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File Reference No. 2024-ED400
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Proposed Accounting Standards Update, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40)* (File Reference No. 2024-ED400)

Dear Mr. Day:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40)*, that was issued by the Financial Accounting Standards Board (FASB or Board).

We support the Board's efforts to address stakeholder feedback to modernize the accounting for internal-use software costs, better align the internal-use software guidance with that for external-use software and enhance the transparency of an entity's cash flows related to software costs.

While we support the Board's objective overall, we suggest it reconsider certain aspects of the proposal to improve operability and better align the guidance with that for external-use software.

Our responses to questions in the proposal and our recommendations for the Board's consideration are included in Appendix A. We provide additional recommendations to clarify other areas of the proposed amendments in Appendix B.

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We would be pleased to discuss our comments with the Board or its staff at their convenience.

Very truly yours,

Appendix A – Responses to Questions for Respondents included in the FASB’s proposal

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.

We agree with the proposed amendments to remove all references to project stages throughout Accounting Standards Codification (ASC) 350-40, *Intangibles – Goodwill and Other – Internal-Use Software*, and require that cash paid for capitalized internal-use software costs be classified as cash outflows from investing activities and be presented separately from other investing cash outflows. We believe that these proposed amendments are clear and operable and would improve the application of ASC 350-40. Refer to our responses to Questions 2 and 4 for further details.

We also support the Board’s efforts to align the internal-use software guidance with that for external-use software as discussed in paragraph BC18(b). We believe this could be better achieved by scoping hosting arrangements,¹ where the software is utilized in providing services,² into ASC 985-20, *Software – Costs of Software to Be Sold, Leased, or Marketed*. Hosting arrangements generally involve the development of software to be used by an external party. These arrangements generally have the

¹ A hosting arrangement as defined in the Master Glossary refers to “... an arrangement in which the customer of the software does not currently have possession of the software; rather the customer accesses and uses the software on an as-needed basis.” A hosting arrangement would include a cloud computing arrangement (CCA) or a software-as-a-service (SaaS) arrangement (for example, an end user who can only access the software through a cloud-based server).

² Paragraph 985-20-15-7 states that if software subject to a hosting arrangement never meets the criteria in paragraph 985-20-15-5, then the software is utilized in providing services and is not within the scope of ASC 985-20 and, therefore, the development costs of the software should be accounted for in accordance with ASC 350-40 on internal-use software.

same development process as software that is sold and used on premises by the customer and we believe the same accounting model should be applied. If the Board does not pursue changes to the scoping guidance, we recommend it make changes to the probable-to-complete threshold to better align to ASC 985-20. Refer to our responses to Question 3 for further details.

Capitalization levels

We believe the proposed amendments could result in the same or a different level of capitalization depending on the judgments an entity has historically made to apply the current internal-use software guidance in an iterative development model and the judgments an entity would make under the proposed amendments. The determination of whether an entity would capitalize more, less or the same amount of internal-use software costs would be based on its determination of whether its software projects have significant development uncertainty. We believe this assessment would be subject to significant judgment, particularly around whether significant performance requirements continue to be substantially revised. Therefore, it is challenging to assess the impact the proposed amendments may have on the amount of software development costs capitalized.

However, we believe that an entity may interpret the proposed guidance to be a lower threshold than expected by the Board (based on paragraph BC18(b)) and could result in an increase to the amount of software costs capitalized. The requirement to assess only "significant" development uncertainty, including whether significant performance requirements continue to be "substantially" revised, may cause an entity to capitalize more costs when evaluated in connection with the removal of the preliminary project phase. For example, given the high thresholds of significant and substantially, an entity may conclude that there is no significant development uncertainty because significant performance requirements aren't substantially revised, and it would begin capitalizing software costs. Refer to Question 3 for more details.

