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# Subscription-Based Information Technology Arrangements

## GASB 96 Accounting Update

Author: Carrie Rice

Johnson Lambert is dedicated to keeping you up to date on the impact of the Government Accounting Standards Board's (GASB) Statement No. 96, *Subscription-Based Information Technology Arrangements* (GASB 96). This white paper presents the most significant changes to accounting for subscription-based information technology arrangements that are likely to impact your financial statements. GASB 96 is effective for fiscal years beginning after June 15, 2022, with early application permitted.

### Background

In May 2020, the GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements* to improve the accounting and reporting for SBITAs.

The guidance defines SBITAs and establishes accounting for the right-to-use subscription asset—an intangible asset—and a corresponding subscription liability. The standard also provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and required financial statement disclosures. The accounting guidance for SBITAs is based on and shares many of the key concepts contained in GASB Statement No. 87, *Leases* (GASB 87), as amended.

### Definition, Classification and Measurement

A SBITA is a contract which conveys control of the right to use another party's (a SBITA vendor) IT software, alone or in combination with tangible capital assets, as specified in the contract for a period of time in an exchange or exchange-like transaction.

In order to determine whether a contract conveys control of the right to use the underlying IT assets, a Government should assess whether it has both of the following:

1. the right to obtain the present service capacity from use of the underlying IT assets as specified in the contract, and
2. the right to determine the nature and manner of use of the underlying IT assets as specified in the contract.

SBITA contracts exclude contracts that solely provide IT support services, but include contracts that contain both a right-to-use IT asset component and an IT support services component.

## Applicability

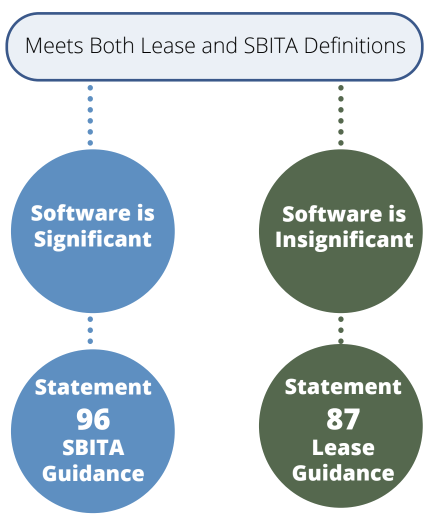
GASB 96 does not apply to the following:

**Scope Exceptions**

- Contacts that would fall under GASB 87, *Leases*;
- Subscribers that provide the right-to-use their IT software and associated tangible capital assets to other entities through SBITAs;
- Contracts that meet the definition of a public-private and public-public partnership; or
- Licensing arrangements that provide a perpetual license to Governments to use a vendor's computer software.

## Lease or SBITA?

When a contract meets both the definition of a Lease and a SBITA, the significance of the software to the contract determines the accounting treatment.




## Examples of SBITAs

### Software as a Service (SaaS)

- Using the vendor's cloud based software application (ex: Quickbooks, FinancialForce, Microsoft 365, Slack, Google Workspace)
- Using the vendor's cloud based software system (ex: Docusign, Adobe)
- Using the vendor's cloud based conferencing system (ex: Zoom, Teams)

### Platform as a Service (PaaS)

- Using the vendor's platform for Software Development - Subscriber has control over the code but not the underlying resources running the code (ex: Appian, Pega, Google App Engine, Azure App Services, AWS Lambda)

### Infrastructure as a Service (IaaS)

- Using the vendor's cloud-based compute, networking, ram and storage services - Subscriber's responsibility to manage and operate (ex: AWS, Azure, Google Cloud Platform, Digital Ocean)

### Warehouse as a Service (WaaS)

- Using the vendor's cloud based on-demand access to warehouse space (ex: Snowflake, AWS RedShift, Google BigQuery)

Governments may enter into subscription-based information technology arrangements with vendors for underwriting and claim systems (ex: Guidewire, Origami). These contracts are SBITAs and fall under one of the above categories depending on the contract terms.

### Accounting Treatment

**Short-term SBITAs** are those with a maximum possible term of twelve months or less, including extension options (regardless of the probability of being exercised). Accounting for short-term SBITAs is overall consistent to present day.

**All other SBITAs** that do not fall under short-term SBITAs are accounted for using the economic resource measurement focus.

