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Capitalizing Cloud Computing Costs

By Ryan Siebel, CPA

With the changing role of technology in the workplace, accounting standards applicable to the costs of technology have had to change as well. The rise of cloud computing arrangements (CCAs) led to a new accounting pronouncement in 2015 that clarified the circumstances under which CCAs should be treated like traditional software development costs. In practice, because few CCAs meet the criteria to be treated as software assets (the contractual right of the company to take possession of the software and the ability to run the software on the company's hardware), many CCAs were accounted for as service contracts. One unanswered question from the 2015 accounting standards change was the treatment of upfront costs in the CCA, such as costs related to implementation and setup activities. These activities presumably created some future benefit to the user of the CCA, but the accounting rules did not address how to record that benefit.

In 2018 the Financial Accounting Standards Board (FASB) issued ASU 2018-15, which aligns the requirements for capitalizing implementation costs in a CCA agreement with those for capitalizing implementation costs in an internal-use software license. Similar to costs for internal-use software, CCA costs relating to coding and testing during the application development stage are capitalizable, while training activities are expensed as incurred. Both internal and external costs are eligible for capitalization.

One of the challenges in implementing the new accounting rule for cloud software is determining the portion of fees that represents implementation costs. The CCA vendor may not readily provide the detail to show how the fees are apportioned, and it will be up to the company to estimate the portion that relates to implementation services.

Any capitalized implementation costs would be amortized over the life of the CCA on a straight-line basis. Companies should determine whether any option periods in the CCA should be included in the amortization period, depending on the probability that those options will be exercised. Amortization begins when a module of the CCA is placed into service (i.e., ready to be used by the company). Costs should be assessed for potential impairment in a manner similar to other long-lived assets, whereby a decrease in the functionality or extent of use could trigger a loss and write-down of the capitalized costs to fair value.

Companies with significant CCA services also have disclosure requirements, including disclosing the nature of the hosting arrangements that are service contracts, along with the types of disclosures typically made for long-lived fixed assets. ASU 2018-15 is effective for private companies for fiscal years beginning after December 15, 2020, and can be adopted either prospectively or retrospectively.

Do you have questions about cloud computing arrangements, or other accounting and auditing issues? Please contact Ryan Siebel, CPA, at 440-449-6800, or rsiebel@skodaminotti.com.