GASB Exposure Draft

May 13, 2019

Comments Due: August 23, 2019

Proposed Statement

of the Governmental Accounting Standards Board

Subscription-Based Information Technology Arrangements

This Exposure Draft of a proposed Statement of Governmental Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 38

Governmental Accounting Standards Board

SUBSCRIPTION-BASED INFORMATION TECHNOLOGY ARRANGEMENTS

WRITTEN COMMENTS

Deadline for submitting written comments: August 23, 2019

Requirements for written comments. Comments should be addressed to the Director of Research and Technical Activities, Project No. 38, and emailed to director@gasb.org.

OTHER INFORMATION

Public hearing. The Board has not scheduled a public hearing on the issues addressed in this Exposure Draft.

Public files. Written comments will become part of the Board's public file and are posted on the GASB's website.

This Exposure Draft may be downloaded from the GASB's website at www.gasb.org.

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Notice to Recipients of This Exposure Draft

The Governmental Accounting Standards Board (GASB) is responsible for (1) establishing and improving standards of state and local governmental accounting and financial reporting to provide useful information to users of financial reports and (2) educating stakeholders—including issuers, auditors, and users of those financial reports—on how to most effectively understand and implement those standards.

The due process procedures that we follow before issuing our standards and other communications are designed to encourage broad public participation in the standards-setting process. As part of that due process, we are issuing this Exposure Draft setting forth proposed standards that would define subscription-based information technology arrangements (SBITAs) for purposes of recognition and disclosure in the financial statements and establish accounting and financial reporting requirements related to SBITAs for government end users.

We invite your comments on all matters in this proposed Statement. Because this proposed Statement may be modified before it is issued as a final Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the GASB should consider.

All responses are distributed to the Board and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Statement. In deciding on changes in accounting and financial reporting standards, the GASB also takes into consideration the expected benefits to users of financial statements and the perceived costs of preparing and reporting the information. Only after the Board is satisfied that all alternatives have adequately been considered, and modifications have been made as considered appropriate, will a vote be taken to issue a Statement. A majority vote of the Board is required for adoption.

Summary

The primary objectives of this proposed Statement are to provide guidance on the accounting and financial reporting of subscription-based information technology arrangements (SBITAs) for government end users (governments) and to eliminate diversity in practice. This proposed Statement would achieve those objectives by (1) defining a SBITA; (2) establishing that a SBITA would result in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) providing the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requiring note disclosures of essential information regarding a SBITA. To the extent possible, the proposed standards for SBITAs are based on the standards in Statement No. 87, *Leases.*

A SBITA would be defined as a contract that conveys control of the right to use another party's (a SBITA vendor) hardware, software, or both, including information technology infrastructure (the underlying hardware or software), as specified in the contract for a period of time in an exchange or exchange-like transaction.

The subscription term would include the period during which a government has a noncancellable right to use the underlying hardware or software. The term also would include periods covered by an option to extend (if it is reasonably certain that the government or SBITA vendor will exercise that option) or to terminate (if it is reasonably certain that the government or SBITA vendor will *not* exercise that option).

Under this proposed Statement, a government would recognize a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability. However, this proposed Statement would provide an exception for short-term SBITAs, which have a maximum possible term under the SBITA contract of 12 months (including any options to extend, regardless of their probability of being exercised). Subscription payments for short-term SBITAs would be recognized as outflows of resources.

For SBITAs other than short-term SBITAs, a government would recognize the subscription liability at the commencement of the subscription term. The subscription liability would be measured at the present value of subscription payments expected to be made during the subscription term. Future subscription payments would be discounted using the interest rate the SBITA vendor charges the government, or the government's incremental borrowing rate if the interest rate is not readily determinable. A government would recognize amortization of the discount of the subscription liability as an outflow of resources in subsequent financial reporting periods.

The subscription asset would be recognized and initially measured as the sum of (1) the initial subscription liability amount, (2) payments made to the SBITA vendor before commencement of the subscription term, and (3) capitalizable implementation costs. A government would recognize amortization of the subscription asset as an outflow of resources over the subscription term.

Activities associated with a SBITA, other than making subscription payments, would be grouped into the following three stages, and their costs would be accounted for accordingly:

- Preliminary Project Stage, including activities such as evaluating alternatives, determining needed technology, and selecting a SBITA vendor. Outlays in this stage would be expensed as incurred.
- Initial Implementation Stage, including all ancillary charges necessary to place the subscription asset into service. Outlays in this stage generally would be capitalized as an addition to the subscription asset.
- Post-Implementation/Operation Stage, including activities such as maintenance and other activities for a government's ongoing operations related to a SBITA. Outlays in this stage would be expensed as incurred.

In classifying certain outlays into the appropriate stage, the nature of the activity would be the determining factor. Training costs, regardless of which stage they are in, would be expensed as incurred.

If a SBITA contract contains multiple components—such as both a subscription component and a nonsubscription component, or multiple underlying hardware or software components—a government would account for each component as a separate SBITA component and allocate the contract price to the different components. If it is not practicable to determine a best estimate for price allocation for some or all components in the contract, a government would account for those components as a single SBITA unit.

This proposed Statement would require a government to disclose descriptive information about its SBITAs other than short-term SBITAs, such as the amount of the subscription asset, accumulated amortization, other payments not included in the measurement of a subscription liability, principal and interest requirements for the subscription liability, and other essential information.

Effective Date

The requirements of this proposed Statement would be effective for fiscal years beginning after June 15, 2021, and all reporting periods thereafter. Earlier application would be encouraged.

How the Changes in This Proposed Statement Would Improve Financial Reporting

The requirements of this proposed Statement would improve financial reporting by establishing a definition for SBITAs and providing uniform guidance for accounting and financial reporting for transactions that meet that definition. That definition and uniform guidance would result in greater consistency in practice. Establishing the capitalization criteria for implementation costs also would reduce diversity and improve comparability in financial reporting by governments. This proposed Statement also would enhance the relevance and reliability of a government's financial statements by requiring a government to report a subscription asset and subscription liability for a SBITA and to disclose important information about the transaction. The proposed disclosures would allow users to understand the scale and important aspects of a government's SBITA activities and evaluate a government's future obligations and intangible capital assets resulting from SBITAs.

How the Board Considered Costs and Benefits in the Development of This Proposed Statement

One of the principles guiding the Board's setting of standards for accounting and financial reporting is the assessment of expected benefits and perceived costs. The Board strives to determine that its standards address significant user needs and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit. The Board believes that the expected benefits that will result from the information provided through implementation of this proposed Statement—more consistent accounting and financial reporting, and more comparable information about SBITAs—are significant and justify the perceived costs of implementation and ongoing compliance.

Certain decisions made by the Board were intended to provide cost relief. For example, this proposed Statement does not require the disclosure of the amount of the subscription assets by major classes of underlying assets. In addition, to reduce the cost of implementation, this proposed Statement includes an exception for short-term SBITAs and the provisions that would treat an entire multiple-component contract as a single unit if determining a best estimate to allocate the contract price to multiple components is not practicable, among other cost-reducing provisions.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.

Proposed Statement of the Governmental Accounting Standards Board

Subscription-Based Information Technology Arrangements

May 13, 2019

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Proposed Statement of the Governmental Accounting Standards Board

Subscription-Based Information Technology Arrangements

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INTRODUCTION

1. It has become common for governments to enter into subscription-based contracts to use third-party vendor-provided information technology (IT). Subscription-based information technology arrangements (SBITAs) provide governments with access to vendors' IT hardware or software for subscription payments without granting governments title or perpetual licenses to the hardware or software. Prior to the issuance of this Statement, there was no accounting or financial reporting guidance specifically for SBITAs.

2. The objective of this Statement is to better meet the information needs of financial statement users by (a) establishing uniform accounting and financial reporting requirements for SBITAs; (b) improving the comparability of financial statements among governments that have entered into SBITAs; and (c) enhancing the relevance, reliability, consistency, and understandability of information about SBITAs.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

3. This Statement establishes standards of accounting and financial reporting for SBITAs by a government end user (a government). The requirements of this Statement apply to financial statements of all state and local governments.

4. This Statement does not apply to:

a. Governments that provide the right to use their hardware or software to other entities through SBITAs
b. Contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*
c. Licensing arrangements that grant a perpetual license to governments to use a vendor's computer software, which are subject to Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*.

5. This Statement supersedes *Implementation Guide No. 2015-1*, Questions Z.51.21 and Z.51.38. This Statement amends Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, paragraphs 116 and 117; Statement No. 38, *Certain Financial Statement Note Disclosures*, paragraph 10; Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, paragraphs 11 and 12; Statement 51, paragraph 3; Statement

No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraph 135; Statement No. 87, *Leases*, paragraph 8; Implementation Guide 2015-1, Questions 5.77.1, Z.51.18, Z.51.22, and Z.51.23; and Implementation Guide No. 2017-2, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, Question 4.61.

