

Memorandum

Software Technology

August 1, 2024

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

INTRODUCTION

At the April 2024 meeting, the Board deliberated accounting for implementation costs associated with cloud-service arrangements. The attached issues paper discusses a framework for the Board to apply when deliberating software license recognition guidance at a future meeting. Staff is requesting the Board's feedback on the recommended framework.

REQUEST FOR FEEDBACK BY August 15, 2024

Prior to the Board's August meeting, please review the attached issues paper and respond to the questions by August 15, 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 continue to coordinate with the working group and other stakeholders to research costs and benefits of financial statement recognition options for software licenses.

ATTACHMENTS

1. Issues Paper
2. Prior Board Meeting Discussions Timeline

Issues Paper

Software Technology

August 1, 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, some members thought it reasonable to conceptualize cloud-service arrangements as right-to-use assets. However, they were concerned that the preparer burden and lack of reporting benefits may not justify the need for asset recognition. The members suggested that disclosures could adequately provide information about 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During the June 2023 meeting, the Board generally agreed with staff's recommended definition and scope language for the draft guidance.

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.

At the April 2024 meeting, the majority of members agreed that reporting entities should not capitalize implementation costs for cloud-service arrangements unless the implementation activities result in a distinct internal use software asset, in accordance with SFFAS 10, *Accounting for Internal Use Software*, independent of the associated cloud-service arrangement. Staff indicated they would next research software licenses to present financial statement recognition options for Board consideration.¹

¹ See Attachment 2 for a summary of each previous Board meeting deliberation on cloud-service arrangements.

Research

For this session, staff coordinated with the working group and other stakeholders to research characteristics of software licenses that federal entities acquire for internal use. Additionally, staff researched prior working group correspondence, the FASAB reexamination project invitation to comment (ITC) responses, internet articles, and other standard-setter guidance, for developing this issues paper. Staff specifically researched and analyzed the following documents for this issues paper:

- GAO-24-105717, *Federal Software Licenses: Agencies Need to Take Action to Achieve Additional Savings*, Jan. 29, 2024
- 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)*
- IPSAS 31, *Intangible Assets*, January 2010
- 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*
- National Institute of Standards and Technology, *The NIST Definition of Cloud Computing*, Special Publication 800-145, September 2011
- SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, December 26, 2007
- SFFAS 10, *Accounting for Internal Use Software*, October 9, 1998
- Technical Release 16, *Implementation Guidance for Internal Use Software*, January 19, 2016
- Technical Release 23, *Omnibus Technical Release Amendments 2024: Conforming Amendments to Technical Releases 10, 16, 20, and 21*
- U.S. Senate: Committee on Homeland Security and Governmental Affairs, Report 118-73, *Strengthening Agency Management and Oversight of Software Assets Act*, July 25, 2023

Staff also spoke with Federal Accounting Standards Board (FASB) staff and International Public Sector Accounting Standards Board (IPSASB) staff to understand the current guidance of each Board on its accounting for software licenses.

RECOMMENDATION

This issues paper recommends a framework for the Board to apply when deliberating software license recognition guidance at a future meeting. Staff requests the Board's feedback on the recommended framework.

ANALYSIS

This analysis will address the following:

1. Characteristics of software licenses
2. History of FASAB guidance
3. Stakeholder guidance needs
4. Review of other standard-setter guidance
5. Guidance framework

Staff has included working group and other stakeholder input throughout the analysis.

