FASAB
THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

# Memorandum

## Software Technology

March 27, 2024

To: Members of the Board
From: Josh R. Williams, Senior Analyst
Thru: Monica R. Valentine, Executive Director
Subject: **Software Technology Guidance Updates** (Topic C)

### INTRODUCTION

At the October 2023 meeting, the Board deliberated financial statement recognition and note disclosure requirements for cloud-service arrangement payments. The attached issues paper discusses financial statement recognition options for implementation costs associated with cloud-service arrangements. Staff is requesting the Board's feedback and preferences on the proposed options.

### REQUEST FOR FEEDBACK BY April 11, 2024

**Prior to the Board's April meeting**, please review the attached issues paper and respond to the questions by April 11, 2024.

Please submit responses to Josh Williams at WilliamsJR@fasab.gov with a cc to Monica Valentine at ValentineM@fasab.gov.

### NEXT STEPS

**Pending Board feedback,** staff will coordinate with the working group and other stakeholders to research financial statement recognition options for software licenses to propose for the Board's consideration.

### ATTACHMENTS

1. Issues Paper
2. Prior Board Meeting Discussions Timeline

# Issues Paper

## Software Technology

March 27, 2024

## CONTEXT

### Background

This project began with the Board considering adopting a right-to-use asset framework for cloud-service arrangements. The Board initially considered adopting guidance that the Governmental Accounting Standards Board (GASB) issued in Statement No. 96, *Subscription-Based Information Technology Arrangements*.

During the October 2022 meeting, the Board discussed whether cloud-service arrangements were right-to-use assets or service contracts. Some members thought it reasonable to conceptualize cloud-service arrangements as right-to-use assets. However, they were concerned that the associated preparer burden and lack of reporting benefits may not justify the need for asset recognition on the balance sheet. The members suggested that disclosures could adequately provide information about the how federal entities use cloud-services for operational needs versus purchasing or developing the IT resource internally.

During the April 2023 meeting, the Board considered potential preparer burdens and user benefits of four reporting options that staff proposed in a cost-benefit analysis. The Board overwhelmingly supported developing guidance to require reporting entities to disclose cloud-service expenses. During the June 2023 meeting, the Board generally agreed with staff's recommended definition and scope language for the draft guidance.[1]

During the October 2023 meeting, the majority of members supported proposed guidance that would establish that reporting entities should apply existing liability and prepaid asset guidance to cloud-service arrangements and expense payments for cloud services as incurred. However, the Board had mixed opinions about whether guidance should require reporting entities to disclose information on cloud-service arrangements. Staff noted they would defer disclosure guidance proposals and focus on recognition guidance for the software-technology project topics.[2]

Staff notes that during the December 2023 meeting, the Board discussed responses to an Invitation to Comment (ITC) for the Reexamination of Existing Standards project. Per staff analysis of the ITC feedback, SFFAS 10, *Internal Use Software* guidance was ranked fourth and considered a top tier topic for reexamination. Additionally, several ITC

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[1] The Board's current working definition for a cloud-service arrangement states, "A cloud-service arrangement is a contract or agreement that provides a federal entity access to IT resources over a network, provided by a nongovernmental vendor in exchange for consideration, without the federal entity taking possession of the IT resource."

[2] See Attachment 2 for a summary of each previous Board meeting deliberation on cloud-service arrangements.

respondents requested that the Board address guidance for cloud computing, software licenses, shared services, and agile development methods, which are all currently part of the software technology project scope.[3]

Regarding this current Board meeting, staff received requests from some federal entities requesting clarification on whether to capitalize or expense implementations costs for cloud-service arrangements. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have both issued guidance on this topic and have taken different accounting positions. Therefore, staff believes the Board should consider issuing guidance on cloud-implementation costs to provide clarity and ensure accounting consistency among federal entities.