Definition

6. For purposes of applying this Statement, a SBITA is a contract that conveys control of the right to use another party's (a SBITA vendor) hardware, software, or a combination of both, including IT infrastructure (the underlying hardware or software), as specified in the contract for a period of time in an exchange or exchange-like[1] transaction.

7. To determine whether a contract conveys control of the right to use the underlying hardware or software, a government should assess whether it has both of the following:

a. The right to obtain the present service capacity from use of the underlying hardware or software as specified in the contract
b. The right to determine the nature and manner of use of the underlying hardware or software as specified in the contract.

8. SBITAs include contracts that, although not explicitly identified as a SBITA, meet the definition of a SBITA in paragraph 6. That definition excludes contracts that solely provide IT support services but includes contracts that contain *both* a right-to-use hardware or software component and an IT support services component.

Subscription Term

9. The subscription term is the period during which a government has a noncancellable right to use the underlying hardware or software (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

[1]The scope of this Statement includes both exchange and exchange-like transactions. Footnote 1 of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, states that "the difference between exchange and exchange-like transactions is a matter of degree. In contrast to a 'pure' exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition."

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 signed, 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. Provisions that allow for termination of a SBITA as a result of (1) payment of all sums due or (2) default on subscription payments are not considered termination options.

10. 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.

11. At the commencement of the subscription term, a government should assess all factors relevant to the likelihood that the government or the SBITA vendor will exercise options identified in paragraphs 9a–9d, regardless of whether those factors are contract based, underlying hardware or software based, market based, or government specific. The assessment often will require the consideration of a combination of interrelated factors, such as the following:

a. A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared with current market rates
b. A potential change in technological development that significantly affects the technology used by the underlying hardware or software
c. A potential significant change in the government's demand for the SBITA vendors' hardware or software
d. A significant economic disincentive, such as costs to terminate the SBITA and sign a new SBITA (for example, negotiation costs, costs of identifying another suitable underlying hardware or software or another suitable SBITA vendor, implementation costs, or a substantial cancellation penalty)
e. The history of exercising options to extend or terminate
f. The extent to which the hardware or software underlying the SBITA is essential to the provision of government services.

12. A government should reassess the subscription term only if one or more of the following occur:

a. The government or SBITA vendor elects to exercise an option even though it was previously determined that it was reasonably certain that the government or SBITA vendor would not exercise that option

b. The government or SBITA vendor elects not to exercise an option even though it was previously determined that it was reasonably certain that the government or SBITA vendor would exercise that option
c. An event specified in the SBITA contract that requires an extension or termination of the SBITA takes place.

Short-Term SBITAs

13. A short-term SBITA is a SBITA that, at the commencement of the subscription term, has a maximum possible term under the SBITA contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. For a SBITA that is cancellable by either the government or the SBITA vendor, such as a rolling month-to-month SBITA or a year-to-year SBITA, the maximum possible term is the noncancellable period, including any notice periods.

14. A government should recognize short-term subscription payments as outflows of resources (for example, expense) based on the payment provisions of the SBITA contract. A government should recognize an asset if subscription payments are made in advance or a liability if subscription payments are to be made subsequent to the reporting period. A government should not recognize an outflow of resources for the period for which the SBITA vendor grants the right to use the underlying hardware or software to the government free of charge (for example, one or more months free).

Recognition and Measurement for SBITAs Other Than Short-Term SBITAs—Economic Resources Measurement Focus

15. At the commencement of the subscription term, a government should recognize a subscription liability and an intangible right-to-use asset (a capital asset hereinafter referred to as the subscription asset), except as provided in paragraphs 13 and 14 (short-term SBITAs).

Subscription Liability

16. 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), initially measured using the index or rate as of the commencement of the subscription term
c. Variable payments that are fixed in substance (as discussed in paragraph 17)
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 40 and 41) receivable from the SBITA vendor

f. Any other payments to the SBITA vendor that are reasonably certain of being required based on an assessment of all relevant factors (subject to paragraph 17).

17. Variable payments based on future performance of a government or usage of the underlying hardware or software should not be included in the measurement of the subscription liability. Rather, those variable payments should be recognized as outflows of resources (for example, expense) in the period in which the obligation for those payments is incurred. However, any component of those variable payments that is fixed in substance should be included in the measurement of the subscription liability.

18. The future subscription payments should be discounted using the interest rate the SBITA vendor charges the government, which may be the interest rate implicit in the SBITA. If the interest rate cannot be readily determined by the government, its estimated incremental borrowing rate (an estimate of the interest rate that would be charged for borrowing the subscription payment amounts during the subscription term) should be used. A government is not required to apply the guidance for imputation of interest in paragraphs 173–187 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* but may do so as a means of determining the interest rate implicit in the SBITA.

19. In subsequent financial reporting periods, a government should calculate the amortization of the discount on the subscription liability and report that amount as an outflow of resources (for example, interest expense) for the period. Any subscription payments made should be allocated first to the accrued interest liability and then to the subscription liability.

20. A government should remeasure the subscription liability at subsequent financial reporting dates if one or more of the following changes have occurred at or before that financial reporting date, based on the most recent SBITA contract before the changes,[2] and the changes individually or in the aggregate are expected to significantly affect the amount of the subscription liability since the previous measurement:

a. There is a change in the subscription term.
b. There is a change in the estimated amounts for subscription payments already included in the measurement of the subscription liability (except as provided in paragraph 21).
c. There is a change in the interest rate the SBITA vendor charges the government, if used as the initial discount rate.
d. A contingency, upon which some or all of the variable payments that will be made over the remainder of the subscription term are based, is resolved such that those payments now meet the criteria for measuring the subscription liability under paragraph 16. For example, an event occurs that causes variable payments that were contingent on the

[2]Changes arising from amendments to a SBITA contract should be accounted for under the provisions of paragraphs 50–54 for contract modifications and terminations.

performance or use of the underlying hardware or software to become fixed for the remainder of the subscription term.

21. If a subscription liability is remeasured for any of the changes in paragraph 20, the liability also should be adjusted for any change in an index or a rate used to determine variable payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A subscription liability is not required to be remeasured solely for a change in an index or a rate used to determine variable payments.

22. A government also should update the discount rate as part of the remeasurement if there is a change[3] in the subscription term and the change is expected to significantly affect the amount of the subscription liability.

23. A subscription liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in a government's incremental borrowing rate.

24. If the discount rate is required to be updated based on the provision in paragraph 22, the discount rate should be based on the revised interest rate the SBITA vendor charges the government at the time the discount rate is updated. If that interest rate cannot readily be determined, the government's estimated incremental borrowing rate at the time the discount rate is updated should be used.

Subscription Asset

Measurement

25. A government initially should measure the subscription asset as the sum of the following:

a. The amount of the initial measurement of the subscription liability (see paragraph 16)
b. Subscription payments made to the SBITA vendor at or before the commencement of the subscription term, less any SBITA vendor incentives (as discussed in paragraphs 40 and 41) received from the SBITA vendor at or before the commencement of the subscription term
c. Capitalizable implementation costs as described in paragraphs 28–38.

26. A subscription asset should be amortized in a systematic and rational manner over the shorter of the subscription term or the useful life of the underlying hardware or software. The amortization of the subscription asset should be reported as an outflow of resources (for example, amortization expense), which may be combined with depreciation expense related to other capital assets for financial reporting purposes.

27. A subscription asset generally should be adjusted by the same amount as the corresponding subscription liability when that liability is remeasured based on paragraphs 20–24. However, if that change reduces the carrying value of the subscription asset

[3]See footnote 2.

to zero, any remaining amount should be reported in the resource flows statement (for example, a gain).

Outlays Other Than Subscription Payments, including Implementation Costs

Stages of implementation

28. Activities associated with a SBITA—other than a government making subscription payments to the SBITA vendor for the right to use the underlying hardware or software—should be grouped into the following stages:

a. *Preliminary Project Stage.* Activities in this stage include the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the SBITA.
b. *Initial Implementation Stage.* Activities in this stage include ancillary charges related to designing the chosen path, such as configuration, coding, testing, and installation associated with the government's access to the underlying hardware or software. Other ancillary charges necessary to place the subscription asset into service also should be included in this stage.
c. *Post-Implementation/Operation Stage.* Activities in this stage include maintenance, troubleshooting, and other activities associated with the government's ongoing access to the underlying hardware or software.