1. Characteristics of software licenses

Copyright License Background

A copyright is a type of intellectual property that protects original works of authorship as soon as an author fixes the work in a tangible form of expression.² A "work", as defined in the U.S. Copyright Act, can include literary works, choreography, films, music, computer programs and code, plays, sculptures, paintings, and architecture.³ A copyright license is a contract between the copyright owner and the third party who wishes to use the copyrighted work. Generally, a copyright license permits certain uses for a certain period of time. The range of permitted uses may be broad or narrow; the time period may be limited or expansive.⁴

Research and working group feedback indicate that many federal entities acquire perpetual and term-based software licenses for internal use.⁵ Perpetual licenses typically require one upfront payment that allows the federal entity to use the software indefinitely. Term-based software licenses allow a federal entity to use the licensed

² [What is Copyright? | U.S. Copyright Office](#)

³ [17 USC 101: Definitions \(house.gov\)](#)

⁴ [What is Copyright Licensing? | Winston & Strawn Legal Glossary | Winston & Strawn](#)

⁵ SFFAS 10, par. 2 provides the scope of internal use software.

software for a defined period of time in accordance with the license agreement. Federal entities typically renew term-based software licenses on an annual basis. Some license agreements simply terminate or renew year-to-year and some license agreements include one base year with 3-5 option years that a federal entity may exercise annually.

Research indicates that the use of the term “software license” varies in practice and can denote a wide range of uses and levels of control over the underlying software resource. A recent GAO performance audit report on software licenses analyzed data specifically on software licenses installed on federal entity owned or controlled computers.⁶ Federal entities also reported to staff that they acquire software licenses to install and control the underlying software on its own IT hardware.

Software License Examples

The working group provided the following as examples of software licenses used at their federal agencies (descriptions were either provided by working group or retrieved from product websites):

Adobe Acrobat Pro - software allows users to convert paper documents into searchable, electronic PDF files, to turn paper forms into fillable PDF forms, and to edit existing PDF documents

BMC Remedy – provides IT service management solutions related to workflow automation, access management, and data analysis

EcoDomus - creates virtual copies of buildings and infrastructure assets for remote analytics and decision making. Uses Building Information Modeling to create digital building twins that make design and construction data available for building operations and maintenance

ForgeRock - helps organizations manage access and identity governance

Jaspersoft - customizable reporting and analytics platform that helps users design, manage, embed, and deploy data visualizations, dashboards, and reports

Java SE - Java offers the user interface, performance, versatility, portability, and security that today's applications require.

Jira - project management tool that helps teams plan, track, and collaborate work

JetBrains IntelliJ IDEA – payment management software

HashiCorp Vault - provides organizations with identity-based security to automatically authenticate and authorize access to data

⁶ GAO-24-105717, *Federal Software Licenses: Agencies Need to Take Action to Achieve Additional Savings*, Jan 29, 2024, pg. 2

HashiCorp Terraform - provides organizations with a single workflow to provision their cloud, private datacenter, and SaaS infrastructure and continuously manage it throughout its lifecycle

Kodak Scanner - to keep agency scanners functioning

ManageEngine - helps teams manage IT operations, including networks, servers, applications, service desk, active directory, security, desktops, and mobile devices

Microsoft Office 365 - include the client installation of Outlook, Word, Excel, PowerPoint, OneNote, and Access

Microsoft Project - project management tool that helps organize, plan, and manage projects

Microsoft SQL - software product with the primary function of storing and retrieving data as requested by other software applications

Microsoft Vizio - a diagramming and vector graphics application

Momentum - a web-based system built to support the federal financial, budget, asset, and procurement management lifecycles

MOVEit - encrypts files and uses file transfer protocols to transfer data, as well as providing automation services, analytics, and failover options

MySQL Enterprise - Comprehensive features, tools, and technical support to achieve scalability, security, reliability, and uptime

Red Hat - Support application deployments—from on premise to the cloud to the edge—in a flexible operating environment

RSMean - designed for professionals who need a greater depth of data and the ability to analyze historical costs

Oracle Database Enterprise Solutions - Provides performance, availability, scalability, and security required for mission-critical applications such as high-volume online transaction processing applications, query-intensive data warehouses, and demanding Internet applications.

