FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: October 29, 2024
Comments Due: January 27, 2025

Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40)

Targeted Improvements to the Accounting for Internal-Use Software

The Board issued this Exposure Draft to solicit public comment on proposed changes to Subtopic 350-40 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2024-ED400, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until January 27, 2025. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2024-ED400
- Sending a letter to "Technical Director, File Reference No. 2024-ED400, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Board is issuing this proposed Update to modernize the accounting for software costs that are accounted for under Subtopic 350-40, Intangibles—Goodwill and Other—Internal-Use Software (referred to as "internal-use software"), and enhance the transparency of an entity's cash flows related to internal-use software costs.

Feedback from preparer and practitioner stakeholders on the 2021 FASB Invitation to Comment, *Agenda Consultation* (2021 Agenda Consultation), indicated that the accounting for software costs should be a top priority for the Board. Those stakeholders encouraged the Board to better align the accounting with how software is developed because the current guidance is outdated and lacks relevance given the evolution of software development. Specifically, many entities have shifted from using a prescriptive and sequential development method (for example, waterfall) to using an incremental and iterative development method (for example, agile). Stakeholders stated that the current internal-use software accounting requirements do not specifically address software developed using an incremental and iterative method. As a result, stakeholders stated there are challenges in applying the current internal-use software guidance, which has led to diversity in practice in determining when to begin capitalizing software costs.

Considering this feedback, the Board decided to make targeted improvements to the internal-use software guidance. Specifically, the Board decided to make targeted improvements to Subtopic 350-40 to improve the operability of the recognition guidance considering different methods of software development and to enhance the transparency of cash outflows for capitalized software costs.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities subject to the internal-use software guidance in Subtopic 350-40. The proposed amendments also would apply to all entities that account for website development costs in accordance with Subtopic 350-50, Intangibles—Goodwill and Other—Website Development Costs.

The amendments in this proposed Update would not affect entities subject to Subtopic 985-20, Software—Costs of Software to Be Sold, Leased, or Marketed, for software to be sold, leased, or marketed (referred to as "external-use software").

What Are the Main Provisions?

The amendments in this proposed Update would remove all references to a prescriptive and sequential software development method (referred to as "project stages") throughout Subtopic 350-40. The proposed amendments would specify that an entity would be required to start capitalizing software costs when both of the following occur:

1. Management has authorized and committed to funding the software project.
2. It is probable that the project will be completed and the software will be used to perform the function intended (referred to as the "probable-to-complete recognition threshold").

In evaluating the probable-to-complete recognition threshold, an entity may have to consider whether there is significant uncertainty associated with the development activities of the software (referred to as "significant development uncertainty"). Factors to consider in determining whether there is significant development uncertainty include whether:

1. The software being developed has novel, unique, unproven functions and features or technological innovations.
2. The entity has determined what it needs the software to do (for example, functions or features), including whether the entity has identified or

continues to substantially revise the software's significant performance requirements.

The proposed amendments would require an entity to separately present cash paid for capitalized internal-use software costs as investing cash outflows in the statement of cash flows.

Additionally, the proposed amendments would supersede the website development costs guidance and incorporate the recognition requirements for website-specific development costs from Subtopic 350-50 into Subtopic 350-40.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Under current GAAP, entities are required to capitalize development costs incurred for internal-use software depending on the nature of the costs and the project stage during which they occur. Stakeholders have said that applying this guidance can be challenging because entities have trouble differentiating between the project stages, particularly in an iterative development environment. The amendments in this proposed Update would improve the operability of the guidance by removing all references to software development project stages so that the guidance would be neutral to different software development methods, including methods that entities may use to develop software in the future.

Many investors have noted that transparency about an entity's software costs could be enhanced and, in certain circumstances, additional information could be decision useful. The amendments in this proposed Update would enhance transparency for investors, lenders, creditors, and other allocators of capital (collectively, "investors") by requiring entities to classify cash paid for software costs accounted for under Subtopic 350-40 as investing cash flows in the statement of cash flows and to present those cash outflows separately from other cash outflows.

What Are the Transition Requirements and When Would the Amendments Be Effective?

The amendments in this proposed Update would permit an entity to apply the guidance either prospectively or retrospectively. Under the prospective transition approach, an entity would apply the proposed amendments to software costs incurred during annual reporting periods (and interim reporting periods within those annual reporting periods) beginning after the effective date, including costs incurred after the effective date for in-process projects.

Under the retrospective transition approach, an entity would recast comparative periods and recognize a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) as of the beginning of the first period presented.

The Board will determine the effective date and whether early application should be permitted after it considers stakeholder feedback on the amendments in this proposed Update.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Targeted Improvements to Subtopic 350-40

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.
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.

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.

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.

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.
b. For investors, would the proposed presentation requirements provide decision-useful information? How would this information be used in your investment and capital allocation decisions? Please explain your reasoning.
c. The proposed presentation requirements would not include cash outflows incurred to implement a hosting arrangement that is a service contract. Those cash outflows are typically classified as operating cash flows due to the separate presentation requirements in paragraph 350-40-45-3, which originated in Accounting Standards Update No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* (see paragraph BC64). Is it necessary to change the current classification of those costs to be consistent with the proposed presentation requirements? Please explain your reasoning.

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?

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?
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.

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.

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.

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.

Amendments to the
FASB Accounting Standards Codification®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Subtopic	**Description of Proposed Changes**
Master Glossary	• Superseded the term *preliminary project stage.* • Added the new term *performance requirements.* • Added the term *probable* to Subtopic 350-40.
350-40, Intangibles—Goodwill and Other—Internal-Use Software	• Amended guidance to remove references to project stages, clarify the starting capitalization threshold, incorporate relevant website-specific development costs guidance, add statement of cash flows presentation requirements, and add illustrative examples.
230-10, Statement of Cash Flows—Overall	• Amended guidance to add statement of cash flows presentation requirements for software costs capitalized under Subtopic 350-40.
350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill	• Amended guidance to clarify disclosure requirements for capitalized software costs.

Codification Subtopic	Description of Proposed Changes
350-50, Intangibles—Goodwill and Other—Website Development Costs	• Superseded Subtopic 350-50.
720-45, Other Expenses—Business and Technology Reengineering	• Amended the guidance to reflect updates to Subtopic 350-40, including removal of references to project stages.
730-10, Research and Development—Overall	• Amended guidance to remove references to Subtopic 350-50 and software development phases.

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–12. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

3. Supersede the Master Glossary term *Preliminary Project Stage*, with a link to transition paragraph 350-40-65-4, as follows:

~~**Preliminary Project Stage**~~

~~When a computer software project is in the preliminary project stage, entities will likely do the following:~~

a. ~~Make strategic decisions to allocate resources between alternative projects at a given point in time. For example, should programmers develop a new payroll system or direct their efforts toward correcting existing problems in an operating payroll system?~~
b. ~~Determine the performance requirements (that is, what it is that they need the software to do) and systems requirements for the computer software project it has proposed to undertake.~~

c. ~~Invite vendors to perform demonstrations of how their software will fulfill an entity's needs.~~
d. ~~Explore alternative means of achieving specified performance requirements. For example, should an entity make or buy the software? Should the software run on a mainframe or a client server system?~~
e. ~~Determine that the technology needed to achieve performance requirements exists.~~
f. ~~Select a vendor if an entity chooses to obtain software.~~
g. ~~Select a consultant to assist in the development or installation of the software.~~

4. Add the new Master Glossary term *Performance Requirements*, with a link to transition paragraph 350-40-65-4, as follows:

Performance Requirements

Performance requirements are what an entity needs the software to do (for example, functions or features).

5. Add the Master Glossary term *Probable* to Subtopic 350-40 as follows:

Probable

The future event or events are likely to occur.

Amendments to Subtopic 350-40

6. Amend paragraphs 350-40-05-1D, 350-40-15-2, 350-40-25-1 and its related heading, 350-40-25-4 through 25-5, 350-40-25-12 and its related heading, 350-40-30-1 and its related heading, 350-40-35-3, and 350-40-55-4, supersede paragraphs 350-40-05-7, 350-40-25-2 through 25-3 and their related heading, 350-40-25-6 through 25-11 and their related headings, 350-40-45-1, and 350-40-55-3, and add paragraphs 350-40-15-1A, 350-40-25-12A, 350-40-25-17A through 25-17I and their related headings, 350-40-45-1A and its related heading, 350-40-45-1B, and 350-40-55-5 through 55-19 and their related headings, with a link to transition paragraph 350-40-65-4, as follows:

Intangibles—Goodwill and Other—Internal-Use Software

Overview and Background

350-40-05-1C The Internal-Use Software Subtopic presents guidance in the following Subsections:

a. General
b. Implementation Costs of a Hosting Arrangement That Is a Service Contract.

350-40-05-1D Certain costs incurred for computer software developed or obtained for internal use should be capitalized ~~depending on the nature of the costs and the project stage during which they were incurred~~ in accordance with the guidance in Section 350-40-25. Computer software to be sold, leased, or otherwise marketed externally is not considered to be for internal use.

350-40-05-7 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Paragraph 350-40-55-3 illustrates the various stages and related processes of computer software development.~~

Scope and Scope Exceptions

> Overall Guidance

350-40-15-1A If an entity acquires an asset that incorporates both software and tangible components, the entity shall apply a reasonable and consistent method to determine whether the software component should be accounted for in accordance with this Subtopic or combined with the tangible component and accounted for in accordance with other generally accepted accounting principles (GAAP) (for example, in accordance with Subtopic 360-10 on property, plant, and equipment).

> Transactions

350-40-15-2 The guidance in the General Subsections of this Subtopic applies to the following transactions and activities:

a. Internal-use software
b. The proceeds of computer software developed or obtained for internal use that is marketed

c. New internal-use software developed or obtained that replaces previously existing internal-use software
d. Computer software that consists of more than one component or module. For example, an entity may develop an accounting software system containing three elements: a general ledger, an accounts payable subledger, and an accounts receivable subledger. In this example, each element might be viewed as a component or module of the entire accounting software system. The guidance in this Subtopic shall be applied to individual components or modules.
e. Costs incurred to develop a website. **[Content moved from paragraph 350-50-15-2(a)]**

Recognition

General

> Costs to Be Expensed as Incurred~~Preliminary Project Stage~~

350-40-25-1 Internal and external costs incurred prior to meeting the requirements in paragraph 350-40-25-12 ~~during the~~ ~~**preliminary project stage**~~ shall be expensed as they are incurred.

~~**> Application Development Stage**~~

350-40-25-2 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Internal and external costs incurred to develop internal-use computer software during the application development stage shall be capitalized.~~

350-40-25-3 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs to develop or obtain software that allows for access to or conversion of old data by new systems shall also be capitalized.~~ **[Content amended and moved to paragraph 350-40-30-1(d)]**

350-40-25-4 Internal and external training~~Training~~ costs are not internal-use software development costs and~~, if incurred during this stage,~~ shall be expensed as incurred.

