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For Cloud Professionals
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Title: **Cloud economics: the new cloud accounting mandate**

Description: As of 1 January 2020, new rules for accounting for cloud costs are in place. To make cloud-cost accounting practices more consistent, the Financial Accounting Standards Board (FASB) has implemented guidance that requires companies to capitalize, rather than expense some cloud costs. These changes promise to bring new benefits such as consistency and reduction of complexity, but to also present some challenges for companies on their journey to cloud. In this episode, David Linthicum and guests, Deloitte's Chris Chiriatti and Sean Torr, discuss the scope of the changes, as well as possible benefits and pitfalls that companies will need to address. The upshot? The changes will likely be positive overall but may require new controls and accounting practices, as well as investments in process automation, to implement correctly.

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Operator:
The views, thoughts, and opinions expressed by speakers or guests on this podcast belong solely to them, and do not necessarily reflect those of the hosts, the moderators, or Deloitte. Welcome to On Cloud, the podcast for cloud professionals, where we break down the state of cloud computing today and how you can unleash the power of cloud for your enterprise. Now here is your host David Linthicum.

David Linthicum:
So welcome back to the On Cloud podcast, your one place to find out how to make cloud computing work for your enterprise. This is an objective discussion with industry thought leaders who provide their own unique perspective around the pragmatic use of cloud-based technology. Today on the show, we have Chris. Chris, pronounce your last name for me. I'm going to blow it here.

Chris Chiriatti:

Chiriatti. It gets misread often, but if you think Chianti, if you start with that as you pronounce my last name, it's much easier to get it right.

David Linthicum:
Yeah, I hear you, brother. Name like Linthicum, I'm usually called Litscum or Lithium, and I'm neither. And Sean Torr. How're you doing, Sean?

Sean Torr:
Good. Thanks, David. Good morning.

David Linthicum:
So Chris is currently Managing Director in Deloitte's national office, accounting service group in this role. Chris engages in teams and clients and complex accounting matters and works with clients on analyzing and implementing complex accounting standards using both the US GAAP. That's general accounting principles, right? What does the second A stand for, anybody?

Chris Chiriatti:
Generally Accepted Accounting Principles.

David Linthicum:
And do this one for me. What does IFRS stand for?

Sean Torr:
International Financial Reporting Standards. It's the equivalent for global public companies.

David Linthicum:
So Sean is a Certified Public Accountant and managing director in Deloitte's LLP advisory practice, more than 20 years of experience in Deloitte. He's focused his career on assisting large, complex clients with their accounting and financial reporting. Sean leads Deloitte advisory services around lease accounting and serves as a frequent speaker for topics around financial transactions, including US GAAP – we know that now – IFRS and convergence. So fill in the missing pieces, Sean, and we're going to go ahead and start with you and then we're going to go to Chris. So what do you do – what's your day job? What do you do – what do you do 9:00 to 5:00? Or of course we're working at Deloitte, so that's 6:00 to 8:00.

Sean Torr:
Yeah, I wish it was 9:00 to 5:00, but unfortunately it's not, David, especially with all of the change in accounting that's been happening. So my role is actually a bit more than leasing as you described there. It's all new accounting standards, and really helping companies operationalize those new standards. And we'll get into more details, but there's been a lot of change in the accounting world, primarily because of the fact that US and the international community have been trying to get towards at least some more commonality between the standards, and that's just promulgated a lot of change in accounting. And so I help companies work through those changes.

David Linthicum:
So, Chris, what about you? What do you do during the day?

Chris Chiriatti:
Well, Sean and I actually complement each other quite a bit. So my role in the national office, much like Sean's been helping clients implement the standards. I do a lot of that as well, but I also develop our firm's interpretive guidance on how the standards should be applied from an accounting perspective. Also spend quite a bit of time working with accounting standard setters and regulators in helping influence how standards get adopted. And, part of what's been done with this cloud computing arrangement standard, which we'll spend some time talking about, is a long time coming. It's been a collaborative work with standard setters and preparers, really all stakeholders in arriving where we are today.

David Linthicum:
Yeah, and I guess that answers the question, why do we have two accounting subject matter experts on a cloud computing show, but evidently they're going to be very much pertinent to our success in the cloud going forward, and there's lots of changes going on in the world of accounting around cloud computing. So who wants to give us a general explanation of what's happening right now?