Oracle Data Integrator - Software package that enables scalable data integration in heterogeneous data environments

Oracle Hyperion - centralized planning, budgeting, and forecasting solution that integrates financial and operational planning processes and improves business predictability

Oracle Identity and Access Management Suite - Scalable identity governance, access management and directory services

Oracle Primavera - Project management software

Oracle Session Border Controller - helps entities deliver trusted, carrier-grade real-time communications services across Internet Protocol network borders.

Oracle WebLogic Suite - ecommerce online transaction processing platform, to connect users in distributed computing production environments and facilitate the integration of mainframe applications with distributed corporate data and applications.

O'Reilly Online Learning Subscription - Software used for troubleshooting SQL database log issues

Sales Force Tableau – an analytics platform that manages and analyzes data

Splunk Enterprise & Splunk IT Service Intelligence - Supports Enterprise log management, analysis, & cybersecurity

Stata - a general-purpose statistical software package for data manipulation, visualization, statistics, and automated reporting

Sublime Text - a text editor for code, markup, and prose

TreeSize - assists with analyzing and managing storage systems and usage

VMware - virtualization software that creates an abstraction layer over computer hardware that allows the hardware elements of a single computer to be divided into multiple virtual computers, commonly called virtual machines

Zixmail - desktop email encryption solution that provides individuals with a high level of security in their email communications

Additionally, the previously mentioned GAO report states that federal agencies paid the following vendors the highest amounts for software licenses: Microsoft, Adobe, Salesforce, Oracle, International Business Machines, VMware, Cisco, and McAfee.⁷

SaaS Characteristics

Working group feedback has indicated that the term “software license” is also used to describe software that federal entities temporarily access through cloud-based software as a service (SaaS) arrangements. The Board’s working definition for a cloud-service arrangement states, “A cloud-service arrangement is a contract or agreement that

⁷ GAO-24-105717, Figure 2, pg. 19

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.”

The National Institute of Standards and Technology (NIST) defines SaaS arrangements as “The capability provided to the consumer is to use the provider’s applications running on a cloud infrastructure. The applications are accessible from various client devices through either a thin client interface, such as a web browser (e.g., web-based email), or a program interface. The consumer does not manage or control the underlying cloud infrastructure including network, servers, operating systems, storage, or even individual application capabilities, with the possible exception of limited user-specific application configuration settings.”⁸

Research and working group feedback indicates that federal agencies acquire both on-premise software licenses and cloud-based SaaS arrangements for the same operational and mission purposes. The differences revolve around which party hosts the software, as well as pricing, term, and management flexibility advantages and disadvantages of each.

Furthermore, there is a current trend with federal entities acquiring more software through the cloud. Some working group members stated that their federal agency policy is to migrate software from on-premise to the cloud whenever possible. However, research and working group feedback indicates that all forms of software licenses, as described in this section, still exist in the federal environment.

2. History of FASAB guidance

This section of the issues paper provides a timeline and summary of key FASAB guidance issuances for software licenses.

SFFAS 10

In 1998, FASAB issued SFFAS 10 to address accounting for internal use software but did not address software licenses in the authoritative guidance. However, the basis for conclusions analogized software licenses to lease accounting concepts in the following:

66. One respondent asked for guidance on accounting for licenses for COTS software. The Board had not discussed software licenses during its deliberations leading up to the publication of the ED. Software licenses can cover periods ranging from the entire estimated service life of the software (a “perpetual” license) to annual or more frequent periods and are similar to leases of general PP&E.

67. The Board believes that it would be appropriate for the federal entity to apply lease accounting concepts and the entity’s existing policy for capitalization thresholds and for

⁸ Previous FASAB deliberations on cloud-service arrangements, based on GASB Statement No. 96, included a broader range of cloud-service arrangements, such as infrastructure as a service (IaaS) and platform as a service (PaaS).

bulk purchases to licenses. Immaterial costs would be expensed, but the entity should consider whether period costs would be distorted by expensing the license.

Paragraph 67 refers to the prior capital lease guidance in SFFAS 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant, and Equipment*.