**Research**

For this session, staff coordinated with the working group and other stakeholders to research the types of upfront costs that federal entities incur to implement cloud services. Additionally, staff researched prior working group correspondence, internet articles, other standard-setter guidance, and the FASAB asset conceptual framework for developing the proposal in this issues paper. Staff specifically researched and analyzed the following documents for this issues paper:

- GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*, May 2020
- IFRS Interpretation Committee, *Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 Intangible Assets)*
- FASB Accounting Standards Update 2015-05, *Intangibles – Goodwill and Other Internal-Use Software (Subtopic 350-40), Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*
- FASB Accounting Standards Update 2018-15, *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*
- SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, December 26, 2007
- SFFAS 1, *Accounting for Selected Assets and Liabilities*, March 30, 1993
- SFFAS 10, *Accounting for Internal Use Software*, October 9, 1998

[3] The software technology project's overall objective is to address inconsistencies and gaps with current software-related accounting practices and to propose new guidance to address IT resources that have become prevalent throughout the federal government. Staff believes the ITC feedback shows that stakeholders support this effort.

- Technical Release 16, *Implementation Guidance for Internal Use Software*, January 19, 2016

Staff also spoke with staff from FASB and the International Public Sector Accounting Standards Board (IPSASB) to better understand the positions of each Board on its accounting guidance for cloud-implementation costs.

## RECOMMENDATION

This issues paper proposes the following options for accounting for implementation costs incurred as part of a cloud-service arrangement:

- Reporting entities should capitalize implementation costs for cloud-service arrangements in accordance with SFFAS 10 and amortize the asset over the estimated term of the associated cloud-service arrangement.

- Reporting entities should not capitalize implementation costs for cloud-service arrangements unless the implementation activities result in a distinct IUS asset, in accordance with SFFAS 10, independent of the associated cloud-service arrangement.

Staff requests that the Board provide feedback on the proposed guidance options.

## ANALYSIS

This analysis will describe the general characteristics of cloud-implementation costs, discuss FASB's and IASB's guidance on accounting for cloud-implementation costs, and explain staff's recommended approach.

### Characteristics of cloud-implementation costs

Several agencies incur implementation, configuration, setup, customization, or other upfront costs to acquire cloud services. [4] The purpose of the implementation costs are to prepare a cloud-service arrangement for use so that the cloud-based resource can function within the federal entity's environment and/or provide enhancement or customization to the service.

Most federal entities indicated that implementation costs are typically distinct from the fees incurred to receive the cloud service and often a different vendor provides the implementation services. The working group provided the following as examples of cloud-implementation costs:

- Application customization
- Cloud architecture consulting

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[4] Staff will refer to these collectively as "implementation" costs in this analysis.

- Controls and risk documentation
- Customized capabilities
- Cybersecurity
- Data conversion/migration
- Licensing
- Market/solution research
- Migration architecture analysis
- Network engineering
- Software coding and configuration
- System accreditation
- Workload segmenting
- Testing
- Training

Most federal entities that reported incurring implementation costs agreed that the costs typically represent a future economic or service benefit that the federal entity will realize as it uses the applicable cloud service. One federal entity described implementation costs as a necessity to make the cloud-service arrangement ready for use. Some federal entities indicated they do not incur implementation costs for cloud-service arrangements, but rather acquire and use cloud-services as provided by the vendor.

Several federal entities stated that if they incur significant implementation costs to use a cloud-service arrangement, then management typically expects to use that cloud service for a significant amount of time. For example, one IT representative stated that if the federal entity incurs significant implementation costs, management will try to use the applicable cloud service for at least 10 years for the investment to be worthwhile.

A few federal entities stated that implementation costs can sometimes result in a separate standalone software resource that the federal entity can control and use internally for purposes other than a particular cloud-service arrangement. Examples include zero-trust cybersecurity applications and business management applications that would have a useful life independent of a cloud-service arrangement. However, it appears more common that implementation activities do not represent a distinct software resource that is severable from a particular cloud-service arrangement.

**Other standard-setter guidance**

This section analyzes guidance that both FASB and IASB have issued on implementation costs for cloud-computing arrangements that are service contracts. This analysis does not consider GASB No. 96 because it applies the right-to-use asset framework to cloud-service arrangements, which this Board has tentatively chosen not to pursue.[5]

[5] Paragraph 29 of GASB No. 96 requires reporting entities to capitalize initial implementation costs for a subscription-based information technology arrangement (SBITA) right-to-use asset in accordance with the stage of the activity: preliminary project stage, initial implementation stage, and operation and additional implementation stage.

