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November 15, 2017

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the October 12, 2017 meeting of the FASB Emerging Issues Task Force (EITF).

The November 16, 2017 EITF meeting will be canceled because there are no open issues that will be ready for deliberation by that time. However, we plan to utilize the January 18, 2018 extra EITF meeting date to discuss Issue 17-A on cloud computing arrangements.

Please call or email me if you have any questions.

Sincerely,

Thomas Faineteau
FASB Practice Fellow



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**Emerging Issues Task Force
Meeting Minutes
October 12, 2017**

	<u>Pages</u>
• Attendees	1
• Administrative Matters	2
• Discussion of Agenda Technical Issues	
1. Issue No. 17-A, “Customer’s Accounting for Implementation, Setup, and Other Upfront Costs (Implementation Costs) Incurred in a Cloud Computing Arrangement That Is Considered a Service Contract”	3-9

**MINUTES OF THE OCTOBER 12, 2017 MEETING
OF THE FASB EMERGING ISSUES TASK FORCE**

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, October 12, 2017

Starting Time: 9:00 a.m.

Concluding Time: 11:15 a.m.

Task Force Members Present:

Susan M. Cospers (Chairman)
Kimber K. Bascom
Paul Beswick (by telephone)
James G. Campbell (by telephone)
Terri Z. Campbell (by telephone)
Alexander M. Corl (by telephone)
Lawrence N. Dodyk
Bret Dooley (by telephone)
Carl Kampel (by telephone)
Mark LaMonte
Ashwinpaul C. (Tony) Sondhi (by telephone)
Robert Uhl
Sagar S. Teotia (SEC Observer) (by telephone)
James A. Dolinar (FinREC Observer) (by telephone)
Yan Zhang (PCC Observer) (by telephone)

Task Force Members Absent:

None

Others at Meeting Table:

Russell G. Golden, FASB Chairman
James L. Kroeker, FASB Vice Chairman
Christine A. Botosan, FASB Member
Harold L. Monk, Jr., FASB Member
Thomas J. Faineteau, EITF Coordinator
Jason Bond, FASB Practice Fellow
Lindsey E. Matherson, FASB Postgraduate Technical Assistant
John W. Schomburger, FASB Postgraduate Technical Assistant

ADMINISTRATIVE MATTERS

- The EITF Coordinator announced that the SEC staff announcement made by the SEC Observer at the July 20, 2017 EITF meeting on transition related to Accounting Standards Update No. 2014-09 on revenue from contracts with customers and Update 2016-02 on leases had been issued as Accounting Standards Update No. 2017-13, *Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments*.
- The EITF Coordinator noted that there only was one active Issue on the EITF agenda, Issue No. 17-A, “Customer’s Accounting for Implementation, Setup, and Other Upfront Costs (Implementation Costs) Incurred in a Cloud Computing Arrangement That Is Considered a Service Contract.” The EITF Coordinator highlighted some staff changes on Issue 17-A, thanked the prior staff members for their contributions to the project, and welcomed Jason Bond as the new project manager on the Issue.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 17-A

Title: Customer's Accounting for Implementation, Setup, and Other Upfront Costs (Implementation Costs) Incurred in a Cloud Computing Arrangement That Is Considered a Service Contract

Dates Discussed: July 20, 2017; October 12, 2017

Background

1. In April 2015, the FASB issued Accounting Standards Update No. 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, to help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (CCA) by providing guidance for determining when the arrangement includes a software license. Examples of CCAs include software as a service (SaaS), platform as a service, infrastructure as a service, and other similar hosting arrangements. A SaaS arrangement uses internet-based application software hosted by a service provider or third party and is the most common CCA.

2. If a CCA includes a license to internal-use software, then the software license is accounted for by the customer in accordance with Subtopic 350-40. This generally means that an asset is recognized for the software license, which is amortized over its useful life, and, to the extent that the payments attributable to the software license are made over time, a liability also is recognized. If a CCA does not include a license to internal-use software, the entity should account for the arrangement as a service contract. This generally means that the hosting costs are expensed as incurred.