29. Data conversion should be considered an activity of the initial implementation stage only to the extent it is determined to be necessary to make the subscription asset operational—that is, in condition for use. Otherwise, data conversion should be considered an activity of the post-implementation/operation stage.

Accounting for outlays incurred

30. Other than subscription payments for the right to use the underlying hardware or software, outlays incurred prior to completing all of the following should be expensed as incurred:

a. Determination of the specific objective of the project and the nature of the service capacity that is expected to be provided by the subscription asset
b. Demonstration of the technical or technological feasibility such that the subscription asset will provide its expected service capacity
c. Demonstration of the current intention, ability, and presence of effort to enter into a SBITA contract.

31. The requirements in paragraph 30 should be considered to be completed only when both of the following occur:

a. The activities noted in the preliminary project stage as described in paragraph 28a are completed.
b. Management implicitly or explicitly authorizes and commits to funding the SBITA, at least for the current fiscal year in the case of a multiyear project.

Preliminary project stage

32. Outlays associated with activities in the preliminary project stage should be expensed as incurred.

Initial implementation stage

33. Outlays associated with activities in the initial implementation stage generally should be capitalized as an addition to the subscription asset. Capitalization of such outlays should cease no later than the point at which the subscription asset is operational.

34. If no subscription asset is recognized (for example, when the contract is a short-term SBITA), activities in the initial implementation stage should be expensed as incurred.

Post-implementation/operation stage

35. Outlays associated with activities in the post-implementation/operation stage should be expensed as incurred, except for those that meet one of the capitalization criteria in paragraph 38.

Accounting for certain outlays

36. The activities within the stages of implementation described in paragraph 28 may occur in a sequence different from that shown in that paragraph. The recognition guidance for outlays other than subscription payments should be applied based on the nature and timing of the activity. Although both factors should be considered, the nature of the activity should be the determining factor. Subscription payments should be accounted for in accordance with the subscription liability recognition requirements in paragraphs 16–24.

37. Training costs, regardless of which stage they are in, should be expensed as incurred.

38. If outlays are a result of contract modifications as described in paragraphs 50–52, the outlays should be accounted for in accordance with paragraphs 50–52. There also may be outlays that are incurred in addition to subscription payments and associated with a SBITA already in operation. Generally, those outlays should be expensed as incurred. However, outlays that are not a result of contract modifications but that result in either of the following should be capitalized as an addition to an existing subscription asset:

a. An increase in the functionality of the subscription asset; that is, the subscription asset allows the government to perform tasks that it previously was incapable of performing
b. An increase in the efficiency of the subscription asset; that is, an increase in the level of service provided by the subscription asset without the ability to perform additional tasks.

Impairment

39. The presence of impairment indicators (described in paragraph 9 of Statement 42) with respect to the underlying hardware or software may result in a change in the manner or duration of use of the subscription asset. Such a change in the manner or duration of use of the subscription asset may indicate that there is a significant, unexpected reduction in the service utility and, therefore, the subscription asset is impaired. The length of time during which the government cannot use the underlying hardware or software, or is limited to using it in a different manner, should be compared to its previously expected manner and duration of use to determine whether there is a significant decline in service utility of the subscription asset. If a subscription asset is impaired, the amount reported for the subscription asset should be reduced first for any change in the corresponding subscription liability. Any remaining amount should be recognized as an impairment.

Incentives Provided by a SBITA Vendor

40. As used in this Statement, incentives provided by a SBITA vendor (SBITA vendor incentives) are (a) payments made to, or on behalf of, a government, for which the government has a right of offset with its obligation to the SBITA vendor, or (b) other concessions granted to the government. A SBITA vendor incentive is equivalent to a rebate or discount and includes assumption of a government's preexisting subscription obligations to a third party, other reimbursements of end user costs, free subscription periods, and reductions of interest or principal charges by the SBITA vendor.

41. SBITA vendor incentives reduce the amount that a government is required to pay for a SBITA. SBITA vendor incentives that provide payments to, or on behalf of, a government at or before the commencement of a subscription term are included in initial measurement by directly reducing the amount of the subscription asset (see paragraph 25). SBITA vendor incentive payments to be provided after the commencement of the subscription term should be accounted for by the government as a reduction of subscription payments for the periods in which the incentive payments will be provided. Those payments should be measured by the government consistently with the government's subscription liability (paragraphs 16–24). Accordingly, SBITA vendor incentive payments to be provided after the commencement of the subscription term are included in the initial measurement and any remeasurement if the incentive payments are fixed or fixed in substance, whereas variable or contingent incentive payments are not included in initial measurement.

Contracts with Multiple Components

42. A government may enter into contracts that contain multiple components, such as a contract that contains both a subscription component and a nonsubscription component or a contract that contains multiple underlying hardware or software components.

43. If a government enters into a contract that contains both a subscription component (the right to use the underlying hardware or software) and a nonsubscription component (maintenance services for the hardware or software), the government should account for the

subscription and nonsubscription components as separate contracts unless the contract meets the exception in paragraph 46.

44. If a SBITA involves multiple underlying hardware or software components and the hardware or software components have different subscription terms, the government should account for each underlying hardware or software component as a separate subscription component. The provisions of this paragraph should be applied unless the contract meets the exception in paragraph 46.

45. To allocate the contract price to the different components, a government first should use any prices for individual components that are included in the contract, as long as the price allocation does not appear to be unreasonable based on the terms of the contract and professional judgment, maximizing the use of observable information; for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid if the right to use the same or similar hardware or software components were contracted individually or if the right to use the same or similar nonsubscription components (such as services) were contracted individually. Some contracts provide discounts for bundling multiple subscription components or bundling subscription and nonsubscription components together in one contract. Those discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices each are discounted by the same percentage from normal market prices, the discount included in those component prices would not appear to be unreasonable.

46. If a contract does not include prices for individual components, or if any of those prices appear to be unreasonable as provided in paragraph 45, a government should use professional judgment to determine its best estimate for allocating the contract price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in the contract, a government should account for those components as a single SBITA.

47. If multiple components are accounted for as a single SBITA as provided for in paragraph 46, the accounting for that SBITA should be based on the primary subscription component within that SBITA. For example, the primary subscription component's contract term should be used for the SBITA if the subscription components have different subscription terms.

Contract Combinations

48. Contracts that are entered into at or near the same time with the same SBITA vendor should be considered part of the same contract if either of the following criteria is met:

a. The contracts are negotiated as a package with a single objective.
b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.

49. If multiple contracts are determined to be part of the same contract, that contract should be evaluated in accordance with the guidance for contracts with multiple components in paragraphs 42–47.

Contract Modifications and Terminations

50. The provisions of a SBITA contract may be amended while the contract is in effect. Amendments modify the provisions of the SBITA contract. Examples of amendments to SBITA contracts include changing the contract price, lengthening or shortening the subscription term, and adding or removing underlying hardware or software. An amendment should be considered a SBITA modification unless the government's right to use the underlying hardware or software decreases, in which case the amendment should be considered a partial or full contract termination. By contrast, exercising an existing option, such as an option to extend or terminate the SBITA as discussed in paragraphs 12a and 12b, is subject to the guidance for remeasurement.

Contract Modifications

51. A government should account for an amendment during the reporting period resulting in a modification to a SBITA contract as a separate SBITA (that is, separate from the most recent SBITA contract before the modification) if both of the following conditions are present:

a. The contract modification gives the government an additional subscription asset by adding access to more underlying hardware or software than was included in the original SBITA contract.
b. The increase in subscription payments for the additional subscription asset does not appear to be unreasonable based on (1) the terms of the amended SBITA contract and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

52. Unless a modification is reported as a separate SBITA contract as provided in paragraph 51, a government should account for a contract modification by remeasuring the subscription liability. The subscription asset should be adjusted by the difference between the remeasured liability and the liability immediately before the contract modification. However, if the change reduces the carrying value of the subscription asset to zero, any remaining amount should be reported in the resource flows statement (for example, a gain).

Contract Terminations

53. A government should account for an amendment during the reporting period resulting in a decrease in the government's right to use the underlying hardware or software (for example, the subscription term is shortened or the underlying hardware or software that the government has the right to use is reduced) as a partial or full contract termination.

54. A government generally should account for the partial or full contract termination by reducing the carrying values of the subscription asset and subscription liability and recognizing a gain or loss for the difference.

Financial Statements Prepared Using the Current Financial Resources Measurement Focus

55. If a SBITA is expected to be paid from general government resources, the SBITA should be accounted for and reported on a basis consistent with governmental fund accounting principles.

56. An expenditure and other financing source should be reported in the period the subscription asset is initially recognized. The expenditure and other financing source should be measured as provided in paragraphs 16–18. Subsequent governmental fund subscription payments should be accounted for consistent with principles for debt service payments on long-term debt.

Notes to Financial Statements

57. A government should disclose the following about its SBITAs (which may be grouped for purposes of disclosure) other than short-term SBITAs:

a. A general description of its SBITAs, including the basis, terms, and conditions on which variable payments not included in the measurement of the subscription liability are determined
b. The total amount of subscription assets, and the related accumulated amortization, disclosed separately from other capital assets
c. The amount of outflows of resources recognized in the reporting period for variable payments not previously included in the measurement of the subscription liability
d. The amount of outflows of resources recognized in the reporting period for other payments, such as termination penalties, not previously included in the measurement of the subscription liability
e. Principal and interest requirements to maturity, presented separately, for the subscription liability for each of the five subsequent fiscal years and in five-year increments thereafter
f. Commitments under SBITAs before the commencement of the subscription term
g. The components of any loss associated with an impairment (the impairment loss and any related change in the subscription liability, as discussed in paragraph 39).

58. For disclosure purposes, subscription liabilities are not considered debt that is subject to the disclosure requirements in Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*.

EFFECTIVE DATE AND TRANSITION

59. The requirements of this Statement are effective for fiscal years beginning after June 15, 2021, and all reporting periods thereafter. Earlier application is encouraged.

60. Changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practicable, for all prior fiscal years presented. If restatement for prior fiscal years is not practicable, the cumulative effect, if any, of applying this Statement should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest fiscal year restated. In the first fiscal year that this Statement is applied, the notes to financial statements should disclose the nature of the restatement and its effect. Also, the reason for not restating prior fiscal years presented should be disclosed.

61. Assets and liabilities resulting from SBITAs should be recognized and measured using the facts and circumstances that existed at the beginning of the fiscal year of implementation. If applied to earlier fiscal years, those assets and liabilities should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest fiscal year restated.

The provisions of this Statement need not be applied to immaterial items.

Appendix A

BACKGROUND

A1. Subscription-based information technology arrangements (SBITAs) have become prevalent in the government environment as state and local governments continue to migrate away from traditional on-premise information technology (IT) arrangements based on a purchasing and perpetual licensing model. A SBITA conveys control of the right to use a SBITA vendor's hardware or software, and the arrangement commonly includes provisions such as remote access to software applications or data storage. A SBITA differs from a traditional technology arrangement covered by existing guidance in that it does not convey ownership. Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* does not address the accounting for SBITAs. Section Z.51 in the *Comprehensive Implementation Guide* addresses only certain aspects of accounting for purchased computer software, including costs of cloud computing services and system configuration. The scope of Statement No. 87, *Leases,* excludes leases of intangible assets, such as SBITAs.

A2. The Financial Accounting Standards Board (FASB) issued Accounting Standards Updates No. 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement,* and No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.* The FASB guidance treats arrangements that are similar to a SBITA as either a licensing arrangement or a service contract. No specific guidance for SBITAs was identified in any other standards setters' literature. In the absence of specific guidance for SBITAs in GASB literature, accounting and financial reporting for SBITAs has been inconsistent. One outcome of that inconsistency has been an increase in the number of technical inquiries the GASB has received in recent years regarding accounting for SBITAs.

A3. At their March 2017 meeting, members of the Governmental Accounting Standards Advisory Council (GASAC) ranked IT arrangements in the top four among all pre-agenda research activities and potential standards-setting topics in the GASB's technical plan. The GASAC members also commented favorably on the possibility of performing pre-agenda research on those types of transactions. The Board approved the start of pre-agenda research in April 2017.

A4. Pre-agenda research was conducted to determine whether specific guidance was needed for SBITAs and to identify key accounting issues relating to them. The GASB conducted interviews with government IT officials and industry IT experts and administered surveys to financial statement preparers and auditors. That research found diverse opinions as to the classification and accounting treatment of SBITAs. Survey results showed that preparers and auditors were analogizing to Statement 51, Statement 87, Concepts Statement No. 4, *Elements of Financial Statements,* and FASB Update 2015-05. Diversity in practice also was exhibited in the accounting for implementation costs related to SBITAs.

A5. Based on findings from the pre-agenda research, the Board added the SBITA project to the current technical agenda in April 2018. The purpose of the project was to provide stakeholders with specific guidance related to the accounting and financial reporting for SBITAs. The Board began deliberations in August 2018. Additional outreach was conducted throughout the project to better understand different aspects of the transactions and needs of the stakeholders. Feedback received from the GASAC members at their November 2018 and March 2019 meetings also was considered during the Board's deliberations.

Appendix B

BASIS FOR CONCLUSIONS

Introduction

B1. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

General Approach and Relationship with Other Statements

B2. The Board developed the guidance in this Statement based on the GASB's conceptual framework and relevant accounting standards and, when needed, developed additional guidance to address specific issues identified by stakeholders through pre-agenda research and outreach activities. Paragraph 4 of Statement 87 defines a lease as "a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction." The Board noted that in a SBITA, the contract (a) grants a government control of the right to use a SBITA vendor's hardware, software, or both, for a period of time and (b) requires the government to pay the SBITA vendor a subscription fee for that right. The Board believes that because the key characteristics of a SBITA resemble those of a lease, the most appropriate and efficient approach to developing guidance for SBITAs is to incorporate into the SBITA standards all relevant guidance from Statement 87.

B3. Based on that approach, the Board reviewed the topics covered in Statement 87 and established three criteria as indicators of whether guidance for a particular topic also should be included in this Statement. The three criteria evaluated were whether a topic is (a) relevant to SBITAs, (b) prevalent in practice, and (c) a key issue identified by stakeholders in the pre-agenda research.

B4. One of the key issues identified by a stakeholder in the pre-agenda research for SBITAs was accounting for implementation costs and other associated outlays. Stakeholders' views differ on whether to capitalize those outlays. Statement 51 provides guidance for whether and when to capitalize outlays incurred at different stages when a government internally generates computer software. Accordingly, the Board considered whether those capitalization criteria should be incorporated into the SBITA standards and decided it was appropriate to do so, as discussed in paragraphs B21–B29.

Scope and Applicability

B5. This project initially was intended to address all IT arrangements, including cloud computing. However, informed by feedback from the additional outreach activities conducted after the project started, the Board decided it was necessary to reconsider the scope of the project.

B6. Two primary factors informed the Board's decision to limit the scope of the project to SBITAs only, rather than to all IT arrangements. First, even though this project provides an opportunity to develop comprehensive standards for all IT arrangements, the Board believes that new guidance is not needed for all types of IT arrangements. Statement 51 and related implementation guidance already provide comprehensive guidance for internally generated computer software and commercially available software acquired through perpetual licensing agreements. Second, stakeholders generally view SBITAs differently from traditional perpetual licensing or purchasing arrangements, because SBITAs only grant a government the right to use a vendor's hardware or software for a limited period specified in a SBITA contract and do not allow a government to own or to use vendor's hardware or software indefinitely. Therefore, much of the guidance in Statement 51 cannot easily be applied to SBITAs. During the Board's additional outreach, some stakeholders asserted that this project should focus on SBITAs because diversity in practice implies a need for specific guidance. Some stakeholders also were concerned that if the scope of the project were too broad, the final standards would not be available on a timely basis.

B7. Another issue considered by the Board was whether there is a need to establish guidance for governments that are providers in SBITAs. The Board noted that certain governments may become SBITA vendors that provide the right to use their own IT hardware or software for other entities. However, research conducted by the GASB found that government providers were not prevalent in practice. Therefore, the Board decided to specify that this Statement (a) applies to government end users and (b) does not apply to governments that provide the right to use their hardware or software to other entities through SBITAs.

SBITA Definition

B8. Based on the research conducted, the Board noted that all SBITAs have the following defining characteristics: (a) they are for the use of IT hardware, software, or both; (b) they grant a government control of the right to use a SBITA vendor's hardware, software, or both; and (c) they are exchange or exchange-like transactions. Those characteristics are similar to those of a lease, a contract that also is based on the right to use an underlying asset. Therefore, the Board decided the definition of a SBITA should resemble that of a lease.

B9. One example of a typical SBITA is a cloud computing arrangement. The three most common deployment models for cloud computing are Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS). All three models involve a SBITA vendor providing the customer with the right to use the SBITA vendor's IT resources, including its software application and cloud infrastructure (including network, servers, operating systems, storage, and other tools). SaaS provides a customer with the ability to use a SBITA vendor's applications (software) through a cloud infrastructure. PaaS allows a customer to use a SBITA vendor's tools or coding language (software) to create applications that will run on the SBITA vendor's cloud infrastructure. IaaS allows a customer to remotely access its network, server, and other fundamental computing tools (hardware) to process, store, and operate the customer's data. Although those cloud computing deployment models are referred to by many as "as a Service," the economic substance of those transactions are in fact SBITAs. The reference to "services" highlights the fundamental difference between the subscription models and the traditional purchasing and perpetual licensing models.

B10. Many SBITAs also include service components, such as routine maintenance and minor updates. However, the primary component of those SBITAs is the right to use the underlying hardware or software, rather than the service components. The presence of the service components does not change the fundamental nature of those SBITAs.

B11. Some firms contract with governments solely to provide IT support services. Those services typically aim to streamline or enhance overall user experience, to provide training for end users' employees, or to provide off-site live troubleshooting for end users of the hardware or software provided by a specific SBITA vendor. Those firms sometimes are referred to as the "partners" in the cloud computing "eco-system." Some SBITA vendors also rely on those service firms to provide after-sale IT support to SBITA end users.

B12. If a firm solely provides IT support services, those support services may be analogized to maintenance services provided by a building management company hired by the landlord (a lessor) for the benefit of a tenant (a lessee) in a lease agreement. Paragraph 6 of Statement 87 specifically excludes contracts for services from the definition of a lease, unless those contracts contain both a lease component and a service component. The Board concluded that this Statement should take the same approach as Statement 87. Thus, the definition of a SBITA excludes contracts that solely provide IT support services. However, as previously noted, the contracts that contain both a right-to-use hardware or software component and an IT support service component are included in the scope of this Statement.

Short-Term SBITAs

B13. Pre-agenda research indicated that the length of a SBITA term may vary from several months to 10 years but generally covers a term from 1 to 5 years. The length of the term may be affected by the size of the SBITA vendor, the needs of the government, and the intended function of the subscribed hardware or software.

B14. In Statement 87, an exception to the recognition, measurement, and disclosure requirements is provided for short-term leases. That exception was intended to provide cost relief based on the Board's considerations that the financing component would be much less significant in lease contracts of 12 months or less. Statement 87 defines a short-term lease using the term *maximum possible term* rather than *lease term*. As discussed in paragraph B29 of Statement 87, "The use of *maximum possible term* in the definition removes the effect of potential options to extend or terminate the lease on the classification of a lease as short term. Maximum possible term assumes that all options to extend would be exercised and inherently would exclude all options to terminate." Under the provisions for short-term leases in Statement 87, no capital asset or long-term liability should be recognized by a lessee. Instead, the short-term lease payments are required to be recognized as outflows of resources based on the payment provisions of the lease contract. In addition, there are no specific disclosure requirements for short-term leases, providing further cost relief.

B15. The Board believes a SBITA with a maximum possible term of 12 months or less is similar to a short-term lease and, therefore, a similar exception should be provided for those SBITAs based on similar cost-benefit considerations. To be consistent with the provisions in paragraph 17 of Statement 87, the Board concluded that a government in a short-term SBITA should recognize subscription payments as outflows of resources (for example, expense) based on the payment provisions in the SBITA contract, rather than recognizing a subscription asset and subscription liability.

Recognition of a Subscription Asset and a Subscription Liability

B16. A key issue identified in the pre-agenda research was to assess whether a SBITA should result in recognition of an asset and liability or an expense for the government. In paragraph 8 of Concepts Statement 4, assets are defined as "resources with present service capacity that the government presently controls." Paragraph 10 of Concepts Statement 4 also states that "an asset may be tangible and have physical form, such as buildings and equipment, or may be intangible, such as the right to use intellectual property. It remains an asset only so long as it is still capable of providing services." At the inception of a SBITA contract, a government obtains the right to use a SBITA vendor's hardware or software by paying a subscription fee for access to that hardware or software. The "right to use" is a resource that provides present service capacity to the government. That right to use may be the right to access the SBITA vendor's remote server (hardware) on which the government's data is stored, or the right to run the SBITA vendor's cloud-based application (software) via internet access. In addition, within the confines of the contract, it is at the discretion of the government to decide when, and to what extent, it will use the SBITA vendor's hardware or software. In other words, the government has control over the nature and manner of the right to use the underlying hardware or software, despite the SBITA vendor owning and having physical possession of the hardware or software. The Board concluded that a government's right to use the underlying hardware or software resulting from a SBITA meets the definition of an asset in Concepts Statement 4 and, therefore, should be recognized as a *subscription asset.*

B17. Paragraph 17 of Concepts Statement 4 defines liabilities as "present obligations to sacrifice resources that the government has little or no discretion to avoid." Liabilities generally cannot be avoided because they are legally enforceable, meaning that a court can compel the government to fulfill its obligation. Paragraph 18 of Concepts Statement 4 also states that "generally, legally enforceable liabilities arise from legislation of other levels of government or contractual relationships, which may be written or oral. . . . For exchange transactions, the obligation becomes a liability and legally enforceable when the underlying exchange takes place." In addition, paragraph 22 of Concepts Statement 4 states that "for an obligation to be a liability, it should be a present obligation. The event that created the liability has taken place."

B18. Subscription payments typically begin at the inception of a SBITA contract, when the SBITA vendor makes access to the subscribed hardware or software available to the government, rather than when the government begins to use that hardware or software. A government often needs to complete an implementation process to make its own hardware or software compatible with the SBITA vendor's hardware or software. The Board believes the government's obligation to make subscription payments becomes a present obligation and is legally enforceable at the inception of a SBITA contract because that obligation arises from an event that has taken place—obtaining access to the underlying hardware or software. Accordingly, the Board concluded that the government's obligation to make subscription payments meets the definition of a liability in Concepts Statement 4 and, therefore, should be recognized as a *subscription liability*.

Subscription Liability

B19. Provisions for the measurement of a subscription liability generally are based on those of a lease liability in paragraph 21 of Statement 87. However, items that the Board determined are not applicable to SBITAs are excluded. Specifically, SBITAs do not include provisions for residual value guarantees or purchase options and, consequently, such features are not included in the measurement of a subscription liability.

B20. This Statement requires that in subsequent reporting periods, a government's subscription payment is allocated first to the accrued interest liability and then to the subscription liability. That requirement is consistent with Statement 87. This Statement does not specify how payments allocated to the accrued interest liability should be classified in the statement of cash flows because the Board believes that guidance already is provided in Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. A SBITA, other than a short-term SBITA, results in the government recording an intangible subscription asset, which is a type of capital asset.

Subscription Asset

Outlays Other Than Subscription Payments, including Implementation Costs

B21. Accounting for implementation costs was another key issue identified by stakeholders during the pre-agenda research. Such costs may include configuration, coding, data conversion, data migration, testing, and other ancillary charges that are necessary for the government to prepare its system for accessing the subscribed hardware or software. The Board considered providing a definition or description of implementation costs in this Statement. However, stakeholders interviewed during the pre-agenda research generally had a common understanding of what implementing a SBITA entails and what the costs of implementation may include. The Board is concerned that a definition or description of implementation costs would have to be broad enough to encompass all types of SBITAs and to continue to be relevant as technology evolves. In addition, the Board noted that this Statement provides guidance on the stages of implementing a SBITA and believes that guidance is sufficient for a government to identify its implementation costs. Therefore, the Board concluded that it is not necessary to provide a definition or description of implementation costs in this Statement.

B22. Statement 51 groups activities associated with internally generated computer software into three stages: (a) preliminary project stage, (b) application development stage, and (c) post-implementation/operation stage. The Board believes it also is necessary to consider all activities in the life cycle of a SBITA, other than making subscription payments, and group them into stages similar to the stages in Statement 51. The types of activities undertaken to internally generate computer software can be different from the types of activities needed to prepare a government's own system for a SBITA. However, despite the differences, the three stages help depict the chronological order of the typical activities undertaken in both circumstances.

B23. Analogizing to the guidance in Statement 51, the Board decided that the first stage for a SBITA also should be referred to as the *preliminary project stage*, which would include those activities that ultimately lead to the final selection of the technology and SBITA vendor. The second stage of implementing a SBITA, however, would reflect the biggest difference from the stages for internally generating computer software. Therefore, the Board believes the term *initial implementation stage* more appropriately reflects the activities in this stage for a SBITA. In the Board's view, the third stage is similar for both internally generated software and a SBITA because activities in this stage would include those associated with a government's ongoing operations. Those operations occur either after the computer software has been generated or after a SBITA has been implemented. As a result, the Board decided *post-implementation/operation stage* also is a suitable term for the third stage of a SBITA.

