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Defining Issues®

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FASB Issues Guidance on Customer’s Accounting for Cloud Computing Fees

The FASB recently issued an Accounting Standards Update (ASU) that clarifies when fees paid in a cloud computing arrangement pertain to the acquisition of a software license, services, or both.[1]

Key Facts

- The ASU provides criteria for customers in a cloud computing arrangement to use to determine whether the arrangement includes a license of software. The criteria are based on existing guidance for cloud service providers.[2] However, the ASU does not change the accounting for cloud service providers.
- The ASU does not provide guidance on allocating fees paid by customers for cloud computing arrangements that include a software license and a service.
- Specific disclosures are required to describe the transition method elected.

Key Impacts

- When a cloud computing arrangement includes a license of software, the customer will capitalize the fee attributable to the software license portion of the arrangement when the criteria for capitalization of internal-use software are met.[3]
- When a cloud computing arrangement does not include a license of software, the customer will account for the arrangement as a service contract and expense the cost as the services are received.
- The ASU supersedes the guidance that required companies to analogize to lease accounting when determining the asset acquired in a software licensing arrangement.

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[1] FASB Accounting Standards Update No. 2015-05, Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement, available at www.fasb.org.

[2] FASB ASC paragraphs 985-605-55-121 to 55-125, available at www.fasb.org.

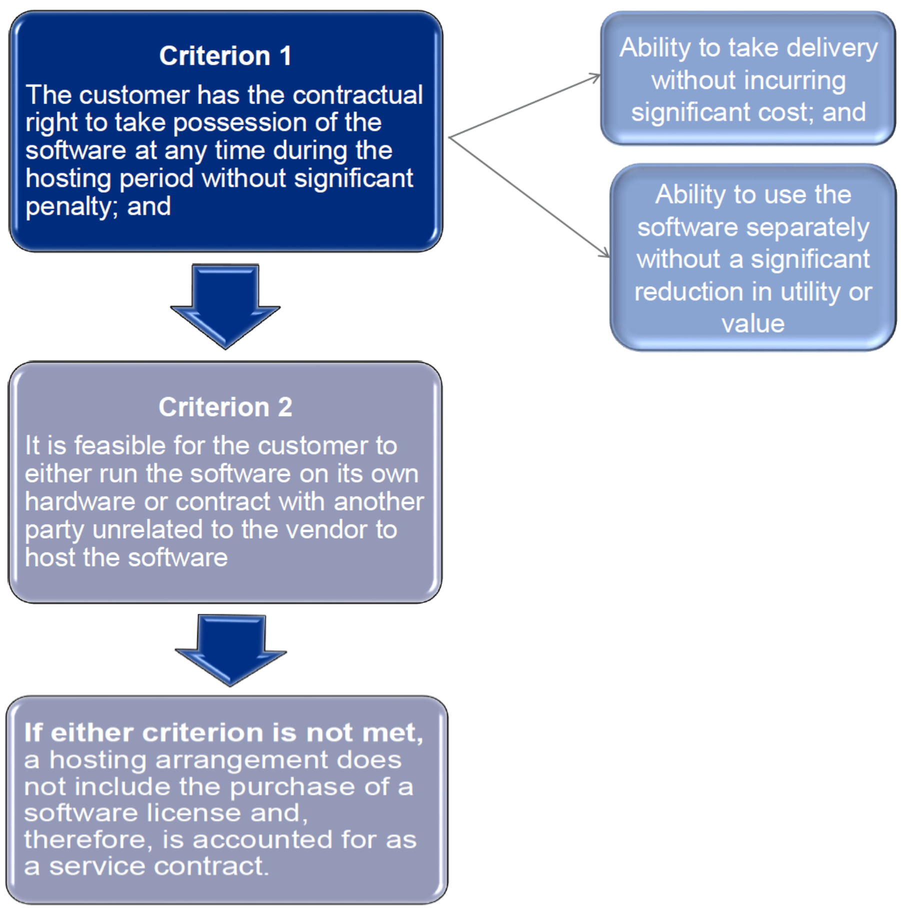
[3] FASB ASC Subtopic 350-40, Intangibles—Goodwill and Other – Internal-Use Software, available at www.fasb.org.

Customer's Accounting for Fees Paid in a Cloud Computing Arrangement

Cloud computing arrangements include software as a service (SaaS), platform as a service, infrastructure as a service, and other similar hosting arrangements. Prior to the issuance of the ASU, U.S. GAAP only provided explicit guidance for cloud computing *providers* to determine whether an arrangement includes a license of software to evaluate whether the software revenue recognition guidance applies to a revenue transaction.[4]

A hosting arrangement is defined as an arrangement in which an end user of the software does not take possession of the software. Instead, the software application resides on the vendor's or a third-party's hardware, and the customer accesses and uses the software on an as-needed basis over the Internet or via a dedicated line.

A hosting arrangement includes a software license if it meets both of the following criteria.



[4] FASB ASC Subtopic 985-605, Software – Revenue Recognition, available at www.fasb.org.

For arrangements that include a software license and cloud services, the ASU does not provide guidance for allocating the fees between the two elements. However, in other transactions in which entities acquire multiple goods or services, an allocation based on a relative fair value basis is generally appropriate.[5] For a cloud computing arrangement that includes a software license for the customer based on the ASU's criteria, the customer should apply the internal-use software guidance to account for its costs. This will generally result in the costs attributed to the software license being capitalized and amortized over the useful life of the software. Amounts attributed to the cloud services are expensed as the services are received by the customer. This ASU may impact certain financial metrics such as earnings before interest, taxes, depreciation, and amortization. Additionally, the cash flow associated with capitalized software costs would be classified as an investing cash outflow. However, cash paid for cloud services would be classified as an operating cash outflow.

The ASU's Basis for Conclusions states that the Board decided not to expand the scope of the project to address upfront costs such as implementation and set-up costs.

Transition, Effective Date, and Disclosures

Entities may elect to adopt the ASU either prospectively for all arrangements entered into or materially modified after the effective date, or retrospectively.

Effective Date. For public business entities, the standard is effective for annual and interim periods in fiscal years beginning after December 15, 2015. For all other entities, the standard is effective for annual periods beginning after December 15, 2015, and interim periods in fiscal years beginning after December 15, 2016. Early adoption is permitted for all entities.

Disclosures. Entities that elect prospective transition should disclose the nature of, and reason for, the change in accounting policy, the transition method, and a qualitative description of the financial statement line items affected by the change. Entities that elect retrospective transition should also disclose quantitative information about the effects of the accounting change. This information should include the cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

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[5] FASB ASC paragraph 350-30-25-2, available at www.fasb.org.