The FASB issued ASU 2018-15\(^1\) to align the requirements for capitalizing implementation costs for hosting arrangements (services) with costs for internal-use software (assets). As a result, certain implementation costs incurred in hosting arrangements will be deferred and amortized. The new ASU is available \[\text{here}\], and the effective date for public companies is for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted.

**BACKGROUND**

The FASB previously issued ASU 2015-05\(^2\) to clarify whether a hosting arrangement\(^3\) includes a license to internal-use software. If the arrangement contains a software license, the customer should account for that element in accordance with Subtopic 350-40\(^4\) (i.e., generally capitalize and subsequently amortize the cost of the license, and recognize a liability for future payments associated with the software element). If the arrangement does not contain a software license based on those criteria, the customer should account for the arrangement as a service contract (i.e., expense fees as incurred). For additional information on ASU 2015-05, refer to [BDO’s Alert](#).

---

\(^1\) Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract

\(^2\) Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement

\(^3\) ASU 2018-15 updated the definition of ‘hosting arrangement’ as follows: In connection with accessing and using software products, an arrangement in which the customer of the software does not currently have possession of the software; rather, the customer accesses and uses the software on an as-needed basis.

\(^4\) Intangibles—Goodwill and Other—Internal-Use Software
In response to ASU 2015-05, stakeholders requested additional guidance on accounting for implementation costs associated with hosting arrangements that do not contain a software license and, therefore, are considered service contracts. The absence of guidance on such implementation costs led to diversity in practice regarding whether an entity capitalized and amortized such costs or reflected them as an expense when incurred.

The FASB issued ASU 2018-15 to address that diversity. The accounting for the hosting fees associated with the hosting arrangement is not affected by this ASU and, accordingly, the hosting fees are expensed as the service is provided.

**MAIN PROVISIONS**

The amendments of ASU 2018-15 require a customer in a hosting arrangement that is a service contract to apply the guidance on internal-use software to determine which implementation costs to recognize as an asset and which costs to expense. Costs to develop or obtain internal-use software that cannot be capitalized under Subtopic 350-40, such as training costs and certain data conversion costs, also cannot be capitalized for a hosting arrangement that is a service contract. The amendments require a customer in a hosting arrangement that is a service contract to determine whether an implementation activity relates to the preliminary project stage, the application development stage, or the post-implementation stage. Costs for implementation activities in the application development stage will be capitalized depending on the nature of the costs, while costs incurred during the preliminary project and post-implementation stages will be expensed immediately.

As such, certain costs in the application development phase will be deferred and amortized over the term of the hosting arrangement. That term begins when the module or component of the hosting arrangement is ready for its intended use and includes the noncancellable period of the arrangement plus periods covered by:

1. an option to extend the arrangement if the customer is reasonably certain to exercise that option;
2. an option to terminate the arrangement if the customer is reasonably certain not to exercise the termination option; and
3. an option to extend (or not to terminate) the arrangement in which exercise of the option is in the control of the vendor.

An entity that has capitalized implementation costs under this new guidance will apply existing impairment guidance in Section 360-10-35 to the capitalized implementation costs as if the costs were long-lived assets. An entity also will apply the abandonment guidance in paragraphs 360-10-35-47 through 35-49 to the capitalized implementation costs related to each module or component when it ceases to be used.

ASU 2018-15 also provides guidance regarding the presentation of implementation costs for a hosting arrangement that is a service contract. The guidance clarifies that the capitalized implementation costs are not long-lived assets, which is reflected in the presentation guidance summarized in the following table:

<table>
<thead>
<tr>
<th>Financial Statement</th>
<th>Presentation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet</strong></td>
<td>Present capitalized implementation costs in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented.</td>
</tr>
<tr>
<td><strong>Income Statement</strong></td>
<td>Reflect expense related to the capitalized implementation costs in the same line item as the fees associated with the hosting element (service) of the arrangement. Accordingly, amortization expense related to those implementation costs cannot be presented along with depreciation or amortization expense for PP&amp;E and intangible assets if such depreciation or amortization is presented separately in the income statement.</td>
</tr>
<tr>
<td><strong>Statement of Cash Flows</strong></td>
<td>Classify payments for capitalized implementation costs consistent with payments made for fees associated with the hosting element.</td>
</tr>
</tbody>
</table>
An entity must provide disclosures related to capitalized implementation costs of a hosting arrangement that is a service contract consistent with those required for internal-use software, and also should make the disclosures in Subtopic 360-10 as if the capitalized implementation costs were a separate major class of depreciable asset.

**EFFECTIVE DATE AND TRANSITION**

The amendments are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2020, and interim periods within annual periods beginning after December 15, 2021. Early adoption is permitted, including adoption in any interim period, for all entities.

The amendments should be applied prospectively to all implementation costs incurred after the date of adoption or retrospectively. Transition disclosures depend on the transition method selected.

**CONTACT**

THOMAS FAINETEAU / National Assurance Partner
214-243-2924 / tfaineteau@bdo.com

JENNIFER KIMMEL / National Assurance Director
617-239-7019 / jkimmel@bdo.com

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, and advisory services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through more than 60 offices and over 650 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of more than 73,800 people working out of 1,500 offices across 162 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information please visit: www.bdo.com.

Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your needs.

© 2018 BDO USA, LLP. All rights reserved.