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November 18, 2014

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Proposed Accounting Standards Update, “Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement” (File Reference No. 2014-230)

Dear Technical Director:

We appreciate the opportunity to respond to the proposed Accounting Standards Update, *Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement* (the proposed ASU).

We agree with the Board’s position that to the extent a customer in a cloud computing arrangement actually has a software license element that it deploys and uses within its own IT environment, the related cost should be accounted for in accordance with ASC Subsection 350-40, *Intangibles—Goodwill and Other—Internal-Use Software*. We also agree that if a cloud computing arrangement does not permit the customer to use a software license that it deploys and uses within its own IT environment, the arrangement should be accounted for as a service arrangement with the costs expensed as the services are provided.

We believe that the key question is whether the customer has possession of the software rather than whether it has the ability to take possession. In many situations, the criteria in proposed ASC paragraphs 350-40-15-4A through 15-4C will be appropriate for determining whether the arrangement transfers control of a software license to the customer. However, we are concerned that in circumstances where a licensee has not taken, and has no intention of taking, possession of the software, the transaction for what is substantively a service arrangement may nevertheless satisfy the criteria in the proposed ASU. We believe a requirement that the customer actually have possession of the software and intend to use it on premise would better align the proposed guidance with the definition of an asset and existing guidance in ASC 350-40. We recognize though that any revision to the proposed ASU to require possession of software in order to capitalize and amortize the software asset would not be consistent with the Board’s desire to align the guidance with existing guidance used by providers to determine whether an arrangement includes the sale or license of software.

In addition to the proposed guidance, we believe there are several other issues concerning cloud computing arrangements that could be addressed and clarified within the ASU to reduce potential diversity.



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For cloud computing arrangements that are deemed to include a software license, the Board should consider expanding the guidance in the proposed ASU to address diversity in practice in applying ASC paragraph 350-40-25-16, which requires customers licensing an internal-use software product from a third party to analogize to Subtopic 840-10 *Leases – Overall* to determine the asset acquired in a software licensing arrangement. We understand this to mean that a perpetual license would be capitalized whereas a time-based license would be evaluated pursuant to the third and fourth criteria under lease accounting requirements. We recommend that the Board make clear whether this is the case and provide additional guidance on how the licensee would assess the useful life and fair value of the software license.

The Board should consider expanding the guidance in the proposed ASU to address potential diversity in practice related to customer accounting for up-front implementation costs associated with a cloud computing arrangement, including any differences caused by the provider of those implementation services being the cloud computing provider or a third party.

For cloud computing arrangements that include a separate license for software that will be used on premise and cloud computing service elements such as those that this proposed ASU endeavors to define, the Board should consider expanding the guidance in the proposed ASU for how to allocate contract consideration between the software and service elements. We believe this will be particularly helpful in applying the guidance in the proposed ASU to hybrid cloud arrangements, which are becoming increasingly prevalent. A hybrid cloud arrangement is an operating environment in which an organization uses a combination of private computing resources, such as in-house data center-based applications, and public cloud services that interact with each other to process or store data. We acknowledge the Basis for Conclusions in the proposed ASU states that a customer should allocate contract consideration between license and service elements, but we believe clarification in the ASU on allocation methods would address potential diversity in practice.

We believe the proposed ASU should require retrospective or modified retrospective transition to promote comparability.

If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419 or Paul Munter at (212) 909-5567.

Sincerely,

KPMG LLP

KPMG LLP

Appendix I

Question 1: *Should a customer in a cloud computing arrangement evaluate whether the arrangement involves a software license by applying the criteria in paragraphs 350-40-15-4A through 15-4C? If not, what guidance should be applied and why?*

We agree with the Board's position that to the extent a customer in a cloud computing arrangement actually has a software license element that it deploys and uses within its own IT environment, the related cost should be accounted for in accordance with ASC Subsection 350-40, *Intangibles—Goodwill and Other—Internal-Use Software*. We also agree that if a cloud computing arrangement does not permit the customer to use a software license that it deploys and uses within its own IT environment, the arrangement should be accounted for as a service arrangement with the costs expensed as the services are provided.

We believe that the key question is whether the customer has possession of the software rather than whether it has the ability to take possession. In many situations, the criteria in proposed ASC paragraphs 350-40-15-4A through 15-4C will be appropriate for determining whether the arrangement transfers control of a software license to the customer. However, we are concerned that in circumstances where a licensee has not taken, and has no intention of taking, possession of the software, the transaction for what is substantively a service arrangement may nevertheless satisfy the criteria in the proposed ASU. The contractual right or ability to take possession of an asset without significant penalty is different than actually having possession of the asset and intending to use it on premise.

Question 2: *Should an entity be permitted to elect prospective or retrospective transition?*

We believe the proposed ASU should not permit an entity to elect prospective transition because retrospective or modified retrospective transition would promote comparability.

Question 3: *Should the amendments in this proposed Update be effective for:*

- a. Public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015, with early adoption permitted?*
- b. All other entities for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016, with early adoption permitted?*

We agree with the proposed ASU's effective dates and the permission to early adopt.