3. After Update 2015-05 was issued, several stakeholders requested that the Board provide additional guidance on the accounting for the costs for implementation activities incurred in a CCA that is considered a service contract. Those stakeholders observed that there currently is diversity in practice because there is no directly applicable GAAP guidance, and therefore entities have looked to various areas of the Codification for additional guidance.

4. On May 10, 2017, the Board decided to add a narrow scope project to the EITF's agenda to address a customer's accounting for costs for implementation activities incurred in a CCA that is considered a service contract.

Issues

5. The following issues were included in Issue Summary No. 1, dated July 7, 2017, and Issue Summary No. 1, Supplement No. 1, dated September 28, 2017. The issues in Issue Summary No. 1 were renumbered in Issue Summary No. 1, Supplement No. 1 to reflect the order in which they were presented to the Task Force at the October 12, 2017 EITF meeting. The listing below illustrates those changes.

- Issue 1: Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is Considered a Service Contract
- Issue 2: Amortization Period, If Applicable
- Issue 3: Definition of Implementation Costs
- Issue 4: Scope of the Project
- Issue 5: Analogy to Other Service Contracts.

6. Issues 1 and 2 were discussed at the July 20, 2017 EITF meeting. Issues 1 and 3 were discussed at the October 12, 2017 EITF meeting. The remaining issues (Issues 4 and 5) were not discussed. These issues will be discussed at a future meeting.

Prior EITF Discussion

Issue 1: Accounting for Implementation Costs Incurred in a CCA That is Considered a Service Contract

7. At its July 20, 2017 meeting, the Task Force considered the following four alternatives to account for costs for implementation activities incurred in a CCA that is considered a service contract:

Alternative A—Implementation Costs Associated with a CCA That Is Considered a Service Contract Would Be Recognized as an Expense When Incurred.

Alternative B—Implementation Costs Associated with a CCA That Is Considered a Service Contract Would Be Recognized as an Asset or an Expense When Incurred on the Basis of Existing GAAP (Topic 340, Subtopic 350-40, Topic 360 Subtopic 720-45).

Alternative C—Implementation Costs Associated with a CCA That Is Considered a Service Contract Would Be Accounted for the Same as Implementation Costs Associated with a Software License.

Alternative C¹—Implementation Costs Associated with a CCA That Is Considered a Service Contract Would Be Accounted for Based on Topic 360.

8. Task Force members did not express support for Alternative A or Alternative C¹, and, accordingly, the discussion focused on Alternative B and Alternative C and the differences between those two alternatives.

9. In evaluating Alternatives B and C, the Task Force discussed the extent to which multiple elements of implementation costs incurred in a CCA would need to be separated for accounting purposes. The staff noted that under Alternative B, the implementation costs would likely require a more detailed breakout than under Alternative C in order to appropriately apply Topic 340, Other Assets and Deferred Costs; Topic 360, Property, Plant, and Equipment; Subtopic 350-40, Internal-Use Software; and Subtopic 720-45, Business and Technology Reengineering. One Board member observed that Alternative C also requires separation of multiple elements, and, therefore, such a feature does not distinguish Alternative B from Alternative C. One Task Force member also observed that allocation guidance between multiple element arrangements exists in GAAP (for example, in Subtopic 350-40), although it may not address all aspects (for example, when elements

are considered to be distinct). During the discussion, a parallel to Topic 606, Revenue from Contracts with Customers, was also discussed. Specifically, certain members of the Task Force discussed the possible application of the notion of “distinct” goods or services to CCAs that are considered service contracts for purposes of contract bifurcation under both Alternatives B and C.

10. Some Task Force members supported Alternative B because it relies on existing GAAP and is consistent with both the decisions reached in Update 2015-05 and the definition of an asset under FASB Concepts Statement No. 6, *Elements of Financial Statements*. However, other Task Force members expressed reservations with Alternative B, which they perceived as potentially resulting in a different accounting outcome for identical costs depending on who performs the service. For example, some Task Force members believed that certain implementation costs incurred by the hosting provider (vendor) would be expensed over the life of the contract if considered not to be distinct from the hosting service, while those same costs would be expensed as incurred if the work is performed internally or by a third-party consultant.

