FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Accounting for and Disclosure of Software Costs
May 7, 2025

Meeting Purpose

1. The purpose of the May 7, 2025 Board meeting is for the Board to discuss feedback received on proposed Accounting Standards Update, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*, and begin redeliberations.

Questions for the Board

Issue A: Removal of Project Stages

1. Does the Board want to affirm its decisions to (a) remove all references to project stages throughout Subtopic 350-40 and (b) require the same recognition guidance for all software within the scope of Subtopic 350-40?

Issue B: Significant Development Uncertainty

2. Does the Board want to affirm its decision to acknowledge that the targeted improvements would require entities to use judgment in evaluating when to recognize internal-use software costs? If "yes", does the Board want to amend the Codification to explicitly state that an entity needs to apply judgment when evaluating significant development uncertainty **(Revision A)**?

3. Does the Board want to affirm its decision to link the term *probable* in Subtopic 350-40 to the Master Glossary definition?

4. Does the Board want to affirm its decision to clarify that if there is significant development uncertainty, the probable-to-complete recognition threshold would not be met until the significant development uncertainty has been resolved? If "yes", does the Board want to require entities to evaluate significant development uncertainty for all software projects (**Revision B**)?

5. Does the Board want to affirm its decision to include two factors that indicate that significant development uncertainty exists, as follows?
    a. **Novel or unproven software**. The software being developed has novel, unique, unproven functions and features or technological innovations.
    b. **Significant performance requirements**. The significant performance requirements of the computer software have not been identified or the significant performance requirements continue to be substantially revised.

    If "yes", does the Board want to make novel or unproven software and significant performance requirements the only two factors that indicate that significant development uncertainty exists (**Revision C**)? Additionally, does the Board want to amend the novel or unproven factor to indicate that uncertainty related to the development of novel or unproven software would be resolved through coding and testing (**Revision D**)?

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

Questions for the Board

6. Does the Board want to affirm its decision to define performance requirements as what an entity needs the software to do (for example, functions or features)?

7. Does the Board want to affirm its decision to use significant in the term *significant development uncertainty* and *significant performance requirements* without adding additional requirements on how an entity should evaluate significance?

8. Not used.

Issue C: Presentation and Disclosure

Presentation & Disclosure Paths Forward

9. Which of the following presentation and disclosure (P&D) paths does the Board prefer?
    a. **P&D Path 1.** Affirm the proposed presentation requirements. This would require an entity to separately present cash outflows for capitalized software costs as investing cash outflows in the statement of cash flows.
    b. **P&D Path 2.** Total costs capitalized. This would require an entity to disclose the total amount of internal-use software costs capitalized during the period.
    c. **P&D Path 3.** Total costs capitalized and amortization. This would require an entity to disclose (i) the total amount of internal-use software costs capitalized during the period and (ii) the amortization expense for internal-use software costs recognized during that period.
    d. **P&D Path 4.** No change to current presentation and disclosure requirements. This would retain the current presentation and disclosure requirements for internal-use software costs and not require any incremental information.

10. If the Board selects P&D Path 2 or 3, does the Board want to extend the disclosure requirement(s) selected in Question 9 to external-use software?

11. If the Board selects P&D Path 2 or 3, does the Board want to require the disclosure (or disclosures) to be provided on an annual or interim basis?

12. If the Board selects P&D Path 1, does the Board want to affirm its decision to exclude cash outflows incurred to implement a hosting arrangement that is a service contract from the proposed presentation requirements?

Subtopic 350-30 Disclosures

13. Does the Board want to affirm its decision not to require the disclosures under paragraphs 350-30-50-1 through 50-3 for software costs capitalized under Subtopic 350-40?

14. If “yes” to Question 13, does the Board want to specify that the disclosure requirements in Subtopic 360-10 apply to all capitalized internal-use software costs regardless of how those costs are classified in the balance sheet?

Issue D: Website Development Costs

15. Does the Board want to affirm its decision to supersede Subtopic 350-50 and incorporate website-specific development costs guidance into Subtopic 350-40?

Issue E: Unit of Account for Software Components and Tangible Assets

16. Does the Board want to affirm its decision to provide guidance on the determination of the unit of account for software components and tangible assets?

17. If “yes” to Question 16, does the Board want to affirm the proposed amendments or make changes to those proposed amendments?

Questions for the Board

Issue F: Other Feedback

18. Does the Board want to address any of the following areas as part of a final Update? If so, how does the Board want to address the area?
    a. The area of GAAP that should apply to costs incurred to develop software that will be sold via a cloud computing arrangement (CCA).
    b. Unit of account in applying Subtopic 350-40.
    c. Upgrades and enhancements.
    d. Artificial intelligence (AI) training and data conversion costs.

Issue G: Private Company Considerations

19. Does the want to Board affirm its decision that the proposed amendments would apply to all entities, including private companies?

Issue H: Transition and Effective Date

20. Does the Board want to affirm its decision to permit an entity to apply the new guidance using either a prospective approach or a retrospective approach?

21. Does the Board want to address any of the following transition areas as part of a final Update? If so, how does the Board want to address the area?
    a. Impairment of capitalized internal-use software costs as of the date of adoption (prospective transition approach)
    b. Use of hindsight (retrospective transition approach).

22. Does the Board want to affirm the proposed transition disclosure requirements?

23. Does the Board support requiring the amendments to be effective for public business entities for annual reporting periods beginning after December 15, 2026, and interim reporting periods within those annual reporting periods? If not, what effective date does the Board prefer?

24. Does the Board support requiring the amendments to be effective for other than public business entities for annual reporting periods beginning after December 15, 2027, and interim reporting periods within those annual reporting periods? If not, what effective date does the Board prefer?

25. Does the Board support permitting early adoption for both interim and annual financial statements that have not yet been issued (or been made available for issuance) with the clarification that if an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the annual reporting period that includes that interim period?

Benefits and Costs, and Permission to Ballot

26. Has the Board received sufficient information and analysis to make an informed decision on the expected benefits and expected costs of change? If not, what other information or analysis is needed?

27. Does the Board (a) believe that the expected benefits would justify the expected costs of the amendments included in a final Update and (b) give the staff permission to proceed to draft a final Update for vote by written ballot?

Background

Overview of Current Software Cost Guidance

2. Subtopic 350-40, Intangibles—Goodwill and Other—Internal-Use Software, and Subtopic 985-20, Software—Costs of Software to Be Sold, Leased, or Marketed, are the principal areas in the Codification applicable to software costs.

3. Determining which Subtopic applies primarily depends on how an entity plans to use the software. Generally, the costs incurred to develop software that will be sold via an on-premise license[1] (referred to as external-use software) are accounted for under Subtopic 985-20. Subtopic 350-40 applies to the costs incurred to (a) acquire or develop software that will be used internally in an entity's own operations, (b) develop software that will be provided to an end user in a CCA,[2] and (c) implement a CCA (referred to as CCA implementation costs). The software described in (a), (b), and (c) and accounted for under Subtopic 350-40 is collectively referred to as internal-use software.

4. Subtopics 350-40 and 985-20 have different requirements for when an entity is required to capitalize software costs:

   (a) **Subtopic 350-40**. Entities are required to capitalize software costs depending on the nature of the costs and the project stage during which they occur. The guidance describes three sequential stages of software development and implementation activities (referred to as project stages) as follows:

      (i) *Preliminary project stage*. This stage generally occurs when an entity considers and defines its software needs and possible solutions, regardless of whether it ultimately pursues a project to develop internal-use software or enter into a CCA.