TR 16

In 2016, FASAB issued Technical Release (TR) 16, *Implementation Guidance for Internal Use Software*. The TR provided the following level C guidance for software licenses, including software licenses as part of cloud-computing arrangements and shared services:

26. Software License: *If the term of software license(s) is 2 years or more with periodic payments, the license should be evaluated against lease criteria as stated in SFFAS 5 paragraphs 43-46 and SFFAS 6 paragraph 20 to determine if it is a capital or operating lease. If the license(s) is perpetual with an upfront cost⁹ to use the software for its entire lifetime, then the entity is purchasing IUS and should apply its existing policy for capitalization thresholds to determine if the license should be capitalized or expensed.*

Footnote 9 - The cost could be charged as a one-time payment or financed over a set period of time.

27. *A license agreement may include executory costs for maintenance and technical support. Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts may be derived from the payment schedule contained in the license agreement. As stated in SFFAS 5, if the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated. Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, for example, initial license, maintenance, and enhancement.*

29. *If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in SFFAS 5 and SFFAS 6, and as discussed in paragraph 26 of this TR. SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license.*

32. *If the shared service arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of their other software licenses, as discussed in paragraph 26 of this TR. SFFAS 10 is not applicable to a shared service arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license.*

SFFAS 54 and TR 20

In 2018, FASAB issued SFFAS 54, *Leases* that rescinded the existing capital lease guidance in SFFAS 5 and SFFAS 6 that TR 16 referenced for software licenses. SFFAS 54 applies a new right-to-use asset framework to leases. However, paragraph 5.b. of SFFAS 54 specifically scopes out software licenses. Accordingly, FASAB issued TR 20, *Implementation Guidance for Leases* that rescinded all the software license guidance in TR 16, creating a gap in software license guidance.

In 2020, the Board considered issuing a Technical Bulletin to address the gap in software license guidance. However, the Board decided to forgo that effort after members determined that SFFAS 10 was insufficient at comprehensively addressing the scope of software license (and other software-related) accounting issues that agencies encounter in the current environment and decided to explore undertaking projects on intangible assets and subscription-based informational technology arrangements (SBITA) on its technical agenda.⁹ This decision ultimately led to the ongoing intangible assets project and software technology sub-project.

TR 23

In July 2024, the Board issued TR 23, *Omnibus Technical Release Amendments 2024: Conforming Amendments to Technical Releases 10, 16, 20, and 21*. This TR restored prior TR 16 guidance for perpetual software licenses, including perpetual software licenses part of cloud-computing arrangements and shared services, that TR 20 had previously rescinded.

The Accounting and Auditing Policy Committee (AAPC) determined that while TR 20 had appropriately amended TR 16 to remove software license guidance that applied to the now rescinded capital lease guidance, TR 20 also removed guidance for perpetual software licenses that was based on SFFAS 10. The AAPC concluded it was prudent to restore prior perpetual software license guidance in TR 16 while the Board progresses through the software technology project so that the gap in software license guidance is not greater than it needs to be in the meantime.

3. Stakeholder guidance needs

Stakeholders have requested additional guidance for software licenses for several years. This section of the issues paper will provide a summary of the feedback that staff has received regarding software license guidance.

Intangible Assets Research Topic

The Board's intangible assets research showed that stakeholders acquire both perpetual and term-based software licenses. The research also indicated that there are

⁹ FASAB Material Tab C, *Software Licenses*, May 29, 2020

inconsistent recognition practices amongst federal reporting entities regarding software licenses due to outdated and general lack of Board guidance on the topic.¹⁰ For example, one federal entity specifically requested guidance on bulk license purchases, useful life for licenses, and multi-year licenses.

Reexamination ITC

During the December 2023 meeting, the Board discussed responses to an ITC for the Reexamination of Existing Standards project. Per staff analysis of the ITC feedback, SFFAS 10 guidance ranked fourth and placed as a top tier topic for reexamination.¹¹

Several ITC respondents specifically requested that the Board address accounting guidance for perpetual and term-based software licenses, including software licenses part of cloud-service arrangements. Some respondents specifically noted the gap in FASAB software license guidance due to the issuance of SFFAS 54.

One respondent requested the Board also provide guidance for bundled services, maintenance, enhancements, and implementation costs for software licenses. Another respondent requested that the Board consider issuing guidance on cloud-service arrangements and software licenses before completing the entire software technology project, highlighting stakeholder needs for guidance addressing these topics.

TR 23 Exposure Draft Comments

As stated previously, the Board recently issued TR 23 to restore prior TR 16 guidance for perpetual software licenses. During the exposure period for this TR, staff received informative comments requesting additional guidance around perpetual and term-based software licenses.¹²

Some respondents requested guidance to define software license terms, address development costs, and provide clarity around maintenance and technical support costs associated with software licenses. A few respondents specifically requested additional guidance on how to account for term-based software licenses.¹³

4. Review of other standard-setter guidance

This section of the issues paper provides a summary of software license guidance issued by other GAAP standard-setters.

¹⁰ FASAB Board Material, *Topic D-Intangible Asset Research*, June 7, 2021, <https://fasab.gov/june-22-23-2021-briefing-materials/>

¹¹ FASAB Board Material, *Topic A-Reexamination of Existing Standards*, November 30, 2023, <https://fasab.gov/board-activities/prior-calendar-years/december-12-13-2023-briefing-materials/>

¹² The AAPC noted in the exposure draft executive summary that further modifications and enhancements to internal use software guidance were under research and development as part of the Board's software technology project.

¹³ TR 23, paragraphs A10-A11

GASB

GASB Statement No. 96 provides accounting guidance for a “contract that conveys control of the right to use another party’s (a SBITA vendor’s) information technology (IT) software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction.”¹⁴ This guidance appears to apply to term-based cloud-service arrangements that entities acquire on a subscription basis, whether or not the arrangement provides a temporary software license to install the underlying software.¹⁵

However, GASB Statement No. 96 specifically scopes out perpetual software licenses that provide title to and allows an entity to use a vendor’s computer software indefinitely.¹⁶ The guidance states that perpetual software licenses are within the scope of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*.¹⁷

FASB

FASB’s intangible asset guidance applies to software licenses.¹⁸ Additionally, FASB guidance separates accounting for software licenses from cloud-service arrangements.

FASB ASU 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*, defines a hosting arrangement as “In connection with accessing and using software products, an arrangement in which the customer of the software does not currently have possession of the software; rather, the customer accesses and uses the software on an as-needed basis.”

Furthermore, FASB guidance states that the intangible asset scope only applies to software that an entity accesses as part of a hosting arrangement if the arrangement provides the entity (1) the contractual right to take possession of the software at any time during the hosting period without significant penalty, and (2) it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.¹⁹ Accordingly, the guidance states “Hosting arrangements that do not meet this criteria are service contracts and do not constitute a purchase of, or convey a license to, software.”²⁰

¹⁴ GASB Statement No. 96, paragraph 6

¹⁵ GASB Statement No. 96, paragraph B14

¹⁶ GASB Statement No. 96, paragraphs 1 and B7

¹⁷ GASB Statement No. 96, paragraph 4.d

¹⁸ FASB Codification, paragraph 350-40-25-17

¹⁹ FASB Codification, paragraph 350-40-15-4A

²⁰ FASB Codification, paragraph 350-40-15-4C

This guidance separately scopes cloud computing as a service contract from the more traditional software license that a customer can install on their own computer. It is staff's understanding that FASB does not currently plan to update any guidance around hosting arrangements or software licenses as part of its active software project.