11. Some Task Force members supported Alternative C. Those Task Force members considered CCAs that are considered services to be economically similar to CCAs that include a software license. Some Task Force members also noted that a customer in a CCA that is considered a service has an asset; it is the “right-to-use” an asset even though that asset is serviced and maintained by an external party. Some Task Force members also preferred Alternative C because it would produce consistent accounting outcomes for implementation costs regardless of who performs the work. However, some Task Force members expressed concerns with Alternative C, noting that it would require revisiting and undoing the prior decisions reached in Update 2015-05. An FASB staff member also observed that a CCA that is considered a service contract is not economically similar to a “right-to-use” software license because the vendor still must perform throughout the term of the CCA in order for the customer to benefit from the arrangement. Several Task Force members also expressed concerns with Alternative C because (a) the guidance in Subtopic 350-40 is perceived as outdated, and (b) there are already practice issues associated with applying the guidance in Subtopic 350-40 to software licenses. They noted that applying the same guidance to implementation costs of a CCA that is considered a service might not reduce diversity in practice.

12. The Task Force directed the FASB staff to perform additional research (focusing on Alternatives B and C) to assist the Task Force in reaching a tentative conclusion on Issue 1. The following potential research areas were outlined by the FASB staff:

- a. Analyze the issues that exist in practice for applying the guidance in Subtopic 350-40 to software licenses, and whether those issues would exist when applied to a CCA that is considered a service contract.
- b. Build new examples for CCAs that are considered service contracts, with implementation activities that include additional complexities such as multiple-service providers (vendors, consultants).
- c. Explore whether Alternative B could be improved to avoid different accounting outcomes depending on who performs the implementation work.
- d. Evaluate whether any other model outside of Subtopic 350-40 could be applied to a CCA that is considered a service contract.

- e. Explore whether a conceptual basis similar to Topic 842, Leases, could be applied, whereby a right-of-use asset is recognized even though control does not pass to the customer (similar to an operating lease).
- f. Consider how to separate the elements of a contract to determine the appropriate accounting treatment.

Issue 2: Amortization Period

13. The FASB staff recommended providing guidance on the amortization period to the extent that the existing guidance is not sufficient (generally for a prepaid asset). The staff recommended that the amortization period under Alternative B of Issue 1 include the noncancelable hosting contract term plus any expected renewal periods. The staff did not recommend providing amortization period guidance under Alternative C of Issue 1 considering that guidance exists in Subtopic 350-40.

14. Task Force members who expressed a view on Issue 2 generally were supportive of the staff recommendation. One Task Force member recommended that an entity should continually reassess the useful life of the asset (for example, based on changes in expectations of renewal option exercises or based on whether the entity continues to expect to benefit from the asset during the renewal periods). Another Task Force member asked whether the staff recommendation took into consideration expectations of renewals of a CCA that does not include contractual rights to renew. That Task Force member also observed that it would be useful if the staff were to provide guidance about how to evaluate renewal options so that practitioners know how to apply the guidance (for example, by providing a threshold above which renewal periods would be included in the useful life of the asset). An FASB staff member clarified that the staff's recommendation was based on options to renew that are included in the contract, not based on expectations of future renegotiations and renewals. There also was a discussion between some Task Force members and Board members about whether prepaid assets would arise under the application of Alternative C.

Current EITF Discussion

Issue 1: Accounting for Implementation Costs Incurred in a CCA That Is Considered a Service Contract

15. At its October 12, 2017 meeting, the Task Force considered three alternatives to account for the costs incurred for implementation activities in a CCA that is considered a service contract. Those alternatives included Alternative B and "Original" Alternative C as presented at the July 20, 2017 meeting. The FASB staff clarified the application of Alternative B to address concerns raised by some Task Force members at the July meeting. The FASB staff also proposed to simplify the application of Alternative B by including specific guidance based on Topic 606 to determine whether an activity is distinct from the hosting service (rather than referencing Topic 606 to make that determination) for the residual activities for which there is no existing GAAP guidance. The FASB staff also introduced a revision to Original Alternative C in response to feedback received at the July meeting and based on outreach performed subsequent to that meeting (Revised Alternative C).

