FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. AI20-1-000
December 20, 2019

TO ALL JURISDICTIONAL PUBLIC UTILITIES AND LICENSEES, NATURAL GAS COMPANIES, AND CENTRALIZED SERVICE COMPANIES

Subject: Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract

The Financial Accounting Standards Board (FASB) has issued Accounting Standards Update (ASU) No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement,* to reduce potential diversity in practice in accounting for the costs of implementing cloud computing arrangements that are service contracts. ASU No. 2018-15 aligns the accounting for costs incurred to implement a cloud computing arrangement that is a service contract with the guidance on capitalizing costs associated with developing or obtaining internal-use software. Specifically, ASU No. 2018-15 clarifies that an entity obtaining a service contract in a cloud computing arrangement should follow the existing guidance in Accounting Standards Codification (ASC) 350-40 to determine which implementation costs can be capitalized and which costs must be expensed, and further provides that the capitalized implementation costs shall be amortized over the term of the associated arrangement. In addition, ASU No. 2018-15 requires the capitalized implementation costs to be reported on the balance sheet in the same line item as any prepayment of the service fees for the associated cloud computing arrangements. The related amortization expense is required to be reported in the same expense line item on the income statement as the expense for the service fees of the associated cloud computing arrangement. For most jurisdictional entities, ASU No. 2018-15 is effective January 1, 2020 for accounting and financial reporting under generally accepted accounting principles (GAAP).

Commission staff received many inquiries from industry participants regarding clarification on how to apply ASU No. 2018-15 within the framework and regulatory intent of the Commission's existing accounting requirements. As discussed herein, for regulatory accounting and reporting to the Commission, jurisdictional entities will be permitted to capitalize certain implementation costs and to amortize those costs over the term of the associated cloud computing arrangement. However, in capitalizing these costs, jurisdictional entities must adhere to the regulations related to plant construction costs set forth under Part 101, Part 201, and Part 367 of the Commission's regulations.[1] Jurisdictional entities must also follow the guidance provided herein with regards to the accounts they should use to record the capitalized costs and the related amortization expense. Service fees and other non-capital costs for the cloud computing arrangement are generally recorded as an expense.

The accounting guidance included herein is intended to result in consistent accounting for the same types of costs incurred for cloud computing arrangements and internal-use software projects for accounting and financial reporting to the Commission. The Commission's accounting requirements are not intended to automatically reflect changes in FASB's Accounting Standards Codification, and FASB updates should not be construed as required for regulatory accounting and reporting to the Commission. However, upon analysis, the Commission may issue accounting guidance to clarify how provisions of an ASU can be reflected within the Commission's existing accounting and financial reporting requirements. Accordingly, this accounting guidance is intended to provide clarity and certainty on how jurisdictional entities should apply the Commission's accounting and reporting requirements related to cloud computing arrangements in response to ASU No. 2018-15.

1. **Question:** How should jurisdictional entities capitalize implementation costs related to cloud computing arrangements?

Response: Implementation costs related to cloud computing arrangements are similar to the costs incurred to develop internal-use software and should be accounted for on the same basis. Jurisdictional entities have historically determined capitalizable internal-use software costs in a manner consistent with the requirements of ASC 350-40, which is an acceptable approach for accounting and financial reporting to the Commission. Accordingly, it is also appropriate for jurisdictional entities to determine capitalized implementation costs related to cloud computing consistent with ASC 350-40. Examples of implementation costs that may be capitalized include upfront costs to integrate with on-premise software, coding, configuration, and customization.

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[1] *See* 18 C.F.R. Part 101, Electric Plant Instructions No. 3 (Components of Construction) and No. 4 (Overhead Construction Costs). *See also* 18 C.F.R. Part 201, Gas Plant Instructions No. 3 (Components of Construction) and No. 4 (Overhead Construction Costs). *See also* 18 C.F.R. Part 367, Service Company Property Instructions No. 367.51 (Components of Construction) and No. 367.52 (Overhead Construction Costs).

2. **Question:** What accounts should jurisdictional entities use to record capitalized implementation costs related to cloud computing arrangements for Commission accounting and reporting purposes?

Response: Jurisdictional entities should record capitalized implementation costs associated with cloud computing arrangements as a utility plant asset, consistent with the Commission's accounting requirements for internal-use software. Accordingly, jurisdictional entities should record capitalized implementation costs in Account 303 (Miscellaneous Intangible Plant), provided such costs are not specifically provided for in other utility plant accounts. For example, public utilities are required to record software used to support regional transmission and market operations in Account 383 (Computer Software). Accordingly, a public utility's capitalized cost related to cloud computing arrangements for regional transmission and market operations should be recorded in Account 383.

3. **Question:** What accounts should jurisdictional entities use to record the amortization or depreciation of capitalized implementation costs related to cloud computing arrangements for Commission accounting and reporting purposes?

Response: Jurisdictional entities should amortize or depreciate capitalized cloud computing costs consistent with the requirements of the utility plant accounts in which they are recorded. Specifically, the amortization of capitalized cloud computing costs recorded as intangible utility plant should be recorded in Account 404 (Amortization of Limited-Term Electric Plant)[2] for public utilities and centralized service companies, and Account 404.3 (Amortization of Other Limited-Term Gas Plant) for natural gas companies.[3] The amortization of capitalized cloud computing costs not classified as intangible utility plant should be recorded in Account 403 (Depreciation Expense).

If a jurisdictional entity believes that its facts and circumstances warrant the use of alternative accounts other than those prescribed herein to record the capitalized costs and related amortization, the jurisdictional entity should request clarification or approval from the Chief Accountant to use the alternative accounting treatment.

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[2] *See* 18 C.F.R. Parts 101 and 367 (2019).

[3] *See* 18 C.F.R. Part 201 (2019).

The Commission delegated authority to act on this matter to the Director of the Office of Enforcement or his designee under 18 C.F.R. § 375.311 (2019). The Director has designated this authority to the Chief Accountant. This letter constitutes final agency action. Your company may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713 (2019).

Sincerely,

Steven D Hunt

Steven D. Hunt
Chief Accountant and Director
Division of Audits and Accounting
Office of Enforcement