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November 12, 2014

Via email to director@fasb.org

Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* (File Reference No. 2014-230) ("the ED")

Dear Ms. Cosper:

We are pleased to provide comments on the proposal related to the recognition of fees paid in a cloud computing arrangement. Although the proposal indicates that some diversity in practice exists for cloud computing fees, that has not been our experience. To our knowledge, requests for guidance on this issue have been limited, perhaps in part because most practitioners have concluded such fees should not be capitalized under current U.S. GAAP.

However, if the Board decides to finalize the ED, we offer several suggestions and observations. First, we question whether customers will find the proposed guidance operational. In contrast to software vendors, this guidance has not been applied in practice by its intended audience, i.e., customers. Those entities do not necessarily have experience accounting for software and hosting revenue recognition arrangements. Consequently, they may find it difficult to apply the proposed framework to determine whether an arrangement should be accounted for as the acquisition of internal use software or as a service arrangement. For example, many hosting arrangements include language indicating that a license has been transferred from a legal perspective to use the vendor's software. However, this often does not equate to the customer having a contractual right to take possession of the software itself. This distinction may not be readily apparent to SaaS customers. In addition, preparers (and indirectly users) will experience additional cost and complexity applying the proposed framework without significant benefit when it does not result in an accounting change. As such, we recommend the Board conduct additional outreach with manufacturing, retail and other non-software companies that generally do not apply Subtopic 985-605[1] to determine whether the proposed guidance will achieve the intended effect of simplification.

Second, additional guidance on what constitutes a service contract may be necessary. While that issue is broader than the scope of the ED, practitioners will be required to distinguish between a service and the purchase of an asset when applying the final amendments. As such, the Board might leverage the definition of an executory contract in EITF 03-17:[2] "a contract that remains wholly unperformed or for which there remains something to be done by either or both parties of

[1] Software—Revenue Recognition
[2] *Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet*

the contract." In addition, we recommend elevating the following language from the basis for conclusions into the final amendments:

> *Some arrangements may include one or more licenses to software as well as a promise to provide services, in which case the customer should allocate the contract consideration between the license(s) and the service element(s).*[3]

We believe that the final guidance also should address the basis of the allocation, perhaps indicating that a "systematic and rational" basis would suffice. Further, it should also specify whether certain ancillary services (including but not limited to: customization, installation, training, and third party setup activities) are included within the scope of the ED. While we believe these clarifications are necessary to make the guidance operational, it also emphasizes that the proposal may not result in simplification. This is especially true if, in effect, a "multiple-element" analysis has to be performed by the customer, in addition to determining whether the arrangement should be accounted for as the acquisition of internal use software or as a service arrangement.

Third, we recommend the final guidance specify the proper accounting treatment when an arrangement does not qualify for capitalization, but is prepaid. Specifically, this type of transaction would not be accounted for under Topic 350, *Intangibles – Goodwill and Other* or Topic 840, *Leases* (or the proposed Topic 842, *Leases*). Rather, such fees would typically be recognized and amortized similar to other general prepaid expenses.

Fourth, we recommend the final amendments clarify that the assessment under paragraph 350-40-15-4A should be performed for the noncancelable term of a contract that allows for renewals (e.g., 12 months at a time for a hosting contract that has yearly renewals, instead of the total expected term including renewals).

Lastly, we agree with the proposed effective dates. With respect to transition methods, we recommend a cumulative effect approach rather than a purely prospective method. That is, we don't see a clear basis for grandfathering long-term contracts.

However, if the Board permits prospective adoption, we recommend clarifying the related transition disclosure requirements. For example, if the entity has a material contract with a three year term, one year of which has passed as of the date of adoption and prospectively applies the guidance, the entity would continue to apply previous U.S. GAAP for the remaining two years of the contract. In that scenario, it is unclear whether the disclosures proposed in paragraph 350-40-65-1(e) would provide any benefit to users.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Adam Brown at (214) 665-0673 or Ken Gee at (415) 490-3230.

Very truly yours,

BDO USA, LLP

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[3] See paragraph BC3 of the exposure draft.