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January 18, 2025

Technical Director
Financial Accounting Standards Board ("FASB")
801 Main Avenue, PO Box 5116
Norwalk, CT 06856-5116

RE: File Reference No. 2024-ED400

Dear Technical Director:

Wipfli LLP appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update—*Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40):* hereafter referred to as the "Exposure Draft".

We support the FASB's efforts to improve the accounting for internal-use software development costs and to align such guidance with how software is currently developed. We would recommend that the FASB issue a final Accounting Standard Update ("ASU") based on the content of the Exposure Draft as written, subject to a few targeted improvements that are discussed in Appendix A to this letter.

Although we appreciate the FASB's consideration of other potential additional amendments, we believe that a final ASU focused solely on the targeted improvements in the Exposure Draft will result in clearer and more consistent accounting and disclosures, while keeping implementation costs low.

Appendix A contains our responses to the Questions for Respondents posed in the Exposure Draft.

We once again thank the Board and its staff for allowing us to comment on the Exposure Draft. If you have any questions regarding the contents of this letter or our responses in Appendix A, please contact Tracy Heideman, Partner at Wipfli, at (920) 662-2978.

Sincerely,

Wipfli LLP

Wipfli LLP

Appendix A

Questions for Respondents

Information for Question 1: The amendments in this proposed update would make targeted improvements to Subtopic 350-40.

Question 1a: *Do you agree with the proposed amendments? Please explain your reasoning.*

We generally support the proposed amendments for several reasons:

- The targeted improvements will better align accounting practices with contemporary nonlinear software development methodologies, such as Agile.
- The enhanced disclosures will promote consistency in financial reporting.
- Although the exact definitions differ, the concept of the "probable-to-complete recognition threshold" described in ASC 350-40-25-12(c), is analogous to "technological feasibility" in ASC 985-20, narrowing the gap between these standards.
- The costs associated with implementing the new standard are expected to be minimal.

Nonetheless, we refer you to our responses to Questions 1c, 3a, 6b, 6c and 7a, for several suggestions on ways to improve the Exposure Draft.

Question 1b: *Are the proposed amendments clear and operable? Please explain your reasoning.*

We generally believe that the proposed amendments are clear and operable.

However, we again refer you to our response to Question 3a regarding our concerns about the concept of significant development uncertainty.

Question 1c: *Would the proposed amendments clarify and improve the application of Subtopic 350-40? Please explain your reasoning.*

The targeted improvements to remove project stages will align accounting practices more closely with current nonlinear software development methodologies, such as Agile. This will improve consistency and application of Subtopic 350-40, as there will be less interpretation around applying modern nonlinear development methodologies to the "waterfall" based principles that currently exist in ASC 350-40.

We further believe that the targeted improvement to introduce a required disclosure for cash paid for capitalized software development costs will provide decision-useful information to financial statement users who seek additional information around a reporting entity's cash inflows and outflows.

However, we do believe that one proposed amendment will not improve the application of ASC 350-40. In situations where entities acquire an asset that incorporates both software and tangible components, proposed paragraph 350-40-15-1A would require application of a reasonable and consistent method to determine whether the software component should be accounted for in accordance with Subtopic 350-40 or combined with the tangible component and be accounted for in accordance with other generally accepted accounting principles. In most cases, it should be readily apparent based on common sense that the software component is incidental and should be combined with the tangible component (and accounted for under other ASC Topics), however there are still judgements that companies will be required to make and document.

We instead would recommend that any amendment to ASC 350-40 include a presumption that software embedded in a tangible asset should be combined with the tangible asset and accounted for under other GAAP, unless the software component is so significant that it clearly represents a separate unit of account to be accounted for under Subtopic 350-40. If this approach is taken, we also recommend that examples are included in the final ASU or other implementation guidance of when a software component would be considered significant and should be accounted for under ASC 350-40.

Question 1d: *Do you anticipate that the proposed amendments would result in a significant change in outcome? For example, would the proposed amendments result in the same level of capitalization of internal-use software or a decrease or an increase in the level of capitalization? Is that outcome appropriate? Please explain your reasoning.*

Other than one exception described below, we do not anticipate that the proposed amendments will result in a significant change in outcome. We believe that entities will likely capitalize a similar amount of costs under both the current methodology and the proposed improvements, although the proposed amendments will make it easier operationally for entities to comply with the provisions of ASC 350-40 (especially since entities will no longer have to apply "waterfall" concepts, like stage of development, to current methods of software development).

