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February 22, 2018

**TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE**

Included are the final minutes of the January 18, 2018 meeting of the FASB Emerging Issues Task Force (EITF).

On February 7, 2018, the Board ratified the Task Force consensus-for-exposure on Issue 17-A on cloud computing arrangements. The proposed Accounting Standards Update is expected to be posted to the FASB website within a week or so.

The March 22, 2018 EITF meeting has been canceled because there are no open issues that will be ready for deliberation by that time. However, we plan to utilize the May 17, 2018 extra EITF meeting date or the June 7, 2018 regular EITF meeting date to discuss stakeholder feedback on Issue 17-A and any other new agenda issues that may result from the March 14, 2018 FASB Agenda Prioritization meeting. We will communicate the date selected for the next EITF meeting in a future announcement.

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  
January 18, 2018**

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**MINUTES OF THE JANUARY 18, 2018 MEETING  
OF THE FASB EMERGING ISSUES TASK FORCE**

Location: FASB Offices  
401 Merritt 7  
Norwalk, Connecticut

Thursday, January 18, 2018

Starting Time: 8:30 a.m.

Concluding Time: 11:40 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  
Mark LaMonte  
Ashwinpaul C. (Tony) Sondhi (by telephone)  
Robert Uhl  
Sagar S. Teotia (SEC Observer) (by telephone)  
James A. Dolinar (FinREC Observer)  
Timothy Curt (PCC Observer) (by telephone)

**Task Force Members Absent:**

Carl Kampel

**Others at Meeting Table:**

Russell G. Golden, FASB Chairman  
James L. Kroeker, FASB Vice Chairman  
Christine A. Botosan, FASB Board Member  
Marsha L. Hunt, FASB Board Member  
Harold L. Monk, Jr., FASB Board Member  
R. Harold Schroeder, FASB Board Member  
Marc A. Siegel, FASB Board Member  
Thomas J. Faineteau, EITF Coordinator  
Jason Bond, FASB Practice Fellow  
John W. Schomburger, FASB Postgraduate Technical Assistant  
John P. Stansel, FASB Postgraduate Technical Assistant

## **ADMINISTRATIVE MATTERS**

- The EITF chairman welcomed Mr. Timothy Curt, Warburg Pincus LLC, who is sitting-in for Yan Zhang as the Private Company Council (PCC) Observer to the EITF.
- 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 announced that the consensus-for-exposure reached at this meeting will be considered by the Board for ratification at the February 7, 2018 Board meeting.
- The EITF Coordinator announced that a future communication would be made about whether to retain the next regular EITF meeting scheduled for March 22, 2018.

## **FASB STAFF Q&A ANNOUNCEMENT**

**Codification Reference:** Topic 740, Income Taxes

**Topic:** FASB Staff Q&As on the Financial Reporting Effects of the Tax Cuts and Jobs Act of 2017

An FASB staff member announced that the staff planned to issue responses to five implementation questions related to the Tax Cuts and Jobs Act of 2017, and asked Task Force members if they had any feedback on the staff responses, of which there was none. The following five Staff Q&As, which are all interpretations of the guidance in Topic 740, have since been made available on the FASB website at [http://www.fasb.org/taxcutsjobsact#section\\_3](http://www.fasb.org/taxcutsjobsact#section_3):

1. Whether Private Companies and Not-for-Profit Entities can apply SAB 118
2. Whether to Discount the Tax Liability on the Deemed Repatriation
3. Whether to Discount Alternative Minimum Tax Credits That Become Refundable
4. Accounting for the Base Erosion Anti-Abuse Tax
5. Accounting for Global Intangible Low-Taxed Income.

## 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; January 18, 2018

### 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, Issue Summary No. 1, Supplement No. 1, dated September 28, 2017, and Issue Summary No. 1, Supplement No. 3, dated January 4, 2018. 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. All issues that remained to be addressed by the Task Force were discussed at the January 18, 2018 EITF 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 C<sup>1</sup>**—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 C<sup>1</sup>, 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.

13. At its October 12, 2017 meeting, the Task Force continued its discussion of Issue 1 and 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

14. 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.

15. 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.

16. 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.

17. 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).

18. 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.

19. 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.

20. 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.

21. 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 2: Amortization Period**

22. At the July 20, 2017 EITF meeting, 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.

23. 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.

### **Issue 3: Definition of Implementation Costs**

24. At its October 12, 2017 meeting, 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.

### **Current EITF Discussion**

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

25. At its January 18, 2018 meeting, the Task Force reached a consensus-for-exposure that would require an entity to capitalize implementation costs of a hosting arrangement that is a service contract using the guidance in Subtopic 350-40 on internal-use software. The accounting for the hosting fees associated with the hosting arrangement would not be affected by this consensus-for-exposure and, accordingly, would be expensed as the service is performed.

