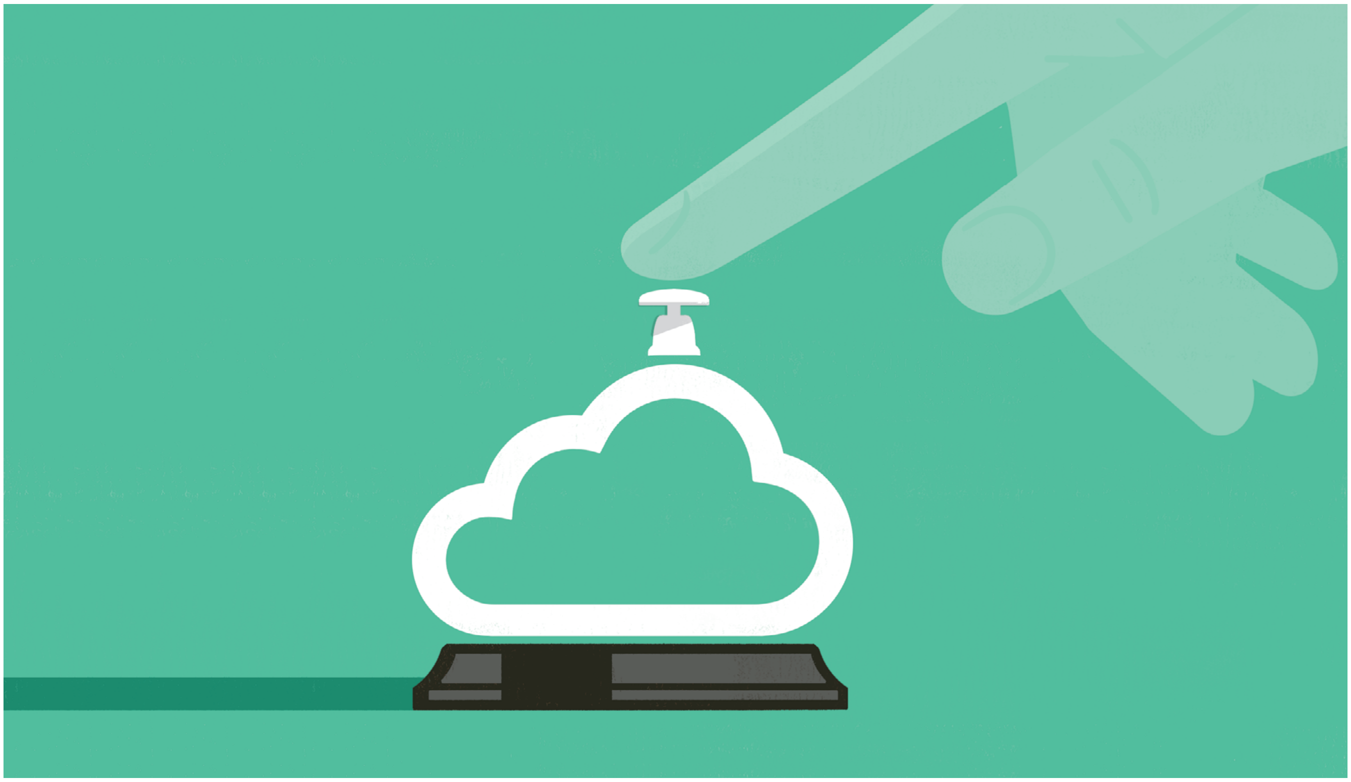

ACCOUNTING

Subscription Supposition

A Look at Practical SBITA Examples

BY MICHELE MARK LEVINE

The authoritative accounting guidance in Governmental Accounting Standards Board (GASB) Statement No. 96, *Subscription-Based Information Technology Arrangements* (GASB 96), is effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. This implementation is challenging governments in many of the same ways we were challenged by GASB Statement No. 87, *Leases* (GASB 87),[1] and in some different ways as well. Like leases, subscription-based information technology arrangements (SBITAs) are often not centrally managed, so just gathering information about contractual arrangements that might be—or contain—SBITAs from multiple departments can be a time-consuming first step. Like for leases, the information necessary to properly classify contracts as being SBITAs or containing SBITA components, to determine the subscription term, and to recognize and measure subscription liabilities and assets, may require legal expertise for interpretation. But for SBITAs, there is arguably more complexity to measurement of subscription assets than there is for lease assets, as certain development costs are included. The good news is that GASB has already issued a substantial amount of implementation guidance for lessees, much of which can be applied by analogy to governments in SBITAs, and that identifying the additional capitalizable costs has considerable precedent in preexisting generally accepted accounting principles (GAAP) applicable to internally generated computer software, so it will be familiar to some.[2]

GFOA has prepared two examples of SBITAs (available online at gfoa.org/gasb-resource-center), each based on a different subscription model. In each case, incurred costs are identified and categorized in accordance with the three stages of development and the capital-eligibility rules identified in GASB 96. The calculations used to measure the subscription liabilities and subscription assets are shown, along with their amortization schedules. Finally, journal entries for each event are provided, linked back to the calculations from which the amounts are derived. Entries for the SBITAs are illustrated both (1) on the current financial resources measurement focus and the modified accrual basis of accounting used for governmental funds and (2) on the economic resources measurement focus and accrual basis of accounting used for all other reporting. The entries to convert between the two are also shown. While this article will point out some key aspects of these examples, their full benefit can only be derived by reading the complete assumptions and reviewing the workbook, which links amounts from assumptions → categorizations → summarizations → liability and asset measurements and amortization schedules → journal entries. This article cannot cover or describe all the important details.[3] Before delving further into the examples, though, let's do a quick review of the basics of accounting for SBITAs.

Highlights of GASB 96 and similarities to GASB 87