      (ii) *Application development stage*. This stage begins after (1) the preliminary project stage is complete, (2) management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project, and (3) it is probable that the project will be completed and the software will be used to perform the function intended (referred to as the probable-to-complete recognition threshold).

[1] Refers to software that can be used offline by external parties.

[2] The term *cloud computing arrangement* (CCA) refers to software that (a) is used to provide services to external parties and (b) can only be accessed and used through the internet (rather than an on-premise license). The external-use software guidance applies to software developed for customers to access in CCAs in which (a) the customer has a contractual right to take possession of the software at any time during the hosting period without significant penalty and (b) it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software. Throughout this handout, the terms CCA, *software as a service* (SaaS), and *hosting arrangement* are used interchangeably.

(iii) *Post-implementation operation stage*. This stage begins when the software project is substantially complete and ready for its intended use, which is analogous to the period after all substantial testing is complete.

Generally, entities are required to expense costs incurred during the preliminary project stage and to capitalize eligible costs incurred during the application development stage. During the post-implementation operation stage, entities are required to capitalize eligible costs that add functionality as enhancements in the same manner as described above and to expense maintenance costs as incurred.

(b) **Subtopic 985-20**. Entities are required to expense all costs incurred to establish the technological feasibility of the software. Technological feasibility is established when an entity has both:

(i) Completed all the planning, designing, coding, and testing activities that establish that the product will meet its design specifications

(ii) Evidenced that technological feasibility has been established through the development of either (1) a detail program design or (2) a working model if the entity's process excludes the development of a detail program design.

After establishing technological feasibility, entities are required to capitalize eligible costs incurred until the product is available for general release. Following general release, entities are required to capitalize eligible costs of enhancements that extend the life or significantly improve the marketability of the software product in the same manner as described in the previous sentence and to expense maintenance costs as incurred.

Overview of the Proposed Amendments

5. The objectives of the amendments in the proposed Update are to (a) modernize the accounting for internal-use software costs and (b) enhance the transparency of an entity's cash flows related to internal-use software costs for investors.

6. The proposed amendments to Subtopic 350-40 would:

(a) Remove all references to project stages throughout Subtopic 350-40.

(b) Specify that an entity would be required to start capitalizing internal-use software costs when both of the following occur:

(i) Management has authorized and committed to funding the software project.

(ii) The probable-to-complete recognition threshold has been met.

(c) Clarify that 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 would not be met.

(d) Require entities to separately present cash paid for capitalized internal-use software costs, other than cash paid for CCA implementation costs, as investing cash outflows in the statement of cash flows.

(e) Supersede the website development costs guidance in Subtopic 350-50, Intangibles—Goodwill and Other—Website Development Costs, and incorporate the recognition requirements for website-specific development costs into Subtopic 350-40.

(f) Require entities to use a reasonable and consistent method to determine the unit of account for an asset that incorporates both software and tangible components.

(g) Permit an entity to apply the guidance either prospectively or retrospectively.

General Summary of Feedback Received

7. Forty comment letters were received on the proposed Update. Not all respondents addressed every question; some focused on specific questions and areas, while others answered all questions and provided detailed comments for relevant issues. The level of detail in the feedback received by each respondent varied depending on the issue. The following table provides the composition of the comment letter respondents by respondent type:

Type of Respondent	Number of Respondents
Practitioners	16
Preparers	10
State Societies	7
Trade Groups	5
Individuals	2
Total Respondents	**40**

8. Overall, a majority of respondents supported the proposed amendments. Respondents said that the proposed amendments (a) would be generally operable and/or auditable and (b) would clarify and improve the application of Subtopic 350-40. However, many respondents expressed operability concerns over certain aspects of the proposed amendments, primarily related to the evaluation of (i) significant development uncertainty and (ii) the proposed statement of cash flows presentation requirements.

Question 1: Overall

9. The proposed Update included the following question:

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

a. Do you agree with the proposed amendments? Please explain your reasoning.
b. Are the proposed amendments clear and operable? Please explain your reasoning.
c. Would the proposed amendments clarify and improve the application of Subtopic 350-40? Please explain your reasoning.
d. 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.
e. 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.
f. Alternatively, would you have preferred that the Board further pursue the single model as described in paragraphs BC45–BC49? Please explain your reasoning.

Support for the Proposed Amendments

10. Eighty-five percent of respondents indicated general support for the amendments in the proposed Update. Respondents provided various reasons for this support, with the most frequently cited being that these proposed amendments would:

    (a) Align the accounting guidance with the ways that software is developed today (for example, agile development) by removing all references to project stages that are based on outdated development methods.

    (b) Simplify the application of Subtopic 350-40.

    (c) Create a principles-based approach to evaluate when to begin capitalization that entities could readily apply across different development teams and processes.

    (d) Narrow the differences in capitalization outcomes between software that is sold via an on-premise license and software that is sold via a CCA.

    (e) Remain relevant when software development evolves in the future.

    For those same reasons, most respondents generally said that the proposed amendments would clarify and improve the application of Subtopic 350-40.

11. Fifteen percent of respondents did not support the proposed amendments. However, almost all of those respondents said that they supported the Board's efforts to modernize the guidance in Subtopic 350-40 and that changes to the guidance are needed to address the challenges faced by preparers in practice. Those respondents who disagreed with the proposed amendments provided the following reasons:

    (a) The proposed amendments would require the use of significant judgment, which will result in diversity in capitalization.

(b) The proposed amendments would continue to require different models with different accounting outcomes for software sold via a CCA and software sold via an on-premise license.

(c) All internal-use software costs should be expensed as incurred.

For the same reasons noted above, those respondents who disagreed with the proposed amendments said that the proposed amendments would not clarify and improve the application of Subtopic 350-40.

Operability of the Proposed Amendments

12. Almost all respondents provided feedback on the operability of the proposed amendments. Of those respondents:

    (a) **Operable or no operability concerns.** Approximately 85 percent of respondents said that the proposed amendments would be operable or did not express broad operability concerns. However, many of those respondents (i) expressed operability concerns over certain aspects of the proposed amendments, primarily related to the evaluation of significant development uncertainty and the proposed statement of cash flows presentation requirements and/or (ii) provided suggestions to improve the operability.

    (b) **Not operable.** Approximately 15 percent of respondents said that the proposed amendments were not operable. Those respondents primarily cited the considerable judgment that would be required to evaluate and/or audit significant development uncertainty. For example, one respondent expressed concern that entities would be able to set their own policies and achieve capitalization outcomes based on their own preferences.

13. Respondents' specific operability concerns have been summarized in the relevant sections of this handout.

Anticipated Change in Capitalization Outcome

14. Almost all respondents provided feedback on anticipated changes in capitalization as a result of applying the proposed amendments. Sixty-five percent of those respondents provided feedback that was in line with the Board's expectations. Those respondents stated that either capitalization of costs is not expected to change significantly or, if there is an expected change, the change would primarily be a decrease in capitalization related to the development of software sold via a CCA.