Alternative B—Residual Approach Utilizing Guidance in Topic 606 (or Another Model) to Determine What Is Distinct.

Original Alternative C—Implementation Costs Associated with a CCA That Is Considered a Service Contract Would Be Accounted for the Same as Implementation Costs Associated with a Software License.

Revised Alternative C—All Hosting Arrangements (as Defined in the Master Glossary) Are within the Scope of Subtopic 350-40.

16. The Task Force first discussed Revised Alternative C, which would require an entity to identify a software element in all of its hosting arrangements, as defined in the Master Glossary of the Codification, and that software element would be within the scope of Subtopic 350-40. Since the software element would be within the scope of Subtopic 350-40, it would be capitalized and the implementation costs to get that software element ready for its intended use and that are capitalizable under Subtopic 350-40 also would be capitalized as part of the cost of the software element. A liability would be recognized for the present value of any fees in the CCA related to the software element that are not paid at contract commencement. Revised Alternative C would address the inconsistencies between Original Alternative C and Update 2015-05 by proposing new amendments that would change the conclusions in Update 2015-05. The discussion included presentation on the income statement, which the FASB staff confirmed would be a noncash operating expense (characterized as amortization). One Task Force member and one Board member questioned whether the term *hosting arrangement*, as defined in the Master Glossary, would cause some hosting arrangements to fall out of the scope of Revised Alternative C because that definition uses the term *license*. They therefore suggested updating the definition of hosting arrangement to avoid any unintended scope restrictions. One Task Force member noted that executory contracts that have a minor software element in the contract might be within the scope of Revised Alternative C, and, accordingly, that Revised Alternative C might have unintended consequences related to executory contracts in general. When comparing Revised Alternative C with Original Alternative C, some Task Force members also discussed the executory nature of hosting arrangements and how there is a lack of well-defined accounting guidance for executory contracts. Some Task Force members and one Board member noted that Revised Alternative C would treat CCAs like leases under Topic 842, but that Topic specifically scopes out leases of intangible assets from its guidance. A Task Force member and a Board member therefore questioned whether other intangible assets should be addressed if the Task Force proposes to treat CCAs like leases.

17. The Task Force then discussed Alternative B, and, in particular, the simplified approach proposed by the staff for determining whether implementation activities are distinct from the hosting service for the residual activities for which there is no existing GAAP guidance. Rather than referring to Topic 606, the proposed simplified approach would provide explicit guidance that would be used to determine whether an implementation activity is distinct from the cloud service provider's hosting service. One Task Force member noted that there would be limited circumstances in which services performed by a third party would be determined not to be distinct under the simplified approach. Some Task Force members questioned the potential outcome of capitalizing as a prepaid asset the costs for customization activities when the activity is performed by a third-party other than the cloud service provider. Another Task Force member expressed concerns with the application of the simplified approach, noting that a vendor using the guidance

in Topic 606 could reach a conclusion that is different from the conclusion that a customer would reach by applying the simplified approach in Alternative B when determining whether an element of a contract is distinct. Other Task Force members noted that Original Alternative C and Revised Alternative C also would not result in symmetry in accounting between a customer and a vendor, and that, therefore, symmetry might not be a critical factor when evaluating Alternative B.

18. The Task Force considered the accounting implications of each alternative. One Board member noted that the objective of the project, when it was added to the EITF's agenda, was to align the accounting for implementation costs for hosting arrangements. Another Board member noted that the criterion set forth in paragraph 350-40-15-4A about the right to take possession of the software might not be substantive and that, therefore, the accounting for CCAs currently might be based on form rather than substance. That Board member observed that what was important was to align the accounting for transactions that are economically similar. Some Task Force members preferred Revised Alternative C to Original Alternative C because they noted few (if any) instances in GAAP in which implementation costs are capitalized without an associated asset. Although one Task Force member noted that Revised Alternative C would introduce complexity into the accounting for implementation costs, which could be avoided by prescribing a simpler approach, some Task Force members noted that the application of Revised Alternative C would not result in any appreciable increase in complexity when compared to Original Alternative C, particularly if the Task Force were to permit entities not to separate the hosting service from the software element of a CCA. Some Task Force members also noted that while Original Alternative C would eliminate the difference in accounting for implementation costs, it would not eliminate all differences in accounting between arrangements that are considered economically similar. It also was noted that Revised Alternative C was the only alternative that would align the accounting for CCAs that are considered service contracts with that of on-premise software licenses.