GASB 96 defines a SBITA as "a contract that conveys control of the right to use another party's (a SBITA vendor's) IT software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction."[4] The only difference between this definition and the definition of a lease is the phrase "IT software, alone or in combination with tangible capital assets (the underlying IT assets)" in place of "nonfinancial assets" in the lease definition. This reflects the broad similarity in the accounting and financial reporting by governmental lessees and governments in SBITAs. The apparent overlap of the definitions (IT assets are nonfinancial assets) is resolved by the statement in GASB 96 that it does not apply to arrangements "in which the software component is insignificant when compared to the cost of the underlying tangible capital assets."[5]

A subscription term is determined in essentially the same manner as a lease term, and it begins as soon as the first independently functional module is—or the first set of interdependent modules are—placed into service.[6] That is the point at which the subscription liability and the subscription asset (which are discussed further below) are first recognized, and amortization of the asset begins. It is also the point *after* which payments to the SBITA vendor for the right to use the underlying IT assets should be treated as *subscription* payments. Any payments made to the vendor for that purpose at or before the SBITA inception date are prepayments. In many cases, the subscription term will begin after the term of the contract that contains the SBITA began, as it is quite common for license payments to be required before any configuration—let alone usage—can begin. While there is a parallel requirement that a lease term and lease payments not begin until the lessee has access to the underlying capital asset,[7] this has nonetheless caused some confusion for many governments implementing GASB 96.

> The good news is that GASB has already issued a substantial amount of implementation guidance for lessees, much of which can be applied by analogy to governments in SBITAs.

The present value (PV) of future payments to be made by the government to the SBITA vendor for the use of vendors' underlying IT assets (subscription payments) constitutes a subscription liability, just as the PV of future lease payments to a lessor constitutes a lease liability for a governmental lessee. The kinds of payments to be included as subscription payments (such as fixed, fixed-in-substance) are similar to those treated as lease payments, and similar remeasurement requirements apply. As in the case of lease liabilities, the subscription liabilities must be amortized using the effective-interest method.[8]

The primary difference between the accounting for SBITAs and leases is in the measurement of the related intangible right-to-use capital assets, called the subscription asset, in the case of a SBITA. Unlike a lease asset, for which only necessary ancillary costs (transportation, testing) are added to the lease liability and the net of other payments to or from the vendor (prepayments, incentives), the subscription asset's measurement includes certain implementation costs, as shown in Exhibit 1.

