

April 30, 2018

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

Via Email: director@fasb.org

From: Tim Chatting

Re: File Reference No. 2018-230

Thank you for the opportunity to comment on the Proposed Accounting Standards Update, *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 am a preparer of financial statements for a privately owned company in the technology industry with annual revenue of approximately \$2 billion. My current role is focused on accounting policy and implementation of accounting standards updates. The views provided in this comment letter are my own and do not necessarily represent those of my employer.

The exposure draft is a practical solution to the diversity in practice that exists with respect to the customer’s accounting for implementation costs incurred in a cloud computing service contract. The proposed amendments will result in a more meaningful presentation of implementation costs incurred in cloud computing service contracts for many entities and will provide consistent accounting for implementation costs regardless of whether they relate to a cloud computing service contract or an arrangement that includes a license to internal-use software. Furthermore, many entities will be able to leverage existing systems, processes, and controls for internal-use software in order to mitigate costs and efforts of adopting the proposed amendments, which is important given the magnitude of accounting standards updates to be adopted by entities over the next few years.

Although I generally support the proposal, it is my view that diversity in the preparation of the statement of cash flows could result from the proposed amendments unless further clarification is provided. It is my understanding that the nature of the asset being recognized under the proposal is a deferred charge asset similar to other assets and deferred costs from contracts with customers in Subtopic 340-40 and that the cash outflows would likely need to be included in the operating activities section of the statement of cash flows; however, the proposed changes were made entirely to the intangible assets guidance in Topic 350 and cash outflows associated with intangible assets are commonly classified as investing cash flows. The Board and the EITF may fall short of its objective of resolving diversity in practice in this area without providing further clarification of the nature of the asset being recognized and the related cash outflows in Topic 340 *Other Assets and Deferred Costs*, Topic 230 *Statement of Cash Flows*, and/or the basis for conclusions included in the final accounting standards update. In addition, I disagree with the proposed requirement to require incremental disclosures for internal-use software and hosting arrangements that include a software license on the basis that such disclosures are not necessary to resolve the diversity in practice being addressed by the Board and the EITF. I believe existing disclosures are adequate and that new disclosures should only be required for implementation costs incurred in cloud computing service contracts.

Responses to the Board’s specific questions are provided below.

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?

Response to Question 1: Yes, I agree with the proposed accounting on the basis that these implementation costs improve the functionality and enhance the value of a contract that grants access to hosted software. This is a practical and cost-effective solution in my view.

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?

Response to Question 2: Yes, I agree with the proposed amendment.

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

Response to Question 3: It might be beneficial to preparers and auditors to document in the codification or explain in the basis for conclusions that this guidance does not need to be applied to arrangements that include only a minor hosting arrangement or a hosting service that is immaterial in the context of the contract similar to Topic 606. Preparers and auditors will need to apply reasonable judgment in making this determination.

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?

Response to Question 4: Yes, I understand from my particular experience that internal personnel were prepared to apply the guidance of Subtopic 350-40 to cloud computing service contracts on the same basis as internal-use software projects before being informed that the authoritative accounting guidance makes a distinction between hosting arrangements that include a software license and hosting arrangements that are determined to be service contracts. The proposed amendments will be received favorably, if finalized, since the project activities are considered similar regardless of whether a license is included in the arrangement.

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?

Response to Question 5: No, I believe it would make sense to apply the same impairment model since the economics are similar from the customer's viewpoint regardless of whether the arrangement includes a license to use software.

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?

Response to Question 6: No, I believe that only the opening and closing asset balances (and where the balances are included on the statement of financial position), total expense recognized during the fiscal year(s) presented, and a qualitative and quantitative (time bands or weighted average life) description of the period over which the implementation costs are recognized as expense should be required. I believe this is similar to what is commonly disclosed in practice, in total, for contracts including a license to internal-use software.

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?

Response to Question 7: No, I believe that the existing disclosures for internal-use software and hosting arrangements that include a software license are adequate and that additional disclosures for such projects are not necessary to satisfy the objective of resolving diversity in practice underlying the exposure draft. Furthermore, it does not make sense to me to disclose a portion of the asset balance and amortization for projects that include a software license and, therefore, such disclosures may not provide decision-useful information. Entities should be welcome to voluntarily disclose such information if they are concerned that undue emphasis would otherwise be placed on implementation costs deferred for cloud computing service contracts by users of their financial statements.

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?

Response to Question 8: Yes, an entity should be permitted to elect prospective transition or retrospective transition. If an entity elects prospective transition, it is my view that the proposed amendments should be applied to implementation costs of the hosting arrangement incurred on or after the effective date for the purpose of transition. Applying current accounting policies to implementation costs incurred for cloud computing arrangements existing on the effective date of the new guidance would extend diversity in practice unnecessarily and would add complexity for preparers in the period of adoption (or longer) due to the potential application of two accounting models.

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.

Response to Question 9: Yes, the transition disclosures appear reasonable for the two transition approaches permitted by the proposed guidance.

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?

Response to Question 10: Most reporting entities likely have systems, processes, and controls in place regarding internal-use software that can be leveraged in the implementation of the proposed amendments. It is possible that some entities may use cloud computing service contracts exclusively and have expensed all implementation costs as incurred, historically, in which case such entities may need an implementation runway similar to the one provided previously for SOP 98-1 *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Early adoption should be permitted since the proposed amendments are expected to reduce diversity in practice; furthermore, I suspect many reporting entities will be interested in early adoption since the proposed amendments will likely result in greater deferral of expenses compared to current accounting policies. Private companies may require more time to implement the proposed amendments solely due to the large number of accounting standards updates to be implemented over the next few years and the view that private companies typically have fewer resources available to participate in implementation activities.

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

Response to Question 11: Application of the proposed amendments should be limited to hosting arrangements in my view.

Regards,

Tim Chatting, CPA