One exception, however, relates to entities that currently create platforms that they will license to customers under Software-as-a-Service ("SaaS") arrangements. Under ASC 350-40 as currently written, these entities typically will capitalize some of the costs of developing their SaaS platforms. Under the proposed amendments, however, it is likely that fewer costs would be capitalized by these entities due to the introduction of the probable-to-complete threshold and the related significant development uncertainty concept. We anticipate that entities that create SaaS platforms will, in many cases, conclude that there is significant development uncertainty until just about the time the SaaS platform (or new/enhanced features to the platform – i.e., "novel, unique, or unproven functions and features") is completed. This change, though, will better align the accounting for development costs incurred by (i) SaaS providers and (ii) licensors that create software within the scope ASC 985-20.

Question 1e: *What costs would be incurred to apply the proposed amendments? If significant, please describe the nature and magnitude of costs, differentiating between one-time costs and recurring costs, as well as whether you expect the proposed amendments to result in any reduction of costs.*

Following adoption of the proposed amendments, we believe that most entities developing software subject to ASC 350-40 will not incur significant costs of adoption or see an increase in recurring costs. The information required for the proposed disclosures should already be tracked and readily available.

However, entities developing novel, unique, or unproven functions and features will incur significant one-time costs to understand how to apply the concept of the significant development uncertainty and create applicable accounting policies. Additionally, they may face increased audit costs, as auditors will need to consult with internal IT specialists or engage third-party IT experts to judge the appropriateness and application of the new accounting policies.

Question 1f: *Alternatively, would you have preferred that the Board further pursue the single model as described in paragraphs BC45–BC49? Please explain your reasoning.*

In principle, the economics of internal-use software are similar to those of external-use software, particularly for entities offering SaaS solutions. That is, both SaaS providers and traditional software licensors create software that will be sold to, licensed to, or accessed by customers. Further, software meets the conceptual definition of an asset and should be recognized and measured consistently, no matter whether the software is used for internal purposes only or marketed to customers. Therefore, we believe a single accounting model would be most appropriate and theoretically would be more desirable than the multiple models presently contained throughout U.S. generally accepted accounting principles and would eliminate any remaining confusion regarding which model to apply.

However, we recognize that transitioning to a single model would require a more comprehensive analysis and additional stakeholder feedback, delaying the incremental improvements proposed in the Exposure Draft and potentially subjecting many entities to significant implementation costs.

The targeted improvements represent a positive step toward aligning the guidance under ASC 350-40 and ASC 985-20, ensuring that the internal-use software accounting model reflects current development methodologies while resulting in minimal one-time and recurring costs.

However, we suggest that FASB keep the single accounting model on its research agenda for future consideration, perhaps after entities have spent a few years applying the proposed amendments in the Exposure Draft.

Question 2: *The proposed amendments would remove all references to software development project stages throughout Subtopic 350-40. As a result, the proposed amendments would require all entities to determine when to begin capitalizing software costs by evaluating whether (a) management has authorized and committed to funding the software project and (b) the probable-to-complete recognition threshold has been met. Do you foresee any operability or auditability concerns with removing the references to project stages? Please explain your reasoning.*

We do not foresee any operability or auditability concerns with the removal of references to project stages. In our experience, preparers are tracking their software development costs by activity and not by stages. The criteria for commencing capitalization, as outlined in (a) and (b), provide a clear principle. The guidance in ASC 350-40-25-17(a) through 25-17(e) offers sufficient direction for determining whether costs should be capitalized, particularly within an Agile development framework.

Information for Question 3: If there is significant uncertainty associated with the development activities of the software (referred to as "significant development uncertainty"), the probable-to-complete recognition threshold described in paragraph 350-40-25-12(c) would not be considered to be met. There may be significant development uncertainty if the software being developed has novel, unique, unproven functions and features or technological innovations or if the significant performance requirements have not been identified or continue to be substantially revised.

Question 3a: *Do you foresee any operability or auditability concerns with determining whether there is significant uncertainty associated with the development activities of the software? Please explain your reasoning.*

We foresee potential operability and auditability concerns regarding the determination of significant uncertainty in software development activities. ASC 350-40-25-12A(a) states that the probable-to-complete recognition threshold is not met if the software being developed includes novel, unique, or unproven functions and features or technological innovations. This guidance is subjective and open to interpretation. Given that companies in the technology sector frequently engage in developing updates, upgrades, and feature sets, it is unclear whether the term "technological innovations" serves as a bright-line test or if its significance affects the probable-to-complete recognition threshold. For example, if the software development contains any new features, does it automatically result in there being significant development uncertainty? In addition, it is unclear whether the relative significance of the updates, upgrades, enhancements, or new feature sets affects the probable-to-complete recognition threshold. For example, assuming a single unit of account, it will be challenging to evaluate whether a software project containing both a novel new feature and routine coding would fail or meet the significant development uncertainty principle. Finally, it may be difficult to assess when, during the development process, software is no longer considered to include novel, unique, or unproven function or features or technological innovations such that capitalization of costs may start.

