

Memorandum

Software Technology

November 19, 2024

To: Members of the Board
From: Josh R. Williams, Senior Analyst
Thru: Monica R. Valentine, Executive Director
Subject: **Software Technology Guidance Updates** (Topic A-1)

INTRODUCTION

At the August 2024 meeting, the Board discussed software license working definitions and the differences between software licenses and cloud services. The attached staff analysis proposes:

1. A scope for software license accounting guidance
2. Recognition and measurement options for software licenses

Staff is requesting the Board's feedback and preferences on the proposals.

REQUEST FOR FEEDBACK

Prior to the Board's December meeting, please review the attached staff analysis and respond to the questions by December 6, 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 stakeholders to research recognition guidance options for shared services. Staff also plans to further research and propose updates, as needed, to existing accounting guidance in SFFAS 10, *Internal Use Software*.

ATTACHMENTS

1. Staff Analysis
2. Prior Board Meeting Discussion Timeline

Analysis

Software Technology

November 19, 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 viewed cloud-service arrangements as service contracts while some members thought it reasonable to conceptualize cloud-service arrangements as right-to-use assets. However, most members 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 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 any 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.

At the August 2024 meeting, the Board discussed a software license guidance framework that included working definitions and a scope to distinguish software licenses from cloud services.¹

¹ See Attachment 2 for a more detailed summary of previous Board meeting deliberations on the software technology project.

Research

For this session, staff coordinated with the working group and other stakeholders to research the costs and benefits of distinct recognition and measurement options for software licenses. 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 these proposals. Staff specifically researched and analyzed the following documents for this issues paper:

- FASAB Board material, *Topic B – Software Technology*, August 1, 2024
- GAO Report to Congressional Committees, GAO-24-105717, *Federal Software Licenses: Agencies Need to Take Action to Achieve Additional Savings*, Jan. 29, 2024
- GAO Report to Congressional Committees, GAO-23-106290, *DOD Software Licenses: Better Guidance and Plans Needed to Ensure Restrictive Practices Are Mitigated*, Sep. 12, 2023
- GAO Report to Congressional Requestors, GAO-25-107114, *Cloud Computing, Selected Agencies Need to Implement Updated Guidance for Managing Restrictive Licenses*, November 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 1, *Objectives of Federal Financial Reporting*, September 2, 1993
- 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

To further understand other standard-setter guidance on software licenses, staff spoke with IPSASB and FASB staff. To further understand relevant characteristics of software licenses and obtain feedback on the types of information that could be useful in federal financial reports, staff spoke with:

- Staff from GAO Information Technology Cybersecurity
- Personnel from three advocacy groups for software/IT resource management in the federal government
- A private citizen who has experience with software licensing in the private industry and federal government

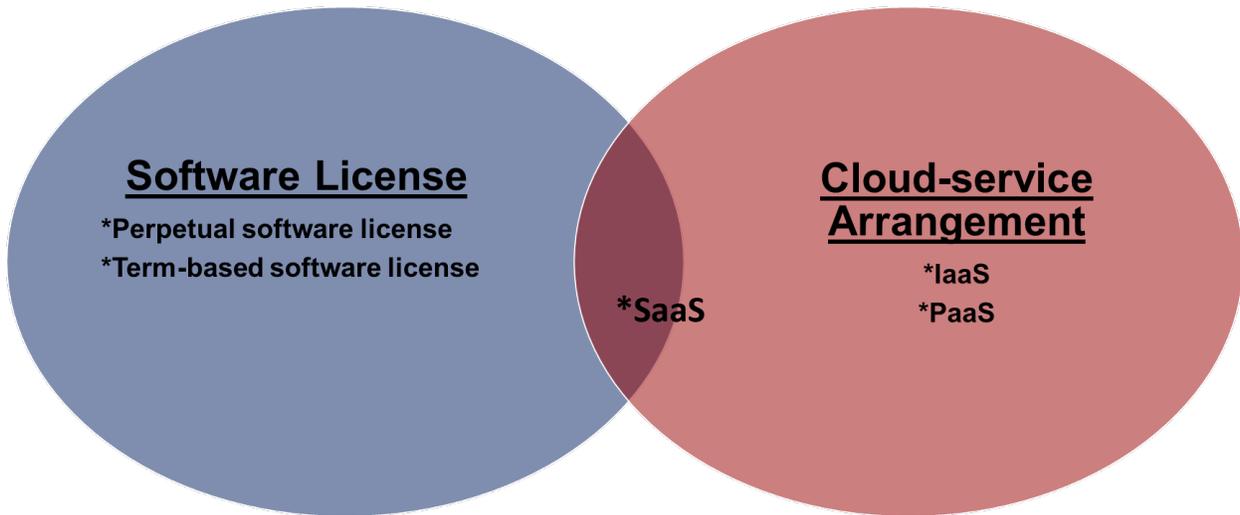
Staff has included insight and opinions from the task force and stakeholders throughout this analysis.

August 2024 Board Deliberations

During the August 2024 meeting, staff proposed a framework for the Board to apply when deliberating recognition guidance for software licenses. The framework included the following working definitions:

- 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 a cloud-based software as a service (SaaS) arrangement.
- A perpetual software license is a non-expiring license that provides a federal entity the right to use a software resource indefinitely.
- 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.

The framework also discussed the differences and similarities between software licenses and cloud-service arrangements. While federal entities typically have more control over the underlying software with software licenses, it appears that the economic substance/services that federal entities receive from software licenses and SaaS arrangements are practically similar. Furthermore, it is possible that some SaaS arrangements could provide a federal entity the ability to take possession of the underlying software.