15. Respondents that provided feedback on this question provided specific feedback as follows:

(a) **No significant change**. Approximately 35 percent of those respondents said that they did not expect a significant change in capitalization outcomes. Some respondents observed that the evaluation of the probable-to-complete recognition threshold is already required and that significant development uncertainty is already considered in an entity's evaluation. For example, one respondent said that the proposed amendments would add clarity to a judgment and assessment that many entities already apply.

(b) **Increase in capitalization**. One respondent said that the proposed amendments would increase capitalization for entities that develop their own internal-use software and websites.

(c) **Decrease in capitalization.** Approximately 15 percent of those respondents said that they expected a decrease in capitalization overall. Those respondents generally said that evaluation of significant development uncertainty will prevent the probable-to-complete recognition threshold from being met until later in the development life cycle.

(d) **Decrease in capitalization for software sold via a CCA.** Approximately 30 percent of those respondents said that they expected a decrease in capitalization for entities that develop CCAs because the introduction of significant development uncertainty would allow those entities to expense more of their development costs. Many of those respondents said that this outcome would better align with the capitalization outcomes for software sold via an on-premise license. However, respondents also noted that capitalization outcomes between these types of software may not be fully aligned. Additionally, a few respondents noted that changes in outcomes may not be consistent due to the judgment that would be applied under the proposed amendments.

(e) **Mixed outcomes**. Approximately 20 percent of those respondents said that they expected mixed changes in outcomes; that is, those respondents expected that while some entities might decrease capitalization, others might increase capitalization. These respondents generally explained that the judgment allowed under the proposed amendments could result in entities reaching different accounting conclusions.

Significant Incremental Costs to Apply the Proposed Amendments

16. Twenty-five respondents provided feedback on whether the proposed amendments would impose significant incremental costs. Of those respondents, approximately 85 percent said that they did not expect significant one-time or recurring costs. Specifically, while many of those respondents indicated that some one-time costs would be incurred, respondents generally said that those costs would not be significant. Examples of expected one-time costs include costs to:

(a) Educate investors and employees, including software engineers

(b) Update and implement revised accounting policies, processes, systems, and internal controls.

17. Furthermore, a few respondents said that they expect a decrease in ongoing costs and/or effort for those entities that capitalize less under the proposed amendments because there would be a reduction in the tracking of software costs.

18. A few respondents said that while they did not expect to incur significant costs to apply the proposed recognition requirements, they did expect to incur significant costs to apply the proposed presentation requirements. Most of these respondents indicated that these costs would be both one time and recurring and primarily related to the requirement to separate cash components from the noncash components of capitalized software costs. See the "Questions 4 and 5: Presentation and Disclosure" section of this handout for further details.

Single Model

19. Twenty-eight respondents provided feedback on whether they would have preferred that the Board pursue the single model.[3] Of those respondents, 22 said that they either would not have preferred the single model or that they did not have a preference. Respondents provided the following reasons:

(a) Although there are merits to a single model, considering stakeholder feedback, the Board's decision to pursue a targeted improvements approach makes sense.

(b) There is a fundamental difference between software that is sold and software that is used internally, and, therefore, the costs to develop these types of software should not be accounted for in the same way.

(c) The single model would have resulted in higher capitalization, particularly for software sold via a CCA, which would not have been a preferable outcome.

(d) The benefits of the single model would not have outweighed the costs.

20. Six respondents said that they would have preferred the single model. These respondents said that it would have been easier to apply one model to all software and/or that the economics and development process is the same for all types of software. However, nearly all of these respondents also acknowledged the reasons that the Board decided to pursue targeted improvements instead, and two of these respondents said that it was a good compromise.

[3] As described in paragraphs BC45–BC49 of the proposed Accounting Standards Update, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*.

21. Four respondents specifically suggested that the Board continue with its efforts to finalize the proposed Update, but also keep researching a single model, either as a separate research project or as part of the December 2024 Invitation to Comment, *Recognition of Intangibles* (Intangibles ITC).

22. Lastly, a few respondents indicated a preference for a model that would account for software sold via a CCA and software sold via an on-premise license in the same way. See the "Other Comment Letter Feedback—The Area of GAAP That Should Apply to Costs Incurred to Develop Software That Will Be Sold via a CCA" section of this handout for further details.

Question 2: Removal of Project Stages

23. The proposed Update included the following question:

> *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.*

24. Almost all respondents provided feedback on removing the project stages from Subtopic 350-40. Respondents generally supported the Board's decision to remove references to project stages throughout Subtopic 350-40 because it would (a) simplify the guidance and (b) better align with modern software development methodologies (for example, agile). Additionally, one respondent specifically noted that an alternative that required distinguishing between linear and nonlinear software development methods[4] would add unnecessary cost and complexity. However, one respondent said that removal of the references to project stages could lead to unforeseen changes in accounting outcomes for true internal-use software.

25. Several respondents said that removing the stages would appropriately shift the focus of when to start capitalization to (a) management commitment and authorization and (b) the probable-to-complete recognition threshold. For example, one respondent said that the proposed amendments would shift the focus of the analysis to the essential criteria for capitalization, which would simplify the framework and allow entities to make decisions on the basis of clear, actionable criteria, rather than navigating the ambiguous project stages in current generally accepted accounting principles (GAAP).

[4] Paragraph BC27 of the proposed Update notes that the Board considered whether to provide different recognition guidance for different software development methods—that is, whether to retain the project stages guidance for software developed using a linear method (for example, waterfall) and add requirements for entities that develop software using a nonlinear method (for example, agile).

26. Some respondents supported removal of the project stages but expressed operability or auditability concerns with other aspects of the starting threshold for capitalization (for example, the probable-to-complete recognition threshold and the evaluation of significant development uncertainty). One of those respondents noted that removal of the project stages would place more emphasis on how an entity evaluates the other aspects of the guidance. Further details on operability and auditability concerns over the probable-to-complete recognition threshold and significant development uncertainty are in the "Question 3: Significant Development Uncertainty" section of this handout.

Question 3: Significant Development Uncertainty

27. The proposed Update included the following question:

> *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.*
>
> *a. 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.*
> *b. 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.*

Operability and Auditability

28. Almost all respondents provided feedback on significant development uncertainty. Respondents' views were mixed on the operability and auditability of determining whether there is significant development uncertainty in accordance with proposed paragraph 350-40-25-12A.

29. Approximately half of the respondents (primarily practitioners) expressed operability and/or auditability concerns with the evaluation. These respondents were primarily concerned with significant development uncertainty for the following reasons:

    (a) Management would be able to apply a significant level of judgment and flexibility, which may result in continued or increased diversity in practice, auditing challenges, and the required use of information technology (IT) experts.

    (b) Although judgment is expected in a principles-based standard, certain areas of the guidance could benefit from clarifications in either the recognition guidance or the illustrative examples to increase auditability and consistency in application. Respondents specifically requested specific guidance on when and how to evaluate significant development uncertainty.

(c) Significant development uncertainty does not completely align with the concept of technological feasibility in Subtopic 985-20 and, therefore, there may continue to be differences in application and outcome between costs of software sold via a CCA and software sold via an on-premise license.

30. Specific areas for which these respondents requested additional clarity are as follows:

(a) Determining the unit of account when evaluating significant development uncertainty. Several respondents questioned what the unit of account should be when evaluating the probable-to-complete recognition threshold and/or significant development uncertainty. These respondents said that it is unclear what constitutes a *software project* in an agile environment. Specifically, while some might view the unit of account to be one large project, others might view the unit of account to be a phase of a project or even a single sprint. These respondents suggested that the Board either (i) add guidance that allows for this flexibility (for example, by removing the word *project* or replacing the word *project* with *development*) or (ii) define the unit of account to reduce judgment and diversity in practice. Other respondents questioned how the factors of significant development uncertainty should be applied at different levels. For example, one respondent questioned whether one novel or unproven feature would affect the evaluation of significant development uncertainty for all other features in the project that are not novel or unproven and whether that entity would conclude that all the software being developed in that project has significant development uncertainty.

(b) When to evaluate significant development uncertainty. Three respondents expressed concerns related to when an entity must evaluate significant development uncertainty, with two of those respondents citing that the evaluation should be undertaken for all projects. One respondent noted that while the evaluation may be simple for many internal-use software projects, an entity should be required to conclude that the factors are met to support that a software project is probable of completion. For example, this respondent said that the reasons illustrated in Example 1 for why significant development uncertainty did not need to be evaluated would be similar to the factors considered in concluding that significant development uncertainty does not exist. However, other respondents stated that they supported that not all software projects must be evaluated for significant development uncertainty.

(c) **The factors that indicate significant development uncertainty.** Several respondents noted that because proposed paragraph 350-40-25-12A describes factors that *may* indicate that there is significant development uncertainty, it is unclear (i) to what extent the presence of these factors indicate that there is significant development uncertainty and (ii) if factors other than those described in proposed paragraph 350-40-25-12A

should be considered. To address these concerns, one respondent suggested removing the word *may* to make the guidance more definitive, while another respondent suggested clarifying that the presence of these factors creates a rebuttable presumption that significant development uncertainty exists. Additionally, one respondent suggested clarifying how an entity should consider its development history, and another respondent suggested clarifying that hindsight should not be considered.

(d) **How to determine if the development uncertainty or a performance requirement is *significant***. A few respondents noted that determining whether development uncertainty or a performance requirement is *significant* would be highly judgmental and may lead to inconsistent application. One respondent observed that *significant* is generally a high threshold in GAAP and may lead to entities concluding that the existing development uncertainty is not significant and, therefore, is capitalizing more costs. This respondent suggested that the Board either:

(i) Replace the phrase *significant development uncertainty* with *more than insignificant development uncertainty* to increase consistency in application, potentially require the application of less judgment, and to better align the capitalization threshold with the threshold in Subtopic 985-20.

(ii) Replace the phrase *significant performance requirements* with *major functions and features* to better align the terminology with Subtopic 985-20.

Additionally, one respondent suggested requiring an evaluation of *key* performance requirements, rather than *significant* performance requirements, to emphasize that the evaluation should be qualitative and not quantitative.

(e) **How to determine if the software being developed has novel, unique, unproven functions and features or technical innovations (novel or unproven).** Several respondents expressed concerns about the subjectivity and complexity of identifying if the software is novel or unproven and stated that this evaluation may vary across entities. Even though Subtopic 985-20 requires a similar evaluation of novel software when reviewing a detail program design,[5] several respondents observed that this guidance often may not be applied because most entities establish technological feasibility with a working model rather than a detail program design. Additionally, some respondents questioned whether the software development is required to be novel to the entity, the industry, or both. One respondent observed that determining whether updates or enhancements to existing software, which are often developed in a small number of

[5] See paragraph 985-20-25-2(a)(3).

sprints, have novel or unproven functions and features could be challenging and difficult to consistently apply (as compared with evaluating an entire project).

(f) **How to identify the point at which significant development uncertainty is resolved.** Because the proposed amendments do not explicitly address how significant development uncertainty overall should be resolved, several respondents noted that it is unclear how an entity would identify this point, which may lead to diversity in practice. Several respondents suggested specifying that an entity must resolve significant development uncertainty by establishing the technological feasibility of the software in accordance with paragraph 985-20-25-2. Additionally, respondents provided specific concerns about how each of the individual factors in proposed paragraph 350-40-25-12A would be resolved, as follows:

(i) **How to identify the point at which significant performance requirements have been *identified* and will *not continue to be substantially revised*.** Several respondents expressed concerns that determining that point can be challenging in an iterative environment where performance requirements can be continuously explored and revised. One respondent stated that a continuous reassessment of the uncertainty (including whether the performance requirements continue to be substantially revised) could be challenging to apply because it is not a discrete point in the software development process. Furthermore, this respondent noted that determining if revisions are substantial would require significant judgment and the potential variability in interpretations may create challenges from an auditability standpoint—requiring an analysis of both the significance of the uncertainty and whether revisions are substantial. To address this concern, this respondent suggested that the Board replace the phrase *the significant performance requirements continue to be substantially revised* with *expected changes to the significant performance requirements are more than minor*. Another respondent suggested incorporating language from paragraph BC35 (that the proposed amendments would not require an entity to identify and cease revising all of the software's performance requirements before it begins to capitalize its software development costs) into the Codification.

(ii) **How to identify the point at which the software being developed is no longer novel or unproven.** Some respondents suggested that the Board include guidance on how an entity would establish that the software being developed is no longer novel or unproven. For example, one respondent observed that the novel or unproven terminology was leveraged from the high-risk development issues (HRDI) guidance in Subtopic 985-20. However, under that guidance, an entity is required to resolve

HRDI through coding and testing before technological feasibility is established, which the respondent stated is simpler to audit.

(g) **How the evaluation of significant development uncertainty compares with the evaluation of technological feasibility in Subtopic 985-20.** A few respondents said that it is unclear how the evaluation of significant development uncertainty is similar to or different from the evaluation of technological feasibility in Subtopic 985-20, considering that the Board intended to more closely align the outcomes between software-as-a-service (SaaS) and on-premise licensed software. These respondents suggested that it would be helpful for the Board to clarify how these evaluations are similar or different.

(h) **Whether IT experts would need to be involved.** Several respondents expressed concerns that preparers and auditors may have to involve IT experts to assess management's assertions and that auditors would have to largely rely on inquiry to perform the audit. For example, two respondents noted that accountants and auditors do not have the expertise to determine whether software has novel, unique, unproven functions and features or technological innovations without the assistance of an IT specialist. In contrast, another respondent noted that, although IT experts may have to be involved, experts are used to auditing other areas of GAAP, and auditors should be able to overcome this concern.

31. The other half of respondents generally acknowledged that although the proposed amendments would require management to apply significant judgment, incorporating significant development uncertainty into the recognition threshold would improve Subtopic 350-40. While some respondents said that the illustrative examples in the proposed Update are helpful, several other respondents noted that additional or different illustrative examples could help to further improve operability and auditability. These respondents did not express significant operability or auditability concerns and supported incorporating significant development uncertainty into the recognition threshold for various reasons, such as:

    (a) The proposed amendments are clear, or the proposed amendments are clearer than current guidance. The factors are helpful in applying the probable-to-complete recognition threshold while not being overly prescriptive and the illustrative examples are helpful for preparers and auditors.

    (b) The proposed amendments to link the definition of *probable* to the Master Glossary provides the necessary framework through which to evaluate management's judgments about whether the probable-to-complete recognition threshold has been met.

    (c) The proposed amendments reflect evaluations and judgments that entities currently perform, such as identifying functionality, risks, and uncertainties.

