

## Heads Up

### In This Issue:

- Introduction
- Key Provisions of the ASU
- Effective Date and Transition
- Disclosures

## Syncing Up

# FASB Issues ASU on Customers' Accounting for Cloud Computing Costs

by Paul Josenhans and Mark Crowley, Deloitte & Touche LLP

### Introduction

On April 15, 2015, the FASB issued [ASU 2015-05](#)<sup>1</sup> (the "ASU"), which clarifies the circumstances under which a cloud computing customer would account for the arrangement as a license of internal-use software under ASC 350-40.<sup>2</sup> As explained in the ASU, the Board released this new guidance as part of its simplification initiative<sup>3</sup> and in response to feedback from stakeholders that the absence of explicit guidance on this topic had "resulted in some diversity in practice as well as unnecessary costs and complexity for some stakeholders."

### Key Provisions of the ASU

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.

### Scope of ASC 350-40

The ASU requires a customer to determine whether a cloud computing arrangement contains a software license. 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; if the arrangement does not contain a software license, the customer would account for the arrangement as a service contract. The ASU does not prescribe how to account for cloud computing arrangements deemed to be service contracts.

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**" (emphasis added).
- "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."

<sup>1</sup> FASB Accounting Standards Update No. 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*.

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

<sup>3</sup> The ASU states that the FASB's simplification initiative is intended to "identify, evaluate, and improve areas of [U.S. GAAP] for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of the financial statements."

In a manner consistent with ASC 985-605-55-122, the ASU describes “without significant penalty” as containing two distinct concepts: (1) the “ability to take delivery of the software without incurring significant cost” and (2) the “ability to use the software separately without a significant diminution in utility or value.”

The ASU also uses the term “software license element.” Although this term is not defined, the ASU’s Basis for Conclusions acknowledges that an arrangement may include a software license as well as a promise to provide services. In such cases, “the customer should allocate the contract consideration between the license(s) and the service element(s).”

**Editor’s Note:** Under the ASU, a customer would perform the same assessment that cloud computing vendors currently perform to determine whether an arrangement includes the sale of a software license that is subject to the software revenue recognition requirements of ASC 985-605. The Board acknowledged that these criteria are already applied and understood in current practice; accordingly, it intentionally aligned the customer’s assessment of whether the arrangement contains a software license with that performed by the vendor. The ASU’s Basis for Conclusions further states that the ASU is not intended to change U.S. GAAP for cloud computing vendors.

## Applying ASC 350-40 to Arrangements Within Its Scope

In addition to amending the scope of ASC 350-40, the ASU amends the accounting for arrangements within the subtopic’s scope. Specifically, the ASU supersedes the requirement in ASC 350-40 to determine the accounting for a software license by analogy to the lease classification test.<sup>4</sup> Under this requirement, the software license would have been accounted for either as a capitalized asset if similar to a capital lease or as an executory contract if similar to an operating lease. Although the Board had originally proposed the superseding amendment in its 2013 [revised exposure draft](#) on leases, it decided to include the change in this ASU because “the accounting for software licenses should not be different from the accounting for other licenses of intangible assets.” As a result, entities with software licenses within the scope of ASC 350-40 would account for them in a manner consistent with the accounting for other licenses of intangible assets.

**Editor’s Note:** In response to the Board’s initial proposal to clarify customers’ accounting for fees paid in cloud computing arrangements, many stakeholders requested guidance on accounting for up-front costs, such as costs related to implementation and set-up activities. The Board ultimately decided not to expand the scope of the cloud computing project to address such fees, concluding that the accounting for up-front costs related to service contracts is a much broader issue than could be addressed within the scope of this project. However, the ASU’s Basis for Conclusions notes that “to the extent a cloud computing arrangement transfers a software license, [ASC] 350-40 provides guidance on how to account for costs such as those resulting from training, data capture, and conversion activities.”

