



North Carolina Office of the State Controller

Financial Reporting Update

GASB 96 Effective for Fiscal Year 2023

February 8, 2022

In May 2020, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*. This statement provides guidance for accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for governments that are end users of SBITAs.

The objective of this statement is to improve the consistency of accounting and reporting for SBITAs by requiring recognition for certain SBITA assets and liabilities that do not meet the definition of a lease in GASB 87, *Leases*. GASB 96 will enhance the comparability, relevance, and reliability of information about SBITA activities of governments.

Identifying SBITAs

GASB 96 defines an SBITA as a contract that conveys control of the right to use an SBITA vendor's information technology (IT) software, alone or in combination with tangible capital assets, as specified in a contract for a period of time in an exchange or exchange-like transaction. A contract conveys control of the right to use the underlying IT asset if it has both of the following:

- a. The right to obtain the present service capacity from use of the underlying IT asset as specified in the contract.
- b. The right to determine the nature and manner of use of the underlying IT asset specified in the contract.

An example of an SBITA for the State of North Carolina is the contract for the right to use cloud software for the new North Carolina Financial System (NCFS) and any other cloud system contracted by a reporting entity of the State of North Carolina and a vendor providing software as a service.

GASB 96 does not apply to the following:

- Contracts that convey control of the right to use another party's combination of IT software and tangible capital assets that meets the definition of a lease in GASB 87, *Leases*, in which the software component is insignificant when compared to the cost of the underlying tangible capital asset.
- Governments that provide the right to use the government's IT software and associated tangible capital assets to other entities through SBITAs.
- Contracts that meet the definition of a public-private, public-public partnership in GASB



94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements.*

- Licensing arrangements that provide a perpetual license to governments to use a vendor's computer software.

Determining the Subscription Term

The subscription term includes the period during which the government has a noncancellable right to use the underlying IT assets. The subscription term also includes periods covered by an option to extend if it is reasonably certain that the government or the SBITA vendor will exercise the option or to terminate if it is reasonably certain the government or the SBITA vendor will not exercise that option. A fiscal funding or cancellation clause should affect the subscription term only if it is reasonably certain the clause will be exercised.

Periods for which both the government and SBITA vendor have an option to terminate the SBITA without permission from the other party are cancellable periods and are excluded from the subscription term.

At the commencement of the subscription term, a government should assess all factors relevant to the likelihood that the government or the SBITA vendor will exercise the options stated above whether the factors are contract based, underlying IT asset based, market based, or government specific.

Examples of these factors include significant economic incentive or disincentive, potential change in technological development that significantly affects the technology of the underlying IT asset, potential significant change in the government's demand for the SBITA vendor's IT asset, history of exercising options to extend or terminate, as well as the extent to which the IT asset in the SBITA is essential to the provision of the government services.

The subscription term should be reassessed if certain circumstances arise. For example, if the government or SBITA vendor elects to exercise an option that it was previously uncertain about or an event specified in the contract that requires an extension or termination of the SBITA takes place.

GASB 96 specifically exempts short-term SBITAs from the provisions of the standard. A short-term SBITA has a maximum possible term of 12 months or less including any options to extend regardless of the probability of being exercised. Governments should recognize short-term subscription payments as expenses based on the payment provisions of the contract. The government should recognize an asset if the subscription payments are made in advance or a liability if the subscription payments are to be made in the subsequent reporting period.



General Financial Reporting Requirements for SBITAs

Proprietary Funds (Enterprise Funds, Internal Service Funds, and Component Units, such as Universities and Community Colleges)

The government should recognize the right-to-use subscription asset, which is an intangible capital asset, and a corresponding subscription liability at the commencement of the subscription term. The commencement of the subscription term occurs when the initial implementation stage is completed and thus the asset is placed into service.

Subscription Liability

Similar to GASB 87, *Leases*, the subscription liability should be measured at the present value of the subscription payments made during the subscription term. The following should be included in the calculation of the SBITA liability:

- Fixed payments
- Variable payments that depend on an index or rate
- Variable payments fixed in substance
- Payments for penalties for terminating the SBITA, if the subscription term reflects exercising the option to terminate or exercising a fiscal funding/cancellation clause
- Subscription contract incentives receivable from the SBITA vendor
- Other payments to the SBITA vendor associated with the contract that are reasonably certain of being required based on assessment of all relevant factors.