The Board agreed with the proposed framework and members provided their tentative thoughts on potential recognition guidance for software licenses. One member stated that a broad and flexible guidance framework, which requires preparer judgment, would likely be more effective to address the fast-changing nature of software resources.

Some members believed that software licenses provide more control over the underlying software resource, when compared to cloud-based SaaS arrangements that exhibit more service contract qualities. However, other members noted that the economic substance and contract terms for term-based software licenses and SaaS arrangements are similar. The members suggested that accounting guidance should treat SaaS and term-based software licenses similarly if they provide similar economic benefits and services regardless of whether federal entities access the software through the cloud or as a resource installed on the customer's own hardware.

Some members believed that a perpetual software license more clearly represents an asset than a term-based license because the customer can control and use the software indefinitely. However, one member noted that even if federal entities acquire term-based software licenses, they will likely need to use that software indefinitely and would probably keep renewing the license. The member believed that accounting guidance should consider this practical reality with software license arrangements. Another member agreed and noted that liability recognition for term-based software licenses would be important to consider if guidance allows asset recognition.

One member observed that not having an intangible asset guidance framework limits the Board's options for addressing guidance needs for software licenses and other potential intangible assets that are becoming more common in the federal government. The member suggested that broad principle-based guidance for intangible assets would provide preparers direction on how to identify and account for intangible assets. Several other members agreed that the Board should consider addressing the gap in intangible asset guidance through a Statement or at least starting with updating relevant asset concepts.

RECOMMENDATIONS AND ANALYSES

Per the August 2024 Board discussions, this paper proposes:

1. A scope for software license accounting guidance
2. Recognition and measurement options for software licenses

The first recommendation will consider the characteristics of software licenses along with FASAB's conceptual framework to propose a scope that distinguishes software licenses from cloud-based SaaS arrangements for recognition guidance purposes. The second recommendation will consider a cost-benefit analysis of recognition and measurement options for both perpetual and term-based software licenses.

RECOMMENDATION NO. 1

Staff recommends that accounting guidance should scope software licenses as an asset, distinct from cloud services, based on the ability to control the underlying software resource. Staff requests the Board's feedback on the proposal.

ANALYSIS

Per the August 2024 Board meeting, the following characteristics of software licenses are significant for deliberating whether software licenses represent assets to the federal government:

- The services that federal entities receive from software licenses and cloud-based SaaS arrangements are practically similar.
- With software licenses, federal entities have more control over the underlying software. Whereas SaaS arrangements are more like a service contract.

This analysis will consider FASAB's asset concepts, characteristics of software licenses, and other standard-setter guidance to propose a scope to distinguish software licenses and cloud-based SaaS arrangements for financial statement recognition guidance.

FASAB Asset Conceptual Framework

SFFAC 5 states that there are two primary characteristics of an asset for financial statement recognition purposes in the following paragraphs:

- SFFAC 5 paragraph 22 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.”*
- SFFAC 5 paragraph 26 states in part, *“... as used in this Statement, economic benefits may result in inflows of cash, cash equivalents, goods, or services to the federal government, whereas the services embodied in an asset may benefit the government in other ways.”*
- SFFAC 5, paragraph 29 states in part, *“The second essential characteristic of an asset is control, which refers to the ability of the federal government to obtain the economic benefits or services embodied in a resource and to deny or regulate the access of others. It is possible that the government does not actively exercise control. Nevertheless, as long as the government currently has the ability to exercise control, the item is an asset of the government.”*
- SFFAC 5, paragraph 30 states in part, *“The ability of the federal government to control access to the economic benefits or services embodied in a resource normally stems from legal rights and may be evidenced by title deeds, contractual agreements, possession, or other devices that protect the government’s interests.”*
- Paragraph 23 of SFFAC 5 states in part, *“To illustrate the distinction between a resource that is an asset and one that is not, the federal government may obtain economic benefits or services from a resource but be unable to deny or regulate the access of other entities to those benefits or services. If so, the resource is not an asset of the federal government.”*
- SFFAC 5 paragraph 24 states in part, *“Whereas access to economic benefits or services often is obtained through legal ownership of the underlying item of property, legal rights to economic benefits or services can be obtained without ownership of the property—for example, under certain lease arrangements.”*

The FASAB conceptual framework makes it clear that for a reporting entity to recognize a resource as an asset in financial statements, the reporting entity must have control over the future economic benefits or services embodied in the resource. Furthermore, the federal government does not have to own the resource outright to have control over the future economic benefits and services.

Software License Characteristics

Staff believes the “control” characteristic of an asset is especially pertinent for distinguishing software licenses from SaaS arrangements.

Federal entities often procure software licenses and cloud services for similar internal operation and mission delivery purposes (i.e., economic benefits and services). However, most stakeholders stated that software licenses that allow a federal entity to install and run the software on its own IT systems, provide management more control over the underlying software. Whereas with cloud-based SaaS arrangements, the service provider controls the underlying software and provides federal entities access to the software as a service.²

For example, federal IT personnel indicated that management is typically responsible for integrating, customizing, maintaining, updating, and securing installed software licenses. They indicated that federal entities typically manage installed software licenses internally or through separate IT service contracts. Whereas with SaaS arrangements, the vendor constantly maintains, updates, and secures the underlying software and management’s ability to customize and integrate the software with its own IT systems is more limited.

For example, one federal entity stated that on-premise software licenses provide the federal entity more control over the actual software, allowing management to integrate the software more deeply into their infrastructure and link the software with other software resources. They further stated that with on-premise licensing, management is responsible for maintaining the software and can choose when and how to implement software updates and patches without an external schedule dictating the pace.