19. Ultimately, the Task Force reached a tentative conclusion to align the accounting for CCAs, wherein all CCAs would include a software element that would be within the scope of Subtopic 350-40 (that is, Revised Alternative C).

20. The Task Force then discussed whether to revise the guidance in Subtopic 350-40 to address the concerns raised at the July 20, 2017 meeting that the guidance in Subtopic 350-40 is outdated and that applying that same guidance to costs to implement a CCA would not reduce diversity in practice. Based on the feedback obtained through outreach performed subsequent to the July meeting, there were no significant challenges identified that would arise in applying the guidance in Subtopic 350-40 for the accounting for costs to implement a CCA, and, accordingly, the Task Force decided not to add guidance in Subtopic 350-40 for those implementation costs. However, one Task Force member suggested an amendment to the title of Subtopic 350-40 to more clearly indicate that CCAs would fall within the guidance of that Subtopic.

21. The Task Force also discussed the practical questions under Revised Alternative C related to the capitalization of the software element of a hosting arrangement, such as how to consider renewal and termination options, what discount rate to use, and how to account for variable payments. The Task Force discussed the extent of the guidance in Topic 842 that would apply if the Task Force were to permit use of the leases guidance by analogy to CCAs. The FASB staff clarified that only specific aspects of the guidance in Topic 842 would apply if the Task Force

were to permit use of the leases guidance by analogy to CCAs. For example, a customer in a CCA would apply the guidance in Topic 842 by analogy for the accounting of variable payments or for the evaluation of extension or termination options included in the arrangement, but the customer would not be required to assess lease classification, nor would the customer be required to provide all disclosures included in Topic 842. The staff also clarified that implementation costs would not be accounted for as initial direct costs under Topic 842.

22. Some Task Force members supported analogizing to certain aspects of Topic 842, but other Task Force members and some Board members preferred obtaining a better understanding of how practice currently applies the guidance in Subtopic 350-40 to on-premise software licenses before determining whether analogizing to Topic 842 is necessary. The Task Force also requested that the staff perform additional research on how certain aspects of Topic 842 would apply to the accounting for hosting arrangements. For example, one Task Force member observed that the guidance about discount rates in Topic 842 would not apply to the software element of a hosting arrangement because, under Topic 842, the incremental borrowing rate is determined on a collateralized basis. While the staff proposed an analogy to a finance lease, one Board member also questioned whether an analogy should be made to an operating lease. Accordingly, the following areas of research were identified by the Task Force and Board members:

- a. Determine whether there currently is diversity in practice in accounting for on-premise software under Subtopic 350-40, including how entities assess variable payments, discount rates, and renewals for internal-use software.
- b. Determine how the accounting for on-premise software under Subtopic 350-40 may change if an analogy to (or alignment with) Topic 842 were to be made for hosting arrangements.
- c. Evaluate whether the capitalized software element of a hosting arrangement is more appropriately analogized to an operating lease or finance lease.
- d. Analyze the disclosure requirements in Topic 842 and assess whether any of those requirements would be applicable to hosting arrangements.

23. The Task Force decided not to provide guidance about separation of elements in a CCA because that question is beyond the scope of this Issue.

Issue 3: Definition of Implementation Costs

24. The Task Force decided not to provide a definition or description of implementation costs within Subtopic 350-40. While one Task Force member observed that adding a description of the different types of implementation costs could be helpful, the Task Force generally agreed that there was no need to include a definition or description of implementation costs because Subtopic 350-40 already has appropriate guidance that entities can apply. One Task Force member also noted that there is no significant diversity in practice today related to identifying implementation costs.

Status

25. Further discussion is expected at a future EITF meeting.