3. **ACCOUNTING**

3.4 **Liabilities**
3.4.X **SBITA**

3.4.X.10 **Definition**

A Subscription Based Information Technology Arrangement (SBITA) is 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.

3.4.X.XX **Exclusions**

The following items should not follow SBITA accounting and reporting guidance:

- Short-term SBITAs – One that, at the beginning of the SBITA, has a maximum possible term of 12 months or less, including any options to extend – e.g. rolling month-to-month contracts
- Contracts that convey control of both IT software and tangible capital assets if the software component is insignificant – e.g., a smart copier
- Governments that provide the right to use their IT software and associated tangible capital assets to other entities through SBITAs
- Contracts that meet the definition of a public-private and public-public partnership (see **LINK TO NEW BARS PAGE)**
- Licensing arrangements that provide a perpetual license to governments to use a vendor's computer software

3.4.X.XX **Perpetual License versus Subscription**

Perpetual license arrangements are indefinite, whereas SBITAs are for a finite period of time. With a perpetual license, the software is directly downloaded onto your governments computer or servers. After you pay for the software, you will never lose access to the software (you can access it perpetually).

A subscription contract requires a monthly or annual fee to continue to access the software. If you do not pay the subscription fee, you will lose access to the software. A subscription contract with indefinite renewal periods, is not the same as a perpetual license.

One way to determine whether it is a perpetual license or a subscription bases contract is to ask yourself: "Can I still log in and access the IT software after the engagement term ends?" If the answer is "no," it is not a perpetual license, and the contract should be further evaluated to determine if it meets the definition of a SBITA.

3.4.X.XX **Subscription Term**

The subscription term includes:

- The period during which a government has a non-cancelable right to use the underlying IT assets
    - plus periods covered by the government's **or** SBITA vendor's option to extend the SBITA (if reasonably certain the option will be exercised)

    - and periods covered by the government's **or** SBITA vendor's option to terminate the SBITA (if reasonably certain the option will not be exercised)
- Subscription term **excludes** periods for which both the government and SBITA vendor each have the option to terminate or both parties must agree to extend.

Determining whether an extension or termination option is reasonably certain of being exercised requires professional judgement and should take into consideration the specific facts and circumstances at your government. Examples of items to consider in this analysis:

- A significant economic incentive, such as contractual terms and conditions for the optional periods that are favorable compared with current market rates
- A potential change in technological development that significantly affects the technology used by the underlying IT assets
- A potential significant change in the government's demand for the SBITA vendor's IT assets
- A significant economic disincentive, such as costs to terminate the SBITA and sign a new SBITA (for example, negotiation costs, costs of identifying another suitable underlying IT asset or another suitable SBITA vendor, implementation costs, or a substantial cancellation penalty)
- The history of exercising options to extend or terminate
- The extent to which the underlying IT assets in the SBITA are essential to the provision of government services

3.4.X.XX **Short-Term SBITA**

A short-term SBITA is one that has a maximum possible term of less than 12 months. The maximum possible term includes all options to extend regardless of whether those options will be exercised or not.

Example: A SBITA contract has an initial noncancelable term of 6 months with an option for the government to extend for another year. The government will most likely not exercise that option.

This is **not** a short-term SBITA because the maximum possible term is 18 months. The extension option is included in the maximum possible term even if it will not be exercised. The subscription term for accounting purposes would only be 6 months.

For a short-term SBITA, a government should recognize an expense/expenditure when subscription payments are due based on the payment provisions of the SBITA contract.

3.4.X.XX **Renewals**

Many SBITA contracts have automatic annual renewals. In most cases at each renewal date, the SBITA vendor and the government can cancel the contract. If both parties can cancel the contract, any periods covered by the renewal terms are considered cancellable periods. Cancelable periods are always excluded from the maximum possible subscription term.

For example, if a government has a one-year SBITA contract for their online teleconferencing and the contract automatically renews each year, and both the SBITA vendor and government can cancel at each renewal, then the maximum possible term is only 1 year because the renewal periods are cancelable periods and excluded from the maximum possible term. This would be considered a short-term SBITA.

3.4.X.XX **Discount Rate**

The subscription payments should be discounted using the rate the SBITA vendor charges the government. This may be a rate stated in the contract (if it's a reasonable rate) or the implicit rate can be estimated. Governments are also allowed to apply GASB Statement 62, paragraphs 173 – 187 for imputation of interest, but are required to. If the implicit rate is not determinable, the lessee's estimated incremental borrowing rate may be used. A lessor can use their own incremental borrowing rate if it is not practicable to determine their lessee's rate.

