GASB 96 – What You Need to Know

The deadline to implement GASB Statement 96, Subscription-Based Information Technology Arrangements (SBITA), has arrived. The standard defines a SBITA, establishes that a SBITA would result in a right-to-use (RTU) asset and a corresponding liability, provides capitalization criteria, and requires new note disclosures. Some common examples include:

- Software as a Service (SaaS) – *e.g.*, Cloud-based conferencing system such as Zoom or Teams
- Platform as a Service (PaaS) – *e.g.*, Environment for software development such as Azure
- Infrastructure as a Service (IaaS) – *e.g.*, Cloud-based storage such as OneDrive

Here's what you need to know.

Statement 96, Effective Date → **Reporting periods beginning after June 15, 2022**

Background

Statement 96 addresses the accounting for the costs related to cloud computing agreements. Prior to the release of this guidance, there was no authoritative governmental accounting literature for these significant investments. Governments analogized to other guidance that—not surprisingly—has given rise to diversity in practice for recognizing and reporting these substantial costs. The statement covers many types of arrangements available—SaaS, PaaS, IaaS, and platform as a service. To capture this variety of products and services, GASB has chosen the term SBITA.

Scope

A SBITA is a contract that conveys control of the right to use information technology (IT) software alone—or in combination with tangible capital assets (underlying IT assets)—for a period of time in an exchange or exchange-like transaction. A government should assess whether it has both of the following:

- The right to obtain the present service capacity from use of the underlying IT assets
- The right to determine the nature and manner of use of the underlying IT assets

This definition excludes contracts that solely provide IT support services but includes contracts that contain both an RTU IT asset and an IT support services component.

This guidance would not apply to:

- Contracts that convey control of the right to use another party's combination of IT software and tangible capital assets (hardware) that meets the lease definition in Statement 87, Leases, **in which the software is insignificant when compared to the cost of the hardware**, *e.g.*, a computer with operating software or a smart copier that is connected to an IT system

- Governments that provide the right to use their IT software and hardware to other entities through SBITAs
- Contracts that meet the definition of a public-private and public-public partnership, which would be covered by Statement 94, Public-Private and Public-Public Partnerships and Availability Payment Arrangements (see article "GASB Updates Public-Private Partnership Accounting")
- Licensing arrangements that provide a perpetual license to governments to use a vendor's computer software, which are subject to Statement 51, Accounting and Financial Reporting for Intangible Assets, as amended

Terminology Differences		
	SBITA (GASB 96)	Lease (GASB 87)
Parties	Vendor Government	Lessor Lessee
Liability	Subscription liability	Lease liability
Intangible RTU Asset	Subscription asset	Lease asset
Underlying Asset	Underlying IT asset	Underlying asset

Subscription Term

The subscription term includes the period during which a government has a noncancelable right to use the underlying IT assets and includes periods covered by an option to extend (if it is reasonably certain that either party—the government or the SBITA vendor—will exercise that option) or to terminate (if it is reasonably certain either party will not exercise that option). At the subscription's commencement, a government should assess all relevant factors to determine the likelihood of exercise options, whether contract-based, asset-based, market-based, or government-specific. The following factors should be considered in evaluating the likelihood of option exercise:

- A significant economic incentive, such as favorable contractual terms and conditions for the optional periods compared with the current market
- A potential change in technological development that significantly affects the IT asset's technology
- A potential significant change in the government's demand for the SBITA vendors' IT assets
- A significant economic disincentive, such as costs to terminate the SBITA and sign a new SBITA, *i.e.*, negotiation costs, costs of identifying another suitable IT asset or suitable SBITA vendor, implementation costs, or a substantial cancellation penalty
- Option exercise history
- The extent to which the SBITA's IT assets are essential to the provision of government services

A rolling month-to-month SBITA—or a SBITA that continues into a holdover period until a new contract is signed—would not be enforceable if both parties have an option to terminate and 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.

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.

Subsequent Update

GASB Statement 99, Omnibus 2022, clarifies that a provision that gives a party to the SBITA the right to terminate the SBITA contract only in certain circumstances or upon the occurrence of certain events, such as the action or inaction of the other party to the SBITA contract, would not be considered an option to terminate the SBITA for purposes of determining the SBITA term. For example, provisions that allow for the termination of a SBITA due to a violation of SBITA terms and conditions, such as a default on payments, are not considered options to terminate the SBITA.

Reassessment

Reassessment of the subscription term is only required if either party changes an exercise election option (extend or terminate) contrary to its previous reasonably certain conclusion or an event specified in the SBITA contract that requires an extension or termination of the SBITA takes place.

Recognition

A government would recognize an RTU subscription asset—an intangible asset—and a corresponding subscription liability at the subscription term's commencement, which begins when the initial implementation stage is completed (described below), at which time the government has obtained control of the right to use the underlying IT assets, and the subscription asset is placed into service.

