

To the Point

FASB – proposed guidance

FASB proposes guidance on accounting for implementation costs in cloud computing arrangements

The proposal would address the diversity in practice in accounting for implementation costs a customer incurs in a hosting arrangement that is a service contract.

What you need to know

- ▶ The FASB proposed requiring a customer in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance in ASC 350-40 to determine which implementation costs to defer and recognize as an asset.
- ▶ The proposal would align the guidance on recognizing implementation costs incurred in a hosting arrangement that is a service contract with that for implementation costs incurred in an arrangement that includes an internal-use software license.
- ▶ Entities would have to make new disclosures about implementation costs for both internal-use software and hosting arrangements.
- ▶ Comments are due by 30 April 2018.

Overview

The Financial Accounting Standards Board (FASB or Board) [proposed](#) requiring a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance in Accounting Standards Codification (ASC) 350-40¹ to determine which implementation costs to defer and recognize as an asset.

The proposal would align the guidance for recognizing implementation costs incurred in a hosting arrangement that is a service contract with that for implementation costs incurred in an arrangement that includes an internal-use software license. The accounting for the service component of a hosting arrangement would not be affected by the proposal (i.e., that component would continue to be accounted for as a service contract).

The FASB also proposed new disclosures for implementation costs for internal-use software and hosting arrangements.

Background

The FASB issued Accounting Standards Update (ASU) 2015-05² to provide guidance to help customers in cloud computing arrangements determine whether an arrangement includes a software license in the scope of ASC 350-40.

ASC 350-40 addresses when customers that obtain software licenses should capitalize or expense implementation, setup or other up-front costs (i.e., implementation costs). These costs may relate to activities performed by the service provider, the customer's internal personnel or third parties.

However, US GAAP does not provide explicit guidance on how to account for similar implementation costs a customer incurs in a cloud computing arrangement that does not include a software license and therefore is a service contract. Some companies expense all of these costs. Others look to other areas of US GAAP such as the guidance in ASC 340³ on prepaid assets, the guidance in ASC 360⁴ on property, plant and equipment or the guidance in ASC 720-45⁵ on business and technology reengineering as a basis for capitalizing or expensing various costs. Still others analogize to the guidance in ASC 350-40.

The proposal is based on a consensus-for-exposure reached by the Emerging Issues Task Force (EITF or Task Force).

Key considerations

Initial measurement

The proposal would clarify that a customer in a hosting arrangement that is a service contract would apply the guidance in ASC 350-40 to determine which costs of implementing the hosting arrangement to defer and recognize as an asset. Under the proposal, entities would defer certain implementation costs incurred during the application development stage (e.g., costs of integration with on-premises software, coding, configuration, customization). Entities would expense other costs as incurred (e.g., planning the project, training, maintenance after implementation, data conversion).

Subsequent recognition

Under the proposal, an entity would expense the deferred implementation costs over the term of the hosting arrangement, which would be the noncancelable term of the arrangement plus any reasonably certain renewal periods. That expense would be included in the income statement in the same line item as the related hosting fees.

A customer would need to periodically reassess the estimated term of the hosting arrangement and account for any change in the estimated term as a change in an accounting estimate in accordance with ASC 250.⁶ That is, the estimated term would be revised and the remaining deferred implementation costs would be recognized over the remaining period.

How we see it

The EITF decided that it would be appropriate for an entity to recognize certain implementation costs of a hosting arrangement as an asset because those costs increase the future benefits of the related service. As a result, the Task Force concluded that the expense related to the deferred implementation costs should be included in the income statement in the same line item as the related hosting fees.

Disclosure

The proposal would require an entity to provide the following quantitative and qualitative disclosures about all implementation costs in the scope of ASC 350-40 (i.e., implementation costs of both hosting arrangements and internal-use software):

- ▶ A description of the terms and conditions of the software or hosting arrangement
- ▶ Significant judgments and assumptions made in applying the guidance
- ▶ A qualitative and quantitative description of the implementation costs capitalized and expensed (e.g., type, amount)
- ▶ A qualitative and quantitative description of the period during which the implementation costs are recognized as an expense

Effective date and transition

The effective date will be determined after the Task Force considers feedback on the proposal. Entities would apply the guidance either prospectively to all arrangements entered into, renewed or materially modified after the effective date or retrospectively to all hosting arrangements.

Entities also would be required to provide transition disclosures to help users of the financial statements understand the effect of the guidance on the financial statements.

Endnotes:

- ¹ ASC 350-40, *Intangibles – Goodwill and Other, Internal-Use Software*.
- ² ASU 2015-05, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40)*.
- ³ ASC 340, *Other Assets and Deferred Costs*.
- ⁴ ASC 360, *Property, Plant, and Equipment*.
- ⁵ ASC 720-45, *Other Expenses, Business and Technology Reengineering*.
- ⁶ ASC 250, *Accounting Changes and Error Corrections*.

The proposed disclosures would apply to both the implementation costs of hosting arrangements and to those incurred for internal-use software.

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