FASB

FASB initially issued Accounting Standards Update (ASU) No. 2015-05, *Intangibles – Goodwill and Other Internal-Use Software (Subtopic 350-40), Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. This amendment clarified that if a cloud-computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This required entities to expense recurring fees for cloud-computing arrangements as incurred, similar to what this Board has tentatively decided.[6]

A few years later, through an Emerging Issues Task Force project, FASB issued ASU No. 2018-15, *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*. This amendment provided guidance on accounting for implementation costs for a cloud-computing arrangement that is a service contract.

In summary, ASU No. 2018-15 aligned the requirements for capitalizing implementation costs incurred in a cloud-computing arrangement, that is a service contract, with the requirements for capitalizing implementation costs incurred to develop or purchase internal-use software (IUS).[7] The guidance requires customers of cloud services to determine which implementation costs to capitalize as an asset in accordance with existing IUS guidance.[8] According to the summary section, it appears the guidance intended to reduce diversity in practice among accounting for software resources.

Furthermore, in paragraph BC8 in ASU No. 2018-15, FASB provides reasons for capitalizing cloud-implementation costs by stating, "In a service contract, while the right to receive the service and the obligation to pay for the service as the service is provided are not recognized on the balance sheet, the Task Force observed that certain costs to implement the hosting arrangement enhance the unrecognized right to receive the related service. Accordingly, the Task Force decided that the implementation costs of a hosting arrangement that is a service contract could be attached to the service contract and, therefore, should be capitalized as an asset and recognized over a period longer than the period over which the implementation services are provided."

Additionally, paragraph BC9 in ASU No. 2018-15 analogized implementation costs for cloud-computing arrangements to a service-provider's perspective. Other FASB guidance that addresses accounting for contracts with customers allows contractors to record an asset for costs incurred to fulfill contracts with customers if the costs relate to

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[6] Staff plans to propose accounting options for software licenses for the Board's consideration at a future meeting.

[7] ASU No. 2018-15, paragraph 350-40-25-18 states, "An entity shall apply the General Subsection of this Section as though the hosting arrangement that is a service contract were an internal-use computer software project to determine when implementation costs of a hosting arrangement that is a service contract are and are not capitalized."

[8] FASB Codification section 340-40-25 provides expense and capitalization requirements for IUS based on the software lifecycle phase (i.e., preliminary project stage, application development stage, and post-implementation/operation stage).

a specific contract, are expected to be recovered, and generate or enhance resources that the provider will use in fulfilling the customer's contract.[9]

However, ASU No. 2018-15 included a dissent from two FASB Board members. In summary, the dissenting opinion believed that capitalizing the costs incurred for implementing a cloud-computing contract, that is a service contract, contradicts the FASB conceptual framework. The dissenters argued that implementation costs, in and of themselves, do not meet the definition of an asset on a standalone basis, independent of the associated cloud-computing contract.

The dissenting opinion questioned how costs to enhance or access a cloud-computing arrangement can represent future economic benefits if the actual access to the cloud arrangement itself does represent a future economic benefit. Also, the opinion stated that it is inconsistent to recognize a deferred implementation cost asset while ignoring the obligation to make future payments for the cloud service that is necessary to render the economic benefit of the capitalized implementation costs.

<u>IASB</u>

The IASB has not issued specific guidance on cloud computing. However, in 2021, the IASB ratified an IFRS Interpretations Committee agenda decision titled, *Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 Intangible Assets)*. This guidance acknowledges that cloud-service arrangements, specifically software as-a-service (SaaS) arrangements, are typically service contracts because they do not provide the customer exclusive control of the underlying resource.

This guidance also addresses whether to capitalize or expense configuration and customization costs for cloud-service arrangements. In the SaaS scenario, the interpretation stated that because the customer does not control the underlying software being configured or customized, those configuration and customization costs do not represent an asset separate from the software.

The interpretation notes that in some circumstances, the cloud-computing arrangement may result in an additional software resource for which the customer has the power to obtain the future economic benefits and restrict others' access to the benefits. In this circumstance, the customer should determine whether the software resource is identifiable and meets the asset recognition criteria in the IASB intangible asset guidance.

