



In This Issue

- [Background](#)
- [Key Provisions of ASU 2018-15](#)
- [Effective Date and Transition](#)

FASB Amends Guidance on Cloud Computing Arrangements

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Background

On August 29, 2018, the FASB issued [ASU 2018-15](#),¹ which amends ASC 350-40² to address a customer's accounting for implementation costs incurred in a cloud computing arrangement (CCA) that is a service contract. ASU 2018-15 aligns the accounting for costs incurred to implement a CCA that is a service arrangement with the guidance on capitalizing costs associated with developing or obtaining internal-use software. Specifically, the ASU amends ASC 350 to include in its scope implementation costs of a CCA that is a service contract and clarifies that a customer should apply ASC 350-40 to determine which implementation costs should be capitalized in a CCA that is considered a service contract. ASU 2018-15 is based on the consensus-for-exposure that the Emerging Issues Task Force (EITF) reached at its January 2018 meeting, which was further deliberated by the EITF at its June 7, 2018, meeting, where the Task Force reached a final consensus for issuance of ASU 2018-15 (see Deloitte's June 2018 [EITF Snapshot](#)).

¹ FASB Accounting Standards Update No. 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*.

² For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's ["Titles of Topics and Subtopics in the FASB Accounting Standards Codification."](#)

Key Provisions of ASU 2018-15

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

ASU 2018-15 aligns a customer's accounting for implementation costs incurred in a CCA that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). Under ASU 2018-15, an entity would apply ASC 350-40 to determine which implementation costs related to a hosting arrangement that is a service contract 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 during the post-implementation-operation stage that result in enhanced functionality to the hosted solution. ASU 2018-15 does not change the accounting for the service component of a CCA.



Connecting the Dots

ASU 2018-15 amends the definition of "hosting arrangement" in the ASC master glossary by (1) removing the reference to licensing, (2) eliminating the requirement for the software to reside on the vendor's or a third party's hardware, and (3) replacing the phrase "does not take possession" with "does not currently have possession." The Board indicated in the Background Information and Basis for Conclusions of the ASU that the initial definition of hosting arrangements may have limited the number of arrangements that could apply this guidance. Common examples of hosting arrangements include software as a service, platform or infrastructure as a service, and other similar types of hosting arrangements.

Presentation and Measurement of Capitalized Implementation Costs in a CCA That Is a Service Contract

Capitalized implementation costs related to a CCA that is a service contract are different from capitalized costs associated with developing or obtaining internal-use software. Internal-use software is, by its nature, a recognizable intangible asset. Accordingly, any incurred and capitalized costs associated with developing or obtaining internal-use software form part of the acquired asset and would generally also be considered an intangible asset. However, a CCA that is a service contract does not give rise to a recognizable intangible asset because it is an executory service contract. Consequently, any costs incurred to implement a CCA that is a service contract would not be capitalized as an intangible asset (since they do not form part of an intangible asset) but instead would be characterized in a company's financial statements in the same manner as other service costs and assets related to service contracts (e.g., prepaid expense). That is, these costs would be capitalized as part of the service contract, and financial statement presentation of the cash flows, the resulting asset, and related amortization would be consistent with the ongoing periodic costs of the underlying CCA.



Connecting the Dots

ASU 2018-15 aligns the accounting for recognition of implementation costs incurred in connection with a CCA with the accounting for costs 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, there are likely to be differences in the presentation of amortization of the capitalized implementation costs. The ASU indicates the following regarding the presentation of implementation costs capitalized in a CCA that is a service contract:

- The expense and the fee associated with the hosting arrangement would be presented as a single line item in the statement of income.

- The balance sheet line item for the customer's presentation of capitalized implementation costs should be the same as that for the prepayment of fees related to the hosting arrangement.
- The manner in which a customer classifies the cash flows related to capitalized implementation costs should be the same as that in which it classifies the cash flows for the fees related to the hosting arrangement.

The ASU specifies that an entity would be required to amortize capitalized 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, economic conditions, rapid changes in the development of hosting arrangements or hosted software, and the significance of the implementation costs whose economic value is expected to be substantial when extension or termination options become exercisable. Amortization of capitalized implementation costs should begin when each module or component of a hosting arrangement is ready for its intended use, even if the overall hosting arrangement will be placed in service in planned stages over multiple reporting periods. If the functionality of a module or component is entirely dependent on the completion of other modules or components, amortization of capitalized implementation costs would commence when both the module or component, and the module or component upon which functionality is dependent, are ready for their intended use.



Connecting the Dots

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.

Application of the ASC 350-40 Impairment Model to Capitalized Implementation Costs in a CCA That Is a Service Contract

In a manner consistent with ASC 350-40, ASU 2018-15 requires an entity to apply the impairment model in ASC 360-10-35 to its capitalized implementation costs of a hosting arrangement that is a service contract. That is, a customer assesses impairment at the asset grouping level (i.e., the lowest level of separately identifiable cash flows that are largely independent of the cash flow of other groups of assets). The ASU provides examples of circumstances in which capitalized costs associated with a CCA that is a service contract may not be recoverable:

- The hosting arrangement is not expected to provide substantive service potential.
- A significant change occurs in the manner in which or the extent to which the hosting arrangement is used or expected to be used.
- The hosting arrangement has had, or will have, a significant change made to it.

At its June 2018 meeting, the EITF clarified that an entity might include assets other than the capitalized costs associated with a CCA that is a service contract when identifying an asset group for potential impairment. However, when applying the impairment guidance, the customer would consider the asset related to each module or component of the hosting

arrangement as the unit of account for abandonment. That is, the customer should account for the capitalized implementation costs as abandoned when an entity ceases to use the related component or module and should evaluate each component or module of a hosting arrangement separately in determining when cease of use occurs.

Disclosures for Hosting Arrangements That Are Service Contracts

The ASU does not expand on existing disclosure requirements except to require a description of the nature of hosting arrangements that are service contracts. An entity would therefore disclose the following for hosting arrangements that are service contracts:

- The nature of its arrangements.
- The information currently required by ASC 350-40, which does not contain specific disclosure requirements but instead refers users to other relevant guidance in U.S. GAAP.
- The required disclosures in ASC 360-10 by treating the capitalized implementation costs as a separate major class of depreciable asset.



Connecting the Dots

Under the guidance in the [proposed ASU](#),³ new disclosures would have been required for hosting arrangements that are service contracts, and those requirements would have applied to other transactions within the scope of ASC 350-40. However, as noted in the Basis for Conclusions of ASU 2018-15, the EITF reached a consensus that the existing disclosures in ASC 350-40 are sufficient.

Effective Date and Transition

The effective dates of the ASU's amendments are as follows:

- *Public business entities* — Fiscal years beginning after December 15, 2019, and interim periods within those fiscal years beginning after December 15, 2019.
- *All other entities* — Fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

The guidance may be early adopted in any annual or interim period for which financial statements have not yet been issued or made available for issuance.

Entities are permitted to apply either a retrospective or prospective transition approach to adopt the guidance. When prospective transition is chosen, entities must apply the transition requirements to any eligible costs incurred after adoption.

³ 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*.

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