EXHIBIT 1

IMPLEMENTATION COSTS INCLUDED IN THE MEASUREMENT OF THE SUBSCRIPTION ASSET

Lease Asset =	Subscription Asset =
Lease liability (PV future lease payments)	Subscription liability (PV future subscription payments)
+ Prepayments	+ Prepayments
+ Ancillary costs	+ Certain capitalizable implementation costs
+ Incentives received	+ Incentives received

EXHIBIT 2 | EXAMPLES OF THE ACTIVITIES AND TREATMENT OF COSTS IN 3 IMPLEMENTATION STAGES

1. Preliminary Project Stage

- Formulate and evaluate alternatives
- Determine existence of needed technology
- Select among alternatives

Expensed as incurred

Beginning of subscription term

2. Initial Implementation Stage

- Design, configure, code, install, and test
- Convert data *needed to make underlying assets operational*

Certain costs are capitalized, becoming part of subscription asset

3. Operation and Additional Implementation Stage

- Train users
- Convert data (other than that needed to make underlying assets operational
- Maintain software (and hardware)
- *Implement additional modules*

Expensed as incurred, *unless improves functionality or efficiency*

GASB 96 provides guidance on what costs should be included in the asset measurement (for example, capitalized) and that guidance very closely resembles the capitalization guidance for internally generated computer software, including the use of three implementation stages, although the stages differ slightly.[9] Exhibit 2 gives examples of the activities and treatment of costs in each of those stages.

Following the initial implementation, costs incurred to increase the functionality or efficiency of an existing subscription asset, such as the implementation costs of subsequent modules, should be capitalized.[10] Thus, there can be additions to subscription assets after they are first put into service, at the same time that they are also being depreciated. Subscription assets are amortized in a "systematic and rational manner over the shorter of the subscription term of the useful life of the underlying IT assets,"[11] generally using the same method used to depreciate or amortize the government's owned capital assets. Most other aspects of accounting for SBITAs (such as contract modifications, contacts with multiple SBITA and non-SBITA components, disclosures) are also very similar to those of lessee accounting for leases.

With that bare-bones refresher, let's turn back to the examples.

1. In Example 1, a government contracts to use proprietary workflow and document management software, to be hosted on the vendor's servers (hardware) and accessed by the government's staff and the public through the internet. The government pays the vendor to initially configure the software for the government's use and then for licenses to use the vendor's software and hardware, and also pays the vendor to perform ongoing maintenance.
2. In Example 2, a government contracts for an enterprise-wide license to use a vendor's proprietary enterprise resource planning (ERP) system (software and hardware) with multiple modules. The government also separately contracts with a third party to configure modules and to maintain the system. This example illustrates how the sequential implementation of independently functioning modules may be accounted for.

Example 1

In Exhibit 3, all costs related to the workflow and document management system (system) are first classified using the stages discussed above. Only a single column is needed for the preliminary project stage, as none of those costs should be capitalized. For the initial implementation stage, in which most costs are capitalizable, the example uses three columns to classify costs as being (1) paid to the vendor and capitalizable, (2) paid to others (in this case, internal staff) and capitalizable, and (3) noncapitalizable costs, regardless of the payee. For the operating and additional implementation stage, no costs are incurred that increase the subscription asset's functionality or efficiency, as would be the case if a new module were implemented, so there are no additional capitalizable costs. The operating and additional implementation stage payments are either subscription payments or period costs for ongoing system maintenance rather than for the right to use the underlying IT assets.

