Proposed Accounting Standards Update: Subtopic 350-40; Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract

The California Society of CPA’s ("CalCPA") Accounting Principles and Assurance Services Committee (the “Committee”) is the senior technical committee of CalCPA. CalCPA has approximately 43,500 members. The Committee consists of 55 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are in international firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee provides the following responses to the questions in the Proposed ASU.

**Question 1:** Should eligible implementation costs of a hosting arrangement that is a service contract be capitalized using the guidance on internal-use software, recognized in profit or loss over the term of the hosting arrangement as defined in this proposed Update, and presented in the same line item in the statement of income as the fee associated with the hosting arrangement? If not, what accounting is more appropriate and why?

The Committee agrees with the proposed accounting and believe it will result in reasonably consistent accounting for arrangements that are, in substance, similar.

**Question 2:** This proposed Update includes an amendment to the definition of hosting arrangement in the Master Glossary. Do you agree with the amendment, and do you have any other concerns with the definition, as amended?

The Committee agrees with the amended definition since it is consistent with the proposed accounting.

**Question 3:** Is additional guidance needed to determine whether the amendments in this proposed Update apply to arrangements that include a minor hosting arrangement?

The Committee believes that the amended definition of a hosting arrangement and the application of existing GAAP are sufficient to determine if arrangements meet the scope of this proposed ASU.
**Question 4:** Can the guidance for determining the project stage (that is, preliminary project stage, application development stage, or post implementation stage) in Subtopic 350-40 be consistently applied to a hosting arrangement? Why or why not?

The Committee believes that the guidance in Subtopic 350-40 can be consistently applied to a hosting arrangement. However, the Committee is aware that under a common approach to software development the stages of development in Subtopic 350-40 may overlap or be difficult to identify.

**Question 5:** Should an entity apply an impairment model to implementation costs of a hosting arrangement that is a service contract that is different from the impairment model included in Subtopic 350-40? Why or why not?

No. The Committee believes that the impairment model in Subtopic 350-40 is appropriate.

**Question 6:** Do you agree with the disclosures included in the proposed amendments? If not, what additional disclosures do you recommend, or what disclosures should be removed and why?

No. The Committee believes that the disclosures currently required in Topics 235 and 275 and Subtopics 360-10 and 730-10 are sufficient for readers to understand the financial statements. The Committee notes that similar arrangements that include internal-use software, but are not hosting arrangements that are service contracts, do not require additional disclosures to those noted in the previous sentence.

**Question 7:** Should the disclosures included in the proposed amendments be applied to internal-use software and hosting arrangements that include a software license? Why or why not?

No. The Committee believes that the disclosures currently required in Topics 235 and 275 and Subtopics 360-10 and 730-10 are sufficient for readers to understand the financial statements.

**Question 8:** Should an entity be permitted to elect prospective transition or retrospective transition? If not, please explain what transition method should be required and why. If an entity elects prospective transition, should the entity apply the transition requirements to each hosting arrangement, each module or component within a hosting arrangement, or costs of the hosting arrangement?

The Committee believes, when material, all accounting changes should be accounted for on a retrospective basis unless the impacts are impracticable to determine. If prospective transition is permitted, the Committee believes the affects should be applied to each hosting arrangement.

**Question 9:** Should an entity be required to provide the transition disclosures specified in the proposed amendments? If not, please explain what transition disclosures should be required and why.

Yes. The Committee agrees with the proposed transition disclosures.
**Question 10:** How much time would be needed to implement the proposed amendments? Should early adoption be permitted? Do entities other than public business entities need additional time to apply the proposed amendments? Why or why not?

The Committee has no basis for estimating the time required to implement the proposed ASU, but ascertaining the stages of development in the absence of an internal-use software license could prove difficult, and could be further complicated by software development methodologies that do not follow sequentially the methodology described in Subtopic 350-40.

The Committee favors early adoption since it would provide similar accounting for arrangements that are similar in substance.

The Committee favors a one-year delay in the implementation date for entities other than public business entities to allow time for entities to receive updates in the normal training cycle.

**Question 11:** Should the proposed amendments be more broadly applied to similar transactions beyond hosting arrangements or be limited to transactions based on the scope of the proposed amendments? If more broadly applied, what transactions are similar to those included in the scope of the proposed amendments?

The Committee agrees that the provisions of the Proposed ASU should not be specifically applied to all service contracts without further study. However, the Committee also agrees that a specific prohibition against applying the methodology in the proposed ASU to other similar arrangements should not exist.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with your further should you have any questions or require additional information.

Sincerely,

Matthew J. Lombardi
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants