

Technical Line

Navigating accounting considerations for artificial intelligence costs

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What you need to know

- ▶ Entities will need to understand the nature and type of costs incurred related to the development, implementation and ongoing use of AI to determine the appropriate accounting guidance to apply.
- ▶ An entity developing an AI software product for internal use or for sale is in the scope of the corresponding software guidance in ASC 350-40, *Internal-Use Software*, or ASC 985-20, *Costs of Software to Be Sold, Leased, or Marketed*.
- ▶ AI token costs used for software development may be capitalized only when they are direct costs attributable to a specific software project.
- ▶ Entities acquiring data to train an AI model will generally need to consider whether it will be used in research and development activities in accordance with ASC 730-10, *Research and Development*, or accounted for as an intangible asset under ASC 350-30, *General Intangibles Other Than Goodwill*.

Overview

The rapid implementation of artificial intelligence (AI) across organizations is raising the question of how to account for the many types of costs related to AI’s development and ongoing use.

This publication discusses the various types of AI costs as well as the facts and circumstances entities need to consider when determining the appropriate guidance to apply for their AI-related arrangements.



Key considerations

The applicable accounting guidance for AI-related costs depends on the type of cost incurred in developing, implementing and using AI.

Type of AI cost	Examples of AI-related costs
Software development costs (internal use or external use)	▶ Fees paid by the entity to a third party to develop an AI software product ▶ Employee labor costs paid by the entity related to prompt engineering and coding to develop the AI software product or train an AI model (e.g., large language model)
Software acquisition costs	▶ Fees paid to a third party to acquire an on-premise license of an AI software product ▶ Fees paid to a third party to implement an AI software product accessed through a cloud computing arrangement
Data-related costs	▶ Data set purchased by the entity to train an AI model, such as a large language model (LLM) or small language model (SLM) ▶ Rights to data (e.g., a license to use the data) used to train an AI model
Infrastructure costs	▶ Purchase of on-premises computer hardware used by the entity to support an AI software product ▶ Costs to construct and operate a data center that supports AI software products ▶ Cloud compute fees to train an AI model ▶ Utilities (e.g., electricity, internet) paid to support use of an AI software product

Determining the appropriate accounting guidance for AI-related costs requires an assessment of the facts and circumstances. AI solutions can take many forms and may include multiple components (e.g., software development, software access, data, implementation services, hardware purchase), each of which may be subject to different accounting models.

Entities will need to identify the underlying components of each arrangement and evaluate each component individually to determine whether it falls in the scope of software guidance, intangible assets guidance, research and development guidance or other guidance. As a result, the amount of AI-related costs entities capitalize or expense may vary based on the specifics of the arrangement and the manner in which the entities are using the AI. For example, an entity may train an LLM and incur computing infrastructure costs (e.g., AI accelerator chips, servers), costs for data sets to train the LLM and software engineering time to code and test the LLM, among other activities. Other entities may be using an LLM to perform software development (e.g., coding and testing) on its technology platform and pay for the service through a subscription-based fee, consumption-based fee (e.g., tokens) or a combination of both.

The following sections summarize the key scoping and accounting considerations for the various types of AI-related costs. This guidance is not intended to be exhaustive, and other matters may require evaluation.

Determining the appropriate accounting guidance for AI-related costs requires an assessment of the specific facts and circumstances.

Software development costs (internal use and external use)

If an entity is developing an AI software product (e.g., LLM, AI agent), either for internal use or for external use, the AI-related software costs are in the scope of the corresponding software guidance. Entities will need to carefully assess the components of the project and only evaluate software development costs for capitalization (e.g., internal labor and external direct costs to code and test the software). Data-related costs used to train an AI model and infrastructure costs are generally not software development costs and would be accounted for as a separate component. See separate discussions below.

Entities also need to determine how the AI software product will be provided to the customer (e.g., whether there is an on-premise license). This determination will impact which software guidance to apply.

An AI software product is internal-use software and accounted for under Accounting Standards Codification (ASC) 350-40 if it is acquired, internally developed or modified solely to meet the entity's internal needs, and during the software's development or modification, no substantive plan exists or is being developed to market the software externally.

If an entity develops an AI software product and provides it as part of a cloud computing arrangement, it applies ASC 350-40. If the entity is a customer in a cloud computing arrangement of an AI software product, it needs to determine whether the arrangement includes a software license or is a service contract. This determination affects the costs that can be capitalized under ASC 350-40. Examples of cloud computing arrangements include software as a service (SaaS), platform as a service, infrastructure as a service and other hosting arrangements.¹

If the AI software product is expected to be sold, leased or otherwise marketed (i.e., on-premise software arrangement), the entity applies ASC 985-20.

How we see it

Typically, entities deploy AI software products for internal-use or provide them to customers through cloud computing arrangements. These arrangements generally do not contain a license and thus are in the scope of ASC 350-40. However, entities need to evaluate each arrangement to appropriately determine whether a software license is present in the contract. Software that an entity develops and provides through a cloud computing arrangement that contains a software license is accounted for under ASC 985-20.

Internal-use software development costs

If an AI software product meets the definition of internal-use software, the entity applies the guidance in ASC 350-40. A software project is the unit of account when applying the capitalization requirements in ASC 350-40. While the guidance does not specifically define what constitutes a software project, entities will need to apply judgment to determine the appropriate unit of account based on their facts and circumstances.

The Financial Accounting Standards Board (FASB) amended ASC 350-40 to modernize the accounting for costs related to internal-use software. Accounting Standards Update (ASU) 2025-06² removes all references to project stages throughout ASC 350-40 and clarifies the threshold entities apply to begin capitalizing costs.

For more information on the ASU, refer to our Technical Line, [**A closer look at the FASB's amended guidance on accounting for internal-use software costs**](#). For purposes of this publication, our ASC 350-40 guidance considerations are post-adoption of this ASU. If an entity has not yet adopted this ASU, it should apply the pre-ASU cost capitalization criteria in ASC 350-40 and only capitalize AI software development costs incurred in the application development stage.

To qualify as internal-use software within the scope of ASC 350-40, the software needs to possess both of the following characteristics:

- ▶ The software is internally developed, acquired or modified solely to meet the entity's internal needs.
- ▶ During the software's development or modification, no substantive plan exists or is being developed to market the software externally.

Capitalization of certain costs related to an AI software product begins when management, with the relevant authority, implicitly or explicitly authorizes and commits to funding the software project and the probable-to-complete recognition threshold is met. The probable-to-complete recognition threshold is met when it is probable that the project will be completed and the software will be used to perform the function intended. An entity evaluating whether the probable-to-complete recognition threshold is met needs to determine whether significant development uncertainty exists.

Significant development uncertainty is considered to exist if either of the following two factors are present:

- ▶ The software being developed has technological innovations or novel, unique or unproven functions or features, and the uncertainty related to those technological innovations, functions or features, if identified, has not been resolved through coding and testing.
- ▶ The significant performance requirements of the software have not been identified, or the identified significant performance requirements continue to be substantially revised.

Any costs incurred before meeting the capitalization threshold are expensed as incurred.

Question 1

Are all AI software products considered to have novel or unique functions and features?

No. The guidance in ASC 350-40 does not specify how management assesses whether software functions and features are novel or unique, so they will need to apply judgment. The assessment could include considerations from the entity's own perspective, as well as considerations of widely recognized technological innovations that are readily accessible to the entity.

For example, an entity may consider its own software development experience and capabilities, the software development experience and capabilities of external vendors, the similarity of commercially available AI software products and readily available knowledge resources (e.g., competitors, consulting services). The determination will be project specific.

Illustration 1: Development of AI software that is not novel

Company A, an e-commerce retailer, is developing a customer inquiry chatbot to handle customer inquiries. This chatbot will be used solely for Company A's internal needs. While Company A has never previously developed a chatbot, such chatbots are widely available across many companies and industries. Company A's internal development team has experience building other AI software products, and there is also information about developing this type of chatbot readily available online to assist the team.

Analysis

Company A assesses whether the chatbot has novel or unique functions and features, which would indicate that significant development uncertainty exists. Because this type of chatbot is not new and the Company believes it has the ability, experience and knowledge (both internally and readily available externally) to be able to successfully develop the software, Company A concludes the chatbot does not have novel or unique functions or features.

Company A still needs to determine whether it has identified the significant performance requirements related to the chatbot and that they won't be substantially revised to conclude that significant development uncertainty does not exist.

Illustration 2: Development of AI software that is novel

At the beginning of 20X1, Company B starts to develop a contract negotiation agent that will autonomously execute the contract process from drafting to finalization. This agent will be used solely for Company B's internal needs. Company B does not have internal resources capable of developing the agent and will need to hire external developers.

Company B meets with several external vendors. While the vendors all have experience developing AI agents, none have experience with developing this type of agent. The vendors indicate that AI agents that can execute multi-step business activities end-to-end are novel and unproven. While some companies are building early versions of this type of agent, no commercial offerings are yet available. The vendors believe that successfully developing this agent will be challenging.

Analysis

Company B assesses whether the agent has novel or unique functions and features, which would indicate that significant development uncertainty exists. Because neither Company B nor the external vendors have the experience to develop this type of agent and it has not been successfully developed by others, Company B determines the agent has novel or unique functions and features, and significant development uncertainty exists.

After the capitalization threshold is met, entities capitalize only those AI-related software development costs that are allowable pursuant to ASC 350-40-30-1, which includes only external direct costs of materials and services consumed in developing or obtaining the software (e.g., fees paid to third parties to develop an AI software product), payroll and payroll-related costs for employees who code and test an AI software product and interest costs incurred during development.

Costs incurred for upgrades and enhancements to AI software products are capitalized if they will result in additional functionality (i.e., modifications to enable the software to perform tasks that it previously was not capable of performing). Entities need to establish a new unit of account for these upgrades and enhancements and apply the capitalization criteria in the guidance, including determining whether significant development uncertainty exists.

If the upgrades and enhancements do not result in additional functionality, the costs are related to maintenance and are expensed as incurred. Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements expense such costs as incurred.

Entities should stop capitalizing AI-related software development costs when the project is substantially complete and ready for its intended use or when it is no longer probable that the software project will be completed and placed in service. Capitalized costs are amortized on a straight-line basis over the AI software product's useful life. Determining an AI software product's useful life requires judgment, and entities need to consider the effects of obsolescence, competition, technology and rapid changes in AI software development. Additionally, entities are required to evaluate capitalized software costs (both in-process and completed projects) for impairment in accordance with ASC 360-10, *Property, Plant and Equipment*.



Question 2 **Should an entity capitalize utility costs incurred during the development of an AI software product?**

No. Utility and other overhead costs (e.g., electricity, air conditioning, internet) do not qualify for capitalization. These costs are incurred to support overall business operations and are not direct costs related to the development of an AI software product. Therefore, utility and other overhead costs are expensed as incurred.

Question 3 **Are entities allowed to capitalize external costs incurred for AI that performs coding and testing of software?**

Yes, provided that the costs are direct costs attributable to a software project and incurred after the capitalization threshold is met. ASC 350-40-30-1 states that entities should capitalize the external direct costs of materials and services consumed in developing or obtaining the software (e.g., fees paid to third parties to develop the software). Overhead costs, including those incurred in the development of AI, are not direct costs and are not permitted to be capitalized under ASC 350-40.

While the guidance does not specifically address external AI that performs software development activities, we believe an entity may capitalize the associated costs (e.g., tokens) if it demonstrates such costs are direct costs attributable to a software project. In these cases, an entity needs to be able to reliably determine (1) which costs qualify for capitalization and (2) which software project the costs relate to.

Many entities incur significant costs for AI platforms or tools that can perform multiple activities. Some of the activities may relate to direct costs of a software development project (e.g., coding and testing) and others may not (e.g., research, search queries). Tracking the costs of AI usage for various projects can be challenging for many entities.

Entities will need to consider the following steps to capitalize software development costs performed by AI:

- | | | |
|----------|--|---|
| 1 | What activity does the AI (e.g., token usage) support? | Only direct costs related to software development (e.g., coding and testing) can be capitalized. Entities need to make sure that they are not capitalizing costs related to indirect expenses or AI usage that is not attributable to software development. |
| 2 | Can the AI usage be attributable to a software project? | Costs need to be attributable to a specific software project to be capitalizable. An entity needs to determine that the identified direct costs are related to software development and such costs are properly attributable to a software project. |
| 3 | Are the costs incurred after the software project meets the capitalization threshold? | Only costs incurred after the capitalization threshold has been met can be capitalized. Entities will need to determine if the capitalization threshold has been met for the software project. See above for further discussion of the capitalization criteria. |
| 4 | Does the entity have appropriate processes and controls to track AI-related software development costs? | Entities will need to have appropriate processes and controls. See the “Internal control over financial reporting considerations” section below for additional information on evaluating processes and controls related to AI arrangements that perform software development. |

How we see it

The capitalization of AI-related software costs depends on the underlying activity performed by the AI service, not the pricing model used to bill for the service. AI platforms or tools may have different pricing models (e.g., token usage, flat subscription fee per user). While these pricing models determine how the AI service is billed, they do not determine the accounting for the AI costs. Only external costs from AI activities related to software development (e.g., coding, testing) can be capitalized, provided an entity has process and controls to properly identify the capitalizable project costs. As a result, entities may find it more challenging to identify the capitalizable costs in subscription-based arrangements than in token-based arrangements.

Illustration 3: Consumption-based AI dedicated to a specific software project

Company Y is developing a new customer-facing claims processing application and enters into an arrangement with a third-party for access to its LLM platform, which will be used to code and develop this specific software project. The arrangement for the LLM platform is priced based on actual consumption (i.e., tokens processed).

Analysis

Company Y assesses whether the consumption-based costs are capitalizable under ASC 350-40 (step 1). Because the LLM platform's use is directly related to the development of the claims processing application, the consumption-based fees represent an external direct cost attributable to a specific software project and thus are capitalizable costs. Management will need to have a process and controls to track that the costs are directly associated with the development of the specific claims processing software project and are not related to activities that should be expensed as incurred, such as maintenance, bug fixes, or general and administrative functions. Company Y will also need to assess whether the capitalization threshold has been met for the project to determine if the costs should be capitalized or expensed.

Question 4

Are entities permitted to allocate software development costs performed by AI to multiple projects?

It depends. AI usage costs (e.g., token costs) should be capitalized only to the extent they are direct costs attributable to a software project and incurred after the capitalization threshold is met. To determine the AI usage that can be capitalized (step 1 in Question 3) and which software project(s) the costs are attributable to (step 2 in Question 3), we believe entities should first use a specific identification method, if possible. Examples of specific identification methods include:

- Project-level token tracking tied to specific software development activities (e.g., coding and testing)
- Usage logs that demonstrate prompts, agents or model consumption attributable to a specific software project

When specific identification is not practicable, a systematic and rational allocation methodology may be appropriate, provided the methodology faithfully reflects the underlying use of the AI resources.

For example, an entity may allocate capitalizable AI software development costs between software projects based on software development labor hours incurred by project. That is, once an entity has determined the capitalizable AI token costs (e.g., coding, testing) for its software developers (step 1 in Question 3), it may be appropriate to allocate these costs to software projects (step 2 in Question 3) based on the software development hours the

developers incurred on these projects. This allocation methodology could potentially be utilized provided there is a relationship between labor effort and tokens consumed in capitalizable software development activities (e.g., coding and testing), the data is reliable and the entity has appropriate processes and controls to track the data. Any allocation utilized should not include any costs that are not permitted to be capitalized under ASC 350-40 (e.g., indirect costs, AI costs that do not relate to software development activities).

We do not believe the following allocation methodologies would be acceptable:

- Broad corporate allocations
- Headcount-based allocations (e.g., 40% of all AI spend because 40% of IT staff are developers)

Any allocation method should be consistently applied and designed to reflect the underlying consumption of AI services by qualifying software development activities. The further the allocation methodology gets from actual usage for a specific software project, the less likely it will be an appropriate method to allocate costs. If an entity is unable to reliably track and allocate costs to a software project, we believe all costs should be expensed as incurred.

How we see it

The costs associated with external AI that is used in software development may be capitalizable only when they represent direct costs. An entity capitalizing such costs needs to demonstrate that they are directly attributable to a specific software project. This will depend on an entity's facts and circumstances. Entities need to be careful that they are not capitalizing AI-related software development costs based on an arbitrary allocation of costs incurred across multiple projects.

Illustration 4: Company-wide AI subscription

Company Z enters into an arrangement with a third-party for access to its LLM platform for a fixed monthly subscription fee. The LLM platform includes multiple agents that perform various functions (e.g., research, analysis, software coding) and is made available to all employees across the organization, including those in finance, human resources, legal, marketing and software development. The monthly subscription fee does not vary based on usage and provides all employees with access to all agents, regardless of their role.

Analysis

Company Z assesses whether the subscription costs for the AI platform are capitalizable under ASC 350-40 (step 1 in Question 3). Although the AI platform may be used by software developers for coding, it is used broadly across the organization and not directly attributable to a specific software project. Company Z does not have a reliable basis to allocate costs to any particular in-process software project, and any amount of the subscription fee that would be allocated to such projects would be similar to an indirect cost allocation that is not appropriate under ASC 350-40. Thus, the monthly subscription fee is not a direct cost that is capitalizable under ASC 350-40 and is expensed as incurred.

External-use software development costs

An entity applies the guidance in ASC 985-20 when an AI software product meets the definition of external-use software.

Under ASC 985-20, all costs incurred to establish technological feasibility are research and development costs and need to be expensed when incurred in accordance with ASC 730-10. Technological feasibility is an accounting definition requiring completion of a product design

and either a detail program design or, in its absence, a working model. Once technological feasibility is reached, costs are capitalized as production costs. ASC 985-20 does not define the types of costs included in production costs.

The general principles for determining the costs of producing other products could be applied when determining the costs that are capitalized under ASC 985-20 when technological feasibility has been achieved. Therefore, production costs should include direct and indirect costs incurred after technological feasibility has been achieved and before the product is available for general release, such as programmers' salaries, outside contractor costs and allocated facility costs (including employee and contractor costs associated with coding and testing AI-enabled functionality). General and administrative costs need to be accounted for as period costs except for the portion that is clearly related to software production.

Amortization begins when the product is available for general release to customers. Capitalized costs are amortized on a product-by-product basis using the greater of amounts computed using the following:

- The ratio of current gross revenues for a product to the total of current and anticipated future gross revenues for that product (referred to as the revenue curve)
- The straight-line method over the remaining estimated economic life of the product, including the period being reported on

Software acquisition costs

Software can be acquired through an on-premise license or accessed via a cloud computing arrangement. Entities need to consider whether an AI software product acquired as an on-premise software license is accounted for under ASC 350-40 or ASC 985-20. Examples of on-premise software in the scope of each guidance include the following:

- An entity may purchase AI software for internal use through an on-premise licensing arrangement. This arrangement includes a software license that is accounted for under ASC 350-40. In this case, the entity should account for the software license as the acquisition of an intangible asset. Entities need to record a liability to the extent that all or a portion of the software licensing fees are not paid on or before the acquisition date of the license. The asset for the software license is recognized and measured at cost, which includes the present value of the license obligation if the license is to be paid for over time.
- An entity acquires AI software that it intends to sell, license or otherwise market externally. The entity accounts for the product under ASC 985-20. In this case, the entity needs to consider whether the purchased software has an alternative future use and whether the criteria for capitalization in ASC 985-20 are met as of the acquisition date. Purchased software in the scope of ASC 985-20 is accounted for with costs either expensed as research and development or capitalized and subsequently amortized, depending on whether the applicable capitalization criteria are met.

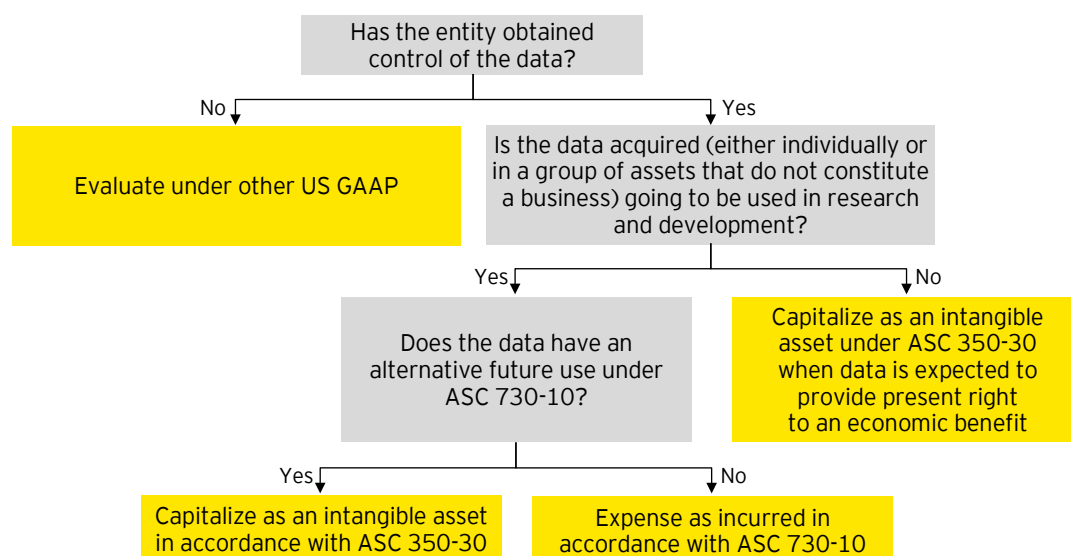
Entities need to apply different accounting considerations for an AI software product acquired through a cloud computing arrangement. Customers that gain access to software in a cloud computing arrangement account for the software as internal use only if the arrangement includes a software license. This occurs if the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty, and it is feasible for the customer to run the software on its own hardware or contract with another party unrelated to the vendor to host the software. The costs incurred to acquire the license, as well as those incurred to modify the licensed software or other internal-use software, are capitalized under ASC 350-40.

If the arrangement does not include a software license, the customer accounts for it as a service contract, and only qualifying implementation costs are capitalized under ASC 350-40.

Data-related costs

Data enables AI to learn patterns, make decisions and generate outputs. It is essential for training AI models (e.g., LLMs, SLMs) to perform their intended function. Data can be quantitative or qualitative and consist of raw facts, figures and observations (e.g., libraries, news archives). We generally do not believe that data-related costs are software costs in the scope of ASC 350-40 or ASC 985-20. See the “Software scope considerations” section below for further discussion. The remainder of this discussion assumes the data-related costs are not in the scope of ASC 350-40 or ASC 985-20.

The following flowchart illustrates how an entity determines the appropriate accounting guidance to apply for data acquired.



As a starting point, an entity evaluates whether it has obtained control of and, therefore, acquired the data. This assessment should consider all facts and circumstances, including contractual terms and restrictions. For example, when an entity obtains access to data through a short or limited term licensing arrangement, it may not have obtained control. If an entity does not obtain control of the data, it evaluates the related costs under other applicable US GAAP based on the nature of those costs (e.g., as a prepaid asset if upfront payment is made).

An entity obtaining control of and, therefore, acquiring data (either individually or in a group of assets that do not constitute a business) needs to consider whether the data will be used for research and development activities.

Data will not be used in research and development

Costs incurred to acquire data to train an AI model that is not being used in research and development, either individually or as a part of a group of assets that does not constitute a business, are recognized as a separate intangible asset under ASC 350-30 when the data is expected to provide a present right to an economic benefit. Under ASC 350-30, acquired data recognized as a separate intangible asset is initially measured at its cost to the acquiring entity and amortized over its useful life. See our Financial reporting developments (FRD) publication, *Intangibles – Goodwill and other*, for further discussion of ASC 350-30.

The applicable accounting guidance for acquired data costs depends on the nature and use of the data.

Data will be used in research and development

An entity applies the guidance in ASC 730-10 if the data is being used for research and development. ASC 730-10-25-2(c) indicates that intangible assets that have an alternative future use should generally be capitalized in accordance with ASC 350-30. The American Institute of Certified Public Accountants (AICPA) Accounting & Valuation Guide, *Assets Acquired to Be Used in Research and Development Activities – Alternative future use*, states that for assets to have an alternative future use, the entity needs to conclude that both:

- It reasonably expects that it will use the acquired assets in an alternative manner and anticipates an economic benefit from the alternative use.
- The use of the acquired asset is not contingent on the further development of the asset after the acquisition date (i.e., the asset can be used in an alternative manner in the condition in which it existed at the acquisition date).

An alternative future use should be currently identifiable, commercially viable and in an application currently available to the entity. Potential future uses that are not reasonably expected to be used by the entity do not meet the alternative future use test.

If the intangible asset has no alternative future use, the costs need to be expensed as incurred in accordance with ASC 730-10.

Software scope considerations

We generally do not believe that data-related costs used to train an AI model are software costs in the scope of ASC 350-40 or ASC 985-20. However, depending on the nature of the costs and how the data will be incorporated into the software, it may be appropriate to account for those costs under the applicable software guidance.

For example, if an entity purchases data solely for use in the development of a specific AI model, the data will not be used for any other software projects and the data has no alternative use to the entity, the costs may be in the scope of the applicable software guidance.

If the software is for internal use and an entity determines the data-related costs are in the scope of ASC 350-40, it would follow the recognition guidance discussed in the “Internal-use software development costs” section above to determine whether the costs should be capitalized. If the capitalization threshold for the software project has not been met when the data-related costs are acquired, the costs would be expensed as incurred.

If the software is for external use and an entity determines that the data-related costs are in the scope of ASC 985-20, it would follow the recognition guidance discussed in the “External-use software development costs” section above to determine whether the costs should be capitalized. If the data-related costs are acquired before an entity establishes technological feasibility, the costs would be expensed as incurred.

Infrastructure costs

Entities may incur infrastructure costs to support the development and operation of AI models (e.g., LLM, SLM) or other AI-enabled software platforms as they require significant resources for computation, storage and energy use. Entities need to consider the nature of these costs to determine the appropriate accounting guidance.

For example, an entity that purchases property, plant and equipment (e.g., computers, servers, semiconductors) or constructs long-lived assets (e.g., data centers) applies the guidance under ASC 360. Under this guidance, property, plant and equipment (including constructed assets) is recorded at historical cost, which includes the costs incurred for activities to bring them to the

condition and location necessary for their intended use. These costs are depreciated over the estimated useful life of the asset in a systematic and rational manner. Other services (e.g., compute fees, data storage fees) or utilities (e.g., electricity, internet) are generally expensed as incurred.

Internal control over financial reporting considerations

Determining the appropriate accounting treatment for AI-related arrangements often requires judgment, including determining whether certain costs should be capitalized or expensed as incurred. Entities need to evaluate whether they have designed and implemented processes and controls to identify AI-related costs, assess the nature of the underlying activities and apply the appropriate accounting guidance. This may include processes and controls over contract review, project authorization, cost classification and the monitoring of activities performed by employees, third-party service providers and AI tools.

Entities with AI arrangements that perform software development will need to consider whether they have appropriate processes and controls to (1) accumulate and track these costs, (2) determine if costs are directly attributable to specific projects, (3) determine the reasonableness of allocation methodologies if utilized and (4) distinguish costs that may qualify for capitalization from costs related to maintenance, training, general and administrative activities or other activities that should be expensed as incurred. If an entity is relying upon third-party reporting for costs, the entity will also need to evaluate controls in place with their vendor (e.g., SOC report). We do not believe entities should capitalize costs if they do not have appropriate processes and controls to reliably determine the amount of costs that should be capitalized.

Management's judgments and related considerations should be documented in line with the applicable guidance to support the operation of related processes and controls and the conclusions reached.

Next steps

- ▶ Entities need to identify and categorize AI-related costs to determine which accounting guidance applies and whether costs should be capitalized or expensed.
- ▶ Entities should evaluate whether they need to make changes to their existing processes and controls to consistently identify, classify and document AI-related costs and the key judgments supporting their accounting treatment.

Endnotes:

- ¹ The Master Glossary of the Codification defines a hosting arrangement as "... 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." Hosting arrangement, cloud computing arrangement and SaaS are often used interchangeably to describe such arrangements.
- ² ASU 2025-06, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*.

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