Chris Chiriatti:
David, I'll start and let Sean chime in as well. So there's been an evolution in accounting standards, much like there's been an evolution in technology, and standard setting might be lagging where technology was. And there'd been a longstanding standard of how companies would account for implementation of on-prem solutions, so this would be technology that sits in a company's data center, where they own the license, and there was a certain cost capitalization model for those types of deployments, and there really wasn't any specific guidance on how companies would account for implementing very similar functionality, but when that functionality's accessed through the cloud. So what's been happening over the last number of years is some attention from the standard setters, who really write the accounting guidance, recognizing that companies are deploying technology much differently today and that there needed to be new accounting guidance to adapt to how companies are deploying technology. And that's what became online for public companies at the beginning of the calendar year. Those with a calendar year end will have to be adopted by all companies in one year.

David Linthicum:
So, Sean, this you think is going to have a positive or negative effect on most of the enterprises out there, leveraging cloud computing?

Sean Torr:
I think it's definitely a positive. One benefit of this, as Chris has outlined, it's creating more consistency for companies as they approach their accounting for these technology arrangements, so I think that consistency is definitely a helpful thing. I think as companies are moving toward the cloud, there's opportunities that are embedded in this. Basically, when you boil this all down, what it allows companies to do, or requires companies to do, is to defer some of those costs of implementation and, deferring costs is never a bad thing, especially when you're talking about business cases to support some

initiatives. So I think, generally speaking, this is a helpful thing for companies to have more consistency and also, potentially, the opportunity to have some deferral of some of those costs that previously would have been taken to the income statement immediately.

David Linthicum:
Yeah, and I'm glad I have you on the podcast because I'm solving two problems at once, and one of the questions I get from my clients, and I'm moving them into cloud as consistently and successfully as I can, is they're looking for advice on how to prepare for these changes, and typically from the CFOs, they're asking the questions. So what words of advice, what kind of planning should be occurring right now? Should it have occurred last year? Is this something we need to consider internationally? So what are the ins and outs of this? And, Sean, I'm going to go to you first.

Sean Torr:
Okay, yeah. Yeah, I mean, I think there's two things that companies need to be looking at. One is, those cloud arrangements that you currently are building out, because if you do have in flight project moment, you will need to be capitalizing those implementation costs. Now these costs are capitalized. So that's one thing that companies should be doing is dealing with the current in-flight project. But then there's also the forward look. You know, many companies have fairly detailed roadmaps of how their technology landscape is going to look in the future, and really thinking about those projects and thinking about some of the opportunity that might come with this new standard to potentially have a better business case, because you're deferring some of these costs over time, and just reassessing that and thinking through what – does that change your decision making? Are there any other opportunities out there? We'll get into the details, but there is quite a bit of complexity in terms of what's in and what's out of this capitalization treatment, and so just getting ahead of that is definitely important.

David Linthicum:
So, Chris, is there any scenario where this is a negative for enterprise?

Chris Chiriatti:
Well, it could be a negative for enterprises if they liked the existing model, which was really not well-defined, because the new standard isn't optional in application, meaning that if the costs that are incurred are within the framework and are those types of costs that need to be deferred, they're required to be deferred. And, that sometimes results in additional processes and controls that need to be put in place to identify what those costs are. Additional tracking might be required. And for organizations that don't have the infrastructure or any existing policies in place to adequately track and capture those types of costs, it could be an additional burden on them for deployment to cloud. So while there's advantageous financial reporting outcomes for the deferral of the cost associate (Inaudible) limitation, capturing those costs sometimes could result in an additional burden in organizations, which, depending on where your perspective is today, could be viewed as a negative.

David Linthicum:
Yeah, and I think a lot of enterprises are going to be in that category, because if you look at people who are deploying cost governance and your ability to kind of figure out usage and the accounting of usage and the ability to show back some chargebacks for departments, some enterprises are well ahead of the game, and I think those are the ones are going to be able to take advantage of these new rules and regulations, and some of them are going to have to catch-up football in putting these automated accounting processes in place. Of course, our advice is you've got to use these processes, from the jump, because we need to figure out who's using resources, how they're using resources, and also put restriction limitations on use of those resources. Sean, I'm going to ask this question to you and put you on the spot. You would say that we should put this sort of automation in place now?

Sean Torr:
Yeah, I think it's definitely a requirement. So if companies are in the cloud or moving to the cloud, they will need to have a process and – which likely requires some software to track these costs. And so it's really non-negotiable. Unfortunately, that's how the standards work and when they become effective, and as Chris mentioned at the outset, we're now in the effective period for public companies. So if a company is heading in that direction or there currently, you're going to at least work through a process to be able to capture these costs and then amortize these costs over the period of the contract.