350-40-25-5 Data conversion costs, except as noted in paragraph 350-40-30-1(d)~~350-40-25-3~~, shall be expensed as incurred. The process of data conversion from old to new systems may include purging or cleansing of existing data, reconciliation or balancing of the old data and the data in the new system, creation of new or additional data, and conversion of old data to the new system.

~~**> Postimplementation-Operation Stage**~~

350-40-25-6 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Internal and external training costs and maintenance costs during the postimplementation-operation stage shall be expensed as incurred.~~

~~**> Upgrades and Enhancements**~~

350-40-25-7 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Upgrades and enhancements are defined as modifications to existing internal-use software that result in additional functionality—that is, modifications to enable the software to perform tasks that it was previously incapable of performing. Upgrades and enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications. In order for costs of specified upgrades and enhancements to internal-use computer software to be capitalized in accordance with paragraphs 350-40-25-8 through 25-10, it must be probable that those expenditures will result in additional functionality.~~ **[Content amended and moved to paragraph 350-40-25-17A]**

350-40-25-8 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Internal costs incurred for upgrades and enhancements shall be expensed or capitalized in accordance with paragraphs 350-40-25-1 through 25-6.~~ **[Content amended and moved to paragraph 350-40-25-17B]**

350-40-25-9 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Internal costs incurred for maintenance shall be expensed as incurred.~~ **[Content amended and moved to paragraph 350-40-25-17C]**

350-40-25-10 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements shall expense such costs as incurred.~~ **[Content moved to paragraph 350-40-25-17D]**

350-40-25-11 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~External costs incurred under agreements related to specified upgrades and enhancements shall be expensed or capitalized in accordance with paragraphs 350-40-25-1 through 25-6. If maintenance is combined with specified upgrades and enhancements in a single contract, the cost shall be allocated between the elements as discussed in paragraph 350-40-30-4 and the maintenance costs shall be expensed over the contract period. However, external costs related to maintenance, unspecified upgrades and enhancements, and costs under agreements that combine the costs of maintenance and unspecified upgrades and enhancements shall be recognized in expense over the contract period on a straight-line basis unless another systematic and rational basis is more representative of the services received.~~ **[Content amended and moved to paragraph 350-40-25-17E]**

> Capitalization of Costs~~Cost~~

350-40-25-12 Capitalization of costs shall begin when both of the following occur:

a. Subparagraph superseded by Accounting Standards Update No. 2025-XX.~~Preliminary project stage is completed.~~
b. Management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project.~~project and it is probable that the project will be completed and the software will be used to perform the function intended.~~ **[Content amended and moved to paragraph 350-40-25-12(c)]** Examples of authorization and commitment to funding a computer software project include the execution of a contract with a third party to develop the software, approval of expenditures related to internal development, or a commitment to obtain the software from a third party. **[Content amended as shown and moved from paragraph 350-40-25-12]**
c. It~~ and it~~ is **{add glossary link}**probable**{add glossary link}** that the project will be completed and the software will be used to perform the function intended (referred to as the probable-to-complete recognition threshold). **[Content amended as shown and moved from paragraph 350-40-25-12(b)]**

~~Examples of authorization include the execution of a contract with a third party to develop the software, approval of expenditures related to internal~~

~~development, or a commitment to obtain the software from a third party.~~ **[Content amended and moved to paragraph 350-40-25-12(b)]**

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

<u>a. The computer software being developed has novel, unique, unproven functions and features or technological innovations.</u>
<u>b. The significant **performance requirements** of the computer software have not been identified, or the significant performance requirements continue to be substantially revised.</u>

<u>For certain software projects, such as illustrated in Example 1 (see paragraphs 350-40-55-5 through 55-8) for the implementation and customization of an enterprise resource planning system using a developed solution, the probable-to-complete recognition threshold described in paragraph 350-40-25-12(c) can be evaluated without having to consider significant development uncertainty. For other software projects, such as illustrated in Example 3 (see paragraphs 350-40-55-13 through 55-15) for the development of a new technology, an entity may have to evaluate significant development uncertainty to determine whether the probable-to-complete recognition threshold is met.</u>

350-40-25-13 When it is no longer probable that the computer software project will be completed and placed in service, no further costs shall be capitalized, and guidance in paragraphs 350-40-35-1 through 35-3 on impairment shall be applied to existing balances.

350-40-25-14 Capitalization shall cease no later than the point at which a computer software project is substantially complete and ready for its intended use, that is, after all substantial testing is completed.

350-40-25-15 New software development activities shall trigger consideration of remaining useful lives of software that is to be replaced. When an entity replaces existing software with new software, unamortized costs of the old software shall be expensed when the new software is ready for its intended use.

350-40-25-17 Entities often license internal-use software from third parties. A software license within the scope of this Subtopic (see paragraphs 350-40-15-1 through 15-4C) shall be accounted for as the acquisition of an intangible asset and the incurrence of a liability (that is, 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) by the licensee. The intangible asset acquired shall be recognized and measured in accordance with paragraphs 350-30-25-1 and 350-30-30-1, respectively.

> Upgrades and Enhancements

350-40-25-17A Upgrades and enhancements are defined as modifications to existing internal-use software that result in additional functionality—that is, modifications to enable the software to perform tasks that it was previously incapable of performing. Upgrades and enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications. In order for costs of specified upgrades and enhancements to internal-use computer software to be evaluated for capitalization~~capitalized~~ in accordance with paragraphs 350-40-25-17B~~350-40-25-8~~ through 25-17E~~25-10~~, it must be probable that those expenditures will result in additional functionality. **[Content amended as shown and moved from paragraph 350-40-25-7]**

350-40-25-17B Internal and external costs incurred for upgrades and enhancements shall be expensed or capitalized in accordance with paragraphs 350-40-25-1~~ through 25-6~~, 350-40-25-4 through 25-5, 350-40-25-12 through 25-14, and 350-40-25-17. **[Content amended as shown and moved from paragraph 350-40-25-8]**

350-40-25-17C Internal and external costs incurred for maintenance shall be expensed as incurred. **[Content amended as shown and moved from paragraph 350-40-25-9]**

350-40-25-17D Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements shall expense such costs as incurred. **[Content moved from paragraph 350-40-25-10]**

350-40-25-17E External costs incurred under agreements related to specified upgrades and enhancements shall be expensed or capitalized in accordance with paragraphs 350-40-25-1~~ through 25-6~~, 350-40-25-4 through 25-5, and 350-40-25-12 through 25-14. If maintenance is combined with specified upgrades and enhancements in a single contract, the cost shall be allocated between the elements as discussed in paragraph 350-40-30-4 and the maintenance costs shall be expensed over the contract period. However, external costs related to maintenance, unspecified upgrades and enhancements, and costs under agreements that combine the costs of maintenance and unspecified upgrades and enhancements shall be recognized in expense over the contract period on a straight-line basis unless another systematic and rational basis is more representative of the services received. **[Content amended as shown and moved from paragraph 350-40-25-11]**

> Additional Considerations for Website Development Costs

350-40-25-17F Fees incurred for website hosting, which involve the payment of a specified, periodic fee to an internet service provider in return for hosting the website on its server(s) connected to the internet, generally are expensed over the period of benefit. **[Content moved from paragraph 350-50-25-5]**

350-40-25-17G Accounting for website content involves issues that also apply to other forms of content or information that are not unique to websites. **[Content moved from paragraph 350-50-25-10]** Costs to input content into a website shall be expensed as incurred. **[Content moved from paragraph 350-50-25-11]**

350-40-25-17H Costs to register the website with internet search engines represent advertising costs and shall be expensed as incurred under paragraph 720-35-25-1. **[Content moved from paragraph 350-50-25-17]**

350-40-25-17I Costs to obtain and register an internet domain shall be evaluated for capitalization~~capitalized~~ under Section 350-30-25. **[Content amended as shown and moved from paragraph 350-50-25-7]**

Implementation Costs of a Hosting Arrangement That Is a Service Contract

350-40-25-18 An entity shall apply the General Subsection of this Section as though the **hosting arrangement** that is a service contract were an internal-use computer software project to determine when implementation costs of a hosting arrangement that is a service contract are and are not capitalized.

Initial Measurement

> Capitalizable Costs~~Cost~~

350-40-30-1 Costs of computer software developed or obtained for internal use that shall be capitalized include only the following:

a. External direct costs of materials and services consumed in developing or obtaining internal-use computer software. Examples of those costs include but are not limited to the following:
   1. Fees paid to third parties for services provided to develop the software~~ during the application development stage~~
   2. Costs incurred to obtain computer software from third parties
   3. Travel expenses incurred by employees in their duties directly associated with developing software.

b. Payroll and payroll-related costs (for example, costs of employee benefits) for employees who are directly associated with and who devote time to the internal-use computer software project, to the extent of the time spent directly on the project. Examples of employee activities include but are not limited to ~~coding and testing during the application development stage. Design~~design of chosen path, including software configuration and software ~~interfaces~~interfaces, ~~Coding~~coding, ~~Installation to hardware~~installation to hardware, and ~~Testing,~~testing, including parallel processing phase. **[Content amended as shown and moved from paragraph 350-40-55-3(b)(1) through (b)(4)]**

c. Interest costs incurred while developing internal-use computer software. Interest shall be capitalized in accordance with the provisions of Subtopic 835-20.

d. Costs to develop or obtain software that allows for access to or conversion of old data by new systems~~ shall also be capitalized~~. **[Content amended as shown and moved from paragraph 350-40-25-3]**

350-40-30-2 If the entity suspends substantially all activities related to the software developed or obtained for internal use, interest capitalization shall cease until activities are resumed.

350-40-30-3 General and administrative costs and overhead costs shall not be capitalized as costs of internal-use software.

Subsequent Measurement

> Impairment

350-40-35-3 When it is no longer **{add glossary link}**probable**{add glossary link}** that computer software being developed will be completed and placed in service, the asset shall be reported at the lower of the carrying amount or fair value, if any, less costs to sell. The rebuttable presumption is that such uncompleted software has a fair value of zero. Indications that the software may no longer be expected to be completed and placed in service include the following:

[The remainder of this paragraph is not shown here because it is unchanged.]

Other Presentation Matters

General

> Statement of Cash Flows

350-40-45-1A Paragraph 230-10-45-13 states that cash flows from capitalized software costs described in Section 350-40-25, other than implementation costs of a **hosting arrangement** that is a service contract described in paragraph 350-40-25-18, shall be classified in the statement of cash flows as cash outflows from investing activities. These cash outflows shall be separately presented from other investing cash outflows described in paragraph 230-10-45-13.

Implementation Costs of a Hosting Arrangement That Is a Service Contract

> Amortization

350-40-45-1 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~An entity shall present the amortization of implementation costs described in paragraph 350-40-35-13 in the same line item in the statement of income as the expense for fees for the associated **hosting arrangement**.~~ **[Content moved to paragraph 350-40-45-1B]**

350-40-45-1B An entity shall present the amortization of implementation costs described in paragraph 350-40-35-13 in the same line item in the statement of income as the expense for fees for the associated **hosting arrangement**. **[Content moved from paragraph 350-40-45-1]**

> Statement of Financial Position

350-40-45-2 An entity shall present the capitalized implementation costs described in paragraph 350-40-25-18 in the same line item in the statement of financial position that a prepayment of the fees for the associated hosting arrangement would be presented.