### Measurement Focus

At the commencement of the subscription, a subscription liability and an intangible right-to-use asset should be recognized as follows on the Statement of Net Position:

| Line Item | Initial Measurement | Subsequent Measurement |
|---|---|---|
| Subscription Asset | Initial subscription liability, plus any prepayments made prior to subscription term, plus capitalizable implementation costs, less any incentives received at or before commencement | Amortized over the shorter of the subscription term or the useful life of the underlying IT assets |
| Subscription Liability | Present value of subscription payments (fixed and certain variable) and contract incentives receivable from the SBITA vendor | Reduced for principal payments made |

### Subscription Term

The subscription term is an important measurement and is comprised of:

**Included in Subscription Term**

- The noncancelable period of the right-to-use the underlying IT assets
- Periods for which it is *reasonably certain* that the option to extend will be exercised
- Periods for which it is *reasonably certain* that termination options will not be exercised

A Subscriber (the Government) should assess all factors relevant to the likelihood that the Subscriber or the SBITA vendor will exercise the options identified above at the commencement of the arrangement. Factors could be contract based, underlying IT asset based, market based, or Government specific. Examples of factors to consider include, but are not limited to, the following:

+ A significant economic incentive or disincentive
+ A potential change in technological development
+ A potential significant change in the demand for SBITA vendor's IT assets
+ History of exercising options to extend or terminate
+ Extent to which the IT assets are essential to the Subscribers' services

Periods for which both the Subscriber 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, because they are not considered legally enforceable.

For example, a rolling month-to-month SBITA, or a year-to-year SBITA that each have cancellable periods, 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 either payment of all sums due or default on subscription payments are not considered termination options.

The subscription term should be reassessed if **one or more** of the following occur:

+ If either party elects to or not to exercise an option that was not previously determined
+ An event specified in the SBITA contract occurs that requires an extension or termination of the SBITA

### Subscription Liability Remeasurement

A remeasurement of the subscription liability should occur when there is a change in:

+ Subscription term (exercising an existing option, such as an option to extend or terminate the SBITA)
+ Estimated payment amount previously used to measure the liability
+ Interest rate charged by SBITA vendor (if using the implicit rate)
+ Event occurring resulting in variable payments becoming fixed

A subscription liability is not required to be remeasured solely for a change in an index or a rate used to determine variable payments.

Accordingly, the subscription asset and liability will be adjusted using revised inputs at the remeasurement date. A Subscriber is required to update the discount rate as part of the remeasurement if there is a change in the **subscription term** and that change is expected to significantly affect the amount of the subscription liability.

### SBITA Modifications and Terminations

A SBITA contract may be amended (renegotiated) while the contract is in effect. This may include:

+ Changing the contract price
+ Extending or reducing the subscription term
+ Adding or removing underlying IT assets
+ Changing the index or rate upon which variable payments depend

Modifications to a contract should be accounted as a separate contract provided both of the following conditions are met:

1. an additional subscription asset is added, and
2. the increase in subscription payments for the additional subscription asset does not appear to be unreasonable priced (priced using readily available observable standalone prices).

Modifications not accounted for as a separate contract should be accounted for by remeasuring the subscription liability.

Any amendment that shortens the SBITA term or reduces the number of underlying assets is considered a partial or full termination of the subscription agreement by reducing the assets and liabilities and recording a gain or loss, if any.

### Implementation Costs - Outlays Other Than Subscription Payments

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

| Stage | Activities | Accounting |
|---|---|---|
| **Preliminary Project Stage** | • Formulate and evaluate alternatives<br>• Determine existence of needed technology<br>• Selection among alternatives | Expensed as incurred |
| **Inital Implementation Stage** | • Design, configure, code, install, and test<br>• Convert data needed to make underlying assets operational (completed when the asset is placed in service) | Capitalized, except for short-term SBITA |
| **Operation and Additional Implementation Stage** | • Troubleshooting and maintenance<br>• Convert data (other than that needed to make underlying assets operational)<br>• Maintain software (and hardware) | Expensed as incurred |
| **All stages** | • Training | Expensed as incurred |

If the SBITA has more than one module, and the modules are implemented at different times, upon the completion of the first module implementation and the subscription asset is placed into service, the implementation stage is considered to be complete, regardless of whether the other modules are completely implemented.