(d) The use of judgment would not be unlike applying other aspects of GAAP, including the evaluation of significance, the use of experts, and applying the current guidance in Subtopic 350-40. Management will make qualitative judgments that auditors will evaluate, and over time, practice will develop, and entities will establish policies about how to apply the guidance to their circumstances.

(e) It is important that the guidance be principles based so that entities can apply judgment when evaluating their specific facts and circumstances, considering the diverse and continuously evolving software development models. Judgment and diversity in practice are expected with principles-based guidance.

(f) Although diversity in practice between software sold via a CCA and software sold via an on-premise license will not be entirely eliminated, the proposed amendments would establish an updated, principles-based approach that entities with varying development processes could more readily apply.

32. Respondents, including some that did not express any operability and/or auditability concerns, provided other suggestions to improve the operability and auditability or further align with the external-use software guidance:

(a) Replace the evaluation of significant development uncertainty with the evaluation of technological feasibility in Subtopic 985-20 or allow entities to apply that guidance instead of significant development uncertainty as a practical expedient or accounting policy election.

(b) Add a consideration of the likelihood of and an entity's ability to recognize a future economic benefit into the probable-to-complete recognition threshold.

(c) Include language in the Codification that acknowledges and accepts reasonable and consistent judgments.

(d) Add an illustrative example in which an entity expenses the development costs associated with software sold via a CCA because it is considered to be novel or unproven until close to the end of the development life cycle.

(e) Explicitly state that an entity does not have to evaluate significant development uncertainty if the software is any of the following:

(i) Being developed as part of the infrastructure of an entity's internal operations and processes

(ii) Is a customer-facing tool that complements the delivery of an entity's products and services

(iii) Is not novel or unproven.

33. In response to the suggestion to use technological feasibility in the evaluation of when to begin capitalization (either instead of significant development uncertainty or how an entity demonstrates that significant development uncertainty has been resolved), some respondents strongly discouraged incorporating technological feasibility into Subtopic 350-40. These respondents cited that utilizing technological feasibility would represent a significant change and result in less capitalization of internal-use software costs.

Definition of Performance Requirements

34. Approximately three-quarters of respondents provided specific feedback on the definition of performance requirements, although not all of these respondents explicitly answered the question of whether the definition is clear and operable.

35. Over half of these respondents indicated that the definition is clear and operable. These respondents said that the definition should not be further expanded or modified for the following reasons:

    (a) **The definition strikes an appropriate balance between guidance and management judgment.** The combination of a simple definition, the cited examples (functions and features), and the illustrative examples provides sufficient guidance, while still allowing management judgment in evaluating the specific facts and circumstances of its software development projects. The definition is appropriate because each software project is unique and the level of specificity for performance requirements will depend on the software being developed.

    (b) **The definition is generally consistent with current practices.** The definition focuses on the essential functions that the software must fulfill and aligns with the description of performance requirements in the current definition of preliminary project stage in Subtopic 350-40. Entities typically document their software's planning and performance requirements, so the definition should not significantly affect practice and existing policies; entities' current practices should be sufficient to support the application of the new guidance.

    (c) **The definition helps in the evaluation of whether significant development uncertainty exists.** If *what an entity needs the software to do (for example, functions and features)* has not been identified or continues to be substantially revised, then it is likely that significant development uncertainty still exists, and the probable-to-complete recognition threshold should be considered not met.

36. A few respondents explicitly indicated that the definition is not clear or operable. Additionally, there were a few other respondents that did not provide specific concerns about the definition

but suggested further clarifications to improve the operability of the definition. Respondents generally cited two primary concerns:

(a) **The definition is vague, which may lead to diversity in practice in how entities evaluate the probable-to-complete recognition threshold.** These respondents indicated that it is unclear at what level of precision performance requirements should be established; that is, whether performance requirements should be high level or more granular. Therefore, an entity could define the unit of account for evaluating the probable-to-complete recognition threshold as a single function or feature (such that the project and the performance requirements would be at the same level). Another respondent noted that unlike Subtopic 985-20 that uses *features*, *functions*, and *technical performance requirements* as distinct terms, the proposed amendments include functions and features as examples of performance requirements that may be confusing for entities that define the unit of account as a single function or feature. Furthermore, the absence of varied and clear examples creates ambiguity.

(b) **The reference to *functions* and *features* may be confusing.** One respondent indicated that these terms may be used by software developers in different ways.

37. Suggestions provided by respondents to address these concerns or further improve the definition of performance requirements included:

(a) Replace the proposed definition with *the significant functionality and features an entity requires from the application or software solution.*

(b) Remove the examples of *features* and *functions* (that is, do not include any cited examples in the definition).

(c) Specify that *features and functions (or functionality)* are equivalent to what *an entity would want or need the software to do* (that is, change *features and functions* from examples to being explicitly included in the definition).

(d) Incorporate certain activities that typically occur during the preliminary project stage as indicators that performance requirements have not been identified, such as (i) the entity is exploring alternative means of achieving significant performance requirements, (ii) system requirements needed to achieve the intended functionality have not been identified, and (iii) resources needed to develop the performance requirements have not been identified.

(e) Clarify whether performance requirements include *how* the software's objective would be accomplished.

38. Although not directly related to the definition of performance requirements, as discussed in the "Question 3: Significant Development Uncertainty" section of this handout, some respondents had other concerns related to performance requirements and requested clarity or additional illustrative examples for:

    (a) How to determine what is a *significant* performance requirement

    (b) How to determine when significant performance requirements have been identified and no longer continue to be substantially revised.

Questions 4 and 5: Presentation and Disclosure

Proposed Presentation Requirements

39. The proposed Update included the following question:

    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.

    a. *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.*
    b. *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.*
    c. *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.*

Cash Paid for Capitalized Software Costs—Operability and Auditability

40. Thirty-two respondents provided feedback on the operability and/or auditability of the proposed presentation requirements, with approximately half of these respondents expressing no concerns. The other half of these respondents noted concerns, primarily related to the costs of implementation and challenges in separating out the cash component of total capitalized costs. Specific feedback received fell into the following categories:

    (a) **No concerns noted**. Eighteen respondents said that the proposed presentation requirements would generally be operable and/or auditable, stating that:

(i) The information needed to comply with the proposed presentation requirements should be readily available.

(ii) Cash paid for capitalized software costs generally is presented as an investing cash outflow on the statement of cash flows and material amounts often are already presented separately from other investing cash outflows.

(iii) Any changes necessary to comply with the proposed presentation requirements should easily integrate into an entity's current systems and internal controls.

(iv) If the information can be prepared, auditors should not face challenges auditing it.

(b) **Expected costs of implementation**. Seven respondents stated that the proposed presentation requirements generally would be operable and/or auditable, but costs would be incurred to modify systems and internal controls to comply with the proposed requirements.

(c) **Challenges in separating cash components from total capitalized software costs.** Six respondents expressed operability and cost concerns related to separating cash paid for capitalized software costs from total software costs capitalized. These respondents provided the following specific feedback:

(i) Total software costs capitalized in the period can be significantly different from the cash paid for capitalized software costs in that same period. For example, capitalized software costs can include stock-based compensation (which is a noncash form of employee compensation) or large upfront cash payments could be made at the beginning of a development contract when no development work has started. One respondent observed that a significant component of capitalized software costs could be stock-based compensation, particularly for entities that develop software internally.