Single model

We do not support the single model as described in paragraphs BC45-BC49, as we believe it has the potential to capitalize research and development costs. If the Board decides to pursue a single model, we believe the guidance in ASC 985-20 would be a better starting point than ASC 350-40. We believe this would achieve the key benefits described by the Board in paragraph BC18(b) as it would promote greater consistency in the financial reporting outcomes and would be a higher threshold than the current guidance in ASC 350-40.

We defer to preparers about what costs would be incurred to apply the proposed amendments.

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 operability or auditability concerns with removing the references to project stages. We agree that removing all references to the stages of development would modernize the software guidance and make it less likely to become outdated in the future as software development evolves.

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.

We acknowledge that the proposed amendments in paragraph 350-40-25-12A are intended to clarify and improve the operability of the capitalization threshold. However, we believe that determining whether there is significant development uncertainty may present challenges for entities and auditors alike.

The qualitative factors used to indicate significant development uncertainty would introduce new and different judgments to the capitalization threshold assessment. The examples below illustrate the potential for diversity in practice.

Significant development uncertainty: We believe it may be challenging to consistently determine and operationalize when existing development uncertainty is significant. We understand that there may be some level of development uncertainty that exists in software projects. Determining whether development uncertainty is significant would be subject to a high level of judgment and may not lead to greater consistency in the financial reporting outcomes. "Significant" is generally a high threshold in US GAAP and therefore may lead companies to conclude that more costs should be capitalized as development uncertainty that exists is not determined to be significant. In addition, if an entity concludes that there is significant development uncertainty in a project, the proposed guidance appears to require a continuous reassessment of the uncertainty (including whether the performance requirements continue to be substantially revised), which could be challenging to apply as it is not a discrete point in the software development process.

Novel/unique/unproven: An entity may determine that any software it develops for the first time under its direction is novel or unique, whereas another entity may consider software developed for the first time in its industry (e.g., pioneering new technologies) to be novel or unique. In addition, the unit of account for capitalization is often not the entire project, but updates or enhancements to existing software that are developed in “sprints.” Determining whether such updates or enhancements are novel, unique or unproven may be challenging and difficult to consistently apply.

Significant performance requirements: Entities may have different judgments regarding whether performance requirements are significant. An entity may consider enhancements to its software to be significant performance requirements, even if the core functionality remains the same, whereas another entity may consider enhancements to its software that only change the core functionality to be significant performance requirements.

Substantially revised: Entities may have different judgments regarding when performance requirements no longer continue to be substantially revised. We understand that there is often some level of revision to the performance requirements in an iterative development environment. Determining which of the revisions are substantial would require significant judgment and could be challenging to operationalize and apply consistently. “Substantial” is generally associated with a high threshold in US GAAP and could lead companies to conclude that more costs should be capitalized as the revisions to performance requirements are not substantial. The potential variability in interpretations of the proposed amendments in paragraph 350-40-25-12A may create challenges from an auditability standpoint, as the capitalization threshold is not based on a defined period in the software development cycle and would require an analysis of the significance of the uncertainty and whether revisions are substantial.

We believe the objectives of the Board would be better achieved through scoping hosting arrangements into ASC 985-20. We believe this approach would provide for the greatest consistency, as hosting arrangements would follow an accounting model better suited for the level of uncertainty in those projects. If the Board decides not to pursue changes to the scoping guidance, we believe it should increase the capitalization threshold in the proposed guidance. Evaluating whether there is significant development uncertainty and whether there continues to be substantial changes to performance requirements could be interpreted to be a lower cost capitalization threshold than intended. We suggest modifying the proposed guidance in paragraph 350-40-25-12A as follows (in strikethrough, bold and underscored text) to better align the probable-to-complete threshold with the threshold in ASC 985-20, as well as increase the consistency in application and potentially require less judgment to apply:

“350-40-25-12A If there is **more than an insignificant** ~~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) is not considered to be met. Once the **more than insignificant** ~~significant~~ development uncertainty has been resolved, an entity shall evaluate the requirements in paragraph 350-40-25-12 to determine when to begin capitalization of costs. The following are factors that may indicate that there is **more than insignificant** ~~significant~~ development uncertainty and that the probable-to-complete recognition threshold is not considered to be met:

- a. The computer software being developed has novel, unique, unproven functions and features or technological innovations.