Several stakeholders clarified that software licenses often provide management the ability to choose where to run the software resource, whether on-premises or on another cloud platform.³ Whereas with SaaS arrangements, federal entities temporarily access software hosted on a vendor’s platform with no control over where to install and run the underlying software.

Staff believes management’s ability to determine where to run the underlying software, whether internally or with a third party, indicates that the federal entity has the ability to control the resource.

² The NIST defines SaaS 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.*

³ GAO reports 23-106290 and 25-107114 discuss challenges that federal entities sometimes face with restrictive licensing practices from vendors when moving software to cloud environments.

Other Standard-setter Guidance

As stated in the August 2024 Board material, all other standard-setters and FASAB have previously determined that software licenses represent assets for financial statement recognition purposes. However, FASB is the only other standard-setter that has issued guidance specifically for scoping software licenses as assets distinctly from cloud-service arrangements.⁴

FASB ASU 2015-05 provides the following guidance for determining whether a hosting arrangement includes a software license:

- **350-40-15-4A** - *The guidance in this Subtopic applies only to internal-use software that a customer obtains access to in a hosting arrangement if both of the following criteria are met:*
 - a. *The customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty.*⁵
 - b. *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.*
- **350-40-15-4C** - *Hosting arrangements that do not meet both criteria in paragraph 350-40-15-4A are service contracts and do not constitute a purchase of, or convey a license to, software.*

Furthermore, the summary section of ASU 2015-05 states in part, *“The amendments in this Update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract.”*

The FASB guidance directs practitioners to its intangible asset guidance to account for software licenses. Paragraph BC8 of ASU 2015-05 states in part, *“The Board observed that licenses of internal-use software are one of many types of licenses and decided that the accounting for software licenses should not be different from the accounting for other licenses of intangible assets.”*

⁴ GASB No. 96 considers both software licenses and cloud services as subscription-based IT arrangement assets. IPSASB considers software licenses as assets but has not issued guidance for cloud services.

⁵ Paragraph 350-40-15-4B defines “without significant penalty” as the ability to take delivery of the software without incurring significant cost and the ability to use the software separately without a significant diminution in utility or value.

Staff Analysis

Staff does not believe the fact that both software licenses and SaaS arrangements provide similar economic benefits and services is sufficient to justify accounting for them in the exact same manner. Per the previous SFFAC 5 analysis, control over the future economic benefits and services is a primary asset characteristic.

Based on the previous analysis, staff believes that software licenses provide federal entities control over the future economic benefits and services of the underlying software if the federal entity can either install and run the software on its own IT systems or can choose to run the software on a third-party platform.

Therefore, while federal entities may acquire software licenses and SaaS arrangements for similar economic benefits and services, the aspect of “control” is a critical characteristic for determining whether a resource is an asset for financial statement recognition purposes.

Current FASAB Guidance

Paragraph 29 of TR 16 currently states in part, *“If a cloud computing arrangement includes a perpetual software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses ... 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.”*

Per the August 2024 Board material, the reexamination project invitation to comment and working group feedback indicate preparers need further guidance clarifying how to distinctly account for software licenses and cloud computing. Staff believes the current TR 16 guidance is too vague for distinguishing software licenses and cloud computing.

For example, preparers and auditors could interpret the meaning of “a contractual right to the IUS” differently and TR 16 does not define “IUS license”. As stated previously, the IT community uses “license” informally to describe both on-premise software and SaaS subscription rights.

Staff believes that the previously discussed FASB guidance is more effective at outlining “control” characteristics of a software license for preparers to determine whether the license or contractual right to the software represents an IUS asset. Furthermore, FASAB has never addressed cloud computing or software licenses in level A guidance, and staff believes it is appropriate for the Board to address accounting for such significant and prevalent software resources in level A guidance rather than implementation guidance.

Staff Recommendation

Staff recommends the following scope language that is based on the Board’s software license working definition, FASB ASU 2015-05, and stakeholder feedback:

Software License Scope

- This guidance applies to internal use software that a reporting entity has the right and ability to either run the software on its own hardware or contract with another party, unrelated to the vendor, to host the software.

This recommended scope language would provide principle-based guidance for reporting entities to recognize software licenses as assets based on criteria that indicates the reporting entity has control over the software resource. Reporting entities would account for arrangements that do not meet these control criteria as cloud-service arrangements and would recognize payments as an expense when incurred.⁶

Staff believes this scope would provide flexibility for management to use judgment for determining whether a software resource meets the criteria for a software license or a cloud-service arrangement when applying recognition guidance.

Question for the Board:

1. Does the Board agree with staff's proposed asset recognition scope for software licenses? Please provide your feedback on staff's analysis and recommendation.

RECOMMENDATION NO. 2

For this recommendation, staff is proposing recognition and measurement options for perpetual and term-based software licenses. Staff requests the Board's feedback and preferences on the proposed options.

ANALYSIS

Paragraph 26A of TR 16 provides asset recognition guidance for perpetual software licenses. However, the FASAB Handbook does not currently provide guidance for term-based software licenses since SFFAS 54, *Leases* rescinded the previous capital lease guidance that applied to term-based software licenses.

Since the Board is considering level A guidance updates for software licenses in general, staff worked with the working group and other stakeholders to develop a cost-benefit analysis for both perpetual and term-based software license accounting options.

⁶ In accordance with recognition guidance the Board previously approved during the October 2023 meeting.

This analysis will consider relevant characteristics of perpetual and term-based software licenses, other standard-setter guidance, and stakeholder feedback to discuss the costs and benefits of each accounting option.

