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January 27, 2025

Mr. Jackson M. Day
Technical Director
Financial Accounting Standards Board
801 Main Avenue
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2024-ED400

Dear Mr. Day:

RSM US LLP is pleased to provide feedback on the Financial Accounting Standards Board's (FASB or Board) proposed Accounting Standards Update (ASU), *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software* (proposed Update or proposal).

Overall, we support the Board's efforts to modernize the existing guidance in Subtopic 350-40 to be more reflective of current software development models. However, while the proposed amendments would better reflect methods of software development that have arisen since the existing accounting standard was issued, we believe that they merely shift the judgments involved in evaluating when capitalization begins and will not result in greater consistency in the application of Subtopic 350-40 across entities. Rather than introducing a new cost capitalization model, we would suggest pursuing a model that further leverages the existing guidance in Subtopic 985-20, *Software—Costs of Software to Be Sold, Leased, or Marketed*. Specifically, we would recommend the Board adopt an approach for the evaluation of "significant development uncertainty" that is based on when the software project meets the "technological feasibility" guidance in paragraph 985-20-25-2. However, should the Board decide to proceed with the proposed Update, we recommend that the Board consider an alternative approach for private companies that would allow expensing all or most costs associated with software development, as detailed in our response to Question 9.

Our responses to the questions posed in the proposed Update, other than those specifically directed solely at investors or preparers, along with comments on other matters for the Board's consideration are included in the remainder of this letter.

Responses to Questions for Respondents

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.

Given the challenges in applying the existing guidance to the agile development model, we agree with the need to modernize the guidance in Subtopic 350-40 by removing references to stages. However, we would suggest pursuing a model that further leverages the existing guidance in Subtopic 985-20 that many preparers and practitioners are already familiar with, thereby eliminating some of the new judgments that would otherwise be introduced by the proposed amendments.

One of the concerns with the current model is the significant judgment and subjectivity involved in identifying the applicable stage of development for a project. While the proposed amendments remove the challenge of identifying stages, they introduce different judgment in evaluating the probability of completing the software project; determining whether the software being developed has novel, unique, unproven functions and features or technological innovations; and identifying what performance requirements are significant. Given that some of these judgments are already addressed in Subtopic 985-20, we would recommend the Board instead adopt an approach for capitalization that is based on when the software project meets the "technological feasibility" guidance in paragraph 985-20-25-2, rather than introducing new judgments.

Overall, we expect the proposed amendments would decrease the amount of costs capitalized because many entities will likely argue that they do not meet the probable threshold until later in the software development process. However, we do not expect the costs incurred to apply the proposed amendments to be reduced, due to the judgments required to determine which costs should be capitalized. On an ongoing basis, entities will continue to incur costs to track the nature and purpose of the costs, consistent with those incurred under the current model. Furthermore, we would expect there to be additional one-time costs incurred in the implementation of this proposed ASU as entities evaluate its impact on existing software development projects.

Conceptually, we believe a single model would be the most appropriate approach to accounting for software development costs, particularly when considering the similarity of the expected benefits of on-premise software to be sold or licensed and software as a service (SaaS) to the entity developing the underlying software. However, we would not suggest pursuing the single model described in paragraphs BC45 through BC49 of the proposed Update given the costs involved and the possibility that such an approach could result in a higher level of capitalization, which would be contrary to the outcome that most users and preparers of financial statements prefer. Rather, if moving toward a single model, we believe it would be preferable to adjust the scope of Subtopic 985-20 to, at a minimum, include software developed to be sold under a SaaS model, if not all software development.

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.

While we support removing all references to software development project stages, we have concerns about the operability and auditability of the proposed amendments. In paragraph BC21 of the proposed Update, the Board acknowledges that "application of the proposed amendments would allow for flexibility in whether and when an entity capitalizes software costs based on an entity's evaluation of specific facts and circumstances." This level of flexibility can be challenging from an auditability perspective, as the subjectivity involved can lead to different interpretations and applications, making it harder for auditors to determine if the financial statements are presented fairly.

With respect to the proposed requirement that "management has authorized and committed to funding the software project," we believe additional guidance would be useful regarding the level of specificity of approval required. For example, if management has approved funding for a significant software development project comprised of multiple components, it is not clear whether management would have to approve a budget for each individual component within the project for the proposed recognition criterion to be met. This may be particularly relevant to start-up entities that may receive significant upfront funding that has been approved for use for the overall software project, but without having approved the budgets for the individual components, some of which may be probable of being completed even if the overall project is not.

Additionally, we believe that the probable-to-complete threshold may be interpreted differently by different entities, especially given the lack of guidance for determining the unit of account at which probability should be assessed. For example, it may be probable that a particular component will be completed, but if that component is part of a larger software development project, the overall project may not be probable of being completed and it may be unclear if the smaller component would have significant value on its own, apart from the overall project. Additionally, when auditing the probability of completion, it's unclear what criteria an auditor should use and whether the use of an information technology (IT) specialist would be required to assess the probability of completion. Management's IT department may be the most qualified to assess the probability of a project being completed, but it is also susceptible to overconfidence bias, particularly if the individuals were employed specifically for the purpose of designing a particular software. Therefore, we anticipate questions will arise as to whether auditors can rely on management's assessment as evidence that the project is probable of being completed or whether auditors would be expected to enlist the assistance of an IT specialist to assess whether a project is truly probable of being completed.

With the move toward agile development models, an individual sprint may include costs to fix bugs in existing software, costs to remove existing code in anticipation of a replacement component, costs to enhance or add functionality, and costs to develop entirely new software or components. If the Board continues to pursue the proposed model, we encourage the addition of examples of agile software development projects in which the costs incurred within an individual sprint are evaluated to determine whether they qualify for capitalization.

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 foresee significant operability and auditability concerns with determining whether there is significant uncertainty associated with the development activities of the software and in determining what are significant performance requirements. Consistent with the concerns noted in our response to Question 2, we believe that there would be diversity in practice when determining what qualifies as "significant uncertainty" and what are "significant performance requirements." We do not believe most accountants or auditors have the expertise to determine whether software has novel, unique, unproven functions and features or technological innovations without the assistance of an IT specialist. While we acknowledge that similar guidance on "novel, unique, unproven functions and features or technological innovations" is included in paragraph 985-20-25-2(a)3, that guidance is only applicable when an entity establishes technological feasibility using a detailed program design. In our experience, most entities establish technological feasibility based on a working model as prescribed in paragraph 985-20-25-2(b), which does not have a similar requirement.

If the Board continues to pursue the amendments in the proposed Update, we encourage the addition of factors to consider when evaluating whether there is significant development uncertainty and evaluating whether a performance requirement is significant. Additionally, we would encourage the addition of more complex examples that better reflect the reality of these evaluations, including examples in which an existing product is being modified, with elements being removed and significant functionality being added.

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. [Omitted]

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 believe the proposed presentation requirements are operable and auditable. The auditing challenge would be in the determination of which costs qualify for capitalization, not in presenting the cash paid for capitalized software costs on the statement of cash flows.

We acknowledge the inherent contradiction involved in presenting cash outflows to implement a hosting arrangement as operating and cash paid for capitalized software costs as an investment activity. We believe this could be resolved if all costs for software to be sold, marketed or licensed—including those incurred to develop the underlying software to be delivered in a hosted environment—were treated consistently (i.e., consistent with software costs capitalized under Subtopic 985-20).

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

We believe the disclosure alternatives considered but dismissed by the Board would be operable. However, as previously noted, we believe there would be operability and auditability challenges in determining the amount of costs to be capitalized under the proposed amendments.

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 support the Board’s decision to supersede the guidance in Subtopic 350-20 and incorporate website-specific development cost guidance from Subtopic 350-50 into Subtopic 350-40. With the shift in website functionality to more commonly serve as an interface to access underlying software, we believe that the specific guidance for website development costs is infrequently applied, and costs related solely to website development are typically immaterial. However, we believe the proposed amendments would have the same operability and auditability challenges noted above with regards to evaluating the probability of completion and the existence of significant development uncertainty.

Question 7

The proposed amendments could be applied either prospectively or retrospectively. 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.

We defer to the preparers of financial statements as to whether the proposed transition method is operable; however, we believe that the retrospective approach would cause auditability challenges. Because the evaluation of probability should be based on the facts and circumstances in existence as of a particular point in time, and most entities would not have processes and controls in place to capture this information prior to the adoption of the proposed ASU, retrospectively evaluating the probability without considering the information that became available later in the process would be a challenge.

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 the preparers of financial statements as to how much time would be needed to implement the proposed amendments, including whether the effective date for entities other than public business entities should be different from the effective date for public business entities (PBEs). However, in our experience, providing nonpublic business entities with additional time to learn from the transition experiences and interpretations of PBEs is helpful for those other entities.

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 existing guidance for internal-use software development costs should be amended for all entities. However, if the Board chooses to move forward with the proposed Update, we encourage the Board to explore an alternative approach for private companies that would allow expensing all or most costs associated with software development. (See also "Alternative approach to accounting for internal-use software development costs," in the "Other matters for the Board's consideration" section below.) We believe that this would be consistent with paragraphs 1.6 and 1.7 of the guidance in the Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies.

Paragraph 1.6 of the guide pertains to the relevance of information to typical users of private company financial statements. When considering the factors in this paragraph, we note that expensing software costs would not affect reported cash balances and cash flows. While it would impact earnings before interest, taxes, depreciation and amortization (EBITDA), our understanding is that many investors would add back any capitalized costs related to software when calculating adjusted EBITDA. The Board even acknowledged in paragraphs BC23 and BC49 of the proposed Update that investors have expressed a desire for greater comparability of earnings across entities, which could be achieved through a model that allows for expensing all or most software development costs.

Further, when considering the additional questions noted in Paragraph 1.6, the expensing or capitalization of software development costs would not significantly affect borrowings, liquidity or leverage. In addition, it typically does not impact, nor is it related to, trade receivables, inventories, fixed assets, other long-term tangible assets, accounts payable or other liabilities. While the accounting treatment of software development costs does not require recognizing and measuring transactions for which uncertainty exists on the basis of the expected most likely outcome, there is, as previously noted, significant judgment and uncertainty regarding when software costs should be capitalized. The accounting for software development costs also does not relate to loss contingencies or commitments that could significantly affect future cash flows. And finally, the measurement guidance for software development costs does not reflect volatility in financial statements resulting from underlying changes in market prices of debt instruments or certain derivatives that are expected to reverse contractually in the future because the entity has the intent and ability to hold the instrument or derivative to its defined maturity or term.

Paragraph 1.7 addresses the cost and complexity of applying accounting guidance. We believe that there would be significant complexity involved in not just the initial application of the proposed Update, but also in the ongoing accounting treatment, due to the level of judgment required in determining whether the criteria for capitalization are met. This may lead to additional costs, such as costs to ensure that information systems, processes and controls are in place to capture and evaluate the required information; costs to assess whether expenditures qualify for capitalization; and costs to engage accounting advisors or IT specialists to assist in ensuring compliance with the amendments in the proposed Update. Further, there may be additional audit costs, particularly if the use of IT specialists is deemed necessary to evaluate whether a software project is probable of completion or involves significant development uncertainty.

We acknowledge that an alternative approach allowing private companies to expense all or most software development costs could cause other challenges for private companies that subsequently are required to apply the accounting standards for public business entities, as they may not have the tracking systems in place to produce the information that would be required to reverse this election. However, we still believe this is an area where a private company alternative should be considered if the proposed Update is codified.

Other matters for the Board's consideration

Costs incurred for wasted labor, material and other resources

When developing software, it is not unusual for certain costs to be incurred that are determined to be "wasted." The amendments in the proposed Update could be interpreted to suggest that all costs incurred after the probable-to-complete threshold is met would be capitalizable. We recommend adding guidance that clarifies that costs incurred for "wasted labor, material, other resources," should be expensed as incurred, similar to the guidance in paragraph 606-10-55-21. Without clarifying that wasted costs should be expensed as incurred, the proposed amendments are open to abuse, as entities could capitalize significant overruns on software development projects, causing the financial condition and operating results to appear more favorable compared with entities that were more efficient in their development work.

Capitalization of costs

In the last paragraph of 350-40-25-12A of the proposed Update, we would recommend clarifying that the Board is not stating that significant development uncertainty does not impact the evaluation of the probable-to-complete threshold. Rather than stating that "the probable-to-complete recognition threshold described in paragraph 350-40-25-12(c) can be evaluated without having to consider significant development uncertainty," we would recommend stating, "it may be clear that there is no significant development uncertainty when evaluating the probable-to-complete recognition threshold described in paragraph 350-40-25-12(c)."