Variable payments based on future performance of a government, usage of the IT assets, or number of user seats should not be included in the measurement of the subscription liability. Those variable payments should be recognized as an expense when incurred. However, if any component of these variable payments is fixed in substance, then include in the subscription liability.

Future subscription payments should be discounted using the interest rate charged by the SBITA vendor. This may be the implicit rate if not specifically stated in the contract. If neither the explicit rate nor the implicit rate is determinable, the government should discount the payments using the incremental borrowing rate. Please refer to the [GASB 87 Discount Rate Procedural Guidance](#) document for information on determining an appropriate discount rate.

In subsequent years, the government should recognize amortization of the discount on the subscription liability as an outflow of resources (e.g., interest expense). Payments should be allocated first to the accrued interest liability and then to the subscription liability. The government should amortize the subscription liability using the determined discount rate and report that amount as an expense in subsequent financial reporting periods.

Remeasurement

SBITAs should be remeasured in subsequent financial reporting periods if any of the following changes are expected to significantly affect the subscription liability: a change in the



subscription term, a change in the estimated amounts for subscription payments included in the measurement of the liability, a change in the interest rate charged by the SBITA vendor, and/or a contingency upon which some of the variable payments that will be made over the remainder of the subscription term.

If the liability is remeasured, the liability should be adjusted for any change in an index or rate used to determine variable payments if that index or rate change significantly affects the liability. The liability is not required to be remeasured solely for an index or rate change.

The discount rate should be updated as part of remeasurement if there is a significant change in the subscription term and that change is expected to significantly affect the amount of the subscription liability. A subscription liability is not required to be remeasured solely for a change in the government's incremental borrowing rate.

Subscription Asset

The subscription asset should be measured by the government as the sum of the subscription liability along with any payments associated with the contract to the SBITA vendor at the commencement of the subscription term and capitalizable initial implementation costs. Any SBITA vendor incentives received at the commencement of the subscription term should be excluded from the calculation of the subscription asset.

Payments made to the SBITA vendor as well as payments made for the capitalizable initial implementation costs before the commencement of the subscription term associated with the SBITA contract should be reported as a prepayment (an asset) and reclassified as an addition to the subscription asset at the commencement of the subscription term. If the SBITA vendor incentives exceed the SBITA vendor prepayments made to the same vendor, the difference should be reported as a liability and reclassified as a reduction to the initial measurement of the subscription asset at the commencement of the subscription term.

The subscription asset should be amortized in a systematic and rational manner over the shorter of the subscription term or the life of the underlying IT asset. The amortization of the subscription asset is reported as an outflow of resources (e.g., amortization expense).

A subscription asset should be adjusted by the same amount as the subscription liability when the liability is remeasured; however, if the carrying value of the subscription asset is reduced to zero, any remaining amount should be reported as a gain.

Governmental Funds (General Fund, Special Revenue Funds, Capital Projects Funds, and Permanent Funds)

If an SBITA is expected to be paid from general government resources, an expenditure and other financing source should be reported in the period the subscription asset is initially recognized.



The expenditure and other financing source should be measured just as the subscription liability is measured using the economic resources measurement focus (refer to Subscription Liability section above). Subsequent governmental fund subscription payments should be accounted for consistent with the principles for debt service payments on long-term debt.

Outlays Other Than Subscription Payments

Activities associated with SBITAs include the following three stages of implementation and costs should be accounted for in the appropriate stage:

- Preliminary Project Stage includes the conceptual formulation and evaluation of alternatives, the determination of needed technology, and final selection. Outlays associated with these activities should be expensed as incurred.
- Initial Implementation Stage includes ancillary charges related to designing the chosen path, such as configuration, coding, testing, and installation associated with the government's access to the underlying IT asset. The initial implementation stage is completed when a subscription asset is placed into service. Outlays associated with these activities should be capitalized as part of the subscription asset. If no subscription asset is recognized, activities in this stage should be expensed. An example would be outlays for a short-term SBITA.
- Operation and Additional Implementation Stage includes maintenance, troubleshooting, and other activities associated with the government's ongoing access to the underlying IT assets. Activities include additional implementation activities related to additional modules that occur after the subscription asset is placed into service. Outlays in this stage should be expensed as incurred, except for those that meet one of the capitalization criteria, such as an increase in the functionality and/or an increase in the efficiency of the subscription assets.