> Statement of Cash Flows

350-40-45-3 An entity shall classify the cash flows from capitalized implementation costs described in paragraph 350-40-25-18 in the same manner as the cash flows for the fees for the associated hosting arrangement.

Disclosure

350-40-50-1 The General Subsection of this Subtopic does not require any incremental disclosures. Disclosure shall be made in accordance with existing authoritative literature including the following:

a. Topic 275
b. Subtopic 730-10
c. Topic 235
d. Subtopic 360-10.

Implementation Guidance and Illustrations

> Implementation Guidance

350-40-55-3 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The following list illustrates the various stages and related processes of computer software development:~~

- ~~a. **Preliminary project stage**:~~
  - ~~1. Conceptual formulation of alternatives~~
  - ~~2. Evaluation of alternatives~~
  - ~~3. Determination of existence of needed technology~~
  - ~~4. Final selection of alternatives.~~
- ~~b. Application development stage:~~
  - ~~1. Design of chosen path, including software configuration and software interfaces~~ **[Content amended and moved to paragraph 350-40-30-1(b)]**
  - ~~2. Coding~~ **[Content amended and moved to paragraph 350-40-30-1(b)]**
  - ~~3. Installation to hardware~~ **[Content amended and moved to paragraph 350-40-30-1(b)]**
  - ~~4. Testing, including parallel processing phase.~~ **[Content amended and moved to paragraph 350-40-30-1(b)]**
- ~~c. Postimplementation-operation stage:~~
  - ~~1. Training~~
  - ~~2. Application maintenance.~~

350-40-55-4 This Subtopic recognizes that certain development activities such as~~the development of internal-use computer software may not follow the order shown in the preceding list. For example,~~ coding and testing are often performed simultaneously. Regardless, for costs incurred subsequent to meeting the requirements in paragraph 350-40-25-12~~completion of the preliminary project stage~~, the guidance shall be applied based on the nature of the costs incurred, not the timing of their incurrence. For example, while some training may occur subsequent to meeting the requirements in paragraph 350-40-25-12 and before the computer software project is substantially complete and ready for its intended use~~in the application development stage~~, it should be expensed as incurred as required in paragraph 350-40-25-4~~paragraphs 350-40-25-2 through 25-6~~.

> Illustrations

• > Example 1: Implementation and Customization of an Enterprise Resource Planning System

350-40-55-5 On February 1, 20X3, a professional services company starts internal discussions to transform its information technology by implementing an enterprise resource planning system to support finance, human resources, accounting, and client relationships.

350-40-55-6 After researching different solutions and performing its due diligence procedures, management executes a contract with a third party on August 1, 20X3, to implement and customize a hybrid solution that offers on-premise software and cloud computing services for the enterprise resource planning system. Within this solution, the third party offers different functionality and features, and the company will have to make customization decisions throughout the development process to select which functionality and features it wants included.

350-40-55-7 The company assesses whether the internal and external costs to implement and customize the enterprise resource planning system meet the capitalization requirements in paragraph 350-40-25-12, as follows:

a. The company determines that management authorized and committed to the funding on August 1, 20X3, when it executed the contract with the third party.
b. As of August 1, 20X3, the company determines that it is **probable** that the software project will be completed and the software will be used to perform the function intended because the company has selected a developed solution, the company will have the third party's expertise during the implementation and customization, and ongoing customization of the software relates to selection of existing functionality and features.

350-40-55-8 Therefore, on August 1, 20X3, the company begins capitalization of eligible costs, including those related to the on-premise software license and those related to implementation of the cloud computing service features of the hybrid solution. Additionally, the presentation requirements in paragraphs 350-40-45-1A and 350-40-45-2 through 45-3 apply to cash paid on or after August 1, 20X3, for capitalized software costs.

• > Example 2: Development of a Mobile Application

350-40-55-9 A company is in the process of internally developing X-Crowd, which is a mobile application that will allow users to see how crowded a restaurant or store is based on a user's real-time input. An internet connection is required to be able to access the application.

350-40-55-10 On February 1, 20X1, management had identified the overall concept of the software (that is, to allow users to see how crowded a restaurant or store is in real time). On this date, management approved funding for internal development of the application. However, the company has not yet determined how the application would accomplish that objective or what functionality would be included in the application. Through November 30, 20X1, the company continues to develop the significant **performance requirements**, including getting feedback on preliminary product versions from user groups and modifying the development of the significant performance requirements to incorporate the feedback. On December 1, 20X1, management determines that it has identified the specific functionality and features it wants the application to have and that it does not anticipate substantial changes to the significant performance requirements. Additionally, on December 1, 20X1, management determines that X-Crowd no longer has novel, unique, unproven functions and features or technological innovations.

350-40-55-11 The company assesses whether the internal and external costs to develop the application meet the capitalization requirements in paragraph 350-40-25-12, as follows:

a. The company determines that management authorized and committed to the software project on February 1, 20X1, when it approved the funding for internal development of the application.
b. As of February 1, 20X1, the company has not yet identified the significant performance requirements and, therefore, in accordance with paragraph 350-40-25-12A, there is significant development uncertainty. Accordingly, as of February 1, 20X1, the company has determined that the software does not meet the requirements in paragraph 350-40-25-12(c).
c. On December 1, 20X1, the company determines that it has resolved the significant development uncertainty by identifying the significant performance requirements, and determining that those performance requirements will not continue to be substantially revised. Additionally,

the company no longer considers the software being developed to have novel, unique, unproven functions and features or technological innovations. Therefore, the company concludes that it is now probable that the software project will be completed and the software will be used to perform the function intended.

350-40-55-12 Therefore, the company begins capitalization of eligible costs on December 1, 20X1. Additionally, the presentation requirement in paragraph 350-40-45-1A applies to cash paid on or after December 1, 20X1, for capitalized software costs.

• > Example 3: Development of a Novel Technology

350-40-55-13 On January 1, 20X1, a software development company starts discussions to develop software with novel and unproven functionality.

350-40-55-14 On February 1, 20X1, management completes its due diligence procedures, approves a budget to internally develop the software, and allocates an internal development team to start developing the novel software. At the time that the company started discussions and management approved a budget, the software still had novel and unproven functionality.

350-40-55-15 The company assesses whether the internal and external costs to develop the application meet the capitalization requirements in paragraph 350-40-25-12, as follows:

a. The company determines that management authorized and committed to the software project on February 1, 20X1, when it approved a budget and allocated an internal development team.
b. As of February 1, 20X1, the software continues to have novel and unproven functionality. Therefore, in accordance with paragraph 350-40-25-12A, there is significant development uncertainty. Accordingly, as of February 1, 20X1, the company has determined that the software does not meet the requirements in paragraph 350-40-25-12(c).
c. The company will continue to expense all software costs and assess when it has resolved the significant development uncertainty (including consideration of whether the significant performance requirements have been identified and whether those performance requirements will not continue to be substantially revised) to determine when it becomes probable that the software project will be completed and the software

will be used to perform the function intended. Because these costs will continue to be expensed, the presentation requirement in paragraph 350-40-45-1A is not applicable.

• > Example 4: Development of a Website

350-40-55-16 An animal rescue organization starts discussions on June 15, 20X5, to develop a website that will be used to share information with users of the organization, including hours of operation, contact details, animals available for adoption, and standard adoption procedures.

350-40-55-17 After researching different website developers and performing its due diligence procedures, management executes a contract with a third party on August 1, 20X5, to develop a website for the organization. The third party is an established website developer and offers different templates that the organization can use to customize its website. In addition to website development fees paid to the third party, the organization incurs costs:

a. To obtain and register an internet domain
b. To input content into the website
c. To register the website with internet search engines
d. For ongoing website hosting fees.

350-40-55-18 The organization assesses whether costs to develop the website meet the capitalization requirements in paragraph 350-40-25-12, as follows:

a. The organization determines that management authorized and committed to the funding on August 1, 20X5, when it executed the contract with the third party.
b. As of August 1, 20X5, the organization determines that it is probable that the software project will be completed and the website will be used to perform the function intended because the organization has selected an established third-party website developer, the organization will have the third party's expertise during the development of the website, and the organization can customize the website by using existing templates.

350-40-55-19 Therefore, the organization begins capitalization of eligible costs on August 1, 20X5. Additionally, the presentation requirement in paragraph 350-40-45-1A applies to cash paid on or after August 1, 20X5. In evaluating which costs are eligible for capitalization and included in cash paid, the organization determines the following:

a. Fees paid to the third party for services to develop the website are evaluated for capitalization in accordance with paragraph 350-40-30-1.
b. Costs incurred to obtain and register the internet domain are evaluated for capitalization in accordance with paragraph 350-40-25-17I.
c. Costs incurred to input content into the website are expensed as incurred in accordance with paragraph 350-40-25-17G.
d. Costs incurred to register the website with internet search engines are expensed as incurred in accordance with paragraph 350-40-25-17H.
e. Ongoing website hosting fees are expensed over the period of benefit in accordance with paragraph 350-40-25-17F.

7. Add paragraph 350-40-65-4 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2025-XX, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*

350-40-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2025-XX, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software:*

Effective date and early adoption

a. All entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after [date to be inserted after exposure], including interim reporting periods within those annual reporting periods.
b. Early adoption of the pending content that links to this paragraph [is or is not] permitted in any interim or annual reporting period in which financial statements have not yet been issued (or made available for issuance). If an entity adopts the pending content that links to this paragraph in an interim reporting period, it must adopt that pending content as of the beginning of the annual reporting period that includes that interim reporting period.

Transition methods

c. An entity shall apply the pending content that links to this paragraph using one of the following transition methods:
   1. Prospectively to software costs incurred, including costs incurred for in-process projects, during annual reporting periods (and interim reporting periods within those annual reporting periods) beginning after the effective date of the pending content that links to this paragraph.
   2. Retrospectively through a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) as of the beginning of the first period presented.

Transition disclosures

d. An entity that applies the pending content that links to this paragraph prospectively in accordance with (c)(1) shall provide the transition disclosures required by paragraph 250-10-50-1(a) in both the interim reporting period (if applicable) and the annual reporting period of the change.
e. An entity that applies the pending content that links to this paragraph retrospectively in accordance with (c)(2) shall provide the transition disclosures required by paragraph 250-10-50-1(a) through (b)(1), (b)(2) for any prior periods retrospectively adjusted, and (b)(3) and (c)(2), in both the interim reporting period (if applicable) and the annual reporting period of the change.