B24. In Statement 51, the costs of activities performed in the preliminary project stage are required to be expensed as incurred because it is not until the activities in that stage are completed and management commits to funding the SBITA that the outlays meet the definition of an asset. The Board believes the same logic applies to a SBITA and, therefore, concluded that the costs of activities in the preliminary project stage of a SBITA should be expensed as incurred. Similarly, Statement 51 requires expensing the costs of activities that occur in the post-implementation/operation stage as they are incurred, unless they meet the capitalization criteria described in paragraph 15 of that Statement. The Board believes that a similar approach is appropriate for SBITAs and, therefore, provides guidance based on that provision.

B25. Statement 51 requires capitalization of the costs associated with activities in the application development stage. Paragraph 18 of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as amended, states that "the cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use." Additionally, paragraph 30 of Statement 87 requires that "initial direct costs that are ancillary charges necessary to place the lease asset into service" be included in the initial measurement of a lease asset. The Board believes the costs of the activities in the second stage of a SBITA life cycle—the initial implementation stage—are similar in nature to ancillary charges for a capital asset as described in Statement 34 and for a lease asset as described in Statement 87. The costs of those activities often are referred to as implementation costs for SBITAs. The Board believes implementation costs add to the value of a subscription asset because, like ancillary charges, they are necessary for the government to place the subscription asset into service. The Board noted that implementation costs can be part of a SBITA's main contract with the SBITA vendor or included in a separate contract with another outside party unrelated to the SBITA vendor.

Regardless of who is associated with the implementation activities, the Board believes the nature of implementation costs is the same and the accounting should not differ. Based on those considerations, the Board concluded that costs incurred in the initial implementation stage of a SBITA should be capitalized as part of the subscription asset.

B26. In Statement 51, paragraph 10c includes *application training* as an example of activities in the post-implementation/operation stage, the last stage of developing and installing internally generated computer software. Further, Statement 51 provides that outlays that are incurred in the first and last stages should be expensed, and outlays incurred in the second stage—the application development stage—should be capitalized. However, paragraph 14 of Statement 51 states that "outlays associated with application training activities that occur during the application development stage should be expensed as incurred." This effectively requires all application training costs to be expensed as incurred, regardless of the stage in which the training costs were incurred.

B27. In addition, the answer to question Z.51.15 in *Implementation Guide No. 2015-1* provides that the training of employees involved with developing internally generated computer software should not be considered an activity of the application development stage and, therefore, the related outlays should be expensed as incurred. The explanation provided in that answer states that "although the skills obtained by the employees through the training may facilitate the development of the computer software, the training itself does not further the development of the software and does not otherwise contribute to putting the software in condition for use."

B28. The Board noted that some governments may incur significant outlays associated with training during the initial implementation stage and post-implementation/operation stage of SBITAs. The Board considered whether it would be appropriate to separate those training-associated outlays into two types: (a) outlays associated with developing or acquiring training materials and (b) outlays associated with all other training activities, in order to determine whether it would be appropriate to capitalize the first type and expense the second type. However, the Board noted that training-associated outlays are not unique to SBITAs. Rather, governments can incur training-associated outlays under many other circumstances, and the respective accounting treatments are part of a broader topic: capitalization criteria for training costs and other similar costs. The Board also noted that there is no conceptual basis to treat training-associated outlays for SBITAs differently from those for internally generated computer software covered in Statement 51. Therefore, the Board does not believe it is appropriate to address the topic of capitalization criteria for training costs in this project. As a result, the Board concluded that the guidance for training-associated outlays in the context of SBITAs should be consistent with that guidance in Statement 51.

B29. As previously discussed, this Statement provides that no capital asset or long-term liability should be recognized for a short-term SBITA. Consequently, the Board concluded that implementation costs for a short-term SBITA should be expensed as incurred.

Impairment of a Subscription Asset

B30. The Board considered whether and how to provide comprehensive guidance for identifying, assessing, and measuring impairment of a subscription asset. Based on the pre-agenda research conducted about the nature of SBITAs, the Board believes it is uncommon for a subscription asset to be considered permanently impaired. As already discussed, for many governments, one of the advantages of the subscription model over the traditional purchasing and perpetual licensing model is the convenience of being able to rely on the SBITA vendor to ensure continuous access to the subscribed hardware or software with minimum interruption. Even if there is a temporary interruption or system downtime for a government, contract provisions in SBITAs generally require the SBITA vendor to restore access to the system within a short period of time. With those considerations, the Board believes providing comprehensive guidance for impairment in the SBITA standards is not necessary. Statement 87 references on Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* and provides minimal guidance for impairment of a lease asset. The Board concluded that the same approach is appropriate for this Statement.

Contracts with Multiple Components

B31. As previously noted from pre-agenda research and subsequent outreach activities, the Board learned that many SBITA contracts have multiple components. Similar to a lease contract with multiple components, a SBITA contract may include a subscription component for the right to use a SBITA vendor's hardware or software and a nonsubscription component, such as SBITA vendor-provided IT support services. For example, a SBITA vendor may provide remote live troubleshooting services to a government's employees. Sometimes, a SBITA contract may include an itemized pricing schedule to reflect the price for each component. Other times, SBITA contracts do not provide itemized pricing and charge a single price for all components in the contract. In addition, the level of itemization in pricing schedules can vary significantly. Statement 87 generally requires that the components of leases be accounted for separately. However, an exception provided in paragraph 67 of Statement 87 allows a government to account for some or all components in the contract as a single lease unit "if it is not practicable to determine a best estimate for price allocation for some or all components in the contract. . . ."

B32. In applying the rationale of Statement 87, the Board believes that even though there will be incremental costs associated with separating multiple components and allocating the contract price to those components, not separating multiple components may cause period expenses to be capitalized and a subscription liability to be recognized for services that have not been provided. However, the Board also acknowledges that there will be circumstances in which it is not practicable for governments to allocate prices due to the complex nature of SBITA contracts. Therefore, similar to Statement 87, the Board believes it is appropriate to provide cost relief and a practical exception by allowing a government to report multiple-component contracts as a single SBITA unit if determining a best estimate to allocate the contract price is not practicable.

Notes to Financial Statements

B33. The Board developed the disclosure requirements for SBITAs based on the disclosure requirements for lessees in Statement 87. During the development of the leases standards, a GASB survey of users regarding the usefulness of proposed lessee disclosures suggested that all of the lessee disclosure requirements were considered to be essential to users' overall understanding and analysis of governmental financial statements. The similarities between the fundamental nature of SBITAs and leases suggests that information essential for users regarding leases also would be essential with respect to SBITAs. The Board believes that requiring similar disclosures for SBITAs will not add significant incremental costs because, at the time of implementation of this Statement, many governments already will have implemented the requirements in Statement 87 and will be familiar with the similar required note disclosures for SBITAs.

B34. The disclosures required for a government include a general description of its SBITAs and information about variable payments. The Board believes that information about variable payments is essential for financial statement users to understand that a government may be required to pay more for the use of the subscription asset than the amount recognized as a subscription liability. To provide users with information about the full cost of the SBITA, a government also is required to disclose the amount of expense recognized in the period for variable subscription payments and other payments not previously included in the subscription liability.

B35. The Board considers the information included in the required disclosures essential. Nevertheless, in an effort to reduce the length of the disclosures for governments with many SBITAs, the Board believes that preparers will consider the significance of their SBITAs and use their professional judgment to decide when it is appropriate to aggregate disclosures.

Disclosures Considered but Not Required

B36. The Board considered all lessee disclosure requirements in Statement 87 but decided not to require certain disclosures that are not applicable to SBITAs. As previously mentioned, the Board decided not to require disclosures related to residual value guarantees or purchase options because they are irrelevant to SBITAs. The Board also decided not to require a government to disclose the amounts of the subscription assets by major classes of underlying assets, separately from other capital assets. For example, the amount of the subscription asset associated with the underlying hardware is not required to be separate from the amount of the subscription asset associated with the underlying software. The Board believes such disclosure is not essential to users' understanding of the subscription asset. The Board believes that the requirement to disclose the total amount of the subscription assets and the related accumulated amortization, separately from other capital assets, is sufficient information for users of financial statements to understand the subscription asset.

Considerations Related to Benefits and Costs

B37. The overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. One of the principles guiding the Board's setting of standards for financial reporting is the assessment of the expected benefits and perceived costs. The Board strives to determine that its standards (including disclosure requirements) address a significant user need and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit.