Software that enhances the functionality of PP&E

We understand that paragraph 350-40-15-1A of the proposed Update was meant to codify the general practice of combining software that is critical to or enhances the functionality of property, plant and equipment as one unit of account. However, we do not believe that stating that entities should "apply a reasonable and consistent method in making that determination" makes it clear that current practice would continue. We believe the proposed guidance should be expanded to include factors to consider when determining whether a software component sold with a tangible asset should be separately recognized under Topic 350, similar to the guidance in paragraphs 606-10-25-19 through 25-22 used to identify if promises are distinct. We also recommend providing examples to illustrate how the factors should be applied.

Cash flows from investing activities

To correctly reference the relevant proposed guidance for classifying payments to develop or obtain internal-use software that were capitalized, an "(e)" should be added at the end of the reference to "Paragraph 230-10-45-13" in proposed paragraph 350-40-45-1A.

Alternative approach to accounting for internal-use software development costs

If our recommendation to leverage the "technological feasibility" guidance in Subtopic 985-20 is not pursued in the proposed Update, we would suggest, as an alternative, that the Board further explore a model that allows for expensing all software development costs, including SaaS implementation costs, except those paid to external third parties for completed software. We believe this approach would address the goal of investors for greater comparability across entities. In practice, it may lead to a similar result as the "expense-all" approach the Board considered, but it would still allow costs paid to third parties for fully functional pre-existing internal-use software solutions to be capitalized. In paragraph BC56 of the proposed Update, the Board gave five reasons for rejecting an expense-all model, which we believe can be addressed as follows:

1. ***At some point in the software development process, the software costs represent an asset that should be recognized as such.*** While we agree that, from a theoretical perspective, some software development costs meet the definition of an asset, the same can be said of internally developed intangible assets, which are not capitalized under current generally accepted accounting principles unless acquired. Furthermore, the same argument could be made for costs incurred in developing software for external use, which, as the Board acknowledged in paragraph BC43, are often not capitalized until very late in the development process (upon completion of a working model to establish technological feasibility).

2. ***Entities would be required to expense acquired software, including term and perpetual licenses, upfront rather than over the life of the software or license term.*** This could be addressed by allowing companies to capitalize costs paid to third parties for completed internal-use software, similar to the treatment of acquired intangible assets.

3. ***The expense all model would require reconsideration of software acquired as part of a business combination or further exacerbate differences between the accounting for software acquired in a business combination and software acquired in an asset acquisition or developed internally.*** The majority of assets acquired in a business combination are recognized at fair value—as opposed to being recorded at book value—and many assets are only recorded when acquired through a business combination. Therefore, the fact that the cost of the internal-use software was expensed pre-acquisition does not prohibit the recognition of an asset for acquired internal-use software in a business combination. Furthermore, the fair value of acquired internal-use software is unlikely to be comparable to an internal-use software asset recorded at cost pre-acquisition. Therefore, we do not believe expensing these costs would have a significant impact on comparability beyond what already exists today.

4. ***Entities could potentially be required to separate the acquisition of a software component from a tangible component and expense the allocated cost of the software component upon acquisition. If not, software acquired as a component of a tangible asset may receive different accounting treatment than software that is not part of a tangible asset, which would place significant pressure on that determination.*** In practice, we believe software components are typically recognized as part of the related hardware in property, plant and equipment. In a case in which there is a separately recognizable software term license, our recommended approach would be to continue to capitalize that cost as it would be paid to a third-party for a completed software.

5. ***The potential costs of providing sufficient disclosures for investors about an entity's investment in software would likely outweigh the benefits of the expense all model because preparers would still need to track software costs to provide those disclosures.*** Overall, we believe that the expense-all model would reduce costs. To apply the Board's proposed Update, the primary cost relates to evaluating the appropriate classification of costs, not to tracking total software costs. Therefore, we believe the benefits would outweigh the costs, even if entities are required to provide additional disclosures. Furthermore, we believe the benefit of increased comparability across entities selling both software and SaaS would outweigh the cost of tracking software costs for disclosure purposes.

We appreciate this opportunity to provide feedback on the proposed Update and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Julia Amstutz at 309.497.1261 or Joseph Cascio at 212.372.1139.

Sincerely,

RSM US LLP

RSM US LLP