Amendments to Subtopic 230-10

8. Amend paragraph 230-10-45-13, with a link to transition paragraph 350-40-65-4, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

• > Cash Flows from Investing Activities

230-10-45-13 All of the following are cash outflows for investing activities:

a. Disbursements for loans made by the entity and payments to acquire debt instruments of other entities (other than cash equivalents and certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21)
b. Payments to acquire equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-18)
c. Payments at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets, including interest capitalized as part of the cost of those assets. Generally, only advance payments, the down payment, or other amounts paid at the time of purchase or soon before or after purchase of property, plant, and equipment and other productive assets are investing cash outflows. However, incurring directly related debt to the seller is a financing transaction (see paragraphs 230-10-45-14 through 45-15), and subsequent payments of principal on that debt thus are financing cash outflows.
d. Payments made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability.
e. Payments to develop or obtain internal-use software that were capitalized in accordance with Section 350-40-25 (see paragraph 350-40-45-1A), other than implementation costs of a hosting arrangement that is a service contract described in paragraph 350-40-25-18.

Amendments to Subtopic 350-30

9. Amend paragraphs 350-30-15-3 through 15-4, with a link to transition paragraph 350-40-65-4, as follows:

Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill

Scope and Scope Exceptions

> Transactions

350-30-15-3 The guidance in this Subtopic applies to the following:

a. Intangible assets acquired individually or with a group of other assets (but not the recognition and initial measurement of those acquired in a business combination, acquired in an **acquisition by a not-for-profit entity**, or recognized by a **joint venture** upon formation)
b. Intangible assets (other than goodwill) that an entity recognizes in accordance with Subtopic 805-20, 805-60, or 958-805 after they have been initially recognized and measured, except for those identified in paragraph 350-30-15-4
c. Subparagraph not used.
d. Costs of internally developing identifiable intangible assets that an entity recognizes as assets.

The disclosure requirements of paragraphs 350-30-50-1 through 50-3 also apply to capitalized software costs related to software to be sold, leased, or marketed that an entity recognizes in accordance with Subtopic 985-20.

350-30-15-4 The guidance in this Subtopic does not apply to the following:

a. Subparagraph not used.
b. Subparagraph superseded by Accounting Standards Update No. 2010-07.
c. Except for certain disclosure requirements as noted in paragraph 350-30-15-3, capitalized software costs that an entity recognizes in accordance with Subtopic 985-20
d. Except for disclosures required by paragraph 944-805-50-1 (however, an insurance entity need not duplicate disclosures that also are required by paragraphs 944-30-50-2A through 50-2B), intangible assets recognized for acquired insurance contracts under the requirements of Subtopic 944-805
e. Crypto assets accounted for in accordance with Subtopic 350-60, except for recognition and initial measurement of crypto assets.
f. Capitalized software costs that an entity recognizes in accordance with Subtopic 350-40 on internal-use software.

Amendments to Subtopic 350-50

10. Supersede Subtopic 350-50, Intangibles—Goodwill and Other—Website Development Costs, with a link to transition paragraph 350-40-65-4, as follows:

~~Intangibles—Goodwill and Other—Website Development Costs~~

~~Overview and Background~~

~~General~~

350-50-05-1 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~This Subtopic provides guidance on accounting for costs incurred to develop a website, including whether to capitalize or expense the following types of costs:~~

~~a. Costs incurred in the planning stage~~
~~b. Costs incurred in the website application and infrastructure development stage~~
~~c. Costs incurred to develop graphics~~
~~d. Costs incurred to develop content~~
~~e. Costs incurred in the operating stage.~~

~~Scope and Scope Exceptions~~

~~General~~

~~> Overall Guidance~~

350-50-15-1 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 350-10-15, with specific transaction qualifications noted below.~~

~~> Transactions~~

350-50-15-2 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The guidance in this Subtopic applies to the following transactions and activities:~~

~~a. Costs incurred to develop a website.~~ **[Content moved to paragraph 350-40-15-2(e)]**

350-50-15-3 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The guidance in this Subtopic does not apply to the following transactions and activities:~~

~~a. The cost of hardware~~
~~b. Acquisitions of servers and related hardware infrastructure.~~

~~Recognition~~

~~General~~

350-50-25-1 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The guidance in this Section refers to various website development stages. See Section 350-50-55 for details regarding the types of costs and activities incurred during those stages.~~

~~> Costs Incurred in the Planning Stage~~

350-50-25-2 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Regardless of whether the website planning activities specifically relate to software, all costs incurred in the planning stage shall be expensed as incurred.~~

~~> Costs Incurred in the Website Application and Infrastructure Development Stage~~

350-50-25-3 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The discussion of website application and infrastructure development assumes that any software is developed for the entity's internal needs and no plan exists or is being developed to market the software externally.~~

350-50-25-4 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~All costs relating to software used to operate a website shall be accounted for under Subtopic 350-40 unless a plan exists or is being developed to market the software externally. Software for which a plan exists or is being developed to market the software externally is subject to Subtopic 985-20, and costs associated with the development of that software shall be expensed until technological feasibility is established. See paragraph 985-20-25-2.~~

350-50-25-5 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Fees incurred for website hosting, which involve the payment of a~~

~~specified, periodic fee to an internet service provider in return for hosting the website on its server(s) connected to the internet, generally are expensed over the period of benefit.~~ **[Content moved to paragraph 350-40-25-17F]**

350-50-25-6 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs incurred to purchase software tools, or costs incurred during the application development stage for internally developed tools, shall be capitalized unless they are used in research and development and meet either of the following conditions:~~

~~a. They do not have any alternative future uses.~~
~~b. They are internally developed and represent a pilot project or are being used in a specific research and development project (see paragraph 350-40-15-7).~~

350-50-25-7 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs to obtain and register an internet domain shall be capitalized under Section 350-30-25.~~ **[Content amended and moved to paragraph 350-40-25-17I]**

~~**> Costs Incurred in the Graphics Development Stage**~~

350-50-25-8 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Graphics are a component of software. The costs of developing initial graphics shall be accounted for under Subtopic 350-40 for internal-use software, and Subtopic 985-20 for software marketed externally.~~

350-50-25-9 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Modifications to graphics after a website is launched shall be evaluated to determine whether the modifications represent maintenance or enhancements of the website.~~

~~**> Costs Incurred in the Content Development Stage**~~

350-50-25-10 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Accounting for website content involves issues that also apply to other forms of content or information that are not unique to websites.~~ **[Content moved to paragraph 350-40-25-17G]**

350-50-25-11 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs to input content into a website shall be expensed as incurred.~~ **[Content moved to paragraph 350-40-25-17G]**

350-50-25-12 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Software used to integrate a database with a website shall be capitalized under paragraphs 350-40-25-2 through 25-4.~~

350-50-25-13 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Data conversion costs shall be expensed as incurred (see paragraph 350-40-25-5).~~

~~> Costs Incurred in the Operating Stage~~

350-50-25-14 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs of operating a website shall not be accounted for differently from the costs of other operations; that is, those costs shall be expensed as incurred.~~

350-50-25-15 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs incurred in the operation stage that involve providing additional functions or features to the website shall be accounted for as, in effect, new software. That is, costs of upgrades and enhancements that add functionality shall be expensed or capitalized based on the general model of paragraph 350-40-25-7 (which requires certain costs relating to upgrades and enhancements to be capitalized if it is probable that they will result in added functionality) or, for software that is marketed, paragraphs 985-20-25-3 through 25-4 (which apply a software capitalization model to product enhancements, which include improvements that extend the life or significantly improve the marketability of a product).~~

350-50-25-16 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The determination of whether a change to website software results in an upgrade or enhancement (if internal-use software), or a product enhancement (if externally marketed software), is a matter of judgment based on the specific facts and circumstances. Paragraph 350-40-25-10 states that entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements shall expense such costs as incurred.~~

350-50-25-17 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs to register the website with internet search engines represent advertising costs and shall be expensed as incurred under paragraph 720-35-25-1.~~ **[Content moved to paragraph 350-40-25-17H]**

~~Implementation Guidance and Illustrations~~

~~General~~

~~> Implementation Guidance~~

350-50-55-1 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The following guidance describes or provides examples of various activities that take place at different stages of website development. See Section 350-50-25 for the relevant accounting guidance.~~

~~• > Planning Stage~~

350-50-55-2 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Planning stage activities include the following:~~

- ~~a. Develop a business, project plan, or both. This may include identification of specific goals for the website (for example, to provide information, supplant manual processes, conduct e-commerce, and so forth), a competitive analysis, identification of the target audience, creation of time and cost budgets, and estimates of the risks and benefits.~~
- ~~b. Determine the functionalities (for example, order placement, order and shipment tracking, search engine, email, chat rooms, and so forth) of the website.~~
- ~~c. Identify necessary hardware (for example, the server) and web applications. Web applications are the software needed for the website's functionalities. Examples of web applications are search engines, interfaces with inventory or other back-end systems, as well as systems for registration and authentication of users, commerce, content management, usage analysis, and so forth.~~
- ~~d. Determine that the technology necessary to achieve the desired functionalities exists. Factors might include, for example, target audience numbers, user traffic patterns, response time expectations, and security requirements.~~

e. ~~Explore alternatives for achieving functionalities (for example, internal versus external resources, custom-developed versus licensed software, company-owned versus third-party-hosted applications and servers).~~
f. ~~Conceptually formulate and/or identify graphics and content (see paragraphs 350-50-25-8 through 25-13).~~
g. ~~Invite vendors to demonstrate how their web applications, hardware, or service will help achieve the website's functionalities.~~
h. ~~Select external vendors or consultants.~~
i. ~~Identify internal resources for work on the website design and development.~~
j. ~~Identify software tools and packages required for development purposes.~~
k. ~~Address legal considerations such as privacy, copyright, trademark, and compliance.~~

~~• > Application and Infrastructure Development Stage~~

350-50-55-3 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~The website application and infrastructure development stage involves acquiring or developing hardware and software to operate the website. The activities in this stage include the following:~~

a. ~~Acquire or develop the software tools required for the development work (for example, HTML editor, software to convert existing data to HTML form, graphics software, multimedia software, and so forth).~~
b. ~~Obtain and register an Internet domain name.~~
c. ~~Acquire or develop software necessary for general website operations, including server operating system software, Internet server software, web browser software, and Internet protocol software.~~
d. ~~Develop or acquire and customize code for web applications (for example, catalog software, search engines, order processing systems, sales tax calculation software, payment systems, shipment tracking applications or interfaces, email software, and related security features).~~
e. ~~Develop or acquire and customize database software and software to integrate distributed applications (for example, corporate databases and accounting systems) into web applications.~~
f. ~~Develop HTML web pages or develop templates and write code to automatically create HTML pages.~~

g. ~~Purchase the web and application server(s), Internet connection (bandwidth), routers, staging servers (where preliminary changes to the website are made in a test environment), and production servers (accessible to customers using the website). Alternatively, these services may be provided by a third party via a hosting arrangement.~~
h. ~~Install developed applications on the web server(s).~~
i. ~~Create initial hypertext links to other websites or to destinations within the website. Depending on the site, links may be extensive or minimal.~~
j. ~~Test the website applications (for example, stress testing).~~

~~**• > Graphics Development Stage**~~

350-50-55-4 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~For purposes of this Subtopic, graphics involve the overall design of the web page (use of borders, background and text colors, fonts, frames, buttons, and so forth) that affect the look and feel of the web page and generally remain consistent regardless of changes made to the content.~~

350-50-55-5 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Graphics include the design or layout of each page (that is, the graphical user interface), color, images, and the overall look and feel and usability of the website. Creation of graphics may involve coding of software, either directly or through the use of graphic software tools. The amount of coding depends on the complexity of the graphics.~~

~~**• > Content Development Stage**~~

350-50-55-6 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Content refers to information included on the website, which may be textual or graphical in nature (although the specific graphics described in paragraph 350-50-55-4 are excluded from content). For example, articles, product photos, maps, and stock quotes and charts are all forms of content. Content may reside in separate databases that are integrated into (or accessed from) the web page with software, or it may be coded directly into the web pages.~~

350-50-55-7 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Content may be created or acquired to populate databases or web pages. Content may be acquired from unrelated parties or may be internally developed.~~

350-50-55-8 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Content is text or graphical information (exclusive of graphics described in paragraphs 350-50-55-4 through 55-5) on the website which may include information on the entity, products offered, information sources that the user subscribes to, and so forth. Content may originate from databases that must be converted to HTML pages or databases that are linked to HTML pages through integration software. Content also may be coded directly into web pages.~~

~~**• > Operating Stage**~~

350-50-55-9 Paragraph superseded by Accounting Standards Update No. 2025-XX.~~Costs incurred during the operating stage include training, administration, maintenance, and other costs to operate an existing website. Activities in the operating stage include the following:~~

- ~~a. Train employees involved in support of the website.~~
- ~~b. Register the website with Internet search engines.~~
- ~~c. Perform user administration activities.~~
- ~~d. Update site graphics (for updates of graphics related to major enhancements, see [h]).~~
- ~~e. Perform regular backups.~~
- ~~f. Create new links.~~
- ~~g. Verify that links are functioning properly and update existing links (that is, link management or maintenance).~~
- ~~h. Add additional functionalities or features.~~
- ~~i. Perform routine security reviews of the website and, if applicable, of the third-party host.~~
- ~~j. Perform usage analysis.~~

Amendments to Subtopic 720-45

11. Amend paragraph 720-45-55-1, with a link to transition paragraph 350-40-65-4, as follows:

Other Expenses—Business and Technology Reengineering

Implementation Guidance and Illustrations

> Implementation Guidance

• > Business Process Reengineering and Information Technology Transformation Project

720-45-55-1 The following table sets forth the accounting for typical components of a business process reengineering/information technology transformation project based on whether the item should be:

a. Expensed as incurred in accordance with the guidance contained in this Subtopic
b. Subparagraph superseded by Accounting Standards Update No. 2025-XX.~~Expensed as incurred in accordance with internal-use software guidance contained in Subtopic 350-40~~
c. Subparagraph superseded by Accounting Standards Update No. 2025-XX.~~Capitalized in accordance with internal-use software guidance contained in Subtopic 350-40~~
d. Capitalized as part of the cost of acquiring a fixed asset in accordance with a company's existing policy.
e. Capitalized or expensed in accordance with the internal-use software guidance contained in Subtopic 350-40.

(Note that letters in the grid refer to the corresponding guidance listed above.)

Steps	Third Party Expense	Third Party Capitalize	Internal Expense	Internal Capitalize
Business process reengineering and information technology transformation:				
Preparation of request for proposal	a		a	
Current state assessment	a		a	
Process reengineering	a		a	
Restructuring work force	a		a	
<u>Acquire, develop, or implement internal-use software</u>	<u>e</u>	<u>e</u>	<u>e</u>	<u>e</u>
~~Preliminary software project stage activities:~~				
~~Conceptual formulation of alternatives~~	~~b~~		~~b~~	
~~Evaluation of alternatives~~	~~b~~		~~b~~	
~~Determination of existence of needed technology~~	~~b~~		~~b~~	
~~Final selection of alternatives~~	~~b~~		~~b~~	
~~Application development stage activities:~~				
~~Design of chosen path, including software configuration and software interface~~		~~c~~		~~c~~
~~Coding~~		~~c~~		~~c~~
~~Installation to hardware~~		~~c~~		~~c~~
~~Testing, including parallel processing phase~~		~~c~~		~~c~~
~~Data conversion costs:~~				
~~a. Costs to develop or obtain software that allows for access of old data by new system~~		~~c~~		~~c~~
~~b. All other data conversion processes~~	~~b~~		~~b~~	
~~Training~~	~~b~~		~~b~~	
~~Post-implementation/operation stage activities:~~				
~~Training~~	~~b~~		~~b~~	
~~Application maintenance~~	~~b~~		~~b~~	
~~Ongoing support~~	~~b~~		~~b~~	
Acquisition of fixed assets:				
Purchase of new computer equipment, office furniture, or work stations		d	N/A	N/A
Reconfiguration of work area—architect fees and hard construction costs		d		d

Amendments to Subtopic 730-10

12. Amend paragraphs 730-10-25-2 and 730-10-25-4 and supersede paragraph 730-10-60-2A, with a link to transition paragraph 350-40-65-4, as follows:

Research and Development—Overall

Recognition

> Elements of Costs to Be Identified with Research and Development Activities

730-10-25-2 Elements of costs shall be identified with research and development activities as follows~~ (see Subtopic 350-50 for guidance related to website development)~~:

[The remainder of this paragraph is not shown here because it is unchanged.]

> Computer Software

730-10-25-4 Development of software to be used in research and development activities, including~~includes~~ costs incurred by an entity in developing computer software internally for use in its research and development activities, are research and development costs and, therefore, shall be charged to expense when incurred. The alternative future use test does not apply to the internal development of computer software; paragraph 730-10-25-2(c) applies only to intangibles purchased from others. ~~This includes costs incurred during all phases of software development because all of those costs are incurred in a research and development activity.~~

Relationships

> Intangibles—Goodwill and Other

730-10-60-2A Paragraph superseded by Accounting Standards Update No. 2025-XX.~~For guidance related to website development costs, see Subtopic 350-50.~~

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
Hillary H. Salo, *Vice Chair*
Christine A. Botosan
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt
Dr. Joyce T. Joseph

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The objectives of the amendments in this proposed Update are to (a) modernize the accounting for internal-use software costs and (b) enhance the transparency of an entity's cash flows related to internal-use software costs for investors.

BC3. The proposed amendments would make targeted improvements to Subtopic 350-40 to (a) improve the operability of the internal-use software recognition guidance considering different methods of software development and (b) enhance the transparency of cash paid for capitalized internal-use software costs. The proposed amendments would not affect entities subject to Subtopic 985-20 for external-use software.

Background Information

BC4. Software, such as application software, is a set of codes or programs that tells hardware what to do. Generally, software is developed independent of the hardware that it can be installed into, such as computer servers, laptops, mobile phones, and other devices. Common examples of application software include word processors, spreadsheets, web browsers, mobile phone applications (apps), databases, and enterprise resource planning (ERP) systems. There are many end users of software, including customers, employees, clients, and vendors (collectively, "end users").

BC5. Entities utilize software in a wide variety of ways, including software that supports an entity's operations, software that facilitates services that an entity provides to its end users (such as online banking, online shopping, and online games), and software that an entity provides to its end users to access information. Another way that entities use software is by selling software to their end users through on-premise licenses (where the software can be used offline by the end user) or through cloud computing arrangements (CCAs) or software-as-a-service (SaaS) arrangements (for example, where an end user can only access and use the software through the internet). Additionally, software is embedded into tangible items, such as network equipment, cars, household appliances, and industrial robots. Therefore, virtually every entity is affected by the accounting for software costs.

BC6. Historically, software was developed using the waterfall method, which often is described as a prescriptive and sequential method. While the waterfall method may be suitable in the development of certain software, it is not considered to be adaptive to changes in software requirements. Because each phase under the waterfall method should be completed in sequential order before moving to the next phase, it may be challenging and costly to go back to a previous phase. Additionally, entities may find it difficult to outline all the performance requirements at the beginning of the software project, and significant changes in later phases can be challenging and costly to incorporate. The internal-use software guidance was issued when software was developed using the waterfall method; therefore, the current guidance does not contemplate other methods of software development.

BC7. To overcome challenges with the waterfall method, other software development methods have emerged, including the agile method. The agile method allows software developers to make incremental and iterative adaptations in response to changes in performance requirements. Within the agile method, a software project is broken down into smaller efforts (or sprints) to develop a specific function or feature within the software project. This iterative environment makes the software project more manageable and allows for entities to quickly incorporate and develop changes.

Current Requirements

BC8. Software costs are costs that an entity incurs to acquire, internally develop, or modify software (collectively, “software development” or “development”). Subtopics 985-20 and 350-40 are the principal areas in the Codification applicable to software costs. Determining what guidance applies is important because there are different requirements for when an entity is required to start capitalizing software costs and those differences can result in significantly different financial reporting outcomes. In addition, entities must make judgments to determine (a) the unit of account for an asset that incorporates both internal-use software and tangible components and (b) whether the software component should be accounted for under Subtopic 350-40 or as part of the tangible asset under other GAAP, such as Subtopic 360-10, Property, Plant, and Equipment—Overall.

BC9. Determining whether Subtopic 985-20 or Subtopic 350-40 applies to software development costs largely depends on how an entity plans to use the software. When an entity has a substantive plan to sell, lease, or otherwise market the software externally (including on-premise licenses or embedded in a tangible item), the entity is required to account for the software costs under Subtopic 985-20. Conversely, Subtopic 350-40 applies when an entity acquires or develops software that will be used internally in its own operations (such as an internal payroll system). Subtopic 350-40 also applies when an entity develops software that will be used to provide services (rather than to license the software) to external parties—these arrangements can vary significantly in nature and are often referred to as CCAs or SaaS arrangements. As a result, Subtopic 350-40 applies to CCAs for both (a) an entity that is incurring costs to develop the software that will be provided to an end user in a CCA and (b) an end user that incurs costs to implement a CCA. However, the external-use software guidance applies to software developed for customers to access in CCAs in which (1) the customer has a contractual right to take possession of the software at any time during the hosting period without significant penalty and (2) it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software. The determination of whether software is accounted for under Subtopic 985-20 or Subtopic 350-40 would not be affected by the amendments in this proposed Update.

Internal-Use Software (Subtopic 350-40)

BC10. The guidance for internal-use software largely originated from AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, which was issued in 1998. In developing SOP 98-1, which is included in the current internal-use software guidance, the Accounting Standards Executive Committee (AcSEC) considered the definition of an asset in now superseded FASB Concepts Statement No. 6, *Elements of Financial Statements*, and the recognition criteria in now superseded FASB Concepts Statement No. 5, *Recognition and*

Measurement in Financial Statements of Business Enterprises. Paragraph 25 of Concepts Statement 6 defined assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events" (footnote reference omitted).

BC11. Entities are currently required to capitalize costs incurred for software developed for internal use and CCA implementation costs, depending on the nature of the costs and the project stage during which they occur. The guidance describes three sequential stages of software development and implementation activities as follows:

a. **Preliminary project stage.** This stage generally occurs when an entity considers and defines its software needs and possible solutions, regardless of whether it ultimately pursues a project to develop internal-use software or enter into a CCA.
b. **Application development stage.** This stage begins after (1) the preliminary project stage is complete, (2) management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project, and (3) it is probable that the project will be completed and the software will be used to perform the function intended.
c. **Post-implementation operation stage.** This stage begins when the software project is substantially complete and ready for its intended use, which is analogous to the period after all substantial testing is complete.

BC12. Generally, entities are required to expense costs incurred during the preliminary project stage and to capitalize eligible costs incurred during the application development stage. During the post-implementation operation stage, entities are required to capitalize eligible costs that add functionality as enhancements in the same manner as described in paragraph BC11 and to expense maintenance costs as incurred.

External-Use Software (Subtopic 985-20)

BC13. The guidance for external-use software originated from FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*, which was issued in 1985.

BC14. Generally, entities are required to expense all costs incurred to establish technological feasibility of the software as research and development (R&D)

costs in accordance with Subtopic 730-10, Research and Development—Overall. Entities are required to capitalize eligible costs incurred after establishing technological feasibility until the product is available for general release. Following general release, entities are required to capitalize eligible costs of enhancements that extend the life or significantly improve the marketability of the software product in the same manner as described in the previous sentence and to expense maintenance costs as incurred.

Key Challenges of Current Requirements

BC15. Stakeholders have provided the following feedback on the key challenges that exist in the accounting for and disclosure of software costs:

a. **The methods used to develop software have evolved.** As described in paragraph BC7, many entities have shifted from using a prescriptive and sequential method to using an incremental and iterative method. As a result, entities find it challenging to apply the project stages in Subtopic 350-40 to software costs incurred in an iterative environment.
b. **Financial reporting outcomes sometimes are unintuitive.** While the internal-use software guidance is applied to software that is used solely for internal purposes (such as an internal payroll system), it also applies to software that is sold as a service (such as a CCA or SaaS arrangement). Under the external-use software guidance, entities often expense a significant amount of software costs as incurred. Conversely, under the internal-use software guidance, some entities capitalize significant costs, including the costs to develop software that will be sold as a service. Overall, stakeholders have trouble understanding why similar projects yield different amounts of capitalized costs depending on how the software is delivered to end users.
c. **There is a lack of transparency about an entity's software costs.** Overall, many investors have noted that transparency about an entity's software costs could be enhanced, and, in certain circumstances, additional information could be decision useful. Many investors indicated that they were not aware that the costs to develop software that will be sold via a CCA are accounted for differently from the costs to develop software that will be sold via a license. Furthermore, investors observed that companies often have inconsistent financial reporting outcomes (for example, some companies capitalize significant amounts of software costs, while others expense all software costs).

Basis for Conclusions

Benefits and Costs

BC16. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC17. Over the course of this project, the Board and the FASB staff conducted extensive outreach with investors, preparers, practitioners, and others to obtain information about potential improvements to the accounting for and disclosure of software costs.

BC18. The Board expects that the key benefits of the amendments in this proposed Update would be as follows:

a. Removing the project stages would improve the operability of applying the internal-use software guidance to software costs incurred in an iterative development environment. Additionally, because the proposed amendments would be neutral to different software development methods, there would be less chance that the guidance could become outdated over time.
b. Aligning the recognition requirements for internal-use software costs more closely with the requirements for external-use software costs, as well as articulating certain judgments needed to recognize internal-use software costs, could help to establish greater consistency in the financial reporting outcomes across entities and within an entity. This consistency in financial reporting would, in turn, benefit investors that analyze software entities. As described in paragraph BC15, stakeholders have expressed concern about the different recognition

requirements for the costs to develop software that will be sold via a CCA under the internal-use software guidance and the costs to develop software that will be sold via an on-premise license under the external-use software guidance, which can result in different capitalization outcomes. These stakeholders said that the costs that are capitalized for software that is developed for sale should not differ depending on how the software is delivered to end users. The Board does not expect that the proposed amendments would result in an increase in capitalization of costs to develop software that will be sold via a CCA. Rather, the Board expects that the proposed amendments could result in increased expensing of these costs.

c. Requiring separate presentation of cash paid for capitalized internal-use software costs as investing cash outflows would enhance transparency for investors.

BC19. The Board also acknowledged that the amendments in this proposed Update could introduce additional costs for preparers, including the following:

a. One-time costs to update systems, processes, and/or accounting policies and ongoing costs to comply with the proposed amendments. The Board expects that the extent of one-time and ongoing costs will vary depending on an entity’s size and complexity, as well as the extent to which the proposed amendments would result in changes to the amount of capitalized software costs. That is because an entity might have to update or implement new systems and processes to track software costs at the level of detail required for capitalization and current disclosure requirements. However, on the basis of stakeholder feedback, the Board does not expect that the proposed amendments would generally result in increased capitalization of software costs, and, therefore, the Board expects that the extent of these costs would be limited. Additionally, the Board expects that there could be reduced ongoing costs for entities that would capitalize less software costs under the proposed amendments because they may not need to track costs at the same level of detail that they do currently.
b. One-time and ongoing costs to apply the proposed statement of cash flows presentation requirements to separately present cash paid for capitalized internal-use software costs. The Board expects that these costs would be limited because the proposed presentation requirements relate to capitalized amounts and preparers have said that the

information associated with those costs should be readily available. Additionally, entities that capitalize less software costs under the proposed amendments may incur minimal ongoing costs to apply the proposed presentation requirements. Nevertheless, some entities may incur one-time and ongoing tracking costs to (1) separate cash from noncash capitalized software costs and (2) identify cash payments incurred in the current period. These costs may be mitigated to the extent that such cash outflows are already being considered investing cash outflows, similar to PP&E.

BC20. Overall, the Board concluded that the expected benefits of the amendments in this proposed Update would justify the expected costs.

Targeted Improvements to Subtopic 350-40

Overall

BC21. The amendments in this proposed Update would make targeted improvements by (a) removing all references to a prescriptive and sequential software development method (referred to as "project stages") throughout Subtopic 350-40 and (b) clarifying the starting capitalization threshold. 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.

BC22. The Board considered other recognition models that would have resulted in more extensive changes to GAAP and the extent of capitalization, including the single model, the dual model, and the expense all model (see paragraphs BC45–BC57 for alternatives considered). The Board's analysis considered the definition of an asset in Chapter 4, *Elements of Financial Statements,* of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting.* Paragraph E16 of Chapter 4 defines an asset as "a present right of an entity to an economic benefit." Although Chapter 4 does not include the term *probable* in the definition of an asset, paragraph E36 implies that because the facts and circumstances that generate intangible assets are so varied, whether an asset has been created often must be resolved at the standards level.

BC23. However, feedback from investors generally indicated that they are not interested in significant increases in the level of software costs capitalized, especially for software to be provided to external parties. Investors strive to compare earnings across entities, and different levels of capitalization can make that comparison challenging. For example, if one entity capitalizes some software costs and another entity expenses all software costs, the amount of expenses on those entities' income statements will not be comparable. Some investors also are concerned about the level of management judgment that is needed to evaluate whether software development costs should be capitalized. Additionally, some investors view expenditures to develop revenue-producing software as representing recurring operating expenses and do not support greater capitalization and amortization of those expenditures. Furthermore, feedback from preparers indicated that more extensive changes to the recognition of software costs that would have increased capitalization could be costly to implement, initially and on an ongoing basis.

BC24. The Board considered an analysis of the definition of an asset and the recognition criteria in the Board's Conceptual Framework in the broader context of the objective of general-purpose financial reporting, which is to provide decision-useful information to investors, and the feedback received from stakeholders, including the strong investor feedback described in paragraph BC23. In light of this consideration and weighing the expected benefits relative to the expected costs, the Board ultimately decided to pursue targeted improvements to Subtopic 350-40, rather than more extensive changes to the recognition of software costs.

BC25. For those reasons, the amendments in this proposed Update focus on the key challenge that entities face in applying Subtopic 350-40—applying that guidance to software that is developed using an incremental and iterative method. The Board acknowledges that there may be other challenges that the proposed amendments do not address. Those challenges include determining (a) what area of GAAP applies to costs to develop software (see paragraphs BC8 and BC9), (b) the unit of account in applying Subtopic 350-40, and (c) whether software costs are for enhancements that add functionality or are maintenance costs in Subtopic 350-40.

Removal of Project Stages

BC26. The amendments in this proposed Update would remove all references to project stages throughout Subtopic 350-40. As a result, all entities would determine when to begin capitalization by evaluating whether (a) management has authorized and committed to funding the software project and (b) it is probable that the project will be completed and the software will be used to perform the function(s) intended.

BC27. The Board considered whether to provide different recognition guidance for different software development methods—that is, whether to retain the project stages guidance for software developed using a linear method (for example, waterfall) and add requirements for entities that develop software using a nonlinear method (for example, agile). Stakeholders indicated that (a) it is uncommon to develop software using an entirely linear development method and (b) requiring entities to distinguish between linear and nonlinear software development methods could add costs and unnecessary complexity. Generally, stakeholders indicated that operability would be enhanced and consistency would be increased by removing the project stages and requiring the same recognition threshold for all internal-use software, regardless of the development method. Therefore, the Board decided to remove all references to project stages and not to require entities to distinguish between linear and nonlinear development methods.

Definition of Probable

BC28. The term *probable* in Subtopic 350-40 is not linked to a Master Glossary term. The amendments in this proposed Update would link the term *probable* in Subtopic 350-40 to the Master Glossary definition. *Probable* is defined as "the future event or events are likely to occur." This definition originated from FASB Statement No. 5, *Accounting for Contingencies*, and is used in numerous Topics.

BC29. Stakeholders have said that the Master Glossary definition of *probable* is well understood and is widely used in GAAP. To increase consistency in application and provide clarity, the Board decided to link the term *probable* in Subtopic 350-40 to the Master Glossary definition.

Significant Development Uncertainty

BC30. The amendments in this proposed Update would clarify that if there is significant development uncertainty associated with the development activities of the software (referred to as "significant development uncertainty"), the probable-to-complete recognition threshold would not be met. The Board decided that an entity may be able to determine that a software project meets the probable-to-complete recognition threshold without having to evaluate significant development uncertainty. For example, in the implementation and customization of an enterprise resource planning system using a developed solution, an entity may be able to conclude that the probable-to-complete recognition threshold has been met without having to evaluate significant development uncertainty.

BC31. The amendments in this proposed Update include two factors that may indicate significant development uncertainty and that the probable-to-complete recognition threshold is not considered to be met:

a. **Novel or unproven software.** The software being developed has novel, unique, unproven functions and features or technological innovations.
b. **Significant performance requirements**. The significant performance requirements of the computer software have not been identified or the significant performance requirements continue to be substantially revised.

Novel or unproven software

BC32. The first proposed factor would include consideration of whether the software being developed has novel, unique, unproven functions and features or technological innovations. This language is similar to current guidance for the development of external-use software. Specifically, paragraph 985-20-25-2 requires an entity to evaluate whether a "detail program design has been reviewed for high-risk development issues" and uses "novel, unique, unproven functions and features or technological innovations" as examples of high-risk development issues. The Board considered whether this factor should be described as *high-risk development issues*, consistent with the language used in Subtopic 985-20. However, stakeholders suggested that if *high-risk development issues* means that the software being developed has novel, unique, unproven functions and features or technological innovations, that should be stated directly, rather than introducing a new term to Subtopic 350-40. Therefore, the Board decided to avoid using the term *high-risk development issues* in the amendments in this proposed Update.