Characteristics of Software Licenses

Perpetual Software License

Federal entities purchase software licenses that provide the right to use the software forever. However, federal entities typically know that they will not actually use the perpetual software license forever because it will become obsolete. Therefore, federal entities typically estimate a useful life for the perpetual software license and amortize the capitalized cost over the estimated useful life.

Working group input indicated it is common for federal entities to pay the entire amount of the perpetual software license upfront. However, it is possible that a federal entity could pay for the perpetual license over multiple reporting periods. Furthermore, working group feedback indicates it is common for federal entities to pay separate recurring fees for the maintenance and service related to the perpetual software license.

Term-based Software License

Federal entities also acquire term-based software licenses that provide the right to use the software for a specified period. Working group feedback indicates that federal entities often acquire/renew software licenses on an annual basis. Some license arrangements terminate or renew year-to-year and some license arrangements include one base year plus 3-5 option years that a federal entity may exercise on an annual basis. With these arrangements, federal entities often incur significant costs each year when exercising renewal/option periods.

However, several federal entities stated that they sometimes acquire multi-year software licenses upfront (i.e., software licenses for multiple years, not including option years). For example, some federal entities reported acquiring 3 and 4-year licenses and one federal entity stated that they have previously acquired a 30-year software license. Like perpetual software licenses, working group input indicated that federal entities typically, but not always, pay the entire amount of a multi-year software license upfront.

Working group feedback indicates that federal entities purchase maintenance and support for term-based software licenses in a variety of ways. For example, federal entities sometimes purchase maintenance and support separately from the software license. Additionally, federal entities sometimes pay a separate maintenance and support fee as part of the same license arrangement. Finally, federal entities sometimes pay for maintenance and support as a bundled price with the software license, especially with software licenses that renew annually.

Other Standard-setter Guidance

Per the August 2024 Board material, FASB, GASB, and IPSASB have all issued accounting guidance for recognizing the cost of acquiring both perpetual and term-based software licenses as assets. However, all three provide different guidance for estimating the useful life of software license assets.

FASB

FASB provides asset recognition guidance for software licenses in its intangible assets guidance in the following paragraph:

- Paragraph 350-30-25-1 states, *“An intangible asset that is acquired either individually or with a group of other assets shall be recognized.”*

FASB provides measurement guidance for acquired intangible assets in the following paragraphs from ASC 805-50-30, *Acquisition of Assets Rather than a Business*:

- Paragraph 805-50-30-1 states in part, *“Assets are recognized based on their cost to the acquiring entity, which generally includes the transaction costs of the asset acquisition ...”*

FASB briefly addresses liability recognition for software licenses in the following paragraph from its internal use software guidance:

- 350-40-25-17 states in part, *“Entities often license internal-use software from third parties. A software license within the scope of this Subtopic ... shall be accounted for as the acquisition of an intangible asset and the incurrence of a liability (that is, to the extent that all or a portion of the software licensing fees are not paid on or before the acquisition date of the license) by the licensee.”*

FASB provides useful life measurement guidance for acquired intangible assets in the following paragraphs from ASC 350-30:

- Paragraph 350-30-35-1 states, *“The accounting for a recognized intangible asset is based on its useful life to the reporting entity. An intangible asset with a finite useful life shall be amortized; an intangible asset with an indefinite useful life shall not be amortized.”*
- Paragraph 350-30-35-3 states in part, *“The estimate of the useful life of an intangible asset to an entity shall be based on an analysis of all pertinent factors, in particular, all of the following factors with no one factor being more presumptive than the other:*
 - a. The expected use of the asset by the entity.*

- b. *The expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate.*
 - c. *Any legal, regulatory, or contractual provisions that may limit the useful life. The cash flows and useful lives of intangible assets that are based on legal rights are constrained by the duration of those legal rights. Thus, the useful lives of such intangible assets cannot extend beyond the length of their legal rights and may be shorter.*
 - d. *The entity's own historical experience in renewing or extending similar arrangements, consistent with the intended use of the asset by the entity, regardless of whether those arrangements have explicit renewal or extension provisions. In the absence of that experience, the entity shall consider the assumptions that market participants would use about renewal or extension consistent with the highest and best use of the asset by market participants, adjusted for entity-specific factors in this paragraph.*
 - e. *The effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels)*
 - f. *The level of maintenance expenditures required to obtain the expected future cash flows from the asset (for example, a material level of required maintenance in relation to the carrying amount of the asset may suggest a very limited useful life). As in determining the useful life of depreciable tangible assets, regular maintenance may be assumed but enhancements may not.”*
- Paragraph 350-30-35-4 states in part, *“If no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity, the useful life of the asset shall be considered to be indefinite. The term indefinite does not mean the same as infinite or indeterminate. The useful life of an intangible asset is indefinite if that life extends beyond the foreseeable horizon—that is, there is no foreseeable limit on the period of time over which it is expected to contribute to the cash flows of the reporting entity.”*

In summary, the FASB intangible asset guidance applies to recognition and useful life measurement for perpetual and term-based software licenses (and other intangible assets). Staff notes that subparagraphs c. and d. of 350-30-35-3 would specifically apply to term-based software licenses. It appears to staff that subparagraph d. requires preparers to consider the probability of renewing the license when estimating the useful life.

GASB

GASB provides asset recognition guidance for perpetual software licenses in its intangible assets standard (GASB 51) in the following paragraph:

- Paragraph 5 states in part, *“All intangible assets subject to the provisions of this Statement should be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets, including the areas of recognition, measurement, depreciation (termed amortization for intangible assets), impairment, presentation, and disclosures should be applied to intangible assets, as applicable.”*

GASB provides guidance for capital assets in the following paragraph from GASB Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments*:

- Paragraph 18 states in part, *“Capital assets should be reported at historical cost.”*

GASB 51 provides useful life estimation guidance for intangible assets in the following paragraphs:

- Paragraph 16 states, *“The useful life of an intangible asset that arises from contractual or other legal rights should not exceed the period to which the service capacity of the asset is limited by contractual or legal provisions. Renewal periods related to such rights may be considered in determining the useful life of the intangible asset if there is evidence that the government will seek and be able to achieve renewal and that any anticipated outlays to be incurred as part of achieving the renewal are nominal in relation to the level of service capacity expected to be obtained through the renewal. Such evidence should consider the required consent of a third party and the satisfaction of conditions required to achieve renewal, as applicable.”*
- Paragraph 17 states in part, *“An intangible asset should be considered to have an indefinite useful life if there are no legal, contractual, regulatory, technological, or other factors that limit the useful life of the asset ... Intangible assets with indefinite useful lives should not be amortized. If changes in factors and conditions result in the useful life of an intangible asset no longer being indefinite, the asset should be tested for impairment because a change in the expected duration of use of the asset has occurred.”*
- Paragraph 77 of GASB 51 that states in part, *“The Board also concluded that to be considered an extension of the existing asset, any anticipated outlays to be incurred as part of achieving the renewal should be nominal in relation to the level of service capacity expected to be obtained through the renewal. The Board believes that outlays associated with renewal that would be greater than*

nominal indicate the creation of a new asset, as opposed to the renewal of the existing asset.”

GASB 51 currently only applies to perpetual software licenses.⁷ However, before GASB issued No. 96, term-based software licenses would have also applied to GASB 51, paragraph 16 above. Paragraph 16 is notable because it limited the useful life of the asset to the contractual and legal provisions of the initial license unless the cost to renew the license is nominal.

However, GASB recently issued statement No. 96 that applied a right-to-use asset and liability recognition framework to both cloud-service arrangements and software licenses (referred collectively as subscription-based IT arrangements (SBITA)). GASB 96 addresses the subscription term measurement in the following paragraphs:

- Paragraph 9 states in part, *“The subscription term is the period during which a government has a noncancellable right to use the underlying IT assets (referred to as the noncancellable period), plus the following periods, if applicable:*
 - a. *Periods covered by a government’s option to extend the SBITA if it is reasonably certain, based on all relevant factors, that the government will exercise that option*
 - b. *Periods covered by a government’s option to terminate the SBITA if it is reasonably certain, based on all relevant factors, that the government will not exercise that option*
 - c. *Periods covered by a SBITA vendor’s option to extend the SBITA if it is reasonably certain, based on all relevant factors, that the SBITA vendor will exercise that option*
 - d. *Periods covered by a SBITA vendor’s option to terminate the SBITA if it is reasonably certain, based on all relevant factors, that the SBITA vendor will not exercise that option.*

Periods for which both the government and the SBITA vendor have an option to terminate the SBITA without permission from the other party (or if both parties have to agree to extend) are cancellable periods and are excluded from the subscription term. For example, a rolling month-to-month SBITA, or a SBITA that continues into a holdover period until a new SBITA contract is entered into, would not be enforceable if both the government and the SBITA vendor have an option to terminate and, therefore, either could cancel the SBITA at any time.”

⁷ GASB No. 96, par. B6 states in part, *“Statement 51, as amended, and related implementation guidance already provide comprehensive guidance for internally generated computer software and commercially available software acquired through perpetual licensing agreements.”*

- Paragraph 10 states, *“A fiscal funding or cancellation clause allows a government to cancel a SBITA, typically on an annual basis, if the government does not appropriate funds for the subscription payments. That type of clause should affect the subscription term only if it is reasonably certain that the clause will be exercised.”*

GASB provides right-to-use asset and liability recognition guidance for SBITA’s in the following paragraphs from Statement No. 96:

- Paragraph 16 states, *“A government initially should measure the subscription liability at the present value of subscription payments expected to be made during the subscription term. Measurement of the subscription liability should include the following, if required by a SBITA:*
 - a. Fixed payments*
 - b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), measured using the index or rate as of the commencement of the subscription term*
 - c. Variable payments that are fixed in substance*
 - d. Payments for penalties for terminating the SBITA, if the subscription term reflects the government exercising (1) an option to terminate the SBITA or (2) a fiscal funding or cancellation clause*
 - e. Any subscription contract incentives (as discussed in paragraphs 42 and 43) receivable from the SBITA vendor*
 - f. Any other payments to the SBITA vendor associated with the SBITA contract that are reasonably certain of being required based on an assessment of all relevant factors.”*
- Paragraph 25 states, *“A government initially should measure the subscription asset as the sum of the following, less any SBITA vendor incentives (as discussed in paragraphs 42 and 43) received from the SBITA vendor at the commencement of the subscription term:*
 - a. The amount of the initial measurement of the subscription liability, as discussed in paragraph 16*
 - b. Payments associated with the SBITA contract made to the SBITA vendor at the commencement of the subscription term, if applicable*
 - c. Capitalizable initial implementation costs as described in paragraph 29b.”*

The GASB No. 96 guidance mirrors right-to-use lease guidance. This framework is distinct in that it requires preparers to consider the probability of executing software license option/renewal years when measuring the useful life of the asset. The Board previously decided not to pursue this framework for cloud-service arrangements.