Data conversion should be included in the implementation stage if it is necessary to place the subscription asset into service, all other data conversions should be considered an activity of the operations and additional implementation phase.

Capitalized implementation costs are included as a component of the subscription asset and amortized over the shorter of the subscription term or the asset's useful life. While the project stages and capitalization criteria above are consistent with other types of internally generated computer software under GASB Statement No. 51, *Intangible Assets*, SBITAs are reliant on the underlying subscription agreement, as such the associated implementation costs would not qualify for capitalization as a stand-alone intangible asset.

### Disclosures

The Subscriber's financial statement footnote disclosures will include the following:

+ A general description of the subscription-based IT arrangements
+ Total subscription assets recognized and related accumulated amortization, disclosed separately from other capital assets
+ Principal and interest requirements to maturity, for the subscription liability for each of the five subsequent fiscal years, and in five-year increments thereafter
+ The amount of variable payments and other payments not included in the subscription liability, and the expense recognized in the reporting period for these payments
+ Commitments under SBITAs before the commencement of the subscription term
+ Impairment losses and any significant related changes in the subscription liability
+ 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

## Discount Rate

The future payments should be discounted by reviewing the contract to determine which discount rate to apply.

If a discount rate is not explicitly stated, then the rate shall default to the Government's incremental borrowing rate, which is an estimate of the rate that would be charged by a bank or lender for the same amount and subscription term.

Discount rates should be reassessed if there is a change in the subscription term and it has a significant effect on the amount of the subscription liability.

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.

## Contracts with Multiple Components

Governments may enter into contracts that contain both a subscription and non subscription components or a contract that contains multiple underlying IT components. Non subscription components may include a separate licensing arrangement or maintenance contracts for IT assets. When a contract contains both a subscription and non subscription component, each component is accounted for as a separate contract.

If a SBITA involves multiple underlying IT assets with different subscription terms, each underlying IT asset should be accounted as a separate subscription component.

To allocate the contract price to the different components, the Subscriber should:

+ Identify prices for individual components that are included in the contract, as long as the price allocation does not appear to be unreasonable
+ If no price is stated in the contract, then stand-alone prices that would be paid for the right-to-use the component should be applied, as if it was contracted individually
+ If discounts for bundling are present, it would be applied to all components

The Subscriber should account for multiple components as one SBITA when one of the following occurs:

+ If it is not practical to determine a best estimate for price allocation for some or all components in the contract, or
+ If there are multiple modules in which the subscription term commences at the same time, all modules will be based on the primary subscription term.

## Contract Combinations

Contracts that are entered into at or near the same time with the same SBITA vendor should be considered part of the same contract and should be evaluated accordingly as contracts with multiple components, if <u>either</u> of the following criteria is met:

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

## Incentives

Incentives received by the Subscriber are payments for which the Subscriber has a right-of-offset with its obligation to the SBITA vendor or other concessions granted to the Subscriber. Incentives can be reimbursements of end user costs, free subscription periods, and reductions of interest or principal charges by the SBITA vendor.

SBITA vendor incentive payments prior to the commencement of the subscription shall reduce prepayments made by the Subscriber if a right-of-offset exists. The incentive payment should be reclassified as an addition to the initial measurement of the subscription asset at the commencement of the subscription term. SBITA vendor incentive payments to be provided after the commencement of the subscription term are included in the initial measurement and any remeasurement of the subscription liability if the incentive payments are fixed or fixed in substance, whereas variable or contingent incentive payments are not included.

## Impairment

Impairment should be evaluated throughout the duration of the subscription term. An asset can become impaired if there is a change in the manner or duration of use of the subscription asset. If the subscription asset is deemed impaired, the subscription asset should be reduced for any change in the liability and any remaining amount should be recognized as an impairment.

## Public-Private and Public-Public Partnerships

GASB Statement No. 94 defines a public-private and public-public partnership (PPP) as an arrangement in which a Government (the transferor) contracts with an operator (a Governmental or non-governmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Such contracts do not meet the definition of a SBITA.

## Transition

GASB 96 is effective for fiscal years beginning after June 15, 2022, with early application permitted. The guidance should be applied retroactively by restating financial statements for all prior periods presented, if practicable. If restatement is not practicable, the cumulative effect, if any, of applying GASB 96 should be reported as a restatement of beginning net position for the earliest fiscal year restated. Assets and liabilities should be recognized and measured using the facts and circumstances that existed at the beginning of the earliest fiscal year restated.