B38. Present and potential users are the primary beneficiaries of improvements in financial reporting. Persons within governments who are responsible for keeping accounting records and preparing financial statements, as well as managers of public services, also benefit from the information that is collected and reported in accordance with GASB standards. The costs to implement the standards are borne primarily by governments and, by extension, their citizens and taxpayers. Users also incur costs associated with the time and effort required to obtain and analyze new information to meaningfully inform their assessments and decisions.

B39. The Board's assessment of the expected benefits and perceived costs of issuing new standards is unavoidably more qualitative than quantitative because no reliable and objective method has been identified for quantifying the value of improved information in financial statements. Furthermore, it is difficult to accurately measure the costs of implementing new standards until implementation has taken place. Nonetheless, the Board undertakes this assessment based on the available evidence regarding expected benefits and perceived costs with the objective of achieving an appropriate balance between maximizing benefits and minimizing costs.

B40. The primary source of information on the expected benefits of this Statement is the pre-agenda research, which showed diversity in practice in accounting and financial reporting for SBITAs due to the lack of specific guidance for those transactions. Diversity in practice diminishes the comparability and, therefore, usefulness of reported financial information. The Board believes that this Statement reduces diversity in practice by providing specific, uniform guidance for SBITAs.

B41. During the pre-agenda research, stakeholders not only expressed a general concern about the lack of guidance for SBITAs but also identified key issues that the new guidance for SBITAs should address. The guidance in this Statement provides (a) a definition of a SBITA, (b) recognition and measurement guidance for SBITAs, (c) accounting guidance for implementation costs associated with SBITAs, and (d) note disclosure requirements for SBITAs. The Board believes the provisions in this Statement address key issues identified by stakeholders.

B42. Information that the Board considered regarding the costs of implementing and complying with the provisions in this Statement came primarily from the anticipated costs of implementation and ongoing compliance of Statement 87. The Board gathered information on the perceived costs from the Statement 87 task force and GASAC members, due process comments, public hearing testimony, and results from a field test of the proposed leases standards. The Board recognizes that there will be costs incurred to implement and continue complying with the provisions in this Statement; however, the Board believes that preparers, auditors, and users familiar with the guidance in Statement 87 will be unlikely to incur significant incremental costs to understand and implement the provisions of this Statement. The Board believes the costs likely will result from reviewing existing SBITAs, staff training, and system changes to track each SBITA contract. The Board believes that governments generally have fewer SBITA contracts than lease contracts, so governments likely will incur relatively less cost to review existing SBITA contracts. Also, as previously noted, because many governments with leases already will have implemented the requirements in Statement 87 at the time of implementation of this Statement, the Board believes some governments may be able to use similar systems from their Statement 87 implementation to implement this Statement.

B43. Certain decisions made by the Board in developing this Statement were intended to provide some measure of cost relief for governments. The Board decided to incorporate exceptions similar to those in Statement 87 to reduce costs of implementation and ongoing compliance. Those include the provisions regarding:

a. The short-term SBITA exception, including not requiring disclosures related to short-term SBITAs
b. Allowing the stated contract prices to be used when allocating the contract price to multiple components of a SBITA, if those prices do not appear to be unreasonable
c. Allowing best estimates to be used for allocating the contract price to multiple components, if no separate prices are included in the contract or if stated prices appear to be unreasonable
d. The requirement to treat an entire multiple-component contract as a single unit if determining a best estimate is not practicable.

In addition, the transition provisions are similar to the transition provisions in Statement 87 and are intended to mitigate costs of implementation.

B44. The Board also made other decisions that were intended to provide cost relief. An example discussed in paragraph B36 is the Board's decision not to require the disclosure of the amount of the subscription assets by major classes of underlying assets.

B45. The Board also considered the aggregate expected benefits and perceived costs associated with the entirety of the requirements in this Statement. The Board is cognizant that the costs of implementing the changes required by this Statement are unavoidable and may be burdensome for some governments. However, the Board believes that the expected benefits that will result from the information provided through implementation of this Statement are significant and justify the perceived costs of implementation and ongoing compliance.

Effective Date and Transition

B46. The provisions of this Statement are effective for fiscal years beginning after June 15, 2021, and all reporting periods thereafter. The Board believes that effective date allows adequate time for financial statement preparers to plan for the transition and implementation of this Statement.

B47. This Statement encourages early application. The Board believes that some preparers, especially those familiar with Statement 87 and Statement 51, might elect to apply the requirements to fiscal years before the effective date. That would provide better information to financial statement users and allow other governments to learn from the experience of the early adopters. The Board considered that there could be comparability issues in the interim if some governments adopt early application but believes that the benefits of early application outweigh the potential interim comparability issues.

B48. This Statement requires that SBITAs be recognized and measured using the facts and circumstances that existed at the beginning of the fiscal year of implementation. The Board believes that it would not be practical to require governments to return to the commencement of each SBITA term and determine what the balances would have been if this Statement had been in effect from that time. Therefore, the adjustments should be made based on the remaining subscription payments as of the beginning of the fiscal year of implementation or the beginning of any earlier fiscal years restated.

B49. The provisions of this Statement should be applied retroactively by restating financial statements, if practicable, for all prior fiscal years presented. The Board generally believes that retroactive application provides more useful and comparable information than prospective application but realizes that a practical approach would be more cost beneficial without completely sacrificing comparability. Therefore, if restatement of prior fiscal years is not practicable, this Statement allows for restatement as of the implementation date.

B50. The phrase *if practicable* has been used in other GASB standards in a similar context as used in this Statement with respect to transition provisions that require restating the financial statements for all prior periods presented. The Board believes that reasonable efforts should be employed before a government determines that restatement of all prior periods presented is not practicable. In other words, *inconvenient* should not be considered equivalent to *not practicable*.

Appendix C

CODIFICATION INSTRUCTIONS

Codification of Governmental Accounting and Financial Reporting Standards—June 2021 Update

C1. The instructions that follow update the December 31, 2018 *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), as amended by Statement 87 and Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, for the provisions of this Statement. Statements 87 and 89 are effective for reporting periods beginning after December 15, 2019. Only the paragraph number of the Statement is listed if the paragraph will be cited in full in the Codification.

* * *

[Update cross-references throughout.]

* * *

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND LEGAL COMPLIANCE **SECTION 1200**

.115 [Insert new subparagraph (d) as follows; renumber subsequent subparagraph.] Section S80, "Subscription-Based Information Technology Arrangements," paragraph .110, discusses the effects of legal restrictions on GAAP for transactions related to subscription-based information technology arrangements.

* * *

REPORTING CAPITAL ASSETS **SECTION 1400**

Sources: [Add GASBS XX.]

See also: [Add Section S80, "Subscription-Based Information Technology Arrangements."]

.123 [Insert new subparagraph (c) as follows; renumber subsequent subparagraphs.] Assets resulting from a subscription-based information technology arrangement, which are addressed in Section S80. [GASBS 51, ¶3, as amended by GASBS 69, ¶39, GASBS 72, ¶64, GASBS 87, ¶20, and GASBS XX, ¶15]

[Insert new paragraph .142 and heading as follows; renumber subsequent paragraphs.]

Capital Assets Resulting from Subscription-Based Information Technology Arrangements

.142 Paragraphs .125–.156 of Section S80 provide guidance on accounting and financial reporting for capital assets resulting from subscription-based information technology arrangements. [GASBS XX, ¶25–¶58]

.172 [Revise footnote 27 as follows:] Paragraph .131 of Section L20 and paragraph .139 of Section S80 provide additional guidance for assessing impairment of lease assets and subscription assets, respectively. [GASBS 42, ¶11, as amended by GASBS 87, ¶34 and GASBS XX, ¶39]

.173 [Revise footnote 28 as follows:] Paragraph .131 of Section L20 and paragraph .139 of Section S80 provide additional guidance for assessing impairment of lease assets and subscription assets, respectively. [GASBS 42, ¶12, as amended by GASBS 87, ¶34 and GASBS XX, ¶39]

[Delete Question .713-8; renumber subsequent question.]

.717-8 [Revise the question as follows:] How should outlays associated with the internal modification of an existing internally generated computer software system that makes it able to interface with a new internally generated computer software system be reported? [GASBIG 2015-1, QZ.51.18, as amended by GASBS XX, ¶38]

.717-10 [Revise the question as follows:] This section provides guidance for the treatment of outlays associated with data conversion and user training activities for internally generated computer software. Section S80 provides guidance for treatment of such outlays associated with subscription-based information technology arrangements. How should such outlays be accounted for when the activities are associated with the acquisition of computer software that is not considered internally generated and is not a subscription-based information technology arrangement? [GASBIG 2015-1, QZ.51.22, as amended by GASBS XX, ¶28–¶38]

[Revise Question .717-11 as follows:]

.717-11 [In the first sentence of the question, replace *A government* with *Associated with a purchased perpetual software license, a government*. In the first sentence of the answer, replace *of computer software* with *of purchased computer software*.] [GASBIG 2015-1, QZ.51.23, as amended by GASBS XX, ¶38 and ¶50–¶52]

[Delete Question .717-13.]