- b. The significant performance requirements of the computer software have not been identified, or **expected changes to** the significant performance requirements **are more than minor** ~~continue to be substantially revised.~~

Additionally, the Board could consider replacing “significant performance requirements” in paragraph ASC 350-40-25-12A(b) with “major functions and features.” We believe this terminology would be preferable, as it is based on the definitions of the activities underlying the process for creating computer software in ASC 985-20 and would achieve the Board’s objective to better align with ASC 985-20.

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.

We generally believe the proposed amendments to require cash paid for capitalized internal-use software costs to be classified in the statement of cash flows as cash outflows from investing activities and to be presented separately from other investing cash outflows would be operable. We defer to preparers about whether the proposed amendments would be operable in terms of systems or internal controls and to investors on whether the proposed presentation requirements would provide decision-useful information.

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.

- 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?

We generally believe the disclosure alternatives would be clear and operable, similar to the proposed cash flow presentation requirements. We defer to preparers about how the costs of these disclosure alternatives compare with the proposed cash flow presentation requirements and to investors about how the decision usefulness of these disclosure alternatives compares with the proposed cash flow presentation requirements.

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.

We understand that entities view the development of websites and software similarly and, therefore, support the Board's decision to require entities to account for the costs to develop websites and internal-use software under the same guidance in ASC 350-40. We do not foresee any operability or auditability challenges. We do not believe the proposed amendments would have a significant effect on practice.

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.

We generally believe the proposed transition requirements would be operable.

Paragraph 350-40-65-4(c) states “c. An entity shall apply the pending content that links to this paragraph using one of the following transition methods: 1. Prospectively to software costs incurred, including costs incurred after the adoption date for in-process projects, during fiscal years (and interim periods within those fiscal years) beginning after the effective date of the pending content that links to this paragraph. [...]” This language suggests that an in-process project would include costs capitalized under pre-adoption and post-adoption guidance. This could pose challenges in cases where the proposed amendments change the level of capitalization. For example, it could result in an indicator of impairment for entities that would capitalize less costs under the proposed amendments (see paragraph BC18).

We defer to investors about whether the information required to be disclosed by paragraph 350-40-65-4(d) through (e) would be decision useful.

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 defer to preparers about how much time would be needed to implement the proposed amendments. We support a longer implementation period and a later effective date for entities other than public business entities and believe early adoption should be permitted.

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 that the proposed amendments should apply to all entities, including private companies. We defer to private companies about considerations that the Board should be made aware of in developing a final Accounting Standards Update.

Appendix B – Other comments:

1. The illustrations in paragraphs 350-40-55-5 through 350-50-55-19 are examples of developing a new software project where the project is the unit of account (i.e., a new system, application, technology, or website). We recommend providing other examples to illustrate (1) where the unit of account is at a lower level than the whole software project and (2) where there is an upgrade or enhancement to an existing software project, rather than a new software project. We believe these types of fact patterns are common and would be helpful for preparers as they implement the proposed amendments.
2. The proposed amendments in paragraph 350-40-15-1A states “If an entity **acquires** an asset that incorporates both software and tangible components...”, while paragraph BC37 states “The Board 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” [emphasis added in bold]. It is not clear whether the Board believes that paragraph 350-40-15-1A addresses only acquired assets or internally developed assets. If the Board’s intent was that the proposed amendments in paragraph 350-40-15-1A would also include internally developed assets, we recommend the following clarification (in strikethrough, bold and underscored text):

“If an entity acquires ~~or internally develops~~ an asset that incorporates both software and tangible components, the entity shall apply a reasonable and consistent method to determine whether the software component should be accounted for in accordance with this Subtopic or combined with the tangible component and accounted for in accordance with other generally accepted accounting principles (GAAP) (for example, in accordance with Subtopic 360-10 on property, plant, and equipment).”