BC33. The Board also considered whether entities should specifically be required to account for and disclose novel or unproven software expenses as R&D (under Subtopic 730-10). However, many stakeholders said that it would be more logical to require entities to consider whether software is novel or unproven in determining when to capitalize software costs (that is, as part of the recognition guidance) because that is relevant in evaluating whether a project is probable of being completed. For example, some stakeholders, particularly SaaS entities, observed that their evaluation of whether software being developed is novel and the identification of significant performance requirements are often performed concurrently. Additionally, some stakeholders expressed concern that some novel or unproven software expenses could be related to operational or administrative software; requiring entities to account for all internal-use software costs that are novel or unproven as R&D would be a change in practice and is inconsistent with stakeholders' views about the nature of those costs. Moreover, some stakeholders that are currently expensing costs to develop revenue-producing software under Subtopic 350-40 said that they typically disclose those expenses in R&D because they are directly related to future revenues. Therefore, the Board decided to include consideration of whether the software is novel or unproven as part of the recognition guidance. Entities would continue to apply the scope guidance in Subtopics 350-40 and 730-10 to determine relevant disclosures for software costs that are not capitalized. For example, Subtopic 730-10 applies to software to be used in R&D and activities aimed at developing or significantly improving a product or service or a process or technique whether the product or process is intended for sale or use.

Significant performance requirements

BC34. The second proposed factor would include consideration of whether the software's significant performance requirements have not been identified or continue to be substantially revised. The amendments in this proposed Update would define performance requirements as what an entity needs the software to do (for example, functions or features). That definition is consistent with how performance requirements are described in the Master Glossary definition of the term *preliminary project stage*.

BC35. The Board included this factor to improve the operability of the amendments in this proposed Update by acknowledging that an entity may develop software using a nonlinear method and may revise the significant performance requirements throughout the project. However, 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*.

BC36. Stakeholders broadly supported this factor in considering whether there is significant development uncertainty. Those stakeholders acknowledged that this consideration would be similar to current requirements, especially for entities that develop software using a nonlinear method.

Unit of Account for Software Components and Tangible Assets

BC37. The amendments in this proposed Update would require an entity to use a reasonable and consistent method to determine the unit of account for an asset that incorporates both software and tangible components and whether the software component should be (a) accounted for separately under Subtopic 350-40 or (b) combined with the tangible component in accordance with other GAAP, such as Subtopic 360-10. The Board does not expect that the proposed amendments would change how an entity determines whether software that is developed would be accounted for as software or as part of another asset.

BC38. Because software is often embedded in hardware, some Board members questioned whether an entity should account for the internal-use software under Subtopic 350-40 or as part of the tangible asset (under other GAAP). The Board understands that, in practice, when software is critical to or enhances the functionality of related PP&E, entities often account for those software costs as one unit of account with the related PP&E. The Board expects this practice to continue. However, some Board members expressed concerns that practice could, in the future, interpret the lack of clear guidance to indicate that an entity should separate the software component for accounting and disclosure purposes. Therefore, to help entities apply the amendments in this proposed Update and the current disclosure requirements, the Board decided to clarify that entities should apply a reasonable and consistent method in making that determination.

Alternatives Considered but Dismissed

BC39. The Board considered but dismissed whether targeted improvements should be made to the external-use software guidance. The Board also considered but dismissed alternative recognition requirements for all software costs—including the single model, the dual model, and the expense all model.

Modernize the External-Use Software Guidance

BC40. The Board considered whether it would be helpful to make targeted improvements to modernize the external-use software guidance (in Subtopic 985-20), specifically to address how to evaluate technological feasibility.

BC41. Technological feasibility is established when an entity has (a) completed all the planning, designing, coding, and testing activities that establish that the product will meet its design specifications and (b) evidenced that technological feasibility has been established through the development of either a detail program design or a working model. Additionally, the guidance requires that if an entity's process excludes the development of a detail program design, a working model of that software must have been completed before the entity can begin capitalizing software costs.

BC42. Stakeholders that apply Subtopic 985-20 indicated that entities generally do not complete a detail program design in a nonlinear development method. Therefore, entities typically rely on the completion of a working model to establish technological feasibility when applying the guidance.

BC43. The Board considered two targeted improvements to Subtopic 985-20. First, the Board considered adding an acknowledgement that an entity often will not create a detail program design when developing software in a nonlinear development method and, therefore, should rely on completion of a working model to determine when technological feasibility has been established. Second, the Board considered adding an acknowledgement that completion of a working model may occur late in the development cycle in a nonlinear development method and, therefore, may limit which costs are eligible for capitalization.

BC44. Ultimately, the Board decided that targeted improvements to Subtopic 985-20 were unnecessary because the current guidance (paragraph 985-20-25-2(b)) explicitly requires an entity to use a working model when it does not create a detail program design. Furthermore, stakeholders have not expressed a significant need to change the guidance in Subtopic 985-20.

The Single Model

BC45. The Board considered requiring an entity to capitalize all direct software costs from the point at which it is probable that the software project will be completed and the software will be used to perform the function intended (referred to as the "single model"). This model would have replaced the recognition requirements for all software costs in Subtopics 985-20 and 350-40.

BC46. Stakeholders that supported the single model stated that it would eliminate the challenge of determining whether the software costs should be accounted for under the internal- or external-use software guidance. Additionally, stakeholders noted that because they view the development of SaaS arrangements and licensed software as having similar—if not identical—economics, the accounting requirements should be the same. The single model would have established the same requirements for all software costs, regardless of how an entity plans to use the software or deliver the software to end users.

BC47. When discussing the single model, stakeholders broadly expected that the single model would increase the amount of software costs that would be capitalized. Investors generally expressed concern about this potential outcome. In particular, investors were concerned that entities would capitalize more costs to develop software that they sell to end users, which are generally expensed under current GAAP. These investors said that they strive to compare earnings across entities and that different levels of capitalization make that comparison more challenging. Additionally, investors were concerned about the potential increase in the level of management judgment that would be applied in evaluating when to capitalize software costs under the single model. Furthermore, some investors said that capitalizing and amortizing expenditures incurred in the development of revenue-producing software would not faithfully represent the economic activity of developing software for sale to customers and would make key performance metrics such as earnings before interest, taxes, depreciation, and amortization (EBITDA) less decision useful.

BC48. Preparers, particularly those that develop external-use software, that were unsupportive of the single model raised concerns about (a) extensive one-time implementation costs to apply the single model because new or updated systems and/or processes would be required to track software costs and (b) a significant increase in ongoing costs to track the capitalized software costs. Additionally, some preparers were concerned that entities would have a high risk of recognizing software asset impairments before and/or after a software project is substantially complete because, in their view, costs would be capitalized too early under the single model.

BC49. Given the input from investors on their preference for expensing rather than capitalizing certain software costs and concerns raised by preparers about the increased costs to track capitalized software costs, the Board ultimately decided not to pursue the single model. Additionally, some Board members and investors were concerned that the single model would not have portrayed the differences in economic activity between software that is sold to end users and software that is used to run an entity's business. Those Board members said that those differences should be reflected in the accounting for software costs to provide investors with decision-useful information.

The Dual Model

BC50. The Board acknowledges that current GAAP is a dual model and would continue to be a dual model under the amendments in this proposed Update. However, the Board considered various alternatives to improve the current distinction between external-use software costs and internal-use software costs, which stakeholders have noted can be challenging to understand. Specifically, the Board considered requiring entities to recognize costs to develop external-use software (in Subtopic 985-20) as incurred expenses and to capitalize costs to develop internal-use software (in Subtopic 350-40) (referred to as the "dual model"). The main objective of that dual model would have been to align the accounting for the development of software to be sold via a CCA and software to be licensed on premise, which has been identified as a challenge when applying the current guidance. Some of the ways that the Board considered distinguishing between different types of software development were based on whether the software would (a) be commercialized or noncommercialized, (b) be external or internal facing, (c) be monetized or nonmonetized, or (d) meet the definition of R&D.

BC51. Stakeholders' support for the dual model was generally contingent upon whether they agreed with the financial reporting outcome in a specific situation, and there was no clear consensus from stakeholders that preferred the dual model on how to improve the distinction between different types of software development. In particular, stakeholders were concerned that any requirement that would include the development of software to be sold via a CCA in the expense as incurred model also would include the development of software that an entity uses to perform the services it sells (for example, a banking app). Stakeholders generally did not support requiring software development costs for software that an entity uses to perform the services it sells to be expensed as incurred. Therefore, a majority of the Board expressed concern that there may not be a feasible way to improve the distinction between external- and internal-use software costs.

BC52. Additionally, stakeholders and several Board members were concerned that the dual model would introduce additional unnecessary complexity by requiring entities to evaluate which model they should apply. Furthermore, given the evolving nature of software development (and related methods of use and delivery), several Board members were not convinced that an operable distinction between commercialized software and noncommercialized software could be identified. Feedback from stakeholders indicated that significant implementation guidance and examples would be needed to illustrate which recognition model applies. Board members were concerned that as software development continues to evolve, the distinction between different types of software development and any implementation guidance and illustrative examples would have a risk of becoming outdated.

BC53. The Board ultimately decided not to pursue the dual model for the reasons described above.

The Expense All Model

BC54. The Board considered requiring entities to expense all costs to develop software as incurred (referred to as the "expense all model").

BC55. Stakeholders that initially supported the expense all model said that it would be simple and operable and would result in consistent financial reporting outcomes across entities. Additionally, those stakeholders said that information for investors about an entity's investment in software could be provided through supplemental disclosures.

BC56. However, when the expense all model was fully introduced with its limitations and outcomes, stakeholders broadly agreed that the model would not improve GAAP. Those stakeholders cited the following reasons:

a. At some point in the software development process, the software costs represent an asset that should be recognized as such.
b. 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.
c. 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.
d. 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.
e. 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.

BC57. The Board ultimately decided not to pursue the expense all model for the reasons described above.

Presentation and Disclosure

BC58. The amendments in this proposed Update would require cash paid for capitalized internal-use software costs, other than implementation costs of a hosting arrangement that is a service contract, to be classified in the statement of cash flows as cash outflows from investing activities. These cash outflows would be required to be presented separately from other investing cash outflows. In arriving at this conclusion, the Board considered current presentation and disclosure requirements, several alternatives to enhance transparency about an entity's software costs, and stakeholder feedback on the expected benefits and costs of providing such information.

BC59. Other than limited presentation and disclosure requirements for implementation costs of a hosting arrangement that is a service contract, Subtopic 350-40 does not require specific presentation or disclosures for internal-use software costs. However, Subtopic 350-40 references disclosure requirements in other GAAP that should be considered—PP&E (Subtopic 360-10), R&D (Subtopic 730-10), notes to financial statements (Topic 235, Notes to Financial Statements), and risks and uncertainties (Topic 275, Risks and Uncertainties).

