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FASB Issues Proposed ASU on Cloud Computing Arrangements

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On March 1, 2018, the FASB issued for public comment a [proposed ASU](#)¹ that would amend ASC 350-40² to address a customer's accounting for implementation costs incurred in a cloud computing arrangement (CCA) that is a service contract. The proposed ASU, which is a result of a consensus reached by the FASB's Emerging Issues Task Force (EITF), would also add certain disclosure requirements related to implementation costs incurred for internal-use software and CCAs. Comments on the proposed ASU are due by April 30, 2018.

Background

In April 2015, the FASB issued [ASU 2015-05](#),³ which clarifies the circumstances in which a customer in a CCA would account for the arrangement as a license of internal-use software under ASC 350-40. The ASU provides guidance on whether a CCA contains a software license or is considered a service contract and thus outside the scope of ASC 350-40. ASC 350-40 currently addresses only the accounting for the costs of implementation activities related to software licenses used internally. At the time the FASB issued ASU 2015-05, the Board specifically decided not to address the accounting for costs associated with implementation activities related to CCAs that are considered service contracts, as noted in the ASU's Background Information and Basis for Conclusions.

¹ FASB Proposed Accounting Standards Update, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract: Disclosures for Implementation Costs Incurred for Internal-Use Software and Cloud Computing Arrangements* — a consensus of the FASB Emerging Issues Task Force.

² FASB Accounting Standards Codification (ASC) Subtopic 350-40, *Intangibles — Goodwill and Other; Internal-Use Software*.

³ FASB Accounting Standards Update No. 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*.

As CCAs have become more prevalent, however, stakeholders have raised concerns that the guidance in U.S. GAAP is unclear about the accounting for implementation costs associated with arrangements that are considered service contracts. In addition, there is currently diversity in practice as a result of the various guidance that entities can apply to account for such costs.

At its May 10, 2017, meeting, the FASB acknowledged that the accounting for a customer's implementation costs in a CCA is an issue that is emerging and prevalent and therefore added a narrow-scope project to the EITF's agenda. The EITF reached a consensus on the accounting for a customer's implementation costs in a CCA at its January 18, 2018, meeting, and the FASB ratified the EITF's consensus on February 7, 2018.

Key Provisions of the Proposed ASU

A Customer's Accounting for Implementation Costs in a CCA That Is a Service Contract

Under the proposed ASU, an entity would apply ASC 350-40 to determine which implementation costs should be capitalized. For example, while an entity would expense costs incurred in the preliminary-project and post-implementation-operation stages, it would capitalize certain costs incurred during the application-development stage, and it might be able to capitalize certain costs related to enhancements that it made. The proposed ASU does not change the accounting for the service component of a CCA.

Under the proposal, capitalized implementation costs related to a CCA that is a service contract would not be considered part of a software intangible asset and therefore the treatment of such costs would be different from that of capitalized costs related to CCAs that contain a software license (i.e., under ASC 350-40). Instead, these costs would be capitalized as part of the service contract, and income statement classification for the related amortization would be consistent with the ongoing periodic costs of the underlying CCA.



Connecting the Dots

When evaluating whether to add a narrow-scope project to the EITF's agenda, the FASB observed that many of the activities associated with implementing an internal-use software solution can be, and often are, the same as those associated with implementing a CCA. However, the treatment of these similar activities can vary greatly under the current accounting guidance. This narrow-scope project aligns the accounting for recognition of implementation costs incurred in connection with a CCA with those incurred to implement an internal-use software solution. However, because a CCA may be a service contract while an internal-use software solution gives rise to a software intangible asset, the presentation of amortization of the capitalized implementation costs may differ.

Under the proposed ASU, an entity would be required to amortize implementation costs over the term of the hosting arrangement "on a straight-line basis unless another systematic and rational basis is more representative of the pattern in which the entity expects to benefit from access to the hosted software." The term of the hosting arrangement should include the fixed noncancellable periods plus renewal periods the customer is reasonably certain to exercise, termination periods the customer is reasonably certain to not exercise, and periods covered by an option to extend (or not to terminate) that is controlled by the vendor. A customer should consider a number of factors in determining whether to include optional periods in the term of the CCA, including obsolescence, technology, competition, changes in the development of CCAs, and the hosted software. Amortization of capitalized implementation costs should begin when each module or component of a hosting arrangement is ready for its intended use.