Additionally, software development often falls outside the expertise of finance departments and auditors, which may hinder their ability to assess whether the software development involves novel, unique, or unproven functions and features. In particular, audit teams may need to consult with internal IT specialists or engage third-party IT experts to help understand and assess management's assertions in this area, which could increase audit costs.

While companies can rely on their internal or external software development teams to make these determinations, the conclusions reached may be subject to management bias due to the subjective nature of the probable-to-complete recognition threshold.

We recommend that the FASB clarify whether the term "technological innovations" serves as a bright-line test or if the relative significance of the novel, unique, unproven functions and features affects the probable-to-complete recognition threshold. Additionally, we would find it helpful if the FASB provided more details to determine whether the significant development uncertainty concept is met similar to how technology feasibility is described in ASC 985-20-25-2.

An alternative the FASB may consider is scoping the costs of developing SaaS solutions into ASC 985-20. We anticipate entities developing SaaS solutions will have the most difficulty applying the significant development uncertainty concept. Since the economics of the SaaS business model are similar to companies applying ASC 985-20, it may be easier to simply scope SaaS development costs into ASC 985-20, as this model is already understood by financial statement users, preparers, and practitioners.

Question 3b: *The proposed amendments would define performance requirements as what an entity needs the software to do (for example, functions or features). Is the definition of performance requirements clear and operable? Please explain your reasoning.*

We find the proposed definition of performance requirements to be clear and operable, as it focuses on the essential functions that the software must fulfill. As noted in the Basis for Conclusion paragraphs BC34 and BC35, this concept aligns with the performance requirements described in the Master Glossary definition of the term "preliminary project stage", a concept that is already understood by preparers and practitioners.

Furthermore, since only significant performance requirements need to be identified, as opposed to all performance requirements, this proposed amendment appears operable.

Information for Question 4: The proposed amendments would require an entity to classify cash paid for capitalized software costs accounted for under Subtopic 350-40 as investing cash outflows in the statement of cash flows and to present those cash outflows separately from other investing cash outflows, such as those related to property, plant, and equipment (PP&E). Similar to cash paid for internally developed PP&E, cash paid for software costs could include certain expenditures related to employee compensation.

Question 4a: *For preparers and practitioners, are the proposed presentation requirements operable in terms of systems, internal controls, or other similar considerations? What auditing challenges, if any, do you foresee related to the proposed presentation requirements? Please explain your reasoning.*

We believe that the proposed presentation requirements for classifying cash paid for capitalized software costs as investing cash outflows are operable and practical for entities to implement. The clarity provided by these requirements aligns well with existing accounting practices and should integrate smoothly into current financial reporting systems.

The amendments specify that cash outflows related to capitalized internal-use software costs must be presented separately from other investing cash outflows, such as those associated with property, plant, and equipment (PP&E). This separation enhances transparency and allows stakeholders to better assess the cash flow implications of software investments. Given that many entities already track capitalized software costs as part of their capital expenditures separate from PP&E, we anticipate that the necessary adjustments to systems and internal controls will be manageable. Separately disclosing cash outflows for software costs is also commonly seen for companies with a material amount of capitalized software development costs, such as technology companies.

In our experience, preparers have internal controls in place to distinguish between capitalized software costs from cash outflows versus non-cash outflows, such as accrued payroll costs, that were capitalized.

We do not foresee significant auditing challenges arising from these presentation requirements. The proposed changes are straightforward and should not complicate the audit process. Auditors are accustomed to evaluating the appropriateness of cash flow classifications, and the clear delineation of software costs as investing activities will facilitate their review. Finally, the information required to comply with these presentation requirements is likely to be readily available, as entities typically maintain detailed records of capitalized software expenditures.