If an SBITA has multiple modules and the modules are implemented at different times, the initial implementation stage for the SBITA is completed and, therefore, the subscription asset is considered to be placed into service when the initial implementation is completed for the first independently functional module for the set of interdependent modules, regardless of whether all remaining modules have been completed or implemented. The remaining modules of the SBITA should be considered subsequent implementation outlays.

Data conversion that is determined to be necessary to place the subscription asset into service should be considered an activity of the initial implementation stage and capitalized as part of the subscription asset. Otherwise, data conversion should be expensed as incurred.

Generally, outlays associated with an SBITA already in operation that are incurred in addition to subscription payments should be expensed as incurred. However, additional outlays not resulting from SBITA modifications that increase the functionality of the asset or increase the



efficiency of the subscription asset should be capitalized as an addition to the existing subscription asset. Training costs should be expensed as incurred regardless of the stage in which these are incurred.

Incentives Provided by SBITA Vendor

SBITA vendor incentives are payments made to or on behalf of a government for which the government has a right of offset with its obligation to the SBITA vendor or other concessions granted to the government. These include an agreement to pay a government's preexisting 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.

SBITA vendor incentives that are provided before the commencement of the subscription term should be included in the initial measurement by directly reducing the amount of the subscription asset. SBITA vendor incentive payments provided after commencement of the subscription should be accounted for in calculation of the present value of the subscription payments for the periods the incentive payments will be provided.

Contracts with Multiple Components

Governments that enter into a contract that contains both a subscription component and a non-subscription component should account for the subscription component separate from the non-subscription component unless the contract does not include prices for the individual components and the government is not able to reasonably estimate the price allocation for some or all components. If the components cannot be reasonably estimated, the government should account for the components as a single SBITA.

SBITA Modifications and Terminations

Governments should account for any amendments to the provisions of the SBITA contract during the reporting period that result in a modification to the SBITA as a separate SBITA if both conditions are present:

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

Unless the modification is reported as a separate SBITA, governments should account for the modification by remeasuring the subscription liability and adjusting the asset. If the changes



reduce the carrying value of the subscription asset to zero, any remaining amount should be reported as a gain.

A government should account for a partial or full SBITA termination by reducing the carrying value of the subscription asset and subscription liability and recognize a gain or loss for the difference.

If variable payments of an SBITA contract depend on an interbank offered rate (IBOR), an amendment of the contract to replace the IBOR with another rate that essentially equates the replacement rate and the original rate, is not a modification to the SBITA contract.

Notes to the Financial Statements

GASB 96 requires governments to make the following disclosures about SBITAs, other than short-term, in the note to the financial statements:

- General description of the SBITA, including the basis, terms, and conditions on which variable payments not included in the measurement of the subscription liability are determined.
- Total amount of subscription assets and the related accumulated amortization, disclosed separately from other capital assets.
- Amount of outflows of resources recognized in the reporting period for variable payments not previously included in the measurement of 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.
- 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.
- Commitments under SBITAs before the commencement of the subscription term.
- Components of any loss associated with an impairment.

Effective Date

Statement 96 is required to be implemented for fiscal year end June 30, 2023. This statement should be applied retroactively by restating the July 1, 2022, beginning net position. Assets and liabilities resulting from SBITAs should be recognized and measured using the facts and circumstances that existed at the beginning of the fiscal year for the year of implementation. Governments are permitted, but are 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.



To gain additional understanding of GASB 96, please refer to the GASB webpage from which you can access a PDF file of GASB 96 as well as other GASB pronouncements – [GASB Pronouncements](#)

Thank you for your time and attention to this important change. OSC will continue to provide updates as the standard is implemented. Questions regarding this specific update should be directed to Yelena Zaytseva at 919-707-0555 or by email at Yelena.Zaytseva@osc.nc.gov.