As seen in Exhibit 3, payments to the vendor for the right to use the underlying IT assets and for their implementation work that are made at or after the inception date (totaling $11,000 on January 1 and $12,000 on March 1) are reported as capital outlays in the general fund and as development-in-progress (a capital asset) in statements prepared on an economic resources measurement focus. Other capitalizable costs—$2,040 in employee costs in this

EXHIBIT 3 | CLASSIFYING ALL COSTS RELATED TO THE WORKFLOW AND DOCUMENT MANAGEMENT SYSTEM

			Stage 1: Preliminary Project Stage	Stage 2: Initial Implementation Stage			Stage 3: Operation and Additional Implementation	
Date Incurred	Description	Amount		Capitalizable– Paid to SBITA Vendor	Capitalizable– Other	Non-capitalizable	Subscription Payments	Non-capitalizable
FY 20X0	Consultant costs (scope, technical feasibility, RFP and specifications development)	$6,000	$6,000					
FY20X0	City staff time (scope, technical feasibility, RFP and specifications development)	$3,000	$3,000					
1/1/X1	Five full licenses full year @$600	$3,000		$3,000	$11,000			
1/1/X1	First installment for implementation	$8,000		$8,000				
3/1/X1	Eight full licenses @ $600 for 10/12 months	$4,000		$4,000	$12,000			
3/1/X1	Second installment for implementation	$8,000		$8,000				
3/31/X1	City staff time for implementation, of which $960 is for training	$3,000			$2,040	$960		
4/1/X1	Twelve full licenses @ $600 for 9/12 months	$5,400		$5,400				
4/1/X1	Final installment for implementation, of which $3,000 is for data conversion and training	$9,000		$6,000	$24,900	$3,000		
4/1/X1	Block of 50,000 user licenses @ $18,000 for 9/12 months	$13,500		$13,500				
4/1/X1	Annual maintenance/support @ $12,000 for 9/12 months	$9,000						$9,000
4/X1-12/X1	City staff time for system administration @ $6,000 for 9/12 months	$4,500						$4,500
1/1/X2	25 full licenses for year @ $600	$15,000				$33,000	$15,000	
1/1/X2	Block of 50,000 user licenses @ $18,000 for year	$18,000					$18,000	
1/1/X2	Annual maintenance/support @ $12,000	$12,000						$12,000
FY 20X2	City staff time for system administration @ $6,000	$6,000						$6,000
1/1/X3	25 full licenses for year @ $600	$15,000				$33,000	$15,000	
1/1/X3	Block of 50,000 user licenses @ $18,000 for year	$18,000					$18,000	
1/1/X3	Annual maintenance/support @ $12,000	$12,000						$12,000
FY 20X3	City staff time for system administration @ $6,000	$6,000						$6,000
		$178,400	$9,000	$47,900	$2,040	$3,960	$66,000	$49,500

example—are reported in the same manner. When the subscription asset is put into service (April 1, 20X1), the accumulated development-in-progress ($11,000 + $12,000 + $2,040 = $25,040) is eliminated (debited), and the balance of that account is added to the amount of the initial subscription liability ($61,270, the present value of the two $33,000 future subscription payments) and capitalizable payments to the vendor that are made at that time ($24,900), and recognized as the subscription asset. See Exhibit 4 for the calculations of the subscription liability and subscription asset values.

EXHIBIT 4 | SUBSCRIPTION LIABILITY AND ASSET MEASUREMENTS

Subscription Liability and Asset Measurements

$ 61,270	Net present value of future payments ($66,000) = subscription liability
$ 61,270	Subscription liability
47,900	Prepayments (1/1, 3/1, and 4/1/20X1 payments to vendor)
2,040	Other capitalizable implementation costs
$ 111,210	Subscription asset

The subscription liability amortization table for this example, part of which is shown in Exhibit 5, is prepared using monthly periods even though the licenses are annual. While the term of the contract that contains the SBITA begins in January 20X1, the *subscription term* doesn't begin until April 1, necessitating part-year amortization. Also note that interest accrues even during months in which no payments are made, as the interest is assumed to compound monthly, and that the interest payable is tracked separately from the subscription liability, based on implementation guidance GASB promulgated for leases that appears applicable to the SBITA in this example.[12] Since there are no subsequent modules implemented in this example, the amortization table for the subscription asset can be established at the time of implementation. A portion of that table is also shown in Exhibit 5.