Question 4b: *For investors, would the proposed presentation requirements provide decision-useful information? How would this information be used in your investment and capital allocation decisions? Please explain your reasoning.*

While we are not investors, we believe that the proposed presentation requirements will enhance consistency and provide more information about capitalized software costs than is currently presented under existing guidelines. As mentioned in the Basis for Conclusions paragraph BC61, some investors view software and technology spending as a current-period cost of doing business. The requirement to disclose cash outflows for capitalized software costs, alongside amortization, which is required to be disclosed in accordance with ASC 350-40-50-1(d) and ASC 360-10-50-1(a), will furnish investors with sufficient information to adjust their financial metrics, including EBITDA or free cash flow, and facilitate comparisons between companies.

Question 4c: *The proposed presentation requirements would not include cash outflows incurred to implement a hosting arrangement that is a service contract. Those cash outflows are typically classified as operating cash flows due to the separate presentation requirements in paragraph 350-40-45-3, which originated in Accounting Standards Update No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (see paragraph BC64). Is it necessary to change the current classification of those costs to be consistent with the proposed presentation requirements? Please explain your reasoning.*

We believe it is not necessary to change the presentation of cash outflows identified in Accounting Standards Update No. 2018-15 (ASU 2018-15). The logic used to determine the presentation conclusion in that update remains relevant and applicable today, and we see no compelling reason to alter it.

The classification of cash outflows for implementation costs incurred in a cloud computing arrangement (CCA) as operating cash flows was based on a thorough analysis of the nature of those costs and their relationship to the hosting service. As described in the basis for conclusions in ASU 2018-15, this is because the asset recognized for the implementation costs is recognized only as a result of enhancing the value of the hosting service, which itself is not recognized as an asset. So, although the implementation costs are recognized as a standalone asset, the future benefit derived from that asset is linked to the benefit derived from the hosting service, which is expensed as incurred. The reasoning behind the original classification in ASU 2018-15 is still valid and appropriate. By maintaining this classification, the adoption of the proposed standard will cause less changes and reduce the overall cost of adoption.

In summary, we advocate for the retention of the current classification of costs as outlined in ASU 2018-15.

Information for Question 5: The Board considered but dismissed two potential disclosures that would have required entities to disaggregate internal-use and external-use capitalized software costs. One alternative would have required an entity to disclose the total amount of internal-use and external-use software costs capitalized during the period. The second alternative would have required an entity to provide a rollforward of the beginning to ending balance of net capitalized software costs (including additions, amortization, impairments, and disposals). These alternatives differ from the proposed cash flow presentation requirements because, among other reasons, they would include both internal-use and external-use capitalized software costs and noncash costs capitalized.

Question 5a: *For preparers and practitioners, how would the operability and costs of these disclosure alternatives compare with the proposed cash flow presentation requirements (described in Question 4)?*

We believe that the information required for these disclosure alternatives would generally be readily available for most companies under their existing internal controls and processes.

Question 5b: *For investors, how would the decision usefulness of these disclosure alternatives compare with the proposed cash flow presentation requirements? How and when would the information provided by each of the disclosure alternatives influence investment and capital allocation decisions?*

Not applicable, as we are not an investor.

Question 5c: *For investors, is the information that you currently receive about capitalized internal-use and external-use software costs sufficient? If not, how would receiving additional information about capitalized internal-use and external-use software costs affect your analysis? How does your analysis differ between capitalized internal-use software costs and capitalized PP&E?*

Not applicable, as we are not an investor.

Information for Question 6: The proposed amendments would supersede the guidance in Subtopic 350-50 and incorporate website-specific development costs guidance from that Subtopic into Subtopic 350-40.

Question 6a: *Would the proposed amendments be operable, and do you foresee any auditability challenges?*

Since the proposed amendments primarily involve relocating website development guidance from ASC 350-50 to ASC 350-40, we believe these amendments would be operable and do not foresee any significant auditability issues.

Question 6b: *Would the proposed amendments have a significant effect on practice? Please explain your reasoning.*

While the proposed amendments mainly involve the relocation of website development accounting guidelines, certain paragraphs currently found in ASC 350-50 are not included in the proposed amendments, such as the treatment of graphics as a component of software (ASC 350-50-25-8), as well as examples of graphics (ASC 350-50-55-4 and 55-5). Differentiating between graphic development and content development is challenging. In fact, ASC 350-50-55-6 describes content as "information included on the website, which may be textual or **graphical** in nature" and ASC 350-50-55-8 states "content is text or **graphical** information…on the website which may include information on the entity, products offered, information sources that the user subscribes to, and so forth."