Connecting the Dots

At its meetings on this issue, the EITF discussed whether adding a definition or description of “implementation costs” would be helpful to preparers but decided that ASC 350-40 already contains sufficient explanatory guidance.

Disclosures for Internal-Use Software and CCAs

Under the proposed ASU, an entity would be required to disclose the following qualitative and quantitative information about internal use software and hosting arrangements that are within the scope of ASC 350-40:

- a. A general description of the terms and conditions of the software acquired or developed for internal use or the hosting arrangement
- b. The significant judgments and assumptions that an entity made in applying this Subtopic to implementation costs
- c. A qualitative and quantitative description of the implementation costs that were expensed and costs that were capitalized during the period
- d. A qualitative and quantitative description of the period over which the implementation costs are recognized as an expense in the income statement.



Connecting the Dots

ASC 350-40 does not currently contain specific disclosure requirements but instead refers users to other relevant guidance in U.S. GAAP. At its January 18, 2018, meeting, the EITF reached a consensus that the proposed disclosure requirements should apply to all transactions within the scope of ASC 350-40, which would give financial statement users consistent information about CCAs. Accordingly, the proposed ASU would require entities to reevaluate and most likely expand their disclosures about internal-use software and hosting arrangements that are within the scope of ASC 350-40.

Transition and Effective Date

Entities would be permitted to apply either a retrospective or prospective transition method when adopting the final guidance.

The FASB plans to determine an effective date and whether to permit early adoption of the final guidance after considering stakeholder feedback on the proposed ASU.

Questions for Respondents

The proposed ASU’s questions for respondents are reproduced below for reference.

Question 1: Should eligible implementation costs of a hosting arrangement that is a service contract be capitalized using the guidance on internal-use software, recognized in profit or loss over the term of the hosting arrangement as defined in this proposed Update, and presented in the same line item in the statement of income as the fee associated with the hosting arrangement? If not, what accounting is more appropriate and why?

Question 2: This proposed Update includes an amendment to the definition of *hosting arrangement* in the Master Glossary. Do you agree with the amendment, and do you have any other concerns with the definition, as amended?

Question 3: Is additional guidance needed to determine whether the amendments in this proposed Update apply to arrangements that include a minor hosting arrangement?

Question 4: Can the guidance for determining the project stage (that is, preliminary project stage, application development stage, or postimplementation stage) in Subtopic 350-40 be consistently applied to a hosting arrangement? Why or why not?

Question 5: Should an entity apply an impairment model to implementation costs of a hosting arrangement that is a service contract that is different from the impairment model included in Subtopic 350-40? Why or why not?

Question 6: Do you agree with the disclosures included in the proposed amendments? If not, what additional disclosures do you recommend, or what disclosures should be removed and why?

Question 7: Should the disclosures included in the proposed amendments be applied to internal-use software and hosting arrangements that include a software license? Why or why not?

Question 8: Should an entity be permitted to elect prospective transition or retrospective transition? If not, please explain what transition method should be required and why. If an entity elects prospective transition, should the entity apply the transition requirements to each hosting arrangement, each module or component within a hosting arrangement, or costs of the hosting arrangement?

Question 9: Should an entity be required to provide the transition disclosures specified in the proposed amendments? If not, please explain what transition disclosures should be required and why.

Question 10: How much time would be needed to implement the proposed amendments? Should early adoption be permitted? Do entities other than public business entities need additional time to apply the proposed amendments? Why or why not?

Question 11: Should the proposed amendments be more broadly applied to similar transactions beyond hosting arrangements or be limited to transactions based on the scope of the proposed amendments? If more broadly applied, what transactions are similar to those included in the scope of the proposed amendments?

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