Example 2

This example is different from Example 1 in that:

- The full cost of annual licensing begins to be paid at the start of the contract;
- The implementation and maintenance work are performed by a third-party contractor, rather than by the SBITA vendor through a non-SBITA component of the same contract; and
- A second module is implemented after the first module is put in service.

EXHIBIT 5 | SUBSCRIPTION LIABILITY AMORTIZATION

		Amortization of Subscription Liability							Amortization of Subscription Asset	
Period #	Payment Date	Subscription Payment Amount	Interest @ Monthly Rate of 0.50%	Subscription Interest Payable	Interest Payment	Principal Payment	Subscription Liability	Total Remaining Liability	Monthly Periods Straight-line 33	Unamortized Balance
							61,270			**111,210**
1	4/1/X1						61,270	61.270	3,370	**107,840**
2	5/1/X1		306	306			61,270	61,576	3,370	**104,470**
3	6/1/X1		308	614			61,270	61,884	3,370	**101,100**
4	7/1/X1		309	924			61,270	62,194	3,370	**97,730**
5	8/1/X1		311	1,235			61,270	62,505	3,370	**94,360**
6	9/1/X1		313	1,547			61,270	62,817	3,370	**90,990**
7	10/1/X1		314	1,861			61,270	63,131	3,370	**87,620**
8	11/1/X1		316	2,177			61,270	63,447	3,370	**84,250**
9	12/1/X1		317	2,494			61,270	63,764	3,370	**80,880**
10	1/1/X2	33,000	319		2,813	30.187	31,083	31,083	3,370	**77,510**
11	2/1/X2		155	155			31,083	31,238	3,370	**74,140**
12	3/1/X2		156	312			31,083	31,395	3,370	**70,770**
13	4/1/X2		157	469			31,083	31,552	3,370	**67,400**
14	5/1/X2		158	626			31,083	31,709	3,370	**64,030**

EXHIBIT 6 | CLASSIFICATION OF COSTS INCURRED DURING THE OPERATING AND ADDITIONAL IMPLEMENTATION STAGE

Classification of costs:

			Stage 3: Operation and Additional Implementation		
Date incurred	Description	Amount	Subscription Prepayment & Payments	Stage Capitalizable – Additional Implementation	Non-capitalizable – Operation
7/1/X1	Semiannual payment to PERP for right to use cloud-based software and related hardware	$ 250,000	250,000		
7/1/X1	1st installment payment to SLEEPS for implementation of AP module	$ 300,000		300,000	
7/1/X1	SLEEPs annual support (1 module for 6 months of 20X1)	$ 100,000			100,000
7/31/X1	County employee work on system AP module implementation	$ 35,000		35,000	
8/1/X1	2nd installment payment to SLEEPs for implementation of A/P module	$ 300,000		300,000	
8/31/X1	County employee work on system AP module implementation	$ 35,000		35,000	
9/30/X1	3rd installment payment to SLEEPs for implementation of AP module ($180,000 data conversion and training)	$ 400,000		220,000	180,000
9/30/X1	County employee work on system AP module implementation ($8,000 data conversion and training)	$ 35,000		27,000	8,000
9/30/X1	GFOA Phase 2 consulting: implementation assistance for AP module ($5,000 data conversion); payable 10/31	$ 30,000		25,000	5,000
10/1/X1	SLEEPs annual support (additional module for three months of 20X1)	$ 50,000			50,000
1/1/X2	Semiannual payment to PERP for right to use cloud-based software and related hardware	$ 250,000	250,000		
1/1/X2	SLEEPs annual support (2 modules for 20X2)	$ 400,000			400,000
7/1/X2	Semiannual payment to PERP for right to use cloud-based software and related hardware	$ 250,000	250,000		
1/1/X3	Semiannual payment to PERP for right to use cloud-based software and related hardware	$ 250,000	250,000		
1/1/X3	SLEEPs annual support (2 modules for 20X3)	$ 40,000			400,000
7/1/X3	Semiannual payment to PERP for right to use cloud-based software and related hardware	$ 250,000	250,000		
		$ 4,921,000	$ 1,250,000	$ 942,000	$ 1,143,000