IPSASB

Neither the International Accounting Standards Board (IASB) nor IPSASB have issued guidance specifically for cloud-service arrangements or software licenses. However, IASB issued IFRS Interpretation Committee, *Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 Intangible Assets)* that asserts that SaaS arrangements provide a customer the right to receive access to the provider's application software and typically represents a service contract, not a software asset. Additionally, the scope of IPSAS 31, *Intangible Assets*, applies to software licenses.²¹

The IFRS Interpretation Committee has further deliberated addressing whether SaaS arrangements represent intangible assets like traditional software licenses that the customer can take possession of.²² However, staff is not aware that the Board is currently planning to address accounting guidance for SaaS arrangements.

5. Guidance framework analysis

This section of the issues paper provides a framework to address recognition guidance for software licenses based on a GAAP comparison, working definitions, and scope.

GAAP Comparison

Per sections 2 and 4 of this issues paper, FASAB, GASB, FASB, and IPSASB provide varying levels of accounting guidance for software licenses through different pronouncements. The following chart depicts the applicable guidance of each standard-setter.

(Chart on following page)

²¹ IPSAS 31, paragraph 17

²² IAS 38 — Cloud computing arrangements (iasplus.com)

Standard-setter Comparison of Software License Guidance

FASAB	<ul style="list-style-type: none"> • TR 16, <i>Implementation Guidance for Internal Use Software</i>, provides limited guidance for perpetual software licenses
GASB	<ul style="list-style-type: none"> • Statement No. 96, <i>SBITAs</i>, applies to term-based software licenses • Statement No. 51, <i>Intangible Assets</i>, applies to perpetual software licenses
FASB	<ul style="list-style-type: none"> • ASC 350-30 <i>General Intangibles other than Goodwill</i>, applies to software licenses
IPSASB	<ul style="list-style-type: none"> • IPSAS 31, <i>Intangible Assets</i>, applies to software licenses

FASAB has never addressed software licenses through level A guidance but has provided some guidance for perpetual and term-based software licenses through TR 16. However, since SFFAS 54 became effective, TR 16 currently provides limited guidance for only perpetual software licenses.

The GASB framework is unique because Statement No. 96 applies lease-based right-to-use asset guidance to both cloud-service arrangements and term-based software licenses. If FASAB had decided to adopt the GASB Statement No. 96, separate deliberations on term-based software licenses would likely not have been necessary. However, after multiple meetings of deliberation, the Board generally agreed to not adopt the GASB Statement No. 96 framework for cloud-service arrangements. Therefore, staff believes the Board should now consider guidance to specifically address software licenses.

Both FASB and IPSASB provide accounting guidance for software licenses in their intangible assets guidance.²³ This is not currently an option for FASAB because the Board has not issued intangible assets guidance. Staff believes that not having a broad intangibles asset framework to apply to software licenses is disadvantageous because it limits the Board's options for addressing guidance needs. However, staff believes it is possible to address software license guidance within the internal use software framework.

Working Definitions and Scope

Staff and the working group developed the following working definitions based on the characteristics of software licenses discussed in section 1 of this issues paper.