David Linthicum:
So I'll go ahead and throw this out to either of you. So the new standard will provide guidance on how to present implementation costs as well as capitalize costs and will appear differently on the balance sheet than it was before. So, what does this mean? We're not financial experts, we're not accounting experts, we're cloud geeks. How should we explain this to people who are implementing cloud computing?

Chris Chiriatti:
Well, I think first and foremost, it creates a need for the organizations that are ultimately—part of the organizations responsible for implementing the cloud solution to have a dialog with the finance function, because it does become a bit of a collaborative effort, really understanding what are the needs of the organization, what are the KPIs from a financial presentation standpoint that are most meaningful. What choices can be made with regards to technology deployment that could align both the needs of the CTO structure in an organization and that within the finance organization. A lot of times, capital deployment and capital budgets could influence cloud spend, and how those metrics are going to ultimately be in that spend, will be impacted in the financial statements will be important. And some choices could be made through deployment on whether it's a mixture of on-prem or cloud, when is the deployment actually occurring, that could permeate the financial statement. So it's important to understand what are the constraints of that organization and what are the financial impacts that matter, and how do these accounting standards impact how these deployments are ultimately going to reflect the financial statements.

David Linthicum:
I love this conversation because I'm getting all the questions around things I know nothing about answered. So the other thing comes down to deadline. There's been some confusion around what the deadline is for implementing the standard. There's some extensions that are out there for nonprofits and things like that. So when does this stuff need to be in play? What should enterprises be concerned about?

Chris Chiriatti:
Well, a company with a calendar year end, that's a public company, would have been required to adopt the standard as of 1/1/2020, which means in their first quarterly report, they would have to have implemented the standard. There have been some very public deferrals of certain accounting standards that

really gave some non-public companies additional time. There's been nothing about this particular accounting standard update that's been deferred. So it is going to be required to be reflected in quarterly reports that will be coming out this spring, with non-public companies having one additional year to comply.

David Linthicum:
So who's the enforcement agency on this?

Chris Chiriatti:
Well, first and foremost, it's going to be an auditor, so whichever professional service firm is signing off on the accuracy of financial statements in accordance with GAAP. For public companies, the SEC, the Securities and Exchange Commission, will be their regulator, which would be ultimately monitoring compliance with new accounting standards and ensuring that the public companies are complying.

Sean Torr:
I totally agree with that, and I'll maybe add, for those public companies, I think the audit committee would be probably, as companies go through their first quarterly filings around this, they'll be probably asking questions around this, too. So there are actually quite a few different stakeholders that are going to be involved and kind of interested in this – the output from this adoption.

David Linthicum:
So how does this affect the way in which we do accounting for state and local government taxes? Anybody take that.

Sean Torr:
Wow, David, ;you loaded that one up, didn't you? So the actual tax treatment will not be impacted. So we really aren't touching anything other than the company's financial statements here, so I don't know that there's necessarily a difference in the way the actual tax returns will be filed. I don't know, Chris, if you had any other perspectives around that.

Chris Chiriatti:
No, but I do appreciate that there's always evolving interpretation of how tax regulations are going to be applied to certain cost categories, and anytime you're changing how something gets reflected from a GAAP standpoint, there's always going to be a need to see if there's a corresponding impact for taxation, and sometimes the objectives don't align, where for external reporting, or GAAP perspectives, you might want to be deferring expenses, and for tax reporting, you might want to be accelerating expenses and getting that immediate deduction, depending on where you are in your tax payee status. So clearly it'll be an area the company should focus on, to recognize if there is an arbitrage opportunity, if certain selections can be made for tax that result in deductions, while being able to defer for financial reporting purposes, is a conversation that should be had.

David Linthicum:
Yeah, the reason I asked the question, one of the things I noticed over the last ten, fifteen years with cloud computing is a lot of state and local governments are finding that they're receiving reduced revenue because people aren't buying things that they can tax as sales tax and moving things into the cloud, and of course, they're trying to figure out how to tax that, or if they can tax it, things like that. And obviously the enterprises are concerned about that, and generally the CFOs. And when you start seeing these accounting changes, I think all these things are interdependent. And, Sean, this is for you first, are these going to change at some point in time in the future? Are we going to have, some legislative activities that are going to adjust this deal with different tax configurations, things like that?

Sean Torr:
You know, at this point, it's really hard to say what the FASB will want to put on the agenda going forward, but this is a new standard; it was implemented in order to conform the cloud rules to, as Chris mentioned earlier, the on-premise accounting rules for implementation costs. There could be – and there might be interpretations on the standard, but it's really too hard to say if it'll change in the future. But I think –I think this is moving more in line with consistency and conformity with existing GAAP, so it's hard to say that there's any changes that are expected.