Given the similarities between graphic and content development, we recommend that the FASB incorporate the relevant guidance from ASC 350-50-55-4 through 55-8 into ASC 350-40. This would ensure that important guidance is not lost, and that practice remains consistent with the FASB's intentions.

Separately, we would also propose that the FASB take the opportunity to consider clarifying the accounting for developed website content besides text or graphics, such as videos or interactive courses. The accounting scope of these activities is not clear. We find many entities analogize to ASC 926, *Entertainment-Films,* or ASC 928, *Entertainment-Music*. Since this type of content is now commonly found within websites, these technical improvements appear to be in the spirit of the proposed accounting update to modernize accounting for software costs in Subtopic 350-40. We suggest the FASB specifically address the accounting for developed website content besides text or graphics, such as videos or interactive courses, perhaps by simply referring practitioners to other applicable GAAP, including but not limited to ASC 926 or ASC 928.

Question 6c: *The Board considered but dismissed an approach that would have retained Subtopic 350-50 and replaced any reference to stages in Subtopic 350-50 with the term activities (for example, replace costs incurred in the planning stage with costs incurred during planning activities). Would you prefer this approach, and would it be more operable and auditable? Please explain your reasoning.*

While current website development cost guidance is based on phases, we believe that the basis for capitalization is fundamentally activity-based. Thus, we would prefer an approach that explicitly describes the activities that should be capitalized or expensed, as this would provide greater clarity regarding what should be capitalized versus expensed in an agile development environment. For these reasons, we recommend that the FASB remove references to stages for website development costs and replace with the term "activities".

Information for Question 7: The proposed amendments could be applied either prospectively or retrospectively.

Question 7a: *For preparers and practitioners, are the proposed transition requirements operable, and do you foresee any auditability challenges? Please explain your reasoning. If the proposed transition requirements are not operable, please explain what transition method would be more appropriate and why.*

Entities opting for retrospective application will recast prior periods to reflect the new guidance. While this may require some adjustments to historical data, we believe that the necessary information is typically available and manageable. The retrospective approach is designed to enhance comparability across reporting periods, which is beneficial for stakeholders. This approach will generally be straightforward and should not present significant auditability challenges for most entities. The clarity of the guidance provided in the proposed update facilitates a smooth transition, allowing companies to adapt their accounting practices with relative ease.

In contrast, there is a specific situation when applying the standard prospectively that may cause confusion for financial statement users. If a company has been capitalizing software costs under previous guidance but does not meet the probable-to-complete threshold as described in the Exposure Draft, the entity would need to cease capitalization of those costs. There is an argument that software previously capitalized, but now failing to meet this threshold for novel, unique, or unproven functions and features should be evaluated for impairment under ASC 350-40-35-1 through 35-3. However, since the impairment test for internal-use software is often tested at an asset group level, the unit of account may preclude the software from being impaired. Additionally, novel, unique, or unproven software may exhibit characteristics described in ASC 350-40-35-3, which would require the asset to be reported at the lower of carrying amount or fair value, with the rebuttable presumption that uncompleted software has a fair value of zero. However, entities may still consider it probable that they will complete the development, thus maintaining the carrying value of the capitalized software.

This outcome would result in a mixed basis for certain software projects that were incomplete as of the date the proposed amendments become effective, and we believe this outcome would be confusing for financial statement users. We ask that the FASB include additional transition guidance for entities with this fact pattern as part of the final ASU.

Question 7b: *For investors, would the information required to be disclosed by paragraph 350-40-65-4(d) through (e) be decision useful? Please explain your reasoning.*

Not applicable, as we are not an investor.

Question 8: *In evaluating the effective date, how much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities be different from the effective date for public business entities? Should early adoption be permitted? Please explain your reasoning.*

We believe that a two-year implementation period would be sufficient for public business entities, except for public business entities meeting the criteria to be a smaller reporting company ("small reporting companies"), while a three-year period would be appropriate for all other entities. We recommend a longer timeline for nonpublic entities and small reporting companies as they typically have less resources than larger public business entities and this would allow them sufficient time to ensure their internal controls and processes are setup to handle the accounting update.

We support permitting companies to early adopt the proposed standard.

Question 9: *The proposed amendments would apply to all entities, including private companies. Do you agree? Are there any private company considerations, in the context of applying the guidance in the Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies, that the Board should be aware of in developing a final Accounting Standards Update? Please explain your reasoning.*

We agree with the proposed amendments applying to all entities, including private companies. We are not aware of any additional private company considerations beyond those alternatives discussed in the basis for conclusions, which the FASB ultimately rejected.