**Staff analysis**

Staff believes that cloud-implementation costs would not apply to the advance and prepayment asset accounting guidance in paragraphs 57-61 of SFFAS 1, *Accounting for Selected Assets and Liabilities*. The only exception being if the federal entity pays

[9] See FASB Codification section 340-40-25-5 for guidance on costs to fulfill a contract.

another entity before receiving the anticipated implementation services, just like other prepayments.[10]

Federal entities typically pay for the cloud-implementation costs as incurred through an exchange transaction. The difference is that federal entities do not receive the economic benefits or services of the implementation costs until a future period in which the federal entity begins using the related cloud service.

Staff believes that federal entities could theoretically apply cloud-implementation costs to the software life-cycle phases (i.e., preliminary design phase, software development phase, and post-implementation/operational phase) and other IUS guidance in paragraphs 10-34 of SFFAS 10 for determining capitalization and expense requirements. This is the approach that FASB ASU No. 2018-15 takes with implementation costs for cloud-computing arrangements that are service contracts.

However, staff shares some of the concerns with the FASB ASU No. 2018-15 dissent. Staff believes that recognizing an asset for implementation costs of a cloud-service arrangement, that is not recognized as an asset, would not conform to the existing FASAB asset conceptual framework.

Paragraph 22 of SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* states, “To be an asset of the federal government, a resource must possess two characteristics. First, it embodies economic benefits or services that can be used in the future. Second, the government controls access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities.”

Staff believes that cloud-implementation costs do typically represent costs to federal entities related to a resource for which they will receive the economic benefits or services in a future period. Basic asset concepts would support capitalizing these costs to recognize the expense in the future period in which the entity receives the economic benefits or services. This would result in a more accurate statement of net position and net cost each reporting period.

However, staff does not believe that federal entities control access to the economic benefits or services of the cloud-implementation costs if the benefits or services are not severable from the associated cloud-service arrangement.

Based on prior deliberations, the Board currently considers cloud-service arrangements as service contracts, not right-to-use assets. Therefore, from a conceptual standpoint, federal entities receive the economic benefits or services of a cloud-service arrangement simultaneously as the vendor provides the service. Therefore, the federal entity does not ever control access to the future economic benefits or services of the cloud-service arrangement.

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[10] Both FASB and IASB guidance distinguish cloud-implementation costs and service prepayments.

Similar to the FASB dissenting opinion, staff believes that the ability to control access of the future economic benefits or services of the implementation costs of a cloud-service arrangement is dependent on the ability to control access to the economic benefits or services of the actual cloud-service arrangement. Without obtaining control to access the benefits or services of the cloud-service arrangement, the federal entity does not control access to the economic benefits or services of the associated implementation costs. Therefore, staff believes that the implementation costs of a cloud-service arrangement alone do not represent an asset to the federal entity if receiving those economic benefits or services is dependent on execution of the associated cloud-service arrangement.

Staff has an additional concern with applying FASB's position on capitalizing implementation costs for cloud-computing arrangements that are service contracts, in the federal environment. It appears in paragraph BC9 of ASU No. 2018-15, FASB considered other FASB guidance, that addresses contracts with customers, in which contractors may record an asset for costs incurred to fulfill contracts with customers if the costs relate to a specific contract, are expected to be recovered, and generate or enhance resources that the provider will use in fulfilling the customer's contract. Staff does not believe this analogy is relevant to FASAB's asset framework since FASAB has not issued guidance related to asset recognition for costs incurred to fulfill service contracts with customers.

Furthermore, it appears to staff that this FASB guidance for contracts with customers is based on a service provider's perspective to match costs for enhancing a resource to fulfill a contract with the associated revenue from performing on the contract in future periods. Staff does not believe all recognition requirements would apply to cloud-service contracts from a customer perspective in the federal environment. For example, staff does not believe a federal entity, as a customer, would recover the implementation costs over the term of the cloud-service arrangement.

<u>Working group input</u>

Most working group members preferred not to capitalize implementation costs for cloud-service arrangements unless the implementation activities result in a distinct IUS asset, in accordance with SFFAS 10, independent of the associated cloud-service arrangement. This is the option more in-line with IASB guidance.