David Linthicum:
So ultimately this is going to bring consistency to the way in which we do accounting for companies in terms of cloud-based resources. This is going to reduce the complexity that we're currently going through right now. I'm trying to catch kind of the talking points that I would tell a client. And ultimately this should be a good thing for existing enterprises. However, you need to have cost governance and cost accounting in place that should be active and automated in order to get the best bang for the buck with this stuff, and you need to do some preplanning as to what the issues are going to be in terms of how you deal with different (Inaudible) in terms of how we're accounting. Did I get that right? I'm going to go to you first, Chris.

Chris Chiriatti:
And another thing, David, I guess the one thing I'd add, as a headline highlight for this standard, is it does remove at least one barrier to cloud deployment, and that would be the immediate earnings drag that a large-scale implementation could have because of the requirement to defer the implementation costs for those types of deployments. So to the extent that that is a barrier to accessing the technology an organization wants, the standard does help alleviate that.

David Linthicum:
Okay, well, it sounds like it's a good thing, and so that's what the cloud professionals, people who listen to this show should kind of take away. I've got kind of an off-topic question for either who wants to take it. We now have attorneys that are focused just on cloud-based computing and cloud law and dealing with it from an international perspective, as well as a national perspective. Are we going to have accountants that specialize in cloud computing accounting going forward? because it seems like this stuff is becoming so specific that it's going to be difficult for accountants to focus on this area, as well as focus on everything else. Are you guys just going to be required to, be general purpose understanding of everything inclusive of cloud computing?

Chris Chiriatti:

Well, David, I guess I'd respond by saying, we're probably already moving in that direction. I think there's kind of a natural alignment in certain specialties, depending on the industries that you tend to operate more often in, so those accountants who are more acclimated to cloud deployments have had to work through the application of the guidance and the types of activities that are typically involved in deploying to the cloud will, just by sheer nature of experience be more – I guess have more deep expertise in the accounting for those applications. So I do see they're developing a certain level of expertise, but it's more as a byproduct just working through with clients who are deploying to the cloud.

David Linthicum:
Sean, what's your take on that? Are we going to have just cloud accountants?

Sean Torr:
We're going to have people that are very specialized in this area. It's complex, requires a lot of judgment, and so I wholeheartedly agree with what Chris just said. I think as you look at companies, obviously most companies can't afford to just have a cloud accounting computing specialist on staff, so what you're finding, and actually this goes with all of the accounting changes that we've had, there have been changes around leasing and revenue recognition and others, is that there's a need for folks with specialized knowledge within the organization, and some of these do have some crossover, so to a certain extent, there's similarities between some of these standards that people can be specialized in the technical nuances to more than just one standard itself. But clearly there is a need for more specialty around the technical aspects of some of these new standards.

David Linthicum:
So kind of speaking for my listeners, so where can we reach out to you if they need to understand more about this topic, and also where do you guys go to, in essence, learn more about this topic?

Chris Chiriatti:
Well, David, we've issued a couple publications that highlight some of the accounting changes and some of the practical challenges to implementation, so those are available to all listeners. Those are externally available publications.

Chris Chiriatti:
But oftentimes it's good just to have a conversation, understand what the particular needs and challenges are and think through in a collaborative way as to, what options there could be and how the accounting rules can be applied against a particular client situation or particular challenges that companies are facing.

David Linthicum:
Yeah, this is why I love working for Deloitte, because I didn't have access to these kinds of skills when I was working for just a technology consulting firm. Now I can reach out to accountants to provide me with detailed answers, and also reach out to human resource professionals, and reach out to a number of different skill sets that really kind of are holistically working with cloud computing. Cloud computing is no longer just a technological implementation, but it's all these things in terms of how you deal with the business case, how you deal with ops changes, how you deal with organizational changes, how you deal with human resources, and this is really just part of the problem that we have to solve. So it's great having you guys on the podcast. So if you enjoyed this podcast, make sure subscribe on iTunes or wherever you get your podcasts. Also check out our past episodes, including the On Cloud podcast hosted by my good friend, Mike Kavis, on his show, Architecting the Cloud. If you'd like to learn more about Deloitte's cloud capabilities, check out DeloitteCloudPodcast.com, all one word. And if you'd like to contact me directly, you can reach me at dlinthicum – L-I-N-T-H-I-C-U-M – at Deloitte.com. So until next time, best of luck in building your cloud computing projects. We'll talk to you guys in a week. Good luck now.

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