26. In reaching its consensus-for-exposure, the Task Force noted that an entity may incur significant costs when implementing a hosting arrangement that is a service contract, which may indicate a future benefit to the entity beyond the period over which the implementation services are performed. In a service contract, while the right to receive the service and the obligation to pay for the service as the service is performed are not recognized on the balance sheet, the Task Force observed that certain costs to implement the hosting arrangement enhance the right to receive the related service. Accordingly, the Task Force decided that the implementation costs of a hosting arrangement that is a service contract could be attached to the service contract and, therefore, could be capitalized as an asset and recognized over a period longer than the period over which the implementation services are provided. That is, those capitalized costs, while not representative of an asset on a standalone basis, result in an increase in future benefits to be received under the hosting arrangement, thus resulting in an asset related to the service contract. While overall, the Board and Task Force members believe that it is important that guidance be developed in a manner in which the outcome is both relevant to investors' needs and responsive to preparers' ability to apply the guidance, some Task Force members weighed the expected costs and expected benefits differently in determining the consensus-for-exposure and its interaction with the FASB conceptual framework. In determining the consensus-for-exposure, the Task Force decided that it represents a practical solution that addresses the original concern that was raised to the Task Force and that it was responsive to the unique characteristics of hosting arrangements that are service contracts.

27. The Task Force noted that implementation costs capitalized under the amendments in the proposed Update relate to the rights and obligations embedded in a hosting arrangement (which are not recognized separately as assets and liabilities) for which the entity has the right to use and that this is similar to other contract-related assets. For example, under Subtopic 340-40 on other assets from contracts with customers, costs that relate to a specific contract and that are expected to be recovered are recognized as an asset if they generate or enhance resources of the entity that will be used in fulfilling the contract in the future. This guidance results in the capitalization of costs that cannot be capitalized in accordance with other GAAP and that are not added to the measurement of another asset. They merely generate a resource for the entity. The Task Force believes that the result of the implementation costs of a hosting arrangement generates a resource for the entity that is used in connection with the hosting arrangement.

28. In discussing the accounting for implementation costs incurred in a hosting arrangement that is a service contract, the Task Force considered other alternatives, including an alternative that would have resulted in recognizing an asset for both the costs incurred to implement the hosting arrangement and the right to use the software embedded in the hosting arrangement based on the premise that the hosting arrangement provides an economic resource to the customer irrespective of ownership or location of the software. A few Task Force members preferred that alternative. They noted that under Subtopic 350-40, costs associated with implementation activities are not

capitalized as a separate or standalone asset. Instead, the software is the identified asset, and costs of implementation activities are added to the measurement of that asset. Those Task Force members also believe that this alternative is consistent with the FASB conceptual framework. Those Task Force members noted that in the absence of an asset to which implementation costs can be added, the implementation costs incurred in a hosting arrangement that is a service contract are like costs incurred in other transactions that, while expected to provide economic benefits in future periods, are not recognized as an asset but rather are expensed as incurred (for example, training costs or business process reengineering costs). However, other Task Force members noted that that alternative also had conceptual limits (for example, it treated the transaction as economically different from how a vendor accounts for the transaction under Topic 606 on revenue from contracts with customers). The Task Force ultimately rejected that alternative. In doing so, the Task Force also considered the general lack of support by preparers and users during outreach. Initial outreach with users indicated that they generally preferred implementation costs to be expensed as incurred and that they also preferred software and related implementation costs of internal-use software to be expensed as incurred, but they saw an argument for capitalizing the implementation costs of a hosting arrangement that is a service contract. In addition, some Task Force members were concerned that accounting for hosting arrangements that are service contracts like leases may have unintended consequences because intangible assets are not in the scope of Topic 842 on leases. Some Task Force members also noted that the alternative would be beyond the scope of the issue given to the Task Force.

## **Issue 2: Amortization Period**

29. The Task Force also reached a consensus-for-exposure to require entities to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement, which would include renewal options that are reasonably certain to be exercised. The Task Force believes that including reasonably certain renewals to determine the period over which the costs should be expensed would represent the expected period of benefit of the enhanced right that is expected to be realized from the hosting arrangement. The Task Force also believes that this is reasonably consistent with the period over which capitalized costs are recognized as an expense for implementation costs of hosting arrangements that contain a license. The Task Force also decided that an entity would record the expense related to the implementation costs in the same line item in the statement of income as the fees for the hosting arrangement (and, accordingly, the amortization expense related to those implementation costs would not be presented along with depreciation or amortization expense related to property, plant, and equipment, and intangible assets). This is because the asset recognized for the implementation costs is recognized only as a result of enhancing the value of the hosting service, which itself is not recognized as an asset. Thus, although the implementation costs are recognized as a standalone asset, the future benefit derived from that asset is linked to the benefit derived from the hosting service, which is expensed as incurred.