EXHIBIT 7 | SUBSCRIPTION LIABILITY AND ASSET MEASUREMENTS

Subscription Liability and Asset Measurements

$ 929,275	Net present value of future payments = subscription liability
$ 929,275	Subscription liability
500,000	Vendor prepayments (1/1X1 and 7/1/X1)
893,000	Other capitalizable pre-term implementation costs (Stage 2 Capitalizable - Other)
$ 2,322,275	Initial subscription asset

EXHIBIT 8 | SUBSCRIPTION ASSET AMORTIZATION

Subscription Asset					
Months of Subscription Term Lapsed in Period	**Remaining Life at End of Period (Months)**	**Period Ending**	**Additions**	**Amortization of In-Service Subscription Asset**	**Balance**
	36	1/1/X1			
	30	6/30/X1	2,322,275		2,322,275
1	29	7/31/X1	335,000	77,409	2,579,866
1	28	8/31/X1	335,000	77,409	2,837,457
1	**27**	9/30/X1	272,000	77,409	3,032,048
1	26	10/31/X1		112,298	2,919,749
1	25	11/30/X1		112,298	2,807,451
1	24	12/31/X1		112,298	2,695,153
6	18	6/30/X2		673,788	2,021,365
6	12	12/31/X2		673,788	1,347,577
6	6	6/30/X3		673,788	673,788
6	–	12/31/X3		673,788	–
			3,264,275	3,264,275	

Module 2 placed into service 9/1/X1

$2,322,275 / 30 months

$3,032,048 / 27 months

$112,298 * 6 months

Asset as measured at inception

$2,322,275 + $335,000 - $77,409

Exhibit 6 shows the classification of costs incurred during the operating and additional implementation stage. While the classification is similar to that in Example 1 for preliminary project stage and the initial implementation stage, here we see capitalizable costs incurred during this final stage because of the additional module that is implemented.

Exhibit 7 uses data from the classifications of costs incurred at all stages, not only those in the operation and additional implementation stage in Exhibit 6, and shows the calculation of the subscription liability and the subscription asset.

Exhibit 8 shows the subscription asset amortization table for this example, illustrating that amortization of the in-service component occurs concurrently with additions to the asset value based on capitalizable costs incurred for the implementation of a second module while the first is in use. This treatment would be applicable to any costs incurred to increase the functionality or efficiency of an in-service subscription asset, whether or not planned for at the inception of the subscription term. Note that for the purpose of this illustration, the asset value is tracked on a monthly basis until all implementations have been completed.

Please pardon the crowded appearance of this final exhibit. Hopefully it will encourage you to look at the example itself, and hopefully you will find it worth your time to do so.

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1 Leases guidance can be found in *GASB 2022-2023 Codification of Governmental Accounting and Financial Reporting Standards* (Cod.), Section (Sec.) L20, "Leases."

2 GASB Cod. Sec.1400, "Reporting Capital Assets," paragraphs .128 to .134.

3 The examples illustrate possible approaches to recognizing and measuring elements of SBITAs. They do not necessarily represent the only acceptable, or the best, application of GAAP.

4 GASB 96, paragraph 6.

5 GASB 96, paragraph 4.a.

6 GASB 96, paragraphs 9, 15, and 30.

7 GASB Cod. Sec. L20.702-1.

8 GASB Cod. Sec. L20.715-4.

9 GASB Cod. Sec. 1400, "Reporting Capital Assets," paragraphs 128 to 134.

10 This is reflected in the name of the last stage: Operation and Additional Implementation.

11 GASB 96, paragraph 27.

12 GASB Implementation Guide 2021-1 paragraphs 4.10 and 4.17, effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter.