Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

330 North Wabash, Suite 3200
Chicago, IL 60611

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Via email to director@fasb.org

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

Re: Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40) - Targeted Improvements to the Accounting for Internal-Use Software (File Reference No. 2024-ED400)

Dear Mr. Day,

We appreciate the opportunity to respond to the Board's exposure draft on *Targeted Improvements to the Accounting for Internal-Use Software*.

We support the Board's proposal to make targeted improvements to the internal-use software guidance and enhance the transparency of cash outflows for capitalized software costs. However, we believe certain additional clarifications would improve operability of the proposed guidance. Our suggestions are detailed in our responses to the Questions for Respondents in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Angela Newell at (214) 689-5669 or Bobbi Gwinn at (214) 665-0749.

Very truly yours,

BDO USA, P.C.

BDO USA, P.C.

Appendix

Overall

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.***

We generally agree with the proposed amendments and believe that they clarify and improve the application of ASC 350-40. In particular we agree that removing references to phases of development makes applying the guidance to projects using the agile software development approach much less confusing. However, we believe certain changes would improve the clarity and operability of the proposed guidance:

1. The proposed paragraph 350-40-15-1A highlights scope considerations when an asset contains both software and tangible components and requires a reasonable and consistent method for determining whether the software should be bifurcated and accounted for under the guidance in ASC 350-40. BC37 notes the Board does not expect changes due to this new paragraph. Additionally, BC38 notes in practice entities often consider whether the software is critical or enhances the functionality of PP&E, but those considerations are not discussed in the proposed paragraph 350-40-15-1A.

   We do not think the proposed paragraph 350-40-15-1A is necessary without further specificity of the scope considerations. Given the ubiquity of software embedded in tangible assets, we are concerned that the proposed paragraph burdens entities by requiring them to document why they did not bifurcate software from every piece of equipment they buy without providing any incremental guidance to help with that analysis. Therefore, we strongly recommend deleting it.

2. The proposed paragraph 350-40-25-12(c) notes that to capitalize costs, it must be probable the project will be completed and the software will be used to perform the function intended. There likely are situations in which management commits to a project where the intended function may slightly evolve during the project due to expected technological challenges or learning during the project. This paragraph seems to imply that the function intended cannot change and needs to be exactly the same as initially approved in the project plan. To provide room for small changes during the project, we believe the Board should consider adding "substantially" as it relates to the function intended. In addition, we recommend the Board consider adding more specificity in the definition of "*performance requirements*" if that definition is critical to proper application of the proposed guidance (see our response to Question 3)

3. We recommend revising the last paragraph in the proposed paragraph 350-40-25-12A as follows to remove the description of the examples:

   > "*For certain software projects, the probable-to-complete recognition threshold described in paragraph 350-30-25-12(c) can be evaluated without having to consider significant development uncertainty, while in other software projects,*

the entity may have to evaluate significant development uncertainty to determine whether the probable-to-complete threshold is met. See Example 1 (paragraphs 350-40-55-5 through 55-8) and Example 3 (paragraphs 350-40-55-13 through 55-15) for illustrations of this concept."

We are concerned that describing the scenarios in the two examples places undue emphasis on enterprise resource planning system implementations in particular and could unnecessarily complicate the analysis by trying to describe an outcome without providing facts and circumstances.

4. Paragraph 350-40-25-17A on capitalization of upgrades and enhancements includes as a requirement that "*it must be probable that those expenditures will result in additional functionality*." As an additional consideration, an entity then applies paragraph 350-40-25-17B, which includes a reference to the proposed paragraph 350-40-25-12 (including condition (c) that "it is probable the project will be completed and the software will be used to perform the function intended.") It is our understanding that the Board's intent is to have two different "probable" assessments for upgrades and enhancements - that it is probable the change will result in additional functionality and that it is probable the change will be completed. However, that intent may not be clear to a reader. Therefore, we recommend clarifying this point in the basis for conclusions or through the addition of an example.

5. We recommend revising the language in BC21 as follows:

   "The Board acknowledges that application of the proposed amendments ~~would allow for flexibility~~ results in determining whether and when an entity capitalizes software costs based on an entity's evaluation of specific facts and circumstances."

   We do not believe that the proposed standard is intended to provide flexibility on whether and when an entity capitalizes software development costs. In other words, an entity does not have a choice of whether or when to capitalize given a specific fact pattern. Rather, an evaluation of specific facts and circumstances will drive the conclusion of whether, and if so when, to capitalize such costs.

Subject to the comments above, we think the overall proposed guidance would be clear and operable.

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.

As contemplated throughout this project, we believe that the proposed amendments will not result in a significant change in the level of capitalization, with a few exceptions. We note that SaaS companies may expense more software development costs with the clarification of the probable-to-complete threshold that explicitly contemplates novel, unique, or unproven functions and features or technological innovations, which is a similar outcome as accounting for external use software development costs under ASC 985-20.

Additionally, we think it is possible that more costs may be capitalized in certain scenarios. For example, management may approve a project to license software from one of a small number of third parties, each of which out-license fully developed software with no development uncertainties. In this case, the criteria in paragraph 350-40-25-12 are both met even though a specific software solution has not yet been decided, which could result in capitalization of the costs associated with meetings with multiple third-party vendors to finalize selection of a developed software solution. We acknowledge that these incremental costs are likely not material.

*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.***

We do not expect the proposed amendments to result in significant adoption costs. We acknowledge that the introduction of new areas of judgment ("probable-to-completion threshold" and "significant development uncertainty") may introduce new costs. These judgments will continue to be made while a software product is being developed resulting in ongoing costs. Additionally, separate judgments may be made for separate software products. However, we agree that the benefits of the proposed model will outweigh any increase in costs as compared to the current ASC 350-40 model.

*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 would have preferred a single model for capitalizing software costs. However, we understand and support the Board's decision to proceed with a dual model after unsuccessfully attempting to develop a single model. The proposed narrow guidance is an efficient approach to address key stakeholder concerns regarding the challenges associated with the current model for internal-use software with its emphasis on phase of development. That said, we would support additional research to confirm whether the proposed model if applied to software to be sold or licensed would result in similar outcomes as the current ASC 985-20 model. We believe that the addition of the probable-to-complete threshold with its emphasis on significant development uncertainty is similar to the threshold of technological feasibility in ASC 985-20-25-2 as noted in BC32. As such, we would support a future project to move to a single model based on the guidance in this proposal.

Removal of Project Stages

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 agree with removing the references to software development project stages. In practice, the accounting phases of a software project as articulated in the current model are not consistent with modern IT development practices which leads to some complexity in translating IT-related activities into those phases. We believe removing the requirement to determine the stage of a project would simplify the assessment of whether software development costs should be capitalized.

Significant Development Uncertainty

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.***

See our response to Question 1 above, including our recommended revisions to paragraph 350-40-25-12A. Also, we would recommend further revising the guidance in the proposed paragraph 350-40-25-12A to be more definitive. Specifically, we would recommend revising the last sentence of the first paragraph to delete the word "may" as follows: "*The following are factors that ~~may~~ indicate that there is significant development uncertainty …*"

Additionally, we believe the definition of performance requirements is too vague to be helpful and thus should be refined if it is critical in assessing the probable threshold as previously noted. We note the language in BC6 which explains that "*entities may find it difficult to outline all the performance requirements at the beginning of the software project*". Further, BC35 states that an entity "*may revise the significant performance requirements throughout the project.... the proposed amendments would not require an entity to identify and cease revising all of the software's performance requirements before it begins to capitalize its software development costs but, rather, to identify only those performance requirements that are significant and/or are significant and continue to be substantially revised.*" We believe these paragraphs include concepts that are important to consider when applying the proposed guidance and should either be moved from the basis to the codification or incorporated more effectively into the definition of "performance requirements." For example, the Board could consider replacing the proposed definition with "*Performance requirements are the significant functionality and features an entity requires from the application or software solution.*"

Presentation and Disclosure

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.***

We do not foresee significant audit challenges and defer to preparers for potential accounting systems issues.

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.***

We defer to investors.

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.***

No, we do not see a need to broaden the scope of this project to change the cash flow presentation for implementation costs incurred in a cloud computing arrangement (CCA). If the Board desires to revisit the accounting or disclosures for CCAs, we recommend a separate project with additional research.

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?

Rollforwards generally increase the complexity and costs in preparing and auditing financial statements, and we agree with the rationale in BC69(b) for not requiring a rollforward. We defer to preparers and investors for additional details.

Website Development Costs

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?

We generally agree that the proposed amendments are operable. However, it is not clear why some portions of the superseded guidance, such as paragraphs 350-50-25-6, 25-9, 55-5 or 55-6, are not being retained and moved to ASC 350-40. We recommend including a discussion in the basis for conclusions to explain the reason.

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

While we do not expect a material accounting effect, deletion of existing guidance implies change and requires an analysis of any potential effects.

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 <u>activities</u> (for example, replace <u>costs incurred in the planning stage</u> with <u>costs incurred during planning activities</u>). Would you prefer this approach, and would it be more operable and auditable? Please explain your reasoning.

We agree with the proposed approach because it is simpler.

Transition and Effective Date

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 agree with the option to apply the proposed requirements retrospectively. However, we believe the Board should allow a modified approach which requires application of the new guidance to any projects that are in process at the date of adoption rather than a prospective approach. For any in-process projects, a prospective approach would require a company to apply the existing model to costs incurred in prior periods and the new model to costs incurred after adopting the proposed guidance. This approach would result in multiple capitalization models being applied to a single asset, which we believe is inconsistent with general measurement principles.

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 do not believe a lot of time would be necessary for adoption given the limited changes to the existing guidance. While we do not believe that private companies need significant additional time, we do not object to allowing those entities the standard one-year deferral. We agree early adoption of the proposed amendments should be allowed.

Private Company Considerations

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 generally agree with consistent accounting guidance for private and public companies. While we acknowledge that allowing private companies a practical expedient to expense all software development costs as incurred would simplify their accounting, we do not believe this would provide better information to users of private companies' financial statements and would not support that approach without further research and outreach by the Board or the Private Company Council.