



July 6, 2018

Accounting for Cloud Computing

AUDIT, PROFESSIONAL SERVICES, RETAIL

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Earlier this month, the Financial Accounting Standards Board's (FASB) Emerging Issue Task Force (EITF) reached a consensus to permit the capitalization of cloud computing implementation costs under hosting agreements that are service contracts. On June 27, 2018 the FASB ratified the EITF's consensus in a 4-2 vote. The FASB designed this guidance to treat cloud applications in the same manner as on-site software applications.

Through this process, the EITF determined that customers in cloud computing services contracts should use the existing guidance on Internal Use Software (Codification Subtopic 350-40) to determine which implementation costs should be recognized as assets. These assets should then be expensed over the term of the hosting agreement. The length of time should include any renewal options determined to be likely. The assets recognized are then subject to impairment considerations under the Internal Use Software guidance. Costs permitted to be capitalized primarily consist of employee training, system reconfiguration, and coding expenses.

The EITF also determined that the expenses relating to the implementation costs are required to be recognized on the same line of the income statement as the expenses incurred for the hosting agreement. Similarly, the capitalized implementation costs must be presented on the same line of the balance sheet, as any prepaid hosting fees and presented on the cash flow statement in the same manner as the fees associated with the hosting agreement.

Entities are also required to disclose the implementation costs of a hosting agreement according to paragraph 35-40-50-1 of the Internal Use Software section of the Codification. This disclosure should include a description of the nature of the entity's hosting agreement.

The FASB plans to publish a final update by the fall of 2018. The FASB has provided entities with the option to apply this guidance retrospectively or prospectively to implementation costs incurred after the adoption date. The guidance is required for public entities with annual periods, including interim periods, beginning after December 15, 2019 and for nonpublic entities with annual periods beginning after December 15, 2020.

Please contact the Schneider Downs Audit and Assurance Department for additional information regarding the EITF's consensus or visit the Our Thoughts On blog for similar articles.

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