BC60. As part of feedback on this project, some investors indicated that the total amount of software costs capitalized in the period would provide decision-useful information. In response to this feedback, preparers indicated that providing additional detailed information on capitalized software costs generally would be operable because the information should be readily available.

Disclosure of Capitalized Software Costs

BC61. The Board considered whether the current disclosure requirements in Subtopics 350-40 and 985-20 should be expanded, including the following incremental disclosure requirements for both capitalized internal- and external-use software costs:

a. **The total amount of software costs capitalized during the period**. As noted above, some investors have indicated that providing the total amount of software costs capitalized during the period would provide decision-useful information. Specifically, some investors said that they would use that information to recognize capitalized software costs in current-period earnings and/or EBITDA because they (1) consider software and technology spending to be a current-period cost of doing business and (2) are concerned about the level of management judgment that is needed to capitalize software development costs. Other investors noted that they do not need additional disclosures about capitalized internal-use software costs beyond PP&E disclosures. However, some Board members observed that this disclosure would not provide investors with all the information necessary to fully adjust EBITDA for capitalized software costs without also requiring disclosure of the associated amortization. Other Board members noted that while they understand this perspective, it seemingly would be relevant for PP&E and other long-term assets, in addition to software. Therefore, these Board members questioned why the total amount of capitalization should be required for only *software costs*, especially if the proposed amendments would result in less software capitalization.

b. **A rollforward of the beginning to ending balance of net capitalized software costs (including additions, amortization, impairments, and disposals)**. Some investors supported a rollforward of capitalized software costs because it is easy to understand and the additions, amortization, and impairment amounts would be helpful in their analyses. For example, some investors observed that the amounts included in a rollforward would provide context for the amount capitalized. Other investors noted that a rollforward would allow investors to compare amounts amortized with additional amounts of capitalized software costs to understand trends. Other investors noted that they do not need additional disclosures about capitalized internal-use software costs beyond PP&E disclosures. Some Board members believe that requiring a rollforward of capitalized software costs would be costly to prepare, especially for entities outside the software industry, and that such granular information about capitalized software costs would not be incrementally useful to investors for many entities. Those Board members also questioned the added utility of requiring this information for capitalized software costs, considering that similar disclosures are not required for PP&E costs, which generally represent a significantly larger amount than capitalized software costs for most entities. Instead, those Board members believe that such disclosure requirements should be considered in a broader context.

BC62. Overall, several Board members questioned the benefit of these incremental disclosures about capitalized software costs, especially if the amendments in this proposed Update would result in decreased capitalization of software costs. Therefore, the Board ultimately decided not to require incremental disclosures in the proposed amendments.

Presentation of Capitalized Internal-Use Software Costs

BC63. When evaluating potential disclosure requirements, the Board considered whether similar information about capitalized software costs could instead be required in the statement of cash flows. Board members observed that investors frequently provide feedback that the statement of cash flows is a key part of their analyses. For example, in the 2021 Agenda Consultation, investors suggested that the Board make improvements to the statement of cash flows, specifically with regards to greater disaggregation and transparency of an entity's cash flows. Several Board members noted that requiring specific presentation in the statement of cash flows could be responsive to this feedback. Therefore, the Board decided to require entities to separately present cash paid for capitalized internal-use software costs as investing cash outflows in the statement of cash flows. The Master Glossary defines *investing activities* as "acquiring and disposing of debt or equity instruments and property, plant, and equipment and other productive assets, that is, assets held for or used in the production of goods or services by the entity (other than materials that are part of the entity's inventory)." This presentation would align the statement of cash flows classification for capitalized software costs and capitalized PP&E with the definition of *investing activities*.

BC64. However, several Board members would have preferred to require disclosure of the total amounts of software costs capitalized and amortized in the period instead of requiring that the cash paid for capitalized internal-use software costs be presented separately as investing cash outflows in the statement of cash flows. Those Board members preferred this alternative because some investors indicated that the total amount of software costs capitalized in the period would provide decision-useful information and preparers indicated that providing additional detailed information on capitalized software costs generally would be operable because the information should be readily available. In addition, the cash outflows amount may be different from the total amount of capitalized software costs. For example, the cash outflows would not include noncash components, such as share-based payments or incurred software license costs that an entity has not yet paid. Additionally, the separate presentation requirements in the amendments in this proposed Update would not include cash outflows for implementation costs incurred in a CCA. This is because 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*, requires that cash outflows for implementation costs incurred in a CCA be classified in the same manner as the cash flows for the associated hosting arrangement fees, which are typically included in operating cash flows. The

Board at that time concluded that the cash flow presentation should be the same because the implementation cost asset is recognized only as a result of enhancing the associated hosting service. However, entities are required to disclose information about noncash investing and financing activities in accordance with paragraph 230-10-50-3. Therefore, if the software component of that noncash investing activity is material, investors should receive that information in that supplemental disclosure.

Disclosure of Expensed Software Costs

BC65. The Board also considered whether to require incremental disclosures for internal- and external-use software costs expensed during the period, including the following:

a. **Disclosure of internal-use software costs expensed before the probable-to-complete recognition threshold is met as R&D**. The Board decided not to require this disclosure and classification because operational and administrative software costs would be included in R&D and Board members did not view those costs as R&D.
b. **Disclosure of total internal- and external-use software costs expensed during the period**. Preparers stated that incremental disclosures of expensed software costs would be costly to provide (both initially and on an ongoing basis) because entities would need to establish new systems and processes, including detailed time tracking, to obtain that information. The Board decided not to require this disclosure because it did not expect that the benefits would justify the costs. Additionally, the Board noted that a public entity would be required to disclose incremental information about its expenses as described in the Board's Disaggregation—Income Statement Expenses (DISE) project; the Board plans to issue a final Accounting Standards Update resulting from that project by the end of 2024.

Intangible Asset Disclosures (Subtopic 350-30)

BC66. Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill, addresses the financial accounting and reporting for (a) intangible assets (other than goodwill) acquired individually or with a group of other assets and (b) the cost of developing, maintaining, or restoring internally generated intangible assets. Paragraph 350-30-15-4 specifically excludes *capitalized software costs* from the scope of Subtopic 350-30, except for the disclosure requirements in paragraphs 350-30-50-1 through 50-3. The guidance in paragraph 350-30-15-4 originated from the FASB Staff Q&A*, Computer Software: Guidance on Applying Statement 86*, which addressed stakeholder questions on the accounting for external-use software. However, paragraph 350-30-15-4 does not specify whether the term *capitalized software costs* refers to internal- or external-use software costs or both. Additionally, while the external-use software guidance references the intangible asset disclosures in Subtopic 350-30, the internal-use software guidance does not.

BC67. The Board considered whether to require the disclosures in paragraphs 350-30-50-1 through 50-3 for capitalized internal-use software costs. Some Board members said that the information required by those paragraphs would be relevant for all capitalized software costs, regardless of whether they are for internal- or external-use software. Other Board members viewed those requirements as duplicative of many of the disclosures required for PP&E (in Subtopic 360-10), which entities are required to consider for capitalized internal-use software.

BC68. The Board ultimately decided not to require the disclosures in paragraphs 350-30-50-1 through 50-3 for capitalized internal-use software costs because adding that requirement would not provide incrementally decision-useful information. Therefore, the amendments in this proposed Update would clarify that the disclosures in paragraphs 350-30-50-1 through 50-3 apply only to external-use software costs capitalized in accordance with Subtopic 985-20.

Private Company Considerations

BC69. The *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies,* provides guidelines that assist the Board and the Private Company Council (PCC) in determining whether and in what circumstances to provide alternative recognition, measurement, disclosure, display, effective date, and transition guidance for private companies reporting under GAAP. The assessment of significant differential factors between private companies and public companies is an important source of input when considering whether to provide accounting alternatives.

BC70. The amendments in this proposed Update would make targeted improvements to the internal-use software guidance for all entities, including private companies. According to research and outreach, including feedback from PCC members, private companies have many of the same challenges in applying the internal-use software guidance as public business entities. Therefore, the Board has not proposed alternative accounting requirements for private companies. However, the Board plans to solicit additional feedback on whether there are any specific private company considerations that the Board should be aware of in developing a final Update.

Website Development Costs

BC71. Subtopic 350-50 addresses whether an entity is required to expense or capitalize website development costs. That guidance includes development stages—similar to Subtopic 350-40—and heavily leverages Sections of Subtopic 350-40 that would be changed by the amendments in this proposed Update. Certain areas of Subtopic 350-50 directly reference guidance in Subtopic 350-40; other areas of Subtopic 350-50 provide incremental guidance on a standalone basis.

BC72. When the website development costs guidance was issued, websites were typically used as a means to promote products, replace manual processes or services, and sell products. Since then, technology has rapidly evolved, and, currently, websites are most often used as an interface to access underlying software, the development of which is generally accounted for under Subtopic 350-40. For those reasons, some stakeholders have stated that the website development cost guidance is infrequently applied or that the costs to develop a website separately from the underlying software are often immaterial. Therefore, the Board decided to supersede Subtopic 350-50 and to incorporate relevant website-specific development costs guidance into Subtopic 350-40.

BC73. The Board also considered an alternative that would have replaced the references 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*). However, the Board ultimately decided not to pursue this alternative because the guidance in Subtopic 350-50 is outdated and infrequently used. Some Board members noted that they view the development of websites and software similarly and, therefore, entities should account for the costs to develop websites and software under the same guidance.

Effective Date and Transition

BC74. The Board decided that the amendments in this proposed Update could be applied using either a prospective approach or a retrospective approach. The prospective approach would apply to all software costs incurred after the effective date, whether for software projects that are in process or that begin after the effective date. Stakeholders indicated that a prospective approach would be operable and would align with the primary transition method in the most recent Accounting Standards Update on software costs, Update 2018-15, which most entities found operable to apply.

BC75. The Board decided not to require a retrospective approach because an entity may not have enough detail about historical software costs to adjust prior periods. However, some stakeholders supported an option to retrospectively apply the guidance to allow for financial statement comparability. The Board decided to allow entities to elect a retrospective approach because it would allow them to determine whether the expected benefits of providing comparable information about software costs to investors would justify the expected costs of providing that information.

BC76. The Board decided to require entities that apply the amendments in this proposed Update to disclose the nature of and reason for the change in accounting principle in accordance with paragraph 250-10-50-1(a). The Board also decided that if an entity elects the retrospective transition approach, it should provide transition disclosures (consistent with paragraphs 250-10-50-1 through 50-2, except for the requirements in paragraph 250-10-50-1(b)(2) and (c)(1) for the current period and in paragraph (b)(4)). The Board decided not to require the disclosures in paragraphs 250-10-50-1(b)(2) and (c)(1) and 250-10-50-3 related to the current periods because those disclosures can be viewed as overly burdensome, since they would require that an entity account for software costs under both the current guidance and the new guidance in the current period.

BC77. The Board will determine the effective date and whether early adoption of the amendments in this proposed Update should be permitted after it considers stakeholders’ feedback on the proposed amendments.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.