



Board Meeting Handout
Leases
Consequential Amendments for Licenses of Internal-Use Software
February 12, 2013

ISSUE SUMMARY

1. Paragraph 350-40-25-16 of the *FASB Accounting Standards Codification*[®], which provides guidance on accounting for a license of internal-use software, states the following:

Entities often license internal-use software from third parties. Though Subtopic 840-10 excludes licensing agreements from its scope, entities shall analogize to that Subtopic when determining the asset acquired in a software licensing arrangement.

2. Current leases guidance in Topic 840 excludes licensing arrangements from its scope, but guidance in Topic 350, Intangibles—Goodwill and Other, directs preparers to analogize to existing leases guidance when determining the asset acquired in a software arrangement. Given that the Board is proposing to change the accounting model for leases, the staff thinks the Board should consider what consequential amendment should be made to the accounting for a license of internal-use software.

Staff Analysis

3. The staff thinks that the most feasible approach for the consequential amendment to internal-use software is to change the analogy in the internal-use software guidance in paragraph 350-40-25-16 from what is stated in current U.S. generally accepted accounting principles (GAAP) to require the recognition and measurement approach in the leases proposals. However, the staff does not think the presentation or disclosure requirements in the leases proposals should apply to a license of internal-use software.
4. The staff considered, but ultimately dismissed, other approaches to accounting for internal-use software. One approach was to require application of the leases

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proposals if the license arrangement would be accounted for by the licensor under a rateable revenue recognition approach in the proposed FASB Accounting Standards Update, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers*. If the arrangement were to be accounted for by the licensor as a promise to provide a right (point-in-time revenue recognition), the licensee would account for the license as the purchase of an intangible asset. The staff thinks that approach is too complex because it would require an entity to evaluate the arrangement under both the proposed Update on revenue recognition and the proposed FASB Accounting Standards Update, *Leases (Topic 840)*. The staff also thinks that approach would not result in a significantly different outcome than applying only the leases proposals because (a) both approaches would involve the recognition of license assets and liabilities and (b) the measurement of the assets and liabilities typically would be the same or similar.

5. Another approach the staff considered, but dismissed, was to account for internal-use software like an executory contract in which the arrangement would not be recognized in the statement of financial position. The staff thinks that this approach would be inconsistent with the accounting for other rights to use an asset, such as that in the model the Board is developing in the leases project. It is not clear to the staff what the Board's basis would be to conclude that a software license and a right-of-use asset in a lease arrangement are sufficiently different to warrant a significantly different portrayal in the financial statements. In addition, the staff does not think a license for internal-use software is an executory contract because some or all of the performance occurs at the commencement of the arrangement.

Staff Recommendation

6. The staff recommends that a license of internal-use software be accounted for in the following ways:
 - a. By analogy under the recognition and measurement approach in the leases proposals

- b. Under a straight-line total expense pattern (Type 2 approach).
7. The staff proposes the following amendments to paragraph 350-40-25-16:

Entities often license internal-use software from third parties. ~~Though Subtopic 840-10~~ Although Topic 842 excludes those arrangements licensing agreements from its scope, entities shall analogize to the recognition and measurement guidance in that Subtopic-Topic when determining the asset acquired in a software licensing arrangement. In addition, entities shall subsequently measure any asset or liability recognized as a Type 2 lease.