Most federal entities thought that capitalizing implementation costs for cloud-service arrangements would not align with the asset conceptual framework and would be inconsistent with expensing the associated cloud-service payments as incurred. Additionally, some federal entities noted the increased resources that management would need to identify the implementation costs of cloud-service arrangements for capitalization requirements and did not believe there would be any benefit to doing so. Some federal entities raised concerns with the difficulty in estimating the useful life of the cloud-service arrangement for which to amortize the capitalized implementation costs due to the general short and variable nature of cloud-service terms.

A few federal entities and a few non-federal stakeholders preferred to capitalize implementation costs for cloud-service arrangements in accordance with SFFAS 10 and amortize the asset over the estimated term of the associated cloud-service arrangement. This is the option more in-line with FASB guidance.

These respondents agreed with the benefits of capitalizing the implementation costs to standup a new cloud-service arrangement and spread the expense over the reporting periods in which the federal entity benefits from the implementation costs. One federal IT professional thought it would be beneficial if the capitalization requirement led to better acquisition practices and cost transparency with cloud-service arrangements.

The non-federal stakeholders also commented that federal entities should look to align with what FASB requires of private entities. The respondents believe that federal entities should provide more accountability and transparency around all costs related to cloud services as they become more common and ingrained in federal IT infrastructure.

Staff recommendation

Staff recommends that reporting entities should not capitalize implementation costs for cloud-service arrangements unless the implementation activities result in a distinct IUS asset, in accordance with SFFAS 10, independent of the associated cloud-service arrangement. This recommendation is primarily based on the conceptual framework concerns previously discussed.

Working group input indicates it is possible, but not common, for cloud-implementation costs to result in a distinct IUS asset. The proposed guidance would require reporting entities to apply judgment in determining if cloud-implementation costs result in a standalone IUS asset that is within scope of SFFAS 10, paragraphs 2-3. If management determined that the implementation costs do result in an IUS asset, they would apply the reporting requirements of SFFAS 10. No working group member noted any concern or difficulty with this requirement. One working group member particularly stated that SFFAS 10 was currently sufficient for this scenario.

This recommendation however would primarily establish that federal entities generally should not capitalize implementation costs associated with cloud-service arrangements. Staff believes the recommended approach would ensure accounting consistency among federal entities and would conform with the FASAB conceptual framework.

**Questions for the Board:**

1. Does the Board have any questions or comments on staff's analysis?

2. Does the Board agree with staff's recommendation that reporting entities should not capitalize implementation costs for cloud-service arrangements unless the implementation activities result in a distinct IUS asset, in accordance with SFFAS 10, independent of the associated cloud-service arrangement?

**Next steps**

Pending Board feedback, staff plans to present financial statement recognition options on software licenses for the Board's consideration at a future meeting. Staff will coordinate with the working group and other stakeholders to research characteristics of perpetual and term-based software licenses that federal entities acquire for both on-premise systems and through cloud-service arrangements.

# Prior Board Meeting Discussions Timeline

## February 2022

At the February 2022 meeting, staff presented an issues paper that provided a framework for developing reporting guidance updates for software technology assets. Specifically, the issues paper recommended a scope and project plan for developing updates for software guidance based on specific needs identified during research. The scope consists of four major categories of software resources that staff plans to address individually in the following order:

1. Cloud-service arrangements
2. Shared services
3. Internal use software updates
4. Other software technology

The Board overwhelmingly supported staff's recommended scope and planned approach. Additionally, members supported staff's approach of addressing each scope category separately but noted that the categories would ultimately overlap and relate to one another.

The Board decided to first focus on reporting-guidance needs for cloud-service arrangements. Research indicated that federal entities are using cloud services at an increasing rate for operational purposes similar to internally developed software, generally due to the need for less investment risk and more flexibility to alter the amount and type of services received based on current needs. Therefore, it is critical to address reporting guidance for this commonly used software-technology resource to ensure reporting consistency throughout the federal government.

## April 2022

At the April 2022 meeting, staff presented characteristics of cloud-service arrangements along with an asset-guidance framework for which to apply the characteristics. The framework analyzes previous asset-guidance decisions that will assist the Board when deliberating whether cloud-service arrangements can represent assets in the federal government. There were three primary takeaways from the discussion:

- The National Institute of Standards and Technology's (NIST) cloud-computing characteristics are widely accepted and used in the federal government.
- Based on the asset-guidance framework, it is appropriate to approach cloud-service arrangements as lease-type transactions that provide a federal entity

access to a provider's software technology resources for the federal entity to use as internal use software for a specified period.