The incremental borrowing is the interest that a borrower would have to pay to finance an asset of that same type, over a similar term, in the current economic environment, and of a similar amount. This is the borrowing rate at the margin for new debt, and not necessarily the rate of other previously negotiated debt which may have a dissimilar borrowing profile.

Governments should use professional judgment to determine their best estimate for the interest rate, maximizing the use of observable information to get a base rate (a starting point). For example, a prime rate would be a reasonable starting place for determining the incremental borrowing rate. Another example would be reviewing a local bank's website for their published interest rates.

If the government determines that they could finance an asset at that base rate (the prime rate, or another reasonable starting point), then that base rate should be used. However, if there are economic factors that would make that rate unobtainable, then the base rate should be adjusted accordingly. It is up to governments to determine the most appropriate discount rate.

3.4.X.XX **Remeasurement**

The government is required to remeasure the subscription liability in the following circumstances:

- Change in subscription term
- Change in estimated amounts for payments already included in the subscription liability
- Change in the interest rate the SBITA vendor charges (if used as the discount rate)
- Contingency for variable payments is resolved.

If the subscription liability is remeasured for any of the changes above, the index or rate used for variable payments and the discount rate should also be updated. However, the liability does not need to be remeasured solely for a change in the index or rate used for variable payments or a change in the incremental borrowing rate (if used as the discount rate).

A subscription asset should generally be adjusted by the same amount as the subscription liability. If the change reduces the carrying value of the subscription asset to zero, any remaining amount should be reported as a gain.

3.4.X.XX **Schedule of Liabilities (Schedule 09) Reporting**

The government will report subscription liabilities on the Schedule of Liabilities (Schedule 09). In the year of implementation, any existing subscriptions should report a beginning balance on the Schedule 09. The beginning balance reported should be the amount calculated for the implementation of GASBS No. 96. In subsequent years, the beginning balance should match the prior year ending balance.

Any new SBITA contracts entered during the year will be reported as an addition on the Schedule 09. The addition will be the liability calculated to add the subscription to your financial statements.

Reductions are the amount the subscription liability is reduced during the year, which is typically the principal portion of payments made.

If the subscription liability is remeasured for any of the items in Section 3.4.X.60, the change in the subscription liability should be reported as either an addition or reduction on the Schedule 09.

See Schedule 09 reporting instructions.

There are also required note disclosures. See template note at Note X – SBITA.

3.4.X.XX **Subscription Liability – Full accrual**

For full accrual reporting (such as the government wide financial statements and proprietary fund statements) at the start of the subscription term, the government will recognize a subscription liability and subscription asset.

The subscription liability is measured at the present value of payments expected to be made during the subscription term. This includes:

- Fixed payments
- Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the start of the subscription term
- Variable payments that are fixed in substance
- Payments for penalties for terminating the SBITA, if the subscription term reflects the government exercising (1) an option to terminate the SBITA or (2) a fiscal funding or cancellation clause
- Any subscription contract incentives receivable from the SBITA vendor
- Any other payments that are reasonably certain of being required based on an assessment of all relevant factors

As the government makes payments, they reduce the subscription liability and recognize interest expense. The subscription liability must be amortized using the interest method.

3.4.X.XX **Subscription Asset – Full accrual**

The subscription asset is measured at the initial subscription liability plus payments associated with the SBITA contract made at the start of the subscription term, plus any capitalizable initial implementation costs (see section 3.4.X.XX).

Payments made to the SBITA vendor and payments for capitalizable initial implementation costs that are made before the start of the subscription term should be reported as a prepayment (an asset). This prepayment should be reduced by any incentives received from the same SBITA vendor. At the start of the subscription term, the prepayment should be reclassified as ab addition to the subscription asset.

The subscription asset should be amortized over the shorter of the subscription term or the underlying IT asset's useful life. GASB does not specify a required amortization method, so governments may choose which method they use (for example the interest method or straight-line).

3.4.X.XX **Initial Implementation Costs**

Implementation is grouped into three phases:

- Preliminary project stage – Activities in this stage include the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the SBITA. **These costs should be expensed.**
- Initial implementation stage – Activities in this stage include ancillary charges related to designing the chosen path, such as configuration, coding, testing, and installation. Other ancillary charges necessary to place the subscription asset into service also should be included in this stage. The initial implementation stage for the SBITA is completed when the subscription asset is placed into service (or when the first module is functional if there is more than one module being deployed). **These costs should be capitalized as a part of the subscription asset.**
- Operation and additional implementation stage – Activities in this stage include maintenance, troubleshooting, and other activities associated with ongoing access to the underlying IT assets. This also includes implementation of additional modules if more than one module is being deployed. **These costs should generally be expensed.**
  If there are additional outlays that increase the functionality or the efficiency of the subscription asset, those should be capitalized.

