Accounting for and Disclosure of Software Costs

FASB | IASB Education Meeting

October 11, 2024

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Project Overview

June 2022
- Added project to the technical agenda
- Project objectives:
  - Modernize the accounting for software costs
  - Enhance the transparency about an entity's software costs

July 2022-September 2023
- Considered several recognition models, including the single model, the dual model, and the expense all model