IPSASB

IPSASB provides asset recognition guidance for software licenses in the following paragraphs from its intangible asset guidance (IPSAS 31):

- Paragraph 28 states, *“An intangible asset shall be recognized if, and only if:*
 - (a) It is probable that the expected future economic benefits or service potential that are attributable to the asset will flow to the entity; and*
 - (b) The cost or fair value of the asset can be measured reliably.”*
- Paragraph 31 states in part, *“An intangible asset shall be measured initially at cost ...”*

IPSASB provides useful life estimation guidance for acquired intangible assets in the following paragraphs from IPSAS 31:

- Paragraph 89 states, *“Many factors are considered in determining the useful life of an intangible asset, including:*
 - (a) The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;*
 - (b) Typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;*
 - (c) Technical, technological, commercial, or other types of obsolescence;*
 - (d) The stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;*
 - (e) Expected actions by competitors or potential competitors;*
 - (f) The level of maintenance expenditures required to obtain the expected future economic benefits or service potential from the asset and the entity’s ability and intention to reach such a level;*
 - (g) The period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and*

(h) Whether the useful life of the asset is dependent on the useful life of other assets of the entity.

- Paragraph 93 states, *“The useful life of an intangible asset that arises from a binding arrangement (including rights from contracts or other legal rights) shall not exceed the period of the binding arrangement (including rights from contracts or other legal rights), but may be shorter depending on the period over which the entity expects to use the asset. If the binding arrangements are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.”*
- Paragraph 95 states in part, *“If the cost of renewal is significant when compared with the future economic benefits or service potential expected to flow to the entity from renewal, the “renewal” cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.”*

Like FASB, IPSASB’s guidance provides several criteria for estimating the useful life of both perpetual and term-based software licenses. However, paragraph 93, like GASB 51, explicitly limits the useful life of the license to the initial terms of the binding arrangement unless the cost to renew the license is nominal. IPSAS 31 does not directly address liability recognition associated with intangible assets.

Cost-benefit Analysis of Accounting Options

This cost-benefit analysis considers potential benefits and preparer burdens associated with recognition and measurement options for both perpetual and term-based software licenses. The analysis considers working group and other stakeholder feedback.

Per the analysis from the first recommendation, these accounting options pertain to software license assets, not SaaS arrangements.⁸

Perpetual Software License Accounting Options

As stated previously, paragraph 26A of TR 16 currently provides guidance for reporting entities to capitalize only perpetual software licenses. As part of this outreach, staff requested feedback on preparer challenges with capitalizing perpetual software licenses and other recognition possibilities.

Furthermore, in accordance with the GAAP hierarchy, staff believes it is appropriate for the Board to provide guidance for software licenses in level A GAAP.⁹ Software licenses

⁸ Software that a reporting entity has the right and ability to either run the software on its own hardware or contract with another party, unrelated to the vendor, to host the software

⁹ SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*

are prevalent in the federal government and present unique accounting issues that SFFAS 10 does not currently address.

This analysis considers the following two recognition and measurement frameworks for perpetual software licenses:

- Option 1 - Reporting entities should account for perpetual software licenses as a purchase of software and capitalize and amortize the cost over its estimated useful life. Reporting entities should recognize a liability for any software licensing fees not paid upon acquisition of the license.
- Option 2 - Reporting entities should account for perpetual software licenses as operational costs and recognize license fee payments as an expense when incurred.

Accounting for Perpetual Software Licenses - Accounting and Reporting Benefits

Staff believes the current accounting approach to recognize and amortize perpetual software licenses as assets (option 1) is most beneficial because it appropriately matches the cost of acquiring an asset to the economic benefits and services that the reporting entity receives from the asset in future reporting periods. Furthermore, option 1 provides reporting transparency benefits because it results in a recognized asset on federal balance sheets.

Accounting for Perpetual Software Licenses - Preparer Burden

Capitalizing perpetual software licenses (option 1) is already a requirement in TR 16 and would therefore not introduce new preparer burdens. However, expensing perpetual software licenses (option 2) would reduce some preparer burden because management would not have to identify, capitalize, and amortize perpetual software licenses in the financial statements.

Accounting for Perpetual Software Licenses – Stakeholder Feedback

Several preparers preferred to continue accounting for perpetual software licenses as a capital asset (option 1) because it meets the matching principle. However, some federal entity preparers preferred option 2 to expense the cost to acquire perpetual software licenses because they did not think that any accounting or reporting benefits justified the cost and effort necessary to account for perpetual licenses as assets.

Staff notes that paragraphs A8 - A11 from TR 23, *Omnibus Technical Release Amendments 2024* indicate that all 17 exposure draft respondents were supportive of restoring the asset recognition guidance for perpetual software licenses to TR 16. Some respondents requested that Board guidance define various software license terms, address development costs, and provide clarity around maintenance and technical support costs associated with software licenses.

A few preparers noted challenges with accounting for perpetual software licenses. Two working group members stated that it can be difficult to identify in the license arrangement whether a software license provides perpetual rights to the software.

One working group member stated it can sometimes be difficult to separate recurring maintenance cost from the license fee costs. However, most working group members stated that recurring maintenance costs are typically separate and distinct from the perpetual software license fee.

A few preparers stated that it is challenging to accurately estimate the useful life of a perpetual software license, which could lead to inaccurate cost amortization. This challenge is especially pronounced due to the fast-changing nature of software resources. Several working group members stated that it would be beneficial if the Board could provide some principle-based guidance on what criteria to consider when estimating the useful life of a perpetual software license.

Other federal and non-federal stakeholders generally believed that software licenses provide federal entities more control over the underlying software compared to a cloud-based SaaS arrangement. They perceived software licenses as assets of a federal entity and SaaS arrangements as service contracts.

However, the stakeholders generally supported more accountability and transparency over the cost that federal entities incur for both software licenses and SaaS arrangements. They favored qualitative and quantitative note disclosures in financial reports similar to the disclosures that the Board deliberated for cloud-service arrangements during the October 2023 meeting.