## ILLUSTRATIONS

### *Example 1 – Short-term SBITA*

Government A enters into a subscription based contract with the following terms:

- Effective date: July 1, 2022
- Length: 12 months
- Asset type: IT subscription contract for claims software
- Payments: $1,000/month

The SBITA will be treated as a short-term SBITA and Government A will record the following monthly entry:

| **On July 1, 2022:** | | |
|---|---|---|
| DR Claims Software Expense | $1,000 | |
| CR Cash | | $1,000 |

### *Example 2 – Accounting for a long-term SBITA Contract (New SBITA)*

The Government's fiscal year end is 06.30.2023. It entered into a new SBITA on 01.01.2023 after the adopting GASB 96 on 07.01.2022. The SBITA is a five year SBITA for claims software. There are no options to extend the SBITA or other SBITA modifications in the contract.

- Effective date: January 1, 2023
- Length: 5 years (60 months)
- Interest rate: 4% (entity's borrowing rate - no implicit rate available)
- Payments: $35,000/month
- Capitalization Costs: $50,000

Because the contract term is greater than twelve months, the Subscriber recognizes a right-to-use subscription asset and a liability:

Straight-line amortization over the shorter of the lease term or the useful life

Present value of SBITA payments = $1,906,802
Total SBITA payments = $2,100,000

| | | Components of the SBITA payment: | | Balances for Subscriber to recognize: | |
|---|---|---|---|---|---|
| Date | SBITA Payment | Interest rate 4% | SBITA Amortization | Asset | Liability |
| 01/01/2023 | | | | $1,956,802 | $1,906,802 |
| 06/30/2023 | $210,000 | $35,992 | $195,680 | $1,761,122 | $1,732,794 |
| 06/30/2024 | $420,000 | $61,385 | $391,360 | $1,369,762 | $1,374,178 |
| 06/30/2025 | $420,000 | $46,774 | $391,360 | $978,401 | $1,000,952 |
| 06/30/2026 | $420,000 | $31,568 | $391,360 | $587,041 | $612,521 |
| 06/30/2027 | $420,000 | $15,743 | $391,360 | $195,680 | $208,264 |
| 12/31/2027 | $210,000 | $1,736 | $195,680 | - | - |
| Totals | $2,100,000 | $193,198 | $1,956,802 | | |

The liability is reduced by the difference between the interest expense and lease payment

The Government will record the following entries:

| On January 1, 2023: | | |
|---|---|---|
| DR Right-to-Use Subscription Asset (Claims Software) | $1,956,802 | |
| CR SBITA Liability | | $1,906,802 |
| CR Capitalized Costs | | $50,000 |
| *To record the SBITA and move the related capitalized costs within the subscription asset* | | |

| On June 30, 2023: | | |
|---|---|---|
| DR SBITA Liability | $174,008 | |
| DR Interest Expense | $35,992 | |
| CR Cash | | $210,000 |
| *To record payments* | | |

| | | |
|---|---|---|
| DR Amortization | $195,680 | |
| CR Right-to-Use Asset - Accumulated Depreciation | | $195,680 |
| *To record amortization* | | |

### *Example 3 – Accounting for a long-term SBITA Contract - Year of Adoption*

The Government's fiscal year end is 06.30.2023. The Government entered into an agreement on 7.1.2020 and adopts GASB 96 on 07.01.2022 and concludes it is impractical to restate its prior period financial statements and elects the Year of Adoption transition method. Governments with straight forward SBITA contracts would generally be unable to conclude it is impractical to restate its prior period financial statements.

- Effective date: July 1, 2020
- Length: 5 years (60 months)
- Interest rate: 4% (entity's borrowing rate - no implicit rate available)
- Payments: $35,000/month
- Incentive Received from Lessor on Commencement Date: $5,000
- Capitalization Costs: $50,000 **

Because the contract term is greater than twelve months, the Subscriber recognizes a right-to-use subscription asset and a liability:

**At transition, the Government may elect to keep previously expensed "Initial Implementation Stage" costs as expensed or bring them into the subscription asset.