- More research and outreach is needed to develop an informed decision on whether cloud-service arrangements can meet all of the essential characteristics of an asset established in SFFAC 5, Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.

The Board generally supported using the NIST's cloud-computing characteristics for developing financial reporting guidance for cloud-service arrangements. Several members agreed with staff's observation that federal entities widely use the NIST cloud-computing characteristics and that it is practical to defer to the information technology (IT) professionals when describing cloud-service arrangements.

The Board generally agreed with staff's proposed asset-guidance framework and observation that it is particularly important to continue to research and deliberate whether cloud-service arrangements can meet the essential characteristics of an asset from SFFAC 5. Some members noted that for an asset to exist, the cloud-service arrangement must represent economic benefits and services that the federal government can use in the future. Other members stated that it is critical to determine whether a consumer of a cloud service could control access to the economic benefits and service of the underlying resource and, particularly, if the user could deny or regulate access to others in accordance with the arrangement.

**June 2022**

At the June 2022 meeting, two panelists from the General Services Administration (GSA) provided the Board an educational session on cloud-service arrangements. The panelists provided members an overview of the characteristics, service models, and deployment models of cloud computing and discussed ways that federal entities procure and pay for cloud services. Additionally, Board members, staff, and panelists discussed potential financial reporting needs and challenges associated with cloud-service arrangements.

**August 2022**

During the August 2022 meeting, the Board continued deliberations on reporting guidance for cloud-service arrangements. Staff presented an issues paper that proposed:

- A framework of cloud-service arrangements that could meet the essential characteristics of an asset for financial reporting purposes

- Potential benefits and challenges of reporting cloud service arrangements as assets in federal financial reports

The Board generally supported staff's analysis on whether certain cloud-service arrangement categories could meet the SFFAC 5 essential characteristics of an asset. Some members recommended more research to better understand how federal entities typically incur costs for long-term cloud-service arrangements. One member recommended more research and deliberation on whether cloud-service arrangements are typical service contracts or if they are more akin to leases or right-to-use assets. Another member recommended consideration of how other standard-setters made their determinations on asset reporting for cloud-service arrangements.

The Board also generally agreed with staff's analysis on the user benefits and preparer challenges with reporting cloud-service arrangements as assets in federal financial reports. One member stated that the identified reporting challenges were valid but thought that they could be overcome with proper guidance. A few members suggested further research and deliberation on the financial reporting benefits with note disclosure options versus asset recognition in financial statements. One member added that it was important to continue to seek out a wide range of federal financial report users that have an interest in cloud-service arrangement reporting.

**October 2022**

During the October 2022 meeting, the Board continued deliberations on reporting guidance for cloud-service arrangements. Staff presented an issues paper that:

- Analyzes how other standard-setting bodies have deliberated the differences between a service contract and a right-to-use asset, along with how those positions have influenced their cloud-service reporting guidance; and

- Examines FASAB's previous discussions of tangible right-to-use assets and service contracts and analyzes whether cloud-service arrangements in the federal environment resemble right-to-use assets or service contracts.

The Board had different opinions on whether multi-year cloud-service arrangements were right-to-use assets or service contracts. One member favored referring to cloud-service arrangements as service contracts because it was difficult to conceive how an entity could exclude others from using an intangible right-to-use asset. Another member stated that cloud services and other types of service contracts possessed a spectrum of right-to-use asset and service components and was concerned that deciding cloud-service arrangements are right-to-use assets could open the door to considering whether other types of service contracts include right-to-use assets.

Several members agreed it was reasonable to conceptualize cloud-service arrangements as right-to-use assets but were concerned that the associated preparer burden and lack of reporting benefits may not justify the need for asset recognition on the balance sheet. The members suggested that disclosures could adequately provide information about the extent that federal entities use cloud-services for mission and operational needs versus purchasing or developing the IT resource internally.

