/18.1) to the AEG members soliciting their opinions through a questionnaire. The questions asked of AEG members and responses received through e-discussions have been summarized in the following table:

Table: Questions asked of the AEG members and response received

No.	Question(s)	Response received		
		Yes	No	No Opinion
1	Do you agree that if a copy (license-to-use) is acquired via regular annual payments, the payments should be recorded as financial lease transactions if it can be established that the purchaser intends to use the copy repeatedly in production until the end of its economic life. Intent to renew the license to use repeatedly can be determined by asking if significant associated costs are incurred on acquisition. For example, for software, the costs involved in training or developing new systems based on the software can be used to determine intent. For other copies, however, intent to renew the license to use repeatedly is likely to be less common.	7	9	2
2	Do you agree that when the acquisition of a license to use a copy is judged to be capital formation then the full value of the software reproduction should be recorded as fixed capital formation at the time of acquisition, with annual license payments corresponding to interest payments thereafter, following the usual national accounts rules for financial leases? When this is not practical, it is acceptable to capitalise the annual license payments as and when they occur and record as consumption of fixed capital in the same year.	14	1	3

Conclusions

5. The results of the consultation show that:
- (i) significant majority of the AEG members participating in the e-discussions supported the recommendations that when the acquisition of a license to use a copy is judged to be capital formation then the full value of the software reproduction should be recorded as fixed capital formation at the time of acquisition, with annual license payments corresponding to interest and repayments thereafter, following the usual national accounts rules for financial leases. When this is not practical, it is acceptable to capitalise the annual license payments as and when they occur and record as consumption of fixed capital in the same year, and

 - (ii) on the proposal that when a copy (license-to-use) is acquired via regular annual payments, the payments should be recorded as financial lease transactions if it can be established that the purchaser intends to use the copy repeatedly in production until the end of its economic life – there is split of opinion, reasons being (a) conceptual line of reasoning underpinning the proposal is not convincing, (b) doubts about “intention to renew”, (c) criterion of “intention” should not be used only in connection with ‘license to use’ but should be used in general, (d) difficulty in determining the economic life particularly as the technology changes so fast, etc. Please refer to the Annex for reasons of disagreement.

A summary of comments is annexed.

Summary of Comments Made by Members in the Questionnaire

The original response and full comments are available on the UN website¹. The objective of this annex is only to give limited extracts to entice readers to read the full comments of the AEG members.

Question 1

Members disagreeing with the proposal argue that:

- criterion of “intention” should not be used only in connection with license to use but should be used in general. If so, a lot of rented buildings should be the GFCF of the tenants.
- doubts about “intention to renew”.
- conceptual line of reasoning underpinning the proposal is not convincing.
- it should be dealt with as part of the leases and licenses issue being considered by the Canberra II Group.
- the paper does not make it clear whether the annual license fee arrangement being discussed is a long term contractual agreement with annual fees, or the license is in fact being renewed each year and for the lessee it is a decision each year whether to renew the lease or not. If it is the former then the annual lease arrangement meets the test of a finance lease. If it is the latter there is more ambiguity.
- it is difficult to consider this as financial leasing as there is difficulty in determining the economic life particularly as the technology changes so fast and annual renewal might entail changes in the copy.
- intention must be found on the terms of the contract (though on practical grounds it may be difficult to achieve) and not by using somewhat indirect information. However, it can happen that even when only the first payment is made, the buyer can use the software until it becomes obsolete, although this could mean missing elements such as possibilities of upgrading the software, receiving professional support (beyond technical support or “maintenance”), and the right to move the software to other stations, for example, all of which are behind the regular or annual payments. The nature of the annual payments is not yet well established and as a consequence neither their treatment as a financial lease.
- Practical approximation (annual capitalisation) should be avoided at a maximum.

Question 2

A large majority agreed with the proposal.

One member does not see the analytical use of capitalizing license payments annually and recording consumption of fixed capital for the same amount. Annual license payments should not only be recorded as interest, but as interest and repayment of the principal.

One member thinks that the second option of capitalising the annual license payment as and when they occur and record as CFC in the same year is more appropriate and is less subject to subjective judgment.

¹ <http://unstats.un.org/unsd/sna1993/viewquestions.asp?tID=12&stID=0&sstID=0>