

Accounting for Cloud Usage



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Issues

- Cloud computing arrangements (CCA)
- Does a CCA contain a software license or not?
- Accounting for a CCA with a software license in it
- Accounting for a CCA without a software license in it
- Which implementation costs can be capitalized and which can be expensed
- Examples

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Cloud computing arrangements (CCA)

- ASU 2015-05 update: *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees in a Cloud Computing Arrangement (CCA)*.
- “The ASU amends ASC 350-40 to provide customers with guidance on determining whether a cloud computing arrangement contains a software license that should be accounted for as internal-use software.
- The ASU cites “software as a service, platform as a service, infrastructure as a service and other similar hosting arrangements” as examples of cloud computing arrangements.



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Does a CCA contain a software license or not?

An arrangement would contain a software license element if both of the following criteria are met:

- “The customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty”
- “It is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.”

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Accounting for a CCA with a software license in it

- If the arrangement contains a software license, the customer would account for the fees related to the software license element in a manner consistent with how the acquisition of other software licenses is accounted for under ASC 350-40.
- The FASB intended for customers to account for licenses of software they acquire as intangible assets under the new guidance. That is, the asset for an acquired software license should be recognized and measured at cost, which includes **the present value of the license obligation if the license is to be paid for over time.**
- Customers that gain access to software in a cloud computing arrangement account for the software as internal-use software within the scope of ASC 350-40, with amortization of all capitalized costs to be spread over the useful life of the software/technology.

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Accounting for a CCA without a software license in it

- If an arrangement does not include a software license, a customer accounts for the arrangement as a service contract.
- **If the CCA does not include a software license,** the arrangement is a service contract, and the fees for the CCA are recorded in the same way as other SaaS expenses, generally as operating expense.

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Which implementation costs can be capitalized?

FASB aligned **both** Cloud Software-license **and** Cloud Service agreements as to implementation costs.

- The Financial Accounting Standards Board (FASB or Board) issued final guidance 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) 350-402 to determine which **implementation** costs to capitalize as assets.
- Capitalized implementation costs related to a hosting arrangement that is a service contract will be **amortized over the term of the hosting arrangement**, beginning when the module or component of the hosting arrangement is ready for its intended use.
- The internal-use software guidance in ASC 350-40 requires the **capitalization** of certain costs incurred **only during the application development stage** (e.g., costs of integration with on-premises software, coding, configuration, customization). The internal-use software guidance also requires entities to **expense** costs during the preliminary project and post-implementation stages (e.g., costs of project planning, training, maintenance after implementation, data conversion) as they are incurred.

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Term of the Hosting Agreement (Services contract model)

Capitalized implementation costs should be expensed over the term of the hosting arrangement, unless another systematic and rational basis is more representative of the pattern in which the entity expects to benefit from its right to access the hosted software.

The term of the hosting arrangement includes the fixed noncancellable period of the arrangement, plus all of the following periods covered by an option to:

- Extend if the customer is reasonably certain to exercise the option
- Terminate if the customer is reasonably certain not to exercise the option
- Extend—or not to terminate—which exercise is controlled by the vendor

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Examples

- Oracle database, running on Oracle cloud, with no rights to bring that database on-premise: Service contract, operating expenses, direct implementation costs capitalized over life of contract (with all expected extensions included in life of contract).
- Oracle database, running on Oracle cloud, with customer having the right to bring the software in-house or to move it to another cloud provider: Software license, recorded as acquisition of an intangible assets at cost (including PV of payments over time), amortized over the expected useful life of the software; direct implementation costs capitalized over that same period; software maintenance costs expenses as incurred.
- **The Issue of Embedded Leases:** “Identifying and collecting the contracts that may contain embedded leases can be tricky because all contracts that meet the accounting definition of a lease will likely not be labeled as such. A contract is, or contains, a lease if it conveys the right to control the use of a specified asset (e.g., plant, property, and equipment) over a period in exchange for consideration. It is not uncommon for service contracts to convey to the customer the right to use a specified asset during the contract term. **Example: IT services:** A hospital subject to HIPAA regulations engages an IT service provider to provide cloud-computing services. To ensure that patient privacy rights are not violated, the contract requires a single dedicated server be used to provide the services. The hospital decides when and how the dedicated server is used based on its instructions to the IT service provider. The contract **contains an embedded lease** of the dedicated server.” [Deloitte, *Identifying Embedded Leases: Are Leases hiding in your contracts?*”, 2018]