Term-based Software License Accounting Options

Per the October 2024 Board material, FASAB guidance does not currently address term-based software licenses and multiple stakeholders have asked that the Board address them. This analysis considers the following recognition and measurement frameworks for term-based software licenses:

- Option 1 - Reporting entities should account for term-based software licenses as operational costs and recognize license fee payments as an expense when incurred.
- Option 2 - If a term-based software license has a useful life of two years or more, the reporting entity should recognize an asset for the cost of the license and a liability for any software licensing fees not paid upon acquisition of the license. The useful life of the asset should not exceed the binding arrangement of the contractual or legal terms of the software license. If the binding arrangements are for a limited term that can be renewed, the useful life of the asset should include the renewal period(s) only if the cost to renew is nominal.

- Option 3 - If a term-based software license has a term of two years or more, the reporting entity should recognize an asset and liability based on the expected future payments for the term of the license. The license term should not exceed the binding arrangement of the contractual or legal terms of the software license. If the binding arrangements are for a limited term that can be renewed, the term of the software license should include the renewal period(s) if it is probable that management will exercise the renewal option(s).

Option 2 applies aspects of FASB, GASB, and IPSASB's intangible asset framework and would follow the same recognition requirements of capitalizing the cost to acquire a perpetual software license. The difference is that the term of the binding arrangement would limit the useful life of term-based software license. Whereas preparers estimate the useful life of perpetual software licenses based on other criteria.

Option 3 applies aspects of GASB's right-to-use asset/liability framework for SBITAs. With option 3, the asset value and useful life measurement would include license renewal options if management determines it probable that they will exercise the option period at a significant cost. Whereas with option 2, the asset measurement is based on the initial cost to acquire the multi-year license and the useful life measurement would only include software license option years if the cost to exercise the option year is minimal. Staff from another standard-setter indicated this scenario is possible for software licenses, but it is probably not common.

Option 3 would also require liability recognition for the cost to renew the option years if management determines it is probable that they will exercise the option years. Whereas option 2 would only require liability recognition for any unpaid license fees based on the binding arrangement of the initial license term. For option 2, if the federal entity paid the entire amount of the license upfront, they would recognize an asset but no liability, similar to a perpetual software license.

Many software license arrangements consist of one base year plus 3-5 option years that a federal entity may exercise on an annual basis at a significant cost. These types of software licenses would apply to the asset and liability recognition requirements under option 3, but not option 2. Option 2 asset recognition requirements would only apply to software licenses that federal entities sometimes acquire for which the initial binding arrangements span multiple years.

Neither option 2 or 3 asset recognition requirements would apply to the scenario in which federal entities simply terminate or pay to renew software licenses on a year-to-year basis. Option 1 would expense all term-based software license payments as incurred, similar to how the Board decided federal entities should account for cloud-service arrangements.

Accounting for Term-based Software Licenses - Accounting and Reporting Benefits

Staff believes that option 2 would result in accounting for term-based software licenses that best represents the matching principle because reporting entities would only recognize an asset and liability based on the initial binding arrangements of the license. Therefore, the cost to acquire the software license would match to the definitive useful life in which the federal entity receives the future economic benefits and services of the software. Option 2 would also likely result in more consistent accounting across federal entities because the asset and liability measurement requirements would not be based on renewal periods that management may or may not choose to exercise.

Staff believes that option 3 would result in reporting entities recognizing more software license assets and liabilities for future outflows of resources that the federal entity is likely to incur. However, the asset and liability recognition would be based on the likelihood of management exercising the renewal option periods for the license. The management judgment necessary for assessing the probability of exercising future option periods would likely lead to inconsistent accounting among federal entities.

Option 1 would potentially provide accounting consistency between term-based software licenses and cloud-based SaaS arrangements. However, accounting option 1 would dismiss the “control” differences between software licenses and SaaS arrangements, which is a primary characteristic of an asset.¹⁰ Furthermore, option 2 would still result in federal entities accounting for annual software license renewals as operating expenses in the same manner as cloud-based SaaS arrangements. Under option 2, asset recognition would apply only to more long-term software licenses.

Accounting for Term-based Software Licenses – Preparer Burden

Expensing all term-based software licenses (option 1) would be the least burdensome option for preparers. Staff believes option 3 would be the most burdensome for preparers to implement because management would have to assess the probability of exercising option periods for software licenses on an annual basis. With option 2, management would have to identify multi-year software licenses for asset recognition consideration but would not have to assess the probability of exercising option periods for asset and liability measurement.

Accounting for Term-based Software License – Stakeholder Feedback

The majority of preparers in the working group preferred option 1 to expense all term-based software licenses because they did not think any accounting or reporting benefits justified the cost and effort necessary to account for term-based licenses as assets.

However, several preparers preferred option 2 to recognize an asset for multi-year software licenses, excluding renewal option periods with more than nominal cost. These

¹⁰ As discussed in Recommendation 1.

preparers believed that this accounting option would best match costs to acquire a software license asset to the future economic benefits and services of the asset.

One working group member believed that option 2 provided the most practical guidance because it would appropriately match costs to expenses for truly long-term software license assets while also making it clear that preparers should generally expense software licenses that management pays a significant cost to renew on an annual basis.

One preparer preferred option 3 to recognize an asset and liability for multi-year licenses, including renewal option periods. The preparer believed that option 3 would result in the most accurate asset and liability recognition for software licenses because they indicated that it was typically probable that management would execute annual option years for software licenses.

