

April 29th, 2018

Technical Director
File Reference: 2018-230

Dear Technical Director, FASB Members, and Staff:

I appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU), *Intangibles— Goodwill and Other— Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*.

I support the FASB and EITF's project to address costs of implementation activities in a cloud computing arrangement. I strongly believe that cloud computing or software-as-a-service (SaaS) arrangements should follow an accounting model similar to licensed software models within the scope of ASC 350-40. Cloud computing and license software models are homogenous in most aspects and the accounting should not differ simply because of how the software is distributed to end users.

As I note in Appendix A (page 6), I believe that ASU 2015-05 has flaws which are further highlighted within this update. I do not believe the substance of software changes simply because of how it is accessed (e.g., over the internet instead of on servers the company owns). Software distribution models will change over time as technology evolves and becomes more efficient and globalized; however, the fundamental accounting should not change if the risks and economics associated with cloud computing or a licensed distribution model remain the same for end users. I am concerned that, even though we get to the right accounting model as outlined under this exposure draft, there appears to be conflicting views now embedded in ASC 350-40-15-4a (where most SaaS or cloud computing arrangements would fail to meet the established criteria to be treated as internal-use software) and the new subsection(s) *Implementation Costs of a Hosting Arrangement That is a Service Contract* (where it is now implied that although cloud computing is purely a service, entities should capitalize implementation costs as if it was internal-use software). I believe the conflicting views are based on a misconception about cloud computing (that they are economically and substantively different) and I encourage the FASB Board Members and Staff to consider closing the gaps on these views in the near future to eliminate confusion and potential diversity in applying the accounting guidance particularly as technology and related distribution channels change, evolve, and become more pervasive.

My responses to the questions can be found on page 2-5 of this letter.

Please feel free to contact me if you have questions. I can be reached at grantnjay@gmail.com.

Regards,

Jay N. Grant, CPA

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?

I agree that implementation costs incurred in implementing a hosting arrangement that is a service contract (i.e., software-as-a-service) be capitalized using the guidance in ASC 350-40.

While cloud computing or software-as-a-service (SaaS) contracts typically grant rights to use instead of rights to own under software licensing arrangements, the utility, use, output, and risks (financial and operational) of both models is virtually the same; it is the distribution of the software that is different which does not warrant different accounting treatment.

Most cloud computing or SaaS contracts require payment of an initial fee (e.g., sign on fee, initiation fee, etc.) and require some level of costs to implement (via the contracting vendor, another third party, or the company's resources) much like a licensed software model. These fees are more akin to an asset than period costs. First, they meet the definition/have characteristics of an asset¹: 1) they result from a past transaction (i.e., signed contract); 2) the benefits to be obtained from the upfront fees and implementation fees come in the future (over the time the SaaS solution is used); 3) can control it (the company generally controls the instance of the software provided to them and the related customization of the software through the service contract period). In addition, the expense recognition principle, in most cases, would be violated by expensing the costs up front since that principle states that expenses represent consumption of economic benefits²; in the case of upfront fees and implementation costs, benefits are consumed and generated over time vs. upon signing.

Also, under current GAAP, companies (vendors) that charge non-refundable upfront fees to customers require that those fees be deferred and recognized into revenue over the life of the contract with the customer under the premise that those fees usually have zero value to the customer at the onset of the contract (e.g., in a SaaS solution, it is the software service solution the customer is after, not the implementation costs)³ and thus do not typically represent a separate performance obligation. By analogy or a reciprocal view, from an expense perspective the implementation costs, absent the vendor providing access to the SaaS solution, have no utility to the end user. The value comes as the SaaS solution is able to be accessed by a customer.

Capitalized costs for cloud computing arrangements should be recognized in profit or loss over the term of the hosting arrangement. However, I do not believe it is appropriate for those costs to be in the same line item in the statement of income as the fee associated with the hosting arrangement. As mentioned previously, cloud-based computing arrangements are analogous to licensed software and should follow a similar accounting model. Accordingly, I believe the capitalized costs should be amortized over the hosting agreement and presented in the same line as licensed software amortization expense. I believe this treatment makes more conceptual sense, is consistent with how other capitalized software costs or other deferred costs in other areas of US GAAP are treated, and limits confusion for end users of financial statements.

¹ SFAC No. 6 (CON 6) paragraph 26

² SFAC No. 5 (CON 5) paragraph 85

³ ASC 606-10-55-50 through 55-53

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?

I agree with the amended definition to include “accessing and using” as it now encompasses, more clearly, cloud based or SaaS contracts.

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

I do not believe additional guidance is needed to determine whether the amendments in this proposed Update apply to arrangements that include a minor hosting arrangement.

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?

I believe that application of the various stages of a software project applied to a hosting arrangement (SaaS solution or Cloud computing) can be applied consistently. As stated in my views for question 1, implementing a cloud-based solution is fundamentally the same as that of a licensed software. That is, both models typically require significant upfront fees to implement and customize in order for the customer to maximize the utility of the software and the nature of these costs are typically agnostic to whether it is a cloud-based or a licensed based model.

In addition, given that most modern organizations extensively use software and are regularly implementing software to modernize or drive operational efficiencies, many organizations and vendors already have systems and processes in place to capture the data needed to identify costs to be capitalized and expensed pursuant to ASC 350-40.

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?