## **Issue 4: Scope of the Project**

30. The Task Force reached a consensus-for-exposure to amend the definition of *hosting arrangement* to remove the reference to licensing. The Task Force noted that the definition of hosting arrangement uses the phrase “licensing of software,” which would potentially limit the

number of arrangements to which the guidance in the amendments in the proposed Update would apply because many hosting arrangements do not provide the customer with a license to the underlying software. In addition, the Task Force discussed whether to add guidance to limit the scope of the proposed amendments to service contracts in which the hosting arrangement is more than minor. The purpose of that guidance would be to reduce the costs of implementing internal controls over financial reporting related to analyzing all service arrangements to determine whether a hosting arrangement, as defined in the Master Glossary, is included in the service arrangement. While the Task Force decided not to add guidance to limit the scope of the proposed amendments, the Task Force decided to obtain feedback on the issue.

### **Issue 5: Analogy to Other Service Contracts**

31. The Task Force discussed and decided to remain silent on whether an entity may apply the guidance in the amendments in the proposed Update by analogy to other transactions and activities. The Task Force noted that explicitly disallowing an analogy to Subtopic 350-40 would not be effective because the guidance in the proposed amendments is based, in part, on an analogy to the guidance in Subtopic 340-40. If the Task Force decided to disallow an analogy to Subtopic 350-40, an entity could still analogize to Subtopic 340-40 on the same basis as the proposed Update. Some Task Force members also believe that few, if any, arrangements are similar to hosting arrangements. As a result, there may not be many transactions for which an entity would attempt to analogize to Subtopic 350-40.

### **Disclosures**

32. The Task Force reached a consensus-for-exposure to add disclosure requirements that would apply to implementation costs of all transactions within the scope of Subtopic 350-40, not just hosting arrangements that are service contracts. The amendments in the proposed Update would require certain qualitative and quantitative disclosures about costs incurred to implement internal-use software or hosting arrangements. The intent of these disclosures would be to provide users with information about the type and amount of implementation costs capitalized as well as information about the subsequent measurement of those costs. The Task Force decided that the new disclosures would be required for all transactions within the scope of Subtopic 350-40 to create consistency between the information provided for internal-use software and hosting arrangements.

### **Transition**

33. The Task Force did not propose an effective date for the guidance in the amendments in the proposed Update. Consequently, the Task Force will take into consideration the comments received from the exposure of the document before determining when the proposed Update would be effective.

34. The Task Force reached a consensus-for-exposure to allow entities to choose between prospective transition and retrospective transition when adopting the guidance in the amendments in the proposed Update. Under prospective transition, an entity would apply the proposed guidance to hosting arrangements entered into, renewed, or materially modified after the effective date. The

prospective transition approach is based on whether a hosting arrangement is entered into (or materially modified or renewed) after the effective date, and not whether implementation costs are incurred after the effective date. The Task Force understands that the benefits of retrospective transition may not justify the costs because the effect of retrospective application may not be significant for many entities. However, the Task Force saw no reason to prohibit an entity from retrospectively applying the proposed amendments, and an entity with significant implementation costs during the comparative periods of the financial statements in which the entity adopts the proposed amendments may believe that retrospective application provides more useful information. The Task Force discussed potential challenges of implementing the proposed guidance in situations in which an entity is incurring costs to implement a hosting arrangement that already exists upon the proposed Update's ultimate effective date. However, in-process implementation costs would be capitalized only if the entity elects retrospective transition.

35. The Task Force reached a consensus-for-exposure to require different transition disclosure requirements depending on the transition method elected. For prospective transition, an entity would disclose the nature of and reason for the accounting change, the transition method, and a qualitative description of the financial statement line items affected by the change. For retrospective transition, the disclosure requirements at transition would include all of the requirements for prospective transition plus quantitative information about the effects of the accounting change. The Task Force decided that the benefits of requiring quantitative disclosure of the effect of the proposed amendments for prospective transition would not justify the costs. The transition disclosures would be in lieu of those required in paragraphs 250-10-50-1 through 50-3.

#### **Status**

36. Upon issuance of the proposed Update, a 60-day comment period will commence. Further discussion is expected at a future EITF meeting.