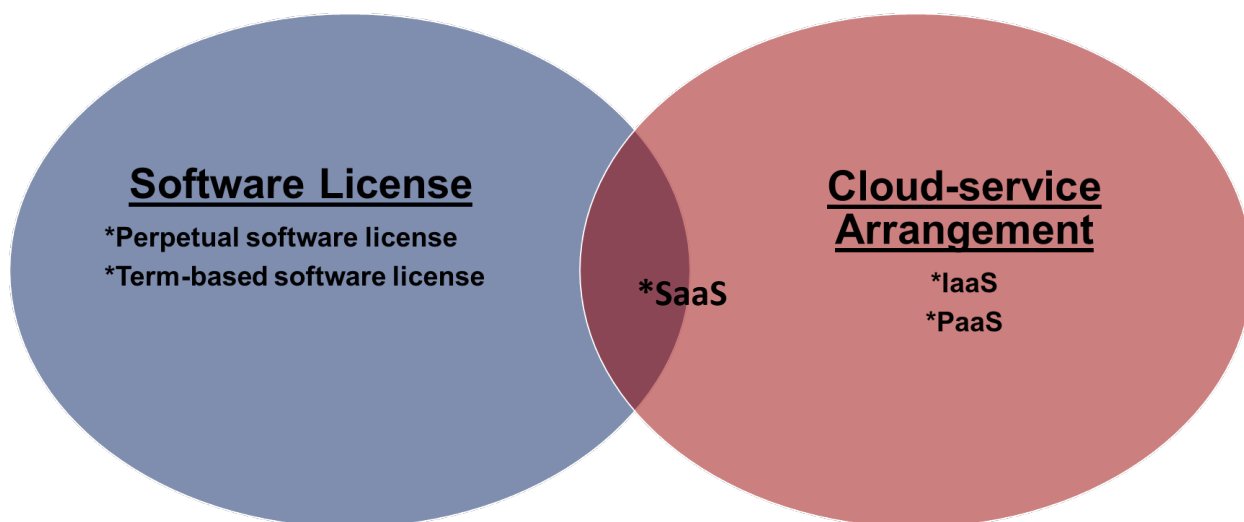
²³ As well as GASB for perpetual software licenses.

Software License Working Definitions

Software license	<ul style="list-style-type: none"> A software license is a legal instrument that provides a federal entity the right to use a software resource under specific terms and conditions. Software licenses allow the federal entity to install and control the underlying software on its own IT hardware. This term does not apply to software that federal entities access over a network on a hosted platform as part of cloud-based software as a service (SaaS) arrangements.
Perpetual software license	<ul style="list-style-type: none"> A perpetual software license is a non-expiring license that provides a federal entity the right to use a software resource indefinitely.
Term-based software license	<ul style="list-style-type: none"> A term-based software license is a temporary license that provides a federal entity the right to use a software resource for a specified period.

For recognition guidance deliberations, staff believes a key scope distinction between software licenses and cloud-service arrangements is whether an entity is receiving a service or has control of an asset. The suggested working definition of software license clearly distinguishes a software license from a cloud-based SaaS arrangement by making it clear that a software licenses allow the federal entity to install and control the software on its own hardware, whereas a SaaS arrangement allows an entity to only access the software over the internet on a hosted platform.

Software License Scope



SaaS Considerations

Staff believes it is necessary to distinguish software licenses from cloud-service arrangements for recognition guidance considerations. However, staff also believes it is

difficult to ignore the similarities and overlap between software licenses and cloud-based SaaS arrangements.

While there is a difference in ability to possess and control the underlying resource between the two, it appears that the economic substance/services that federal entities receive from software licenses and SaaS arrangements are practically the same. Furthermore, it is possible that some SaaS arrangements could provide a federal entity the ability to take possession of the underlying software.

Recommendation and Next Steps

Pending Board feedback, staff plans to continue discussions with the working group and other stakeholders to develop a cost benefit analysis of potential financial statement recognition options for term-based and perpetual²⁴ software licenses using the framework discussed above. Specifically, staff will apply the working definitions and scope criteria to research recognition possibilities using FASB, GASB, and IPSASB guidance as examples.

Based on the cost-benefit analysis, staff will propose some software license financial statement recognition options for the Board to deliberate at a future meeting.

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 recommended framework for developing recognition guidance for software licenses?

²⁴ While TR 16 offers some guidance, stakeholders have requested the Board provide more guidance for perpetual software licenses. Additionally, staff believes it is more appropriate to provide recognition guidance for software licenses in level A guidance instead of implementation guidance.

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.

April 2024

At the April 2024 meeting, the Board deliberated accounting options for implementation costs associated with cloud-service arrangements. The majority of members agreed that reporting entities should not capitalize implementation costs for cloud-service arrangements unless the implementation activities result in a distinct internal use software asset, in accordance with SFFAS 10, *Accounting for Internal Use Software*, independent of the associated cloud-service arrangement.