

Application Service Provider: the legal issues

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Contracting for ASP services raises a broad range of issues for prospective customers. The ASP is a fairly new and innovative service. However, it is fair to say that service options and expectations are presently in a state of flux.

What is an application service provider (asp)?

The usual way of obtaining software

Customers usually purchase and licence business application software directly from software providers or shrink-wrapped software from the software provider's Value Added Resellers (VARs).

Purchasing and licensing software from software providers or their resellers is an expensive outlay of funds for any size business. Managing, maintaining and up-keeping the software in-house are additional and necessary expenses associated with purchasing software. Qualified technical staff may also be required to operate and maintain software used in any business.

The ASP alternative

The alternative to purchasing and licensing the software directly from the software provider is 'renting' or 'outsourcing' the software from hybrid software-services companies known as Application Service Providers (ASPs).

Broadly defined, an ASP is any organisation or third party that provisions software applications over the Internet, typically for a fee.

As a part of the customer's subscription, ASPs host and manage the applications from the ASP facilities or from co-location centre(s), and coordinate the ongoing support, maintenance and upgrades of the applications.

By combining software, hardware, networking technologies and technical expertise, ASPs provide superior performance and increased security, reliability and scalability

over traditional corporate-owned, in-house corporate-run applications — without a significant up-front financial commitment.

Virtually any software application can be delivered through an ASP. Businesses are especially using the following applications: email, e-commerce, enterprise resource planning (ERP), communications, customer relationship management and back-office solutions.

The role of the Internet

The role of the Internet has had the biggest impact on ASP services becoming an alternative to customers purchasing and licensing software themselves.

Until the Internet became readily accessible to users, there was no cheap, non-proprietary means for a desktop computer to communicate with an off-site application host system and no standard customer environment that could interact with the remote application.

The Internet provides a publicly accessible infrastructure that is able to connect users to off-site application servers, known as remote access. Access to the Internet, in conjunction with desktop web-browser software provides a standard way to interact with an application hosted on a web server.

ASPs use servers connected to the Internet to host software applications. ASP customers can interact with a remotely managed application or suite of applications via web-browser software on an 'anytime, anywhere' basis. And neither the Internet nor web-browser software adds much cost to the outsourcing equation.

The positives of an ASP

According to industry analysts, application service provisioning is slated to become the dominant model for software application delivery. ASP customers can rent services on a per-user, per-month basis (or several other payment models) at a fraction of the cost of purchasing, deploying and supporting

traditional high-end business applications. Some of the benefits of the ASP are dealt with in this section.

No investment in new technology required

Given the fact that most businesses already have access to the Internet and email, they usually will not require new or even upgraded technology to take advantage of an outsourced application. In any case, it is worth asking the ASP what hardware/software, if any is required at your business site other than a web browser.

Customised applications

Software access and maintenance is tailored to your business specific needs and the ASP provides choices regarding how software applications are managed and delivered, customising applications.

Reducing the strain on business resources

By outsourcing software applications that require a high level of availability or technical expertise, that the customer may not ordinarily have, or does not wish to maintain in-house as a core-competency, the strain on the customer's business resources can be alleviated and:

- theoretically, the only client software required on the user's desktop is a web browser, which eliminates the need to manage client software on a desk-by-desk basis, and
- the ASP maintains the hardware server 'farms' (large facilities of servers) which are required to efficiently host complex applications and thus removes the need for businesses to buy, maintain and upgrade in-house hardware.

Immediate access to new business applications

ASP customers can sign up new

users or workgroups for an application at almost a moment's notice without the need for complex infrastructure and implementation, resourcing, planning and expenditure.

Immediate access to new business applications

As a part of the ASP service the ASP ensures that the latest versions of software applications are available to enterprise wide users without the need for costly site-by-site in-house upgrades. New users can access the application without expensive upgrades to the local technology environment.

Enables a smoother and more predictable cost model over time

Cost savings would have to be the most important benefit for any size business in using ASPs. The basic pricing model of an outsourced ASP application, which usually includes an initial setup fee (if any) plus a monthly rental fee per user, inevitably simplifies cash flow management.

The fees do not change from month to month because such variables as cost peaks due to upgrades are factored into the ASP cost. ASP customers are thus able to control more precisely the total cost of technology ownership through scheduled payment schemes. Small businesses can afford big-ticket applications that would be too costly to buy outright and implement.

The negatives

For all the positives, there are some drawbacks to the ASP outsourcing model, which customers should take into account before contracting for ASP services. Some of the negatives of the ASP are dealt with in this section.