Present value of SBITA payments = $1,906,802
Total SBITA payments = $2,100,000

Straight-line amortization over the shorter of the lease term or the useful life

| | | Components of the SBITA payment: | | Balances for Subscriber to recognize: | |
|---|---|---|---|---|---|
| Date | SBITA Payment | Interest rate 4% | SBITA Amortization | Asset | Liability |
| 07/01/2020 | | | | $1,951,802 | $1,906,802 |
| 06/30/2021 | $420,000 | $68,474 | $390,360 | $1,561,442 | $1,555,276 |
| 06/30/2022 | $420,000 | $54,152 | $390,360 | $1,171,081 | $1,189,428 |
| 06/30/2023 | $420,000 | $39,247 | $390,360 | $780,721 | $808,675 |
| 06/30/2024 | $420,000 | $23,735 | $390,360 | $390,360 | $412,410 |
| 06/30/2025 | $420,000 | $7,590 | $390,360 | - | - |
| Totals | $2,100,000 | $193,198 | $1,951,802 | | |

The liability is reduced by the difference between the interest expense and lease payment

The Government will record the following entries:

| **On July 1, 2022:** | | |
|---|---|---|
| DR Right-to-Use Subscription Asset (Claims Software) | $1,171,081 | |
| CR SBITA Liability | | $1,189,428 |
| DR Net Position | $18,347 | |

*Transition SBITA in accordance with GASB 96, with Management electing to include capitalize costs within the subscription asset*

| **On June 30, 2023:** | | |
|---|---|---|
| DR SBITA Liability | $380,753 | |
| DR Interest Expense | $39,247 | |
| CR Cash | | $420,000 |

*To record first year payments*

| | | |
|---|---|---|
| DR Amortization | $390,360 | |
| CR Right-to-Use Asset - Accumulated Depreciation | | $390,360 |

*To record amortization*

***Example 4 – Accounting for a long-term SBITA - Restatement of Prior Year***

The Government's fiscal year end is 06.30.2023. The Government entered into an agreement on 7.1.2020 and adopts GASB 96 on 07.01.2022 and elects the restatement transition method. As the Government presents comparative financial statements as of 06.30.2023 and 06.30.2022, the restatement is recorded as of 07.01.2021 (first year presented).

- Effective date: July 1, 2020
- Length: 5 years (60 months)
- Interest rate: 4% (entity's borrowing rate - no implicit rate available)
- Payments: $35,000/month
- Incentive Received from Lessor on Commencement Date: $5,000
- Capitalization Costs: $50,000 **

Because the contract term is greater than twelve months, the Subscriber recognizes a right-to-use subscription asset and a liability:

Present value of SBITA payments = $1,906,802
Total SBITA payments = $2,100,000

Straight-line amortization over the shorter of the lease term or the useful life

| | | Components of the SBITA payment: | | Balances for Subscriber to recognize: | |
|---|---|---|---|---|---|
| Date | SBITA Payment | Interest rate 4% | SBITA Amortization | Asset | Liability |
| 07/01/2020 | | | | $1,951,802 | $1,906,802 |
| 06/30/2021 | $420,000 | $68,474 | $390,360 | $1,561,442 | $1,555,276 |
| 06/30/2022 | $420,000 | $54,152 | $390,360 | $1,171,081 | $1,189,428 |
| 06/30/2023 | $420,000 | $39,247 | $390,360 | $780,721 | $808,675 |
| 06/30/2024 | $420,000 | $23,735 | $390,360 | $390,360 | $412,410 |
| 06/30/2025 | $420,000 | $7,590 | $390,360 | - | - |
| Totals | $2,100,000 | $193,198 | $1,951,802 | | |

The liability is reduced by the difference between the interest expense and lease payment

The Government will record the following entries:

| **On July 1, 2021:** | | |
|---|---|---|
| DR Right-to-Use Subscription Asset (Claims Software) | $1,561,442 | |
| CR SBITA Liability | | $1,555,276 |
| CR Net Position | | $6,166 |

*Transition SBITA in accordance with GASB 96, with Management electing to include capitalized costs within the subscription asset*

| On June 30, 2022: | | |
|---|---|---|
| DR SBITA Liability | $365,848 | |
| DR Interest Expense | $54,152 | |
| CR Cash | | $420,000 |
| *To record payments* | | |
| | | |
| DR Amortization | $390,360 | |
| CR Right-to-Use Asset - Accumulated Depreciation | | $390,360 |
| *To record amortization* | | |

**The discount rate was kept steady for illustration purposes despite the changing of rates during the periods described above.

**Author:** Carrie Rice