Entities that incur up-front costs in cloud computing arrangements accounted for as service contracts will need to continue to use judgment in accounting for such payments. For example, entities might look to Concepts Statement 6<sup>5</sup> when evaluating whether up-front fees and other costs related to a cloud computing arrangement give rise to an asset.<sup>6</sup>

## Effective Date and Transition

For public business entities, the ASU is effective for annual periods (and interim periods therein) beginning after December 15, 2015; for all other entities, the ASU is effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted. Entities may adopt the guidance (1) retrospectively or (2) prospectively to arrangements entered into, or materially modified, after the effective date.

<sup>4</sup> ASC 350-40-25-16 currently states, “Though [ASC] 840-10 excludes licensing agreements from its scope, entities shall analogize to that Subtopic when determining the asset acquired in a software licensing arrangement.”

<sup>5</sup> FASB Concepts Statement No. 6, *Elements of Financial Statements*.

<sup>6</sup> Concepts Statement 6 defines assets as “probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.”

## Disclosures

Depending on the method of transition elected, public business entities are required to provide the disclosures indicated in the table below.

Prospective Transition	Retrospective Transition
<p>Public business entities that elect prospective transition are required to disclose the following information in the first interim period and annual period after the effective date:</p> <ul style="list-style-type: none"> <li>• “The nature of and reason for the change in accounting principle.”</li> <li>• “The transition method.”</li> <li>• “A qualitative description of the financial statement line items affected by the change.”</li> </ul>	<p>Public business entities that elect retrospective transition are required to disclose the following information in the first annual period after the entity’s adoption date and in the interim periods within the first annual period:</p> <ul style="list-style-type: none"> <li>• “The nature of and reason for the change in accounting principle.”</li> <li>• “The transition method.”</li> <li>• “A description of the prior-period information that has been retrospectively adjusted.”</li> <li>• “The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item(s), and any affected per-share amounts for the current period and any prior periods, retrospectively adjusted.”</li> <li>• “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.”</li> </ul>

All other entities are also required to disclose the information above (as applicable to the transition method elected), except that interim disclosures in the first annual period after the entity’s adoption date generally do not apply.

## Subscriptions

If you wish to receive *Heads Up* and other accounting publications issued by Deloitte's Accounting Standards and Communications Group, please [register](http://www.deloitte.com/us/accounting/subscriptions) at [www.deloitte.com/us/accounting/subscriptions](http://www.deloitte.com/us/accounting/subscriptions).

## *Dbriefs* for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Financial reporting for taxes.
- Transactions and business events.
- Driving enterprise value.
- Governance, risk, and compliance.
- Financial reporting.
- Technology.

*Dbriefs* also provides a convenient and flexible way to earn CPE credit — right at your desk. [Subscribe](#) to *Dbriefs* to receive notifications about future webcasts at [www.deloitte.com/us/dbriefs](http://www.deloitte.com/us/dbriefs).

Registration is available for this upcoming *Dbriefs* webcast. Use the link below to register:

- [Preventing and Detecting Financial Crime: The Example of Wire Transfer Fraud](#) (April 30, 2 p.m. (EDT)).

## Technical Library and US GAAP Plus

Deloitte makes available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called Technical Library: The Deloitte Accounting Research Tool, the library includes material from the FASB, EITF, AICPA, PCAOB, IASB, and SEC, in addition to Deloitte's own accounting and SEC manuals and other interpretive accounting and SEC guidance.

Updated every business day, Technical Library has an intuitive design and navigation system that, together with its powerful search features, enable users to quickly locate information anytime, from any computer. Technical Library subscribers also receive *Technically Speaking*, the weekly publication that highlights recent additions to the library. For more information, including subscription details and an online demonstration, visit [www.deloitte.com/us/techlibrary](http://www.deloitte.com/us/techlibrary).

In addition, be sure to visit [US GAAP Plus](#), our free Web site that features accounting news, information, and publications with a U.S. GAAP focus. It contains articles on FASB activities and updates to the *FASB Accounting Standards Codification*™ as well as developments of other U.S. and international standard setters and regulators, such as the PCAOB, AICPA, SEC, IASB, and IFRS Interpretations Committee. Check it out today!

*Heads Up* is prepared by the National Office Accounting Standards and Communications Group of Deloitte as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.