[Insert new heading .723 and associated text as follows; renumber subsequent headings and questions.]

.723 Capital Assets Resulting from Subscription-Based Information Technology Arrangements

No questions assigned.

* * *

REPORTING LIABILITIES SECTION 1500

.129 [Revise the third sentence as follows:] For this purpose, debt does not include leases, except for contracts reported as a financed purchase of the underlying asset, subscription liabilities arising from subscription-based information technology arrangements, or accounts payable. [GASBS 38, ¶10, as amended by GASBS 88, ¶4 and ¶6 and GASBS XX, ¶58]

* * *

CLASSIFICATION AND TERMINOLOGY SECTION 1800

Sources: [Add GASBS XX.]

[Insert new heading and paragraph .129 following current paragraph .128 as follows; renumber subsequent paragraphs.]

Subscription-Based Information Technology Arrangement Transactions

.129 [GASBS XX, ¶56]

[Insert new heading .718 and associated text as follows; renumber subsequent headings and questions.]

.718 Subscription-Based Information Technology Arrangement Transactions

No questions assigned.

* * *

NOTES TO FINANCIAL STATEMENTS SECTION 2300

Sources: [Add GASBS XX.]

.106 [Insert new subparagraph (k) as follows; renumber subsequent subparagraphs.] Required disclosures about subscription-based information technology arrangements. (See Section S80, "Subscription-Based Information Technology Arrangements," paragraphs .157 and .158.)

[Revise current subparagraph (l) as follows:] Required disclosures about capital assets, including lease assets and subscription assets arising from subscription-based information technology arrangements. (See paragraphs .117–.119 and .121 of this section.)

[In the sources, add GASBS XX, ¶57 and ¶58 to the amending sources of GASBS 34, ¶116 and ¶117; add GASBS XX, ¶57 and ¶58 as a source.]

.117 [Revise the second sentence as follows:] The information disclosed should be divided into major classes of capital assets, with separate presentation of totals for (a) lease assets and (b) subscription assets arising from subscription-based information technology arrangements, and major classes of long-term liabilities, as well as between those associated with governmental activities and those associated with business-type activities. [GASBS 34, ¶116, as amended by GASBS 63, ¶8, GASBS 87, ¶37, and GASBS XX, ¶57 and ¶58]

.118 [Replace *with lease assets presented separately,* with *with the total for lease assets and the total for subscription assets arising from subscription-based information technology arrangements each presented separately*.] [GASBS 34, ¶117, as amended by GASBS 87, ¶37 and GASBS XX, ¶57 and ¶58]

* * *

DEBT EXTINGUISHMENTS AND TROUBLED DEBT RESTRUCTURING — SECTION D20

.136 [Revise the first sentence as follows:] For purposes of applying paragraphs .129–.165, troubled debt restructurings do not include changes in lease agreements (the accounting is prescribed by Section L20, "Leases"), subscription-based information technology arrangements (the accounting is prescribed by Section 80, "Subscription-Based Information Technology Arrangements,") or employment-related agreements (for example, pension or other postemployment benefit plans and deferred compensation contracts). [GASBS 62, ¶135, as amended by GASBS 87, ¶3–¶8 and ¶10–¶91 and GASBS XX, ¶51–¶54; GASBS XX, ¶51–¶54]

* * *

LEASES — SECTION L20

.106 [Insert new subparagraph (d) as follows; renumber subsequent subparagraphs.] Contracts that meet the definition of a subscription-based information technology arrangement in paragraphs .103–.105 of Section S80, "Subscription-Based Information Technology Arrangements." [GASBS 87, ¶8, as amended by GASBS XX, ¶3]

* * *

[Insert new Section S80, "Subscription-Based Information Technology Arrangements," as follows:]

SUBSCRIPTION-BASED INFORMATION TECHNOLOGY ARRANGEMENTS — SECTION S80

Sources: GASBS XX

See also: Section 1400, "Reporting Capital Assets"
Section 2300, "Notes to Financial Statements"

Scope and Applicability of This Section

.101–.102 [GASBS XX, ¶3–¶4]

.103–.156 [GASBS XX, ¶5–¶58, including headings and footnotes]

* * *

BANKRUPTCIES — SECTION Bn5

[In heading before .107, replace *Leases* with *Leases and Subscription-Based Information Technology Arrangements*. Replace paragraph .107 with the following:]

.107 If the provisions of a lease or a subscription-based information technology arrangement are modified in a way that changes the amount of the remaining lease liability or subscription liability, respectively, and the modification either (a) does not give rise to a new agreement or (b) does give rise to a new agreement but such agreement also meets the definition of a lease or a subscription-based information technology arrangement, respectively, then the present balances of the lease asset and the lease liability, or the subscription asset and the subscription liability, respectively, should be adjusted by an amount equal to the difference between the lease liability or subscription liability, respectively, under the revised or new agreement and the carrying amount of the pre-petition lease liability or subscription liability, respectively. The lease liability or subscription liability under the revised or new agreement should be computed using the rate of interest used to report the lease or subscription-based information technology agreement in the reporting period before the Plan of Adjustment is confirmed by the court. A termination of a lease or a subscription-based information technology arrangement should be accounted for by removing the lease asset and lease liability, or the subscription asset and subscription liability, respectively, with a gain or loss recognized for the difference. [GASBS 58, ¶8, as amended by GASBS 87, ¶73, ¶74, and ¶78; GASBS XX, ¶51–¶54]

* * *

PENSION PLANS ADMINISTERED THROUGH TRUSTS THAT MEET SPECIFIED CRITERIA—DEFINED BENEFIT — SECTION Pe5

.713-1 [In the question and in the answer, replace *subscriptions* with *subscriptions to industry publications*.] [GASBIG 2015-1, Q5.77.1, as amended by GASBS XX, ¶6–¶8]

* * *

POSTEMPLOYMENT BENEFIT PLANS (OTHER THAN PENSION PLANS) ADMINISTERED THROUGH TRUSTS THAT MEET SPECIFIED CRITERIA—DEFINED BENEFIT **SECTION Po50**

.716-1 [In the question and in the answer, replace *subscriptions* with *subscriptions to industry publications*.] [GASBIG 2017-2, Q4.61, as amended by GASBS XX, ¶6–¶8]

Comprehensive Implementation Guide—June 2021 Update

C2. The instructions that follow update the December 31, 2018 *Comprehensive Implementation Guide,* as amended by Statement 87, for the provisions of this Statement. Statement 87 is effective for reporting periods beginning after December 15, 2019. Only the paragraph or footnote number of the Statement is listed if the paragraph or footnote will be cited in full in the *Comprehensive Implementation Guide.*

* * *

[Update cross-references throughout.]

* * *

5.77.1. [In the question and in the answer, replace *subscriptions* with *subscriptions to industry publications*.] [GASBIG 2015-1, Q5.77.1, as amended by GASBS XX, ¶6–¶8]

8.117.1. [In the question and in the answer, replace *subscriptions* with *subscriptions to industry publications*.] [GASBIG 2017-2, Q4.61, as amended by GASBS XX, ¶6–¶8]

Z.51.18. [Revise the question as follows:] How should outlays associated with the internal modification of an existing internally generated computer software system that makes it able to interface with a new internally generated computer software system be reported? [GASBIG 2015-1, QZ.51.18, as amended by GASBS XX, ¶38]

[Replace Question Z.51.21 with the following:]

Z.51.21. [Question number not used]

Z.51.22. [Revise the question as follows:] This section provides guidance for the treatment of outlays associated with data conversion and user training activities for internally generated computer software. Statement No. XX, *Subscription-Based Information Technology Arrangements,* provides guidance for treatment of such outlays associated with subscription-based information technology arrangements. How should such outlays be accounted for when the activities are associated with the acquisition of computer software that is not considered internally generated and is not a subscription-based information technology arrangement? [GASBIG 2015-1, QZ.51.22, as amended by GASBS XX, ¶28–¶38]

Z.51.23. [In the question, replace *A government has* with *Associated with purchased software, a government also has*. In the first sentence of the answer, replace *computer software* with *purchased computer software*.] [GASBIG 2015-1, QZ.51.23, as amended by GASBS XX, ¶38 and ¶50–¶52]

[Replace Question Z.51.38 with the following:]

Z.51.38. [Question number not used]