Training costs should always be expensed.

3.4.X.XX SBITA Reporting in Governmental Funds

Governmental funds do not report a subscription asset or subscription liability. Instead, the government would record a Capital Outlay Expenditure (debit) and an Other Financing Source for SBITA (credit). As the government makes payments, they would record a Debt Service Principal Expenditure (debit), Debt Service Interest Expenditure (debit), and reduce cash (credit).

3.4.X.XX SBITA BARS Codes

In a full accrual fund, the only revenue and expense accounts used are interest expense and amortization expense.

592.PP.80	Recording interest expense payments
501.PP.00	Recording amortization expense on subscription asset

In a modified accrual there is no subscription asset or subscription liability, so the accounts used are different.

594.PP.60	Recording the capital outlay expenditure at the start of the subscription term
391.70.00	Recording the "other financing source" at the start of the subscription term
591.PP.70	Recording debt principal payments
592.PP.80	Recording interest expense payments

The "P" stands for prescribed numbers that are related to the function of government the SBITA is supporting. Review your chart of accounts to identify the applicable function and determine the full BARS Code. For example, if a government has a water utility fund and has a SBITA for software that calculates the customer water bills, the principal payment would be coded to BARS 591.34.70.

Expenses for short-term SBITA contracts should be coded to the regular, functional BARS expense/expenditure codes. For example, if a government has a short-term SBITA for software used by the water utility fund, the subscription expense would be coded to BARS 534.00.40.

3.4.X.XX Example Journal Entries – Full Accrual

A government signs a 60-month SBITA contract for their accounting software. The payments are $1,000 per month (made at the beginning of the month) and the government uses an annual discount rate of 3%.

The government first calculates the present value of the subscription payments to be $55,791. The government had no capitalizable initial implementation costs, so the subscription asset is the same amount as the subscription liability:

Subscription asset	55,791	
Subscription liability		55,791

The government records the first month's subscription payment. Since this payment is made at the very start of the subscription term, the present value is $1,000 and all the payment goes towards principal and directly reduces the subscription liability.

Subscription liability	1,000	
Cash		1,000

The government also records the first month's subscription asset amortization. This example uses straight line amortization ($55,791 initial subscription asset divided by 60 total months equals monthly amortization of $930). This will be the exact same journal entry each month since straight line amortization is used.

Amortization expense (BARS 501.PP.00)	930	
Accumulated amortization – subscription asset		930

The government records the second month's subscription payment. This time there is interest expense, because one month of interest has accrued. The interest is calculated by multiplying the balance of the subscription liability from the prior month of $54,791 ($55,791 initial subscription liability minus the $1,000 payment in the first month) by the monthly interest rate of 0.25% (annual interest rate of 3% divided by 12 months). The remaining portion of the payment is the principal amount that reduces the subscription liability.

Subscription liability	863	
Interest expense (BARS 592.PP.80)	137	
Cash		1,000

3.4.X.XX Example Journal Entries – Modified Accrual

A government signs a 60-month SBITA contract for their accounting software. The payments are $1,000 per month (made at the beginning of the month) and the government uses an annual discount rate of 3%.

The government first calculates the present value of the subscription payments to be $55,791. Since the modified accrual funds do not record a subscription asset or subscription liability different accounts are used. However, the amounts calculated for the full accrual journal entries are the exact same that are used for the modified accrual journal entries.

Capital outlay – subscription asset (BARS 594.PP.60)	55,791	
Other financing source – SBITA (BARS 391.70.00)		55,791

The government records the first month's subscription payment. Since this payment is made at the very start of the subscription term, the present value is $1,000 and all the payment goes towards principal. Since there is no subscription liability to reduce, the payment is recorded as a debt service expenditure.

Debt service expenditure – principal (BARS 591.PP.70)	1,000	
Cash		1,000

There is no subscription asset in the modified accrual fund, therefore there is nothing to amortize.

The government records the second month's subscription payment. This time there is interest expense, because one month of interest has accrued. The same amounts calculated for the full accrual journal entries are used.

Debt service expenditure – principal (BARS 591.PP.70)	863	
Debt service expenditure – interest (BARS 592.PP.80)	137	
Cash		1,000