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Cloud computing: a background
ASU 2015-05 and 2018-15

• ASU 2015-05: *Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement*
  • Issued in April 2015
  • Provided guidance on when a cloud arrangement was software (subject to ASC 350-40, *Internal use software*) or a service contract
  • Did not address implementation and setup costs for cloud computing “service” contracts

• ASU 2018-15: *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40), Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*
  • Issued August 2018
  • Amends the definition of a “hosting arrangement”
  • Applies guidance in ASC-350-40 to determine which implementation costs to capitalize or expense in hosting “service” contracts
  • Does not define “implementation costs”
  • Renewed focus on *implementation costs*
Cloud computing guidance for *customers*

ASU 2015-05

<table>
<thead>
<tr>
<th>Software license in a hosting arrangement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer has right to take possession of software without significant penalty?</td>
</tr>
<tr>
<td>It is feasible for customer to run the software on its own hardware or contract with another party to host software?</td>
</tr>
<tr>
<td></td>
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</tr>
</tbody>
</table>

- Eliminates analogy to lease guidance when determining asset acquired in *any* software license
  - Software is recognized as an intangible at cost (including PV of license obligation if paid over time)
Cloud computing arrangement
ASU 2018-15

• Use internal-use software guidance to determine which implementation costs to defer and recognize as an asset
  • Expense over the term of the hosting arrangement
  • Classify in the same item as the hosting arrangement fees
• Follow existing US GAAP to account for other implementation costs
• Does not affect the accounting for the hosting arrangement component of a contract

<table>
<thead>
<tr>
<th>Effective date for calendar year-ends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transition method</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>Prospective or retrospective</td>
</tr>
</tbody>
</table>

Prospective or retrospective adopted for Q1 2020 and 2021.
Cloud computing arrangement
ASU 2018-15

- Hosting arrangements with multiple components
  - E.g., payroll system and reservation system
- Multiple-element arrangements
  - Allocate costs based upon relative stand-alone purchase price
  - Not contract price; change from “objective evidence of FV”
- Amortization period
  - Term of the noncancelable hosting arrangement plus reasonably certain renewal periods
  - Periodically reassess for change in estimates
  - Commence once component is ready for intended use
- Evaluate for impairment/abandonment under ASC 360
- Presentation
Internal-use software
ASC 350-40

<table>
<thead>
<tr>
<th>Stage of software development</th>
<th>Accounting treatment</th>
<th>Example activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preliminary project</td>
<td>Expense</td>
<td>• Determining performance requirements</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Vendor demonstrations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Selecting vendors/consultants</td>
</tr>
<tr>
<td>Application development</td>
<td>Capitalize</td>
<td>• Design, software configuration and software interfaces</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Coding</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Installation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Testing, including parallel processing</td>
</tr>
<tr>
<td>Post-implementation</td>
<td>Expense</td>
<td>• Internal and external training</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Maintenance</td>
</tr>
</tbody>
</table>

- Application phase commences after preliminary project phase and management commits to a project that is probable of completion and will be used as intended
- Eligible costs:
  - External direct costs
  - Payroll and payroll-related costs (e.g., benefits)
  - Interest costs
- Overhead costs, including general and administrative, are not capitalizable
Internal-use software
ASC 350-40

• Data conversion costs
  • Costs incurred to develop or obtain software that provides access or converts data are capitalizable
  • Other data conversion costs are expensed (e.g., reconciling data, purging existing data, inputting new data)

• Upgrades and enhancements
  • Capitalizable if results in additional functionality
  • Costs to extend useful life, fix bugs are maintenance costs
  • Unspecified vs. specified upgrades
    • Unspecified — recognize over the contract period
    • Specified — capitalize (assuming criteria are met) and amortize once delivered
Internal-use software
Other considerations

- Payment terms and prepaid assets
- Hardware and leasing considerations
- Regulatory accounting
- Non-linear activities
- Unit of account
Cloud computing
Example

• A company enters into an agreement with a third-party provider for a SaaS solution for payroll and HR management services for five years. As part of the agreement, the third-party provider will provide consultants to help the company’s internal IT specialists configure the solutions to interface with legacy systems, and install and perform testing of the SaaS solution. The third party will also conduct training for all company users before the go-live. The company does not have the ability to take possession of the software. The cost is $10 million.
Cloud computing

Example

- Does the arrangement contain a software license?
  - No. The company does not have the ability to take possession of the software. The contract is a service contract that should be evaluated under ASU 2018-15.

- What are the elements in the arrangement?

<table>
<thead>
<tr>
<th>Element</th>
<th>ASC 350-40</th>
<th>Accounting **</th>
</tr>
</thead>
<tbody>
<tr>
<td>SaaS — Payroll</td>
<td>No</td>
<td>Evaluate under other GAAP. If paid in advance, recognize as a prepaid asset.</td>
</tr>
<tr>
<td>SaaS — HR</td>
<td>No</td>
<td>Evaluate under other GAAP. If paid in advance, recognize as a prepaid asset.</td>
</tr>
<tr>
<td>Configuration, installation and testing — third party *</td>
<td>Yes</td>
<td>Capitalize</td>
</tr>
<tr>
<td>Configuration, installation and testing — internal *</td>
<td>Yes</td>
<td>Capitalize</td>
</tr>
<tr>
<td>Training — internal and external</td>
<td>No</td>
<td>Expense</td>
</tr>
</tbody>
</table>

* Separately for the payroll and HR components

** Allocation is done based on estimates of relative stand-alone selling price
AccountingLink

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