I believe the impairment model used in ASC 350-40 should be applied to implementation costs of cloud-based solution. In some cases, many organizations may begin the process to implement a cloud-based solution only to find out mid-way through the project is no longer viable, there are no capital resources to fund the project on an indefinite basis, or another more modern solution has become available. These are similar headwinds and risks licensed software models face and therefore, the impairment considerations should remain the same for cloud-based offerings.

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?

I agree with the proposed disclosure requirements as they provide more decision useful information. Software is used in almost all industries and is and will remain a key element for success for most organizations in the current and future economy. More robust disclosures about the nature and extent of those software arrangements would be useful to users allowing them to better understand the costs in the financial statements relating to software (which are not typically discussed in appropriate detail in most financial statements today).

Cyber threats are now a material risk for most organizations (particularly those arrangements done via the cloud) and, while not the direct intention of the proposed disclosure requirements, I believe that understanding the nature and extent of software arrangements provides indirect insight and creates better linkage between what is in the financial statements to supplemental discussions of cyber security risks and overall current and future financial risk.

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?

Yes, as outlined in question 1 and in Appendix A, the nature of cloud computing and a licensed model are virtually the same. As discussed in question 6, the enhanced disclosures should be applied to all material software arrangements regardless if they are distributed via a licensed model or a cloud-based model as it enhances the users understanding of historical and future costs and risks.

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?

I am supportive of allowing entities to adopt the proposed Update on a prospective or retrospective basis. In general, retrospective adoption is typically more useful for end users in driving comparability and understanding the effects of the change. However, given that previous guidance on accounting for implementation costs in a cloud computing arrangement were virtually non-existent, many organizations may not have tracked these costs as they do for licensed software in the scope of ASC 350-40 which would make retrospective application particularly onerous. Organizations should apply the transition requirements (regardless of transition method) to all hosting arrangements.

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.

I believe entities should be required to provide the transition disclosures in the proposed Update. These disclosures will help end users understand the changes and the effects of those changes on previously issued and future financial statements.

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?

As noted in my response to question 4, many organizations have processes to capture implementation costs related to software related projects as either capital or expense; the transition should not be extensive (particularly for larger organizations). Therefore, I believe the proposed amendments should be effective as soon as possible and also allow organizations to adopt early.

I do not believe entities other than public business entities need additional time to apply the proposed amendments as even small organizations, given the pervasiveness of software today, have some means of tracking software implementation costs for internal-use software and those processes would not materially deviate for cloud computing or SaaS type arrangements. Further, those entities are subject to similar materiality considerations under current GAAP as for public business entities.

Question 11: Should the proposed amendments be more broadly applied to similar transactions beyond hosting arrangement 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?

I do not believe it would be appropriate to apply the proposed amendments more broadly unless those arrangements are clearly software related or have characteristics similar to the arrangements described within ASC 350-40.

Appendix A - Characterization of certain cloud computing arrangements as service contracts instead of characterizing as internal-use software

While not in the scope of the exposure draft, I believe modifications are needed to ASC 350-40 in order to be less confusing, minimize conceptual issues, and to be modernized. ASU 2015-05 added criteria for entities to use in determining whether or not a cloud computing arrangement was in the scope of ASC 350-40. While I think cloud computing arrangements can take many forms and certainly there needs to be clarity and guidance to determine whether the set of circumstances warrant following the guidance in ASC 350-40, the current criteria, in many cases, inappropriately characterize cloud computing arrangements as purely a service.

Many ERPs or General Ledger systems, for example, are now offered in the cloud and in some cases the end user will never be able to take ownership of the ERP or General Ledger. The offering of an ERP or General Ledger in the cloud reduces costs on the front end and allows entities to spread those costs over time (including maintenance related costs), reduce internal technology infrastructure costs, and/or expands the versatility of the solution. It is for these reasons (among others) cloud-based models are becoming more optimal for organizations (and within the next decade will likely to be the norm). To the end user the look, feel, functionality, output, and general economic impact is the exact same as if the software was offered via a traditional licensed distribution model (e.g., NetSuite and Oracle Cloud offerings are great examples). In addition, the risk of obsolescence and the amount of capital resources invested in these platforms is generally the same (i.e., significant to material for organizations). Accordingly, these solutions (both the implementation costs and hosting fees) should still be characterized as internal-use software and not be viewed different simply because the distribution to the end user has shifted.

There are, however, instances where cloud computing is purely a service and not necessarily internal-use software. For example, in the healthcare or health insurance industry, certain organizations subscribe to cloud-based health data information (e.g., medical trends, statistics, etc.). The Big 4 accounting firms offer access to accounting guidance via the cloud. Under those cloud computing models, the offering is purely a service and thus would be appropriately characterized as a service under the current guidance within ASC 350-40.

Based on the above, I believe the FASB and Staff should review and enhance the current criteria in ASC 350-40-15-4A to ensure that the accounting is not fundamentally changed in character simply given how it is distributed unless that distribution model clearly and materially changes the substance and overall economics.

Another long standing conceptual issue resides within the scope limitations of ASC 842 which scopes out intangible assets much like the legacy guidance did in ASC 840. Cloud computing arrangements typically grant the "right to use" software which is no different than the right to use a building or equipment and, therefore, should follow a similar accounting model consistent with those arrangements in the scope of ASC 842. While I understand the practical reasons for excluding software (or intangibles) from ASC 842 at this time, I think it drives inconsistencies in accounting for transactions that are similar in nature. I see this, compared to other current agenda items, as urgent in nature given the pervasiveness of these kinds executory arrangements.