Problems with using the Internet

Switching from an internally managed and accessed local- or wide-area network (LAN or WAN) to the publicly managed and accessible Internet means that access to outsourced applications may be subject to influences beyond a business' control.

A delay in application response times, due to Internet traffic is a common problem. It is worth querying with the ASP whether the application is stored on a dedicated or shared server. The former means that your business has its own server, rather than as the latter term suggests, a server which is dedicated to a number of users.

It is also worth considering the potential for breaches of security, an issue which always attaches to the use of the Internet for transferring confidential information such as accounting, employee or customer data. Whether the ASP offers a secure connection such as via a virtual private network (VPN), may be the most important concern for many businesses.

Limited customisation potential

Using an ASP may not be a viable option for a business that require a packaged application to be extensively modified for its specific needs. A complex application system such may require considerable time and cost to configure to specific business need. The objective of an ASP is to have every customer using the same code base — not to manage dozens of different customised versions.

Lack of service standards

Most importantly to bear in mind, ASPs are a fairly new and innovative service. Thus, service options and expectations are in a state of flux.

The ASP Consortium is an international industry body (comprising some 90 companies that provide ASP-related services) whose primary goal is to foster the development of standard practices for ASPs. The Consortium's 'Best Practices Committee' is concerned with benchmark standards and criteria for effective application of the ASP delivery model. However, it is fair to say that an industry standard for service options and expectations, though discussed, has not been uniformly adopted.

Conclusion

This paper has sought to give prospective customers for ASP services a better understanding of what this service entails and the levels of service that should be anticipated. By initially understanding some of the positive and negative aspects of an ASP service, customers will be able to come to a more fully informed decision regarding whether the ASP will indeed enhance the operations of their business.

The expectations that we have covered with respect to contracting for ASP services include the operation of software licensing, or more accurately, sub-licensing from ASP to customer. This form of sub-licensing importantly distinguishes ASP service from ordinary software purchasing and licensing. In this respect, ASPs provide a new alternative to businesses for procuring and accessing software applications over the Internet.



More than 50 new economy companies must explain their financial reports

ASIC has written to 53 new economy companies requesting clarification of their financial reporting and disclosure.

ASIC's action follows the completion of a surveillance project in which the financial reports of 140 companies as at June 2000 and cash flow statements for March and June 2000 were reviewed. The companies operate in the hi-tech, dot com or related business sectors. A high proportion of them have listed on the ASX within the past three years.

In many cases it appeared that the acquisition of businesses involved the purchase of businesses with small or negative net assets, for large sums and, sometimes, from related parties. Often the disclosure in relation to these transactions was confusing and inadequate. For instance, it was often not possible to easily determine the fair value of assets purchased or the calculation of the resulting goodwill.

Intangible assets often make up the largest portion of the company's net worth. In a number of cases it was very difficult to understand what the amount disclosed as the value of

an intangible represented. Many did not seem to be amortised properly and in some cases it appeared doubtful as to whether their recoverable amount had been properly assessed.

Instances were found where the quarterly cash flow statements appeared inaccurate. Some statements did not tie up quarter to quarter and others did not correspond to the figures in the annual financial statements.

There were instances of the apparent premature recognition of revenue, lack of notes on revenue and inadequate disclosure.

'We have identified a variety of issues requiring additional explanation by more than one-third of the companies that were the subject of our recent surveillance', said Mr David Knott, the Chairman of ASIC.

'Typical areas of concern include the accounting for acquisition of businesses, the reporting and amortising of intangibles, the accuracy of quarterly cash flow statements and the recognition of revenue', he said.

ASIC foreshadowed its intention to carry out this surveillance following the market downturn in new economy stocks in April 2000 and against a background of increasing public concern about the standards of disclosure by this sector of the market. The project has been undertaken by ASIC's Office of Chief Accountant (Mr Ian Mackintosh) and has involved intensive review and analysis of the sector's financial reporting.

Commenting on ASIC's intended response to these findings, Mr Knott said 'We have written to each of the 53 companies identifying our concerns about their financial reporting and providing them with an opportunity to explain or otherwise address those concerns.

Replies were required from the companies by 2 February and will each be reviewed on a case by case basis. If satisfactory explanations or corrective actions are not forthcoming ASIC will initiate additional regulatory action, including enforcement where appropriate.

Mr Knott went on to say, 'ASIC expects that many of the companies will be able to clarify or adequately explain their reporting and accordingly we do not intend to publicly identify the companies until they have had the opportunity to respond to our enquiries.'



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