Subscription Liability

The subscription liability would be measured at the present value of subscription payments expected to be made during the subscription term, including the following:

- Fixed payments

- Variable payments that depend on an index or rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the subscription term's commencement
- Variable payments that are fixed in substance
- Termination penalties, if the subscription term reflects the government exercising a termination option or a fiscal funding or cancellation clause
- Any subscription contract incentives receivable from the SBITA vendor. These may include assumption of a government's pre-existing 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
- Any other payments to the SBITA vendor that are reasonably certain of being required based on an assessment of all relevant factors

Future subscription payments would be discounted using the interest rate the SBITA vendor charges the government or the government's incremental borrowing rate (IBR) 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, *e.g.*, interest expense, in subsequent financial reporting periods.

Subscription Asset

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

Pre-commencement payments to the SBITA vendor, as well as pre-commencement payments made for the capitalizable initial implementation costs, should be reported as a prepayment (an asset). Pre-commencement prepayments should be reduced by any incentives received from the same SBITA vendor if a right of offset exists. At term commencement, the prepayment should be reclassified as an addition to the subscription asset's initial measurement. If the vendor incentives are greater than the vendor prepayments, the difference should be reported as a liability until the subscription term commencement, at which time that amount should reduce the subscription asset's initial measurement.

Subscription Liability	• Present value of subscription payments expected to be made during the subscription term
RTU Asset	• Initial liability + • Upfront payments to the SBITA vendor + • Capitalizable implementation costs

Short-Term Exception

GASB has provided an exception for short-term SBITAs, which are 12 months or less, including any options to extend, regardless of their probability of being exercised. For a SBITA that is cancelable by either the government or SBITA vendor, such as a rolling month-to-month SBITA or a year-to-year SBITA, the maximum possible term is the noncancelable period, including any notice periods. Subscription payments for short-term SBITAs would be recognized as outflows of resources over the subscription term. 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, *e.g.*, one or more months free.

Subsequent Update

Statement 99 clarifies that a SBITA that previously had been determined to be short term and that has been modified to extend the initial maximum possible term under the SBITA contract should be reassessed from the contract's **inception**. If the reassessed maximum possible term is greater than 12 months, the SBITA should no longer be considered a short-term SBITA. For a SBITA that is reclassified from a short-term SBITA, the SBITA term should be assessed beginning at the date of the modification for purposes of measuring the subscription liability.

Remeasurement

Certain changes will require remeasurement of the subscription liability if—individually or in the aggregate—they are expected to significantly affect the amount of the subscription liability since the previous measurement:

- Change in the subscription term
- Change in the estimated amounts for subscription payments already included in the measurement of the subscription liability
- Change in the interest rate the SBITA vendor charges the government, if used as the initial discount rate
- Resolution of a contingency, upon which some or all of the variable payments that will be made over the remainder of the subscription term are based and now meet the criteria for measuring the subscription liability

A change solely in the rate used to determine variable payments or the discount rate does not require remeasurement.

A government also should 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 liability amount. If the discount rate is required to be updated, 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 IBR at the time the discount rate is updated should be used.

At remeasurement, the subscription asset should be adjusted by the same amount as the subscription liability. If the change reduces the asset's carrying value to zero, any remaining amount should be reported in the resource flows statement, *i.e.*, a gain.

Subsequent Update

Statement 99 clarifies that a subscription liability should not be remeasured solely for a change in an index or a rate used to determine variable payments, nor should the discount rate be reassessed solely for a change in a government's IBR.

Implementation Costs & Other Outlays

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 conceptual formulation, evaluating alternatives, determining needed technology, and final selection. Outlays in this stage would be expensed as incurred.
- **Initial Implementation Stage**, including all ancillary charges necessary to place the subscription asset into service, including design, configuration, coding testing, and installation. Outlays in this stage generally would be capitalized as an addition to the subscription asset. If no subscription asset is recognized, *e.g.*, a short-term SBITA contract, activities should be expensed as incurred.
- **Post-Implementation/Operation Stage**, including activities such as maintenance, troubleshooting, and other activities for a government's ongoing access to the underlying IT assets. Outlays in this stage would be expensed as incurred.

If these activities overlap or occur in a different sequence, this recognition guidance should be applied based primarily on the nature of the activity.

It is common for a SBITA to have more than one module that could be implemented at different times. In these situations, the initial implementation stage for the SBITA is completed, and the subscription asset is placed into service when initial implementation is completed for the first independently functional module or for the first set of interdependent modules, regardless of whether all remaining modules have been completely implemented.

Data conversion should be considered an activity of the initial implementation stage only to the extent it is necessary to make the subscription asset operational. Otherwise, data conversion should be considered an activity of the post-implementation stage.

Training costs—regardless of which stage they are in—would be expensed as incurred.

Additional costs should be capitalized as an addition to the existing subscription asset only if the expenditure results in an increase in the asset's functionality (new task) or efficiency (an increase in the level of service provided).

Stage	Activities Description	Accounting Treatment
Preliminary Project	• Conceptual formulation, evaluating alternatives • Determining needed technology • Final selection	Expense as incurred
Initial Implementation	• Ancillary charges necessary to place the subscription asset into service, including design, configuration, coding, testing, and installation	Capitalized as an addition to the subscription asset
Operation and Additional Implementation	• Maintenance, troubleshooting, and other activities for a government's ongoing access to the underlying IT assets	Expense as incurred, unless certain criteria are met

Impairment

A change in the manner or duration of use of the subscription asset may indicate 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 IT assets or is limited to using them 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 the asset's service utility. If impaired, the subscription asset carrying value should be reduced first for any change in the corresponding subscription liability. Any remaining amount should be recognized as an impairment.

Vendor Incentives

Vendors may provide incentives—a rebate that may offset the government's vendor obligation or other concessions. Examples include an agreement to pay a government's pre-existing subscription obligations to a third party, other reimbursements of end-user costs, free subscription periods, and reductions of interest or principal charges. Pre-commencement vendor incentives should be included in initial measurement by directly reducing the amount of the subscription asset. Post-commencement vendor incentives should be factored into the present value of the subscription payments for the periods in which the incentive payments will be provided, when initially measuring the subscription liability.

Multiple Components

If a SBITA contract contains multiple components—such as both a subscription component and a nonsubscription component or multiple IT assets —a government would account for each component as a separate SBITA component and allocate the contract price to the different components.

If a SBITA involves multiple underlying IT asset components and the IT asset components have different subscription terms, the government should account for each underlying IT asset component as a separate subscription.

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.

Contract Combinations

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

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

If combined, a government should follow the multiple component guidance above.

Contract Modifications & Terminations

The guidance covers contract amendments that change the SBITA contract provisions, including price updates, term changes, adding or removing underlying IT assets, and changing the variable payment index or rate. An amendment should be considered a modification unless the government's right to use the underlying IT assets decreases, which would be considered a partial or full SBITA termination.

Exercising an existing option, such as an option to extend or terminate the SBITA, is subject to remeasurement guidance and is not considered a modification.

Updates related to the London Interbank Offered Rate (LIBOR) sunset—either changing the rate or updating fallback provisions—are not considered contract modifications (see article "GASB Finalizes LIBOR Transition Relief").

A modification would be treated as a separate SBITA arrangement only if both of the following conditions are present:

- A modification that gives the government an additional subscription asset by adding access to more underlying IT assets that were not included in the original SBITA contract
- The increase in subscription payments for the additional subscription asset does not appear to be unreasonable based on the amended contract terms and professional judgment, maximizing the use of observable information, *i.e.*, readily available observable standalone prices

Unless a modification is reported as a separate contract, a government should account for a SBITA 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 SBITA modification. If the change reduces the carrying value of the subscription asset to zero, any remaining amount should be reported in the resource flows statement, *i.e.*, a gain.

Disclosures

A government should disclose the following information about its SBITAs (other than short-term SBITAs) in the financial statement notes:

- A general description of its SBITAs, including the basis, terms, and conditions on which variable payments not included in the subscription liability's measurement are determined
- The total amount of subscription assets—and the related accumulated amortization—disclosed separately from other capital assets
- The amount of outflows of resources recognized in the reporting period for variable payments not previously included in the subscription liability's measurement
- The amount of outflows of resources recognized in the reporting period for other payments, such as termination penalties, not previously included in the subscription liability's measurement
- 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
- Pre-commencement SBITA commitments
- The components of any impairment—the impairment loss and any related change in the subscription liability

Effective Date & Transition

These changes are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. Earlier application is encouraged.

The changes should be applied retroactively by restating financial statements, if practicable, for all prior fiscal years presented. If restatement is not practicable, the cumulative effect—if any—should be reported as a restatement of beginning net position for the earliest fiscal year restated. In the first fiscal year the amendments are applied, note disclosure is required for the nature of the restatement and its effect, as well as the reason for not restating prior fiscal years presented, if applicable.

SBITA assets and liabilities should be recognized and measured using the facts and circumstances 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 at the beginning of the earliest fiscal year restated. Governments are permitted—but not required—to include in the measurement of the subscription asset capitalizable outlays associated with the initial implementation stage and the operation and additional implementation stage incurred prior to the implementation.

	Implement for Fiscal Years Ending			
Fiscal Years Beginning After	March 31	June 30	September 30/ October 31	December 31
June 15, 2022	2024	2023	2023	2023

If you have any questions or need assistance, please reach out to a professional at **FORVIS**.

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