(ii) Many entities use a standardized approach to determine capitalization amounts under Subtopic 350-40 (for example, a percentage of employee time multiplied by a fully burdened compensation rate). These entities would have to perform estimations and allocations to determine the cash portion of capitalized software costs, which may pose significant operational challenges and be a costly undertaking. For example, one respondent noted that disaggregating between cash and noncash components of capitalized software costs could be difficult for preparers that use a standard costing methodology to determine the amounts that are capitalized.

(iii) Two respondents suggested that the Board provide an expedient or acknowledgment about the use of estimates to ease the burden on preparers. For example, one respondent suggested that the Board acknowledge that the use of

estimates and allocations are appropriate in applying the proposed cash flow presentation requirements, similar to the acknowledgments provided in paragraphs 220-40-50-1 and BC53 of Accounting Standards Update No. 2024-03, *Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*.

41. Three respondents suggested that the Board instead consider whether changes to presentation and disclosure are needed for internal-use software costs as part of its Statement of Cash Flows research project and/or the Intangibles ITC, rather than as part of this project.

Cash Paid for Capitalized Software Costs—Decision Usefulness

42. Fifteen respondents commented on the decision usefulness of the proposed presentation requirements.

43. Two respondents indicated that the proposed presentation requirements could be decision useful to investors. One of those respondents said that the amount presented could be used to adjust various financial metrics—including earnings before interest, taxes, depreciation, and amortization (EBITDA) and free cash flow. The other respondent said that the proposed presentation requirements may be useful in assessing investing activities. However, that respondent also said that the continued diversity in capitalization practices could limit comparability and usefulness.

44. Eleven respondents questioned the decision usefulness of the proposed information. These respondents provided the following reasons:

    (a) **Incomplete picture of total costs capitalized.** A few respondents observed that the proposed presentation requirements could have limited use to investors. Most of these respondents pointed to the fact that this amount would not include the noncash components of total capitalized software costs, which for some entities could be material (as discussed in paragraph 40(c) of this handout).

    (b) **Amortization amount needed to adjust EBITDA.** Additionally, a few respondents questioned the decision usefulness of the proposed presentation requirements without the amortization because both amounts would be needed when adjusting EBITDA for comparability purposes.

    (c) **Separate presentation places undue emphasis.** A few respondents questioned why capitalized software costs should be separately presented from other investing activities. For example, one respondent said that separate presentation could inadvertently suggest that software costs pose a higher risk to the entity or are more important than other capital investments.

45. Lastly, a few respondents expressed support for the Board's decision to include cash outflows for capitalized software costs in investing activities. However, one respondent expressed a concern with this required classification because it views development costs to operate a SaaS company as an operating activity.

Cash Outflows Incurred to Implement a Hosting Arrangement That Is a Service Contract

46. Twenty-eight respondents provided feedback on the classification of cash outflows for CCA implementation costs. Of these respondents, approximately three-quarters stated that it is not necessary to change the current classification requirement.[6] Overall, these respondents said that (a) the nature of CCA implementation costs is different from the costs to develop internal-use software, (b) the presentation of CCA implementation costs should be consistent with the classification of the underlying fees for these arrangements, and (c) the Board's reasoning for ratifying the Emerging Issues Task Force's (EITF's) conclusion in paragraph BC12 of Update 2018-15 for the required cash flows classification remains appropriate.

47. Four respondents commented that the Board should require presentation of cash outflows incurred for CCA implementation costs as investing activities. Some of these respondents said that they view the nature of some of these costs to be an investing activity, while other respondents said that it would be simpler for all costs accounted for under Subtopic 350-40 to be presented in the same manner.

48. Three respondents suggested that if the Board wants to explore changing the classification of cash outflows incurred for CCA implementation costs, it should research that in either a project that would broadly consider all presentation requirements for CCA implementation costs (including the statement of financial position, income statement, and statement of cash flows) or the Statement of Cash Flows research project.

Disclosure Alternatives

49. The proposed Update included the following question:

    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.

[6] Paragraph 350-40-45-3 requires an entity to classify the cash flows from capitalized implementation costs in the same manner as the cash flows for the fees for the associated hosting arrangement.

a. *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)?*
b. *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?*

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?

Disclosure Alternatives—Operability and Costs

50. Twenty-five respondents provided feedback on the operability and/or costs of the disclosure alternatives. Some respondents addressed one alternative only, while some respondents addressed each alternative and other respondents provided broader disclosure comments.

51. Feedback was mixed and often varied depending on which alternative was being considered (for example, whether a respondent provided feedback on the total cost alternative, the rollforward alternative, or both). Respondents provided the following feedback:

    (a) **More operable (minimal respondents).** One respondent indicated that the information needed to provide the disclosure alternatives would be more readily available to preparers than the proposed presentation requirements. Another respondent noted that the total cost alternative should be easier to apply than the proposed presentation requirements.

    (b) **No significant difference (approximately half of respondents).** Ten respondents stated that there would be no significant difference in the operability and/or costs of the disclosure alternatives as compared with the proposed presentation requirements. Four other respondents provided the same feedback only about the total cost alternative. Those respondents generally provided similar reasons to the respondents that said that the proposed presentation requirements would be operable (that is, the information should be readily available under an entity's current systems and processes). However, one respondent commented that although operable, some entities would need to perform additional work to separate internal-use software costs from external-use software costs.

    (c) **Less operable or more costly (approximately half of respondents).** Eight respondents said that the disclosure alternatives would be less operable or more costly than the proposed presentation requirements, while six other respondents provided the same feedback for the rollforward alternative only. Those respondents generally commented that significant costs would be incurred to track the information required (especially for private companies) or entities would be required to update processes,

systems, and controls. However, one respondent noted that entities frequently produce a rollforward for audit purposes. Lastly, one respondent observed that the costs to disclose the rollforward would likely be one-time costs and that ongoing costs should be minimal.

Disclosure Alternatives—Decision Usefulness

52. Ten respondents commented on the decision usefulness of the disclosure alternatives to investors, as follows:

    (a) Four respondents stated that the disclosure alternatives would be more decision useful than the proposed presentation requirements. Two respondents reasoned that the disclosures would give investors a complete picture of the total amount of software costs capitalized (that is, including noncash costs capitalized).[7] However, some of these respondents differed on which disclosure alternative would be more decision useful (that is, some said the total cost alternative would be more decision useful and others said the rollforward alternative would be more decision useful). Another respondent said that the information provided by the disclosure alternatives would be helpful in understanding the diversity in practice that would occur as a result of applying the proposed amendments.

    (b) Six respondents questioned the decision usefulness of the disclosure alternatives. Three respondents commented that the disclosures would not provide incremental information to either the information investors receive today or to the information that would be provided from the proposed presentation requirements. Two respondents said that while a rollforward may provide some decision-useful information to investors, in their view, the costs to prepare a rollforward would not outweigh the benefits. Lastly, one respondent said that the value provided by the disclosure alternatives would be limited because that respondent would capitalize less software costs under the proposed amendments.