**April 2023**

At the April 2023 meeting, staff presented a cost-benefit analysis that considered potential preparer burdens and user benefits for the following financial reporting options for cloud-service arrangements:

1. Balance sheet recognition
2. Commitment disclosure
3. Expense disclosure
4. Expense recognition only

The Board overwhelmingly agreed with the cost-benefit analysis and supported staff's recommendation that reporting guidance should require federal entities to disclose cloud-service expenses. Most members agreed that expense disclosure was optimal after considering the potential preparer burdens and user benefits of each reporting option. Additionally, the majority of members initially favored disclosing cloud-service expenses in required supplementary information rather than financial statement notes.

**June 2023**

At the June 2023 meeting, staff recommended definition and scope language for the Board's consideration in developing cloud-service arrangement standards. The purpose of the definition is only to inform readers about cloud-computing resources in the federal environment that the standards will address. However, the purpose of the scope is to provide authoritative guidance by explaining the economic transactions associated with cloud-service arrangements that would and would not apply to the standards.

The Board generally agreed to include the cloud-computing definition developed by the National Institute of Standards and Technology (NIST) Special Publication 800-145, The NIST Definition of Cloud Computing, in the draft reporting guidance proposal. The Board generally agreed that the NIST definition along with a reference to the special publication thoroughly explains cloud-computing resources and including the definition in the standards would help readers understand the reporting guidance. Two members voiced concern that the NIST definition was detailed and technical and, therefore, may not be the most effective definition for financial reporting guidance. One member generally preferred to use a more generic and broad definition to provide flexibility in the reporting guidance.

The Board also generally agreed to include staff's recommended scope language in the draft reporting guidance proposal. The scope includes the following guidance:

- A cloud-service arrangement is defined as a contract or agreement that provides a federal entity access to IT resources over a network, provided by a vendor in exchange for consideration, without the federal entity taking possession of the IT resource.

- The Statement applies to cloud services that federal entities acquire from nongovernmental vendors for internal use purposes in accordance with paragraph 2 of SFFAS 10, Accounting for Internal Use Software, as amended.

- The Statement does not apply to

    - cloud-based IT services acquired from other federal entities (such as, but not limited to shared services);

    - internally developed or purchased commercial off-the-shelf software that is reported in accordance with SFFAS 10 and TR 16, Implementation Guidance For Internal Use Software;

    - licensed software that allows the federal entity to possess and control the underlying software resource on its own hardware or systems that is reported in accordance with SFFAS 10 and TR 16; or

    - arrangements that provide the federal entity the right to control the use of property, plant, and equipment that is reported in accordance with SFFAS 54, Leases, as amended.

The Board generally agreed that the Board should revisit the definition and scope if a need arises while deliberating reporting requirements. Staff recommended that the Board eventually consider if the scope should also include shared services.

**October 2023**

At the October 2023 meeting, the Board deliberated financial statement recognition and note disclosure requirements for cloud-service arrangements.

The proposed recognition guidance would establish that reporting entities should apply existing liability and prepaid asset guidance to cloud-service arrangements and expense payments for cloud services as incurred. Additionally, the proposed guidance would require reporting entities to disclose total annual cloud-service expenses along with a general description, terms and conditions, and risks and benefits of significant cloud-service arrangements in financial statement notes.

The Board generally supported the proposed recognition guidance but preferred the guidance to directly reference existing liability and prepaid asset recognition requirements in SFFAS 1, Accounting for Selected Assets and Liabilities. The Board had mixed opinions about whether the guidance should require reporting entities to disclose information on cloud-service arrangements.

Some members supported the requirements to disclose annual cloud-service expenses along with some of the proposed qualitative information on significant cloud-service arrangements. The members viewed cloud services as significant to federal IT spending and supported a forward-looking approach with issuing reporting guidance to address a fundamental change with how federal agencies use software technology resources.

However, some members did not support any of the proposed note disclosure requirements because they viewed the requirements as too burdensome relative to the benefits. The members questioned why the Board would require the note disclosures for cloud-service arrangements when the Board does not require reporting that level of information for other service contracts.

Some members did not believe that annual cloud-service costs would ever be material relative to what the federal government spends each year. Other members acknowledged that may be true for government-wide and some component entity financial reports. However, the members believed that the information would be useful to some stakeholders and thought it beneficial for reporting entities to have the reporting guidance to apply if cloud-service arrangements are determined by a reporting entity to be qualitatively or quantitatively material now or in the future.

For now, staff will defer disclosure guidance proposals and focus on recognition guidance needs for the software-technology project topics.