Several preparers agreed that option 3 would be the most burdensome to implement because management would have to use judgment to determine the probability of executing annual option years for many software licenses. Several preparers noted that option 2 would not apply to many term-based software licenses. However, one preparer was against any new capitalization requirements because it would require management to identify and monitor a population of software licenses, establish a materiality threshold, and implement policy and accounting system changes.

Other federal and non-federal stakeholders believed that software licenses provide federal entities more control over the underlying software compared to a cloud-based SaaS arrangement. They perceived software licenses as assets of a federal entity and SaaS arrangements as service contracts.

However, the stakeholders strongly supported more accountability and transparency over the cost that federal entities incur for both software licenses and SaaS arrangements, regardless of the term. They favored qualitative and quantitative note disclosures in financial reports similar to the disclosures that the Board deliberated for cloud-service arrangements during the October 2023 meeting.

Staff Recommendation

Staff recommends the following recognition and measurement frameworks for software licenses that are based on the intangible asset frameworks used by FASB, GASB, and IPSASAB:

- [Perpetual Software License Option 1](#) - Reporting entities should account for perpetual software licenses as a purchase of software and capitalize and amortize the cost over its estimated useful life. Reporting entities should recognize a liability for any software licensing fees not paid upon acquisition of the license.

- Term-based Software License Option 2 - If a term-based software license has a useful life of two years or more, the reporting entity should recognize an asset for the cost of the license and a liability for any software licensing fees not paid upon acquisition of the license. The useful life of the asset should not exceed the binding arrangements of the contractual or legal terms of the software license. If the binding arrangements are for a limited term that can be renewed, the useful life of the asset should include the renewal period(s) only if the cost to renew is nominal.

Staff believes the recommended accounting frameworks would establish a high bar for recognizing only long-term software licenses as assets and would generally not require management to assess the probability of exercising annual option periods when measuring asset and liability values. Staff believes these recommendations align with GASB and IPSASB's observations that outlays associated with renewal that would be greater than nominal indicate the purchase of a new asset, as opposed to the renewal of an existing asset.¹¹

Furthermore, staff believes these accounting options would apply to the operating performance objectives from SFFAC 1, per the following paragraphs:

- Paragraph 65 discusses accounting for assets by stating in part, *“Expected benefits often are not cash inflows but rather are the services provided by the asset. Sometimes those services are provided to the government itself (e.g., government office buildings or motor pools). More often, the services are provided to the public (e.g., education and research and development).”*
- Paragraph 123 states in part, that the operating performance objective *“arises from a democratic government’s duty to be accountable to its citizens for managing resources and providing services economically and efficiently and for effectiveness in attaining planned goals. Also, the government should be accountable for raising resources efficiently.”*
- Paragraph 124 states, *“Because government services are not usually provided in exchange for voluntary payments or fees, expenses cannot be matched against revenue to measure “earnings” or “net income” as would be done in business accounting. Moreover, directly measuring the value added to society’s welfare by government actions is difficult. Nonetheless, expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results.”*

Capitalizing and amortizing the cost of software license assets with a useful life of two years or more (including perpetual licenses) would appropriately match the expense of the software license to the future economic benefits and services that the software license provides federal entities for operational and mission delivery purposes.

¹¹ GASB 51, par. 77 and IPSAS 31, par. 95

Furthermore, these recommendations would establish accounting consistency by making it clear that reporting entities should generally not capitalize software licenses that federal entities pay to renew on an annual basis. This would apply to many of the types of software licenses that federal entities renew year-to-year or acquire with base year plus annual option year arrangements.

During the August 2024 meeting, one Board member questioned the practical differences between purchasing new versions of downloaded software every year versus paying to access software through the cloud on an annual basis. Staff believes the recommended accounting options would generally result in accounting for both of these types of software transactions as operational expenses.

Questions for the Board:

2. Does the Board agree with staff's recommended recognition and measurement framework for perpetual software licenses? Please provide your feedback on staff's analysis and recommendation.
3. Does the Board agree with staff's recommended recognition and measurement framework for term-based software licenses? Please provide your feedback on staff's analysis and recommendation.

Final Thoughts and Next Steps

The following flowchart depicts the accounting guidance framework for software licenses that staff has recommended in this paper:

(Chart on next page)

Recommended Framework for Software License Accounting Guidance

Recommendation No. 1

Is the reporting entity able to either run the software on its own hardware or contract with another party, unrelated to the vendor, to host the software?

Yes

No

Operational
expense

Recommendation No. 2

Does the software license have either a perpetual or initial term of two years or more (not counting optional renewal periods unless cost to renew is nominal)?

Yes

No

Recognize
Asset

Next Steps

As discussed, FASB, IPSASB, and GASB, all provide accounting guidance for software licenses within the framework of their broader intangible asset guidance. Furthermore, in this paper staff has recommended an intangible asset-based framework for recognition guidance for software licenses. In topic A-2, staff requests the Board also consider a conceptual and recognition guidance framework for intangible assets.

Pending Board feedback on this topic and topic A-2, staff will coordinate with stakeholders to research recognition guidance options for shared services. Staff also plans to further research and propose updates, as needed, to existing accounting guidance in SFFAS 10. This includes addressing working group feedback requesting Board guidance on estimating useful life for software assets, particularly perpetual software licenses.

Prior Board Meeting Discussion 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.

August 2024

At the August 2024 meeting, the Board discussed an accounting guidance framework for software licenses. The framework includes the following working definitions:

- 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 a cloud-based SaaS arrangement.

- A perpetual software license is a non-expiring license that provides a federal entity the right to use a software resource indefinitely.
- 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.

The Board also discussed key distinctions between a software license and cloud-service arrangement.