Disclosures—Decision Usefulness of Current Disclosures

53. Two respondents provided feedback on the decision usefulness of current software cost disclosures. Those respondents said that current disclosures for software are sufficient. Furthermore, one of those respondents noted that software cost information typically does not affect its analysis and decision making from a liquidity perspective and, if needed, investees with significant software assets provide sufficient disclosures under Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill, or Subtopic 360-10, Property, Plant, and Equipment—Overall.

[7] Consistent with the feedback provided in paragraph 44(a) of this handout related to why the decision usefulness of the proposed presentation requirements might be limited.

Disclosures—Other Feedback

54. One respondent noted that it disagreed with the proposed amendments to clarify that the intangible asset disclosures in paragraphs 350-30-50-1 through 50-3 only apply to external-use software costs capitalized in accordance with Subtopic 985-20. The respondent noted that paragraph 350-40-25-17 specifically requires licensed internal-use software (for example, an enterprise resource planning [ERP] system licensed from a third party), which can represent a significant portion of many entities' total internal-use software assets, to be classified as an intangible asset. This respondent expressed concerns that if the Subtopic 350-30 disclosures are explicitly not applicable to internal-use software, disclosures for these assets could be omitted because entities might determine that none of the disclosures in Subtopic 350-30 or Subtopic 360-10 would apply. This respondent suggested the following solutions to clarify the disclosure requirements:

    (a) Remove the proposed amendments to paragraphs 350-30-50-1 through 50-3.

    (b) Modify the proposed amendments to paragraphs 350-30-50-1 through 50-3 to include internal-use software costs capitalized in accordance with Subtopic 350-40.

    (c) Specify that the disclosure requirements in Subtopic 360-10 apply to all internal-use software costs capitalized in accordance with Subtopic 350-40, regardless of whether an entity classifies these costs as PP&E or an intangible asset.

Question 6: Website Development Costs

55. The proposed Update included the following question:

    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.

    a. *Would the proposed amendments be operable, and do you foresee any auditability challenges?*
    b. *Would the proposed amendments have a significant effect on practice? Please explain your reasoning.*
    c. *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.*

56. Thirty respondents provided feedback on website development costs. None of those respondents provided significant operability or auditing concerns with the proposed amendments for website development costs. Additionally, most respondents expressed support for the proposed amendments because they would align the accounting for website development costs with the costs to develop internal-use software. Respondents said that they do not view the nature of these costs as different.

57. No respondents stated that they would expect the proposed amendments to have a significant effect on practice, stating that (a) Subtopic 350-50 is infrequently applied and (b) the costs incurred to develop a website (separately from developing the underlying software) generally are immaterial.

58. Two respondents observed that the proposed amendments did not incorporate certain paragraphs[8] from Subtopic 350-50 into Subtopic 350-40. One of those respondents suggested that the Board include discussion in its basis for conclusions on why this guidance was not included. The other respondent recommended that this guidance be retained because it differentiates between graphics development and other development, the former of which is eligible for capitalization. Additionally, that respondent requested that the Board consider clarifying the accounting for developed website content besides text or graphics, such as videos or interactive courses, by referring to other GAAP, including but not limited to Topic 926, Entertainment—Films, or Topic 928, Entertainment—Music.

59. In contrast, another respondent suggested removing the specific website development costs guidance (in proposed paragraphs 350-40-25-17F through 25-17I) because the specific guidance is generally consistent with other transactions and activities addressed in Subtopic 350-40.

60. Lastly, one respondent said that it preferred retaining Subtopic 350-50 and replacing any references to stages in that Subtopic with the term *activities* because it would provide an explicit description of what costs should be capitalized, while two respondents said that they did not have a preference. All other respondents indicated a preference for the proposed amendments because it would be more operable to have the guidance for website development costs and the costs to develop internal-use software in the same place.

Questions 7 and 8: Transition and Effective Date

Transition

61. The proposed Update included the following question:

> *Question 7: The proposed amendments could be applied either prospectively or retrospectively.*
>
> *a. 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.*
> *b. 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.*

[8] Paragraphs 350-50-25-6, 350-50-25-8 through 25-9, 350-50-55-4 through 55-6, and 350-50-55-8.

Transition Method

62. Thirty-three respondents provided feedback about the transition methods. Overall, these respondents indicated that (a) the proposed transition requirements would be operable and/or auditable and (b) the ability to elect either the retrospective transition approach or the prospective transition approach would provide flexibility for financial statement preparers. Approximately 75 percent of these respondents expressed no operability or auditability concerns with applying the proposed guidance prospectively or retrospectively. This included nine respondents that noted that the retrospective approach may be difficult to apply and, therefore, were generally supportive of having an option to apply the proposed amendments prospectively. Those respondents explained that historical information, including processes and controls, needed to accurately determine and support the exact point at which capitalization should begin may be unavailable at the time of transition.

63. Five respondents noted that the proposed amendments do not address how an entity should assess whether there was significant development uncertainty in the retrospective periods and that it may be challenging for a preparer to reach a conclusion without applying hindsight. Therefore, two respondents suggested that the Board allow the use of hindsight when applying retrospective transition.

64. Additionally, three respondents noted that the prospective approach may pose challenges because it could result in multiple capitalization models being applied to a single asset for software projects that are in process as of the adoption date. Two of these respondents observed that there could be impairment challenges upon transition. For example, if an entity expenses more software costs under the proposed amendments, there could be questions on whether existing capitalized software costs at the date of adoption should be impaired (particularly for in-process projects). To overcome those challenges, those respondents suggested (a) including additional transition guidance to address impairment or (b) allowing a modified approach that would require application of the new guidance to in-process projects at the date of adoption, rather than a prospective approach.

Transition Disclosures

65. Two respondents provided the following observations related to transition disclosures:

    (a) One respondent stated that the transition disclosures are decision useful because it is important to understand potential comparability differences between current- and prior-year financial statements.

    (b) One respondent agreed with the Board's decision not to require the disclosures in paragraphs 250-10-50-1(b)(2) and (c)(1) and 250-10-50-3 related to the current periods

because of the incremental effort that would be required to account for software costs under both the current guidance and new guidance when applying the retrospective approach.

Effective Date

66. The proposed Update included the following question:

> *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.*

Time Needed for Implementation

67. Twenty-one respondents provided feedback on how much time would be needed to implement the proposed amendments. The time suggested ranged from one to three years:

    (a) **Not a significant time and/or one year or less.** Five respondents stated that implementation of the proposed amendments would not require a significant period of time. Additionally, 11 other respondents stated that 1 year or less would be enough time to adopt the proposed amendments. Some of those respondents noted either that current systems and processes should support the proposed requirements or that limited updates to systems and processes would be required.

    (b) **Eighteen to 24 months.** Four respondents suggested an implementation period between 18 and 24 months. Two of those respondents noted that additional time may be needed to implement the proposed amendments because of the concurrent implementation of other standards (specifically, implementation of the amendments in Update 2024-03).

    (c) **Two to three years.** One respondent stated that an adoption period of two to three years or sooner would be appropriate. However, this respondent further explained that it expects many entities to want to early adopt the proposed amendments; therefore, an earlier effective date may result in a more consistent adoption.

Public Business Entities versus Other Than Public Business Entities

68. Twenty respondents provided feedback on how much time entities other than public business entities should have to adopt the proposed amendments. Most of those respondents supported a later effective date for other than public business entities.

69. Four respondents stated that the effective date should be the same for all entities either because (a) they are not aware of any reason why other than public business entities should have a later adoption date or (b) it would improve comparability.

70. Sixteen respondents supported a later effective date for other than public business entities. These respondents said that more time would (a) be helpful for these entities to implement changes to their policies, systems, and processes and/or (b) allow other than public business entities to learn from public business entity adoptions. Of those respondents that supported a later effective date, some did not specify how much additional time should be given, while others provided suggestions that varied from one to three additional years. The most frequent suggestion was an additional year. Respondents noted that providing an additional year is fairly standard. Additionally, a few respondents noted that additional time should only be provided to other than public business entities if early adoption is allowed.

Early Adoption

71. Twenty-four respondents provided feedback on whether early adoption should be permitted. All of these respondents supported permitting entities to early adopt the proposed amendments. Respondents said that either (a) significant changes are not expected to outcomes or processes or (b) the proposed amendments would be easier to apply than current GAAP because they better align with current development processes.

Question 9: Private Company Considerations

72. The proposed Update included the following question:

> *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.*

73. Twenty-seven respondents provided feedback on private company considerations. Approximately 80 percent of those respondents said that the proposed amendments (for example, removing the project stages) should apply equally to all entities, including private companies. Many of those respondents also did not identify any private-company-specific considerations. Those respondents generally stated that they agreed with the Board's reasoning in its basis for conclusions. Specifically, many of those respondents said that private companies face the same challenges in applying the current guidance as public entities because the use of agile development is no less prevalent in private companies.

74. Some respondents suggested that private companies be allowed certain expedients to ease the burden on private company preparers. Specifically, a few respondents suggested that the Board either (a) require private companies to expense all of their software costs or (b) consider a practical expedient that would allow private companies to expense all or most software costs as incurred with relevant disclosures. For example, one of those respondents suggested a practical expedient to allow private companies to expense all software development costs for projects that are expected to have a useful life of three years or less. However, another respondent acknowledged that such an option would cause challenges for private companies that later go public because those private companies would not have tracked the level of detail required to apply public reporting requirements.

75. Lastly, two respondents commented that private companies would benefit from additional examples.

Other Comment Letter Feedback

76. Several respondents provided feedback in addition to the questions asked in the proposed Update.

Unit of Account for Software Components and Tangible Assets

77. The amendments in the proposed Update would require an entity to use a reasonable and consistent method to determine the unit of account for an asset that incorporates both software and tangible components and whether the software component should be (a) accounted for separately under Subtopic 350-40 or (b) combined with the tangible component in accordance with other GAAP, such as Subtopic 360-10.

78. Eight respondents expressed concerns about the operability and/or auditability of this proposed requirement. Primary concerns expressed by respondents were that the proposed requirement would (a) be viewed as an accounting policy election, (b) imply that there is a change from current practice (that is, changing words implies a new or different accounting requirement), (c) create complexity for preparers and practitioners, and/or (d) increase diversity in practice that could affect investors. Some respondents specified that the proposed amendments could result in a change in practice, which may be inconsistent with the Board's intentions expressed in paragraph BC37[9] of the proposed Update.

[9] Paragraph BC37 in the proposed Update states:

> The amendments in this proposed Update would require an entity to use a reasonable and consistent method to determine the unit of account for an asset that incorporates both software and tangible components and whether the software component should be (a) accounted for separately under Subtopic 350-40 or (b) combined with the tangible component in accordance with other GAAP, such as Subtopic 360-10. The Board

79. Respondents provided the following suggestions to address their concerns:

    (a) **Remove the proposed paragraph.** Four respondents said that the proposed guidance is unnecessary, primarily because practice already applies reasonable judgment.

    (b) **Revise the proposed amendment to improve its operability.** Four respondents provided the following suggestions to improve the operability and/or consistency in application of the proposed amendment:

        (i) **Require the application of an existing framework to determine the unit of account.** Three respondents suggested leveraging an existing framework, such as guidance in Topic 606, Revenue from Contracts with Customers, or the Master Glossary definition of the term *identifiable*.

        (ii) **Require the application of a new framework to determine the unit of account.** Two respondents suggested that the Board develop a new framework and related illustrative examples to help entities to determine the unit of account. For example, one respondent suggested creating a rebuttable presumption that software embedded in a tangible asset should be combined with the tangible asset unless the software component is so significant that it clearly represents a separate unit of account.

    (c) **Clarify that software combined with a tangible component could be accounted for under Subtopic 350-40 if software is the predominant component.** One respondent said that the proposed amendments appear to indicate that if the software component is combined with the tangible component, it should *always* be accounted for under other GAAP and not under Subtopic 350-40. This respondent suggested that the Board require an entity to consider whether *Subtopic 350-40* or *other GAAP* is more appropriate by evaluating whether the predominant nature of the combined asset is the software or the tangible asset.

The Area of GAAP That Should Apply to Costs Incurred to Develop Software That Will Be Sold via a CCA

80. The amendments in the proposed Update would not change the scope for the costs to develop software that will be sold via a CCA and the costs to develop software that will be sold via an on-premise license.

81. Eleven respondents suggested that the Board change the scope of the software guidance so that software costs incurred to develop a CCA are accounted for in the same way as software

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does not expect that the proposed amendments would change how an entity determines whether software that is developed would be accounted for as software or as part of another asset.

that will be sold via an on-premise license. Almost all of those respondents suggested that the Board change the scope of Subtopic 985-20 to include the costs incurred to develop a CCA. Respondents provided the following feedback to support their suggestion:

(a) Software to be sold via a CCA and software to be sold via an on-premise license have similar economics and development processes, and how an entity delivers its software to customers should not determine the accounting model that the entity uses to account for its development costs.

(b) If the Board's intent is to align accounting outcomes between software that is sold via a CCA and software that is sold via an on-premise license, it could be better achieved by changing the scope of current guidance.

(c) Accounting for all of these costs under Subtopic 985-20 would simplify the accounting for hybrid arrangements, which are challenging to account for under current guidance.

Upgrades and Enhancements

82. The proposed amendments would not change the accounting for upgrades and enhancements (collectively referred to as "enhancements"), including whether modifications to existing internal-use software are accounted for as enhancements, which are eligible for capitalization, or as maintenance costs, which are expensed as incurred.

83. Two respondents provided feedback on the recognition requirements for enhancements. These respondents recommended that enhancements be expensed as incurred, either through a requirement that applies to all enhancements or through an accounting policy election.

84. Additionally, five respondents provided feedback about how an entity would evaluate the proposed aspects of the starting threshold for capitalization when evaluating enhancements (versus a new project). For example, one respondent said that the evaluation of whether an enhancement is novel or unproven would be challenging to apply. Other respondents noted that the proposed amendments only included examples of new software projects and that an example that illustrates the evaluation of significant development uncertainty in an enhancement would be helpful.

Artificial Intelligence (AI) Training and Data Conversion Costs

85. Two respondents observed the increased prevalence in AI development and suggested that the Board consider clarifying whether certain areas of Subtopic 350-40 should apply to AI development costs. Those respondents suggested that the term *training costs* as used in paragraph 350-40-25-4 be clarified to specify that training costs are only personnel costs (and not the costs of training an AI model or algorithm). Additionally, one of these respondents

suggested clarifying the terminology related to data conversion costs because it could be interpreted to include costs that are common in AI development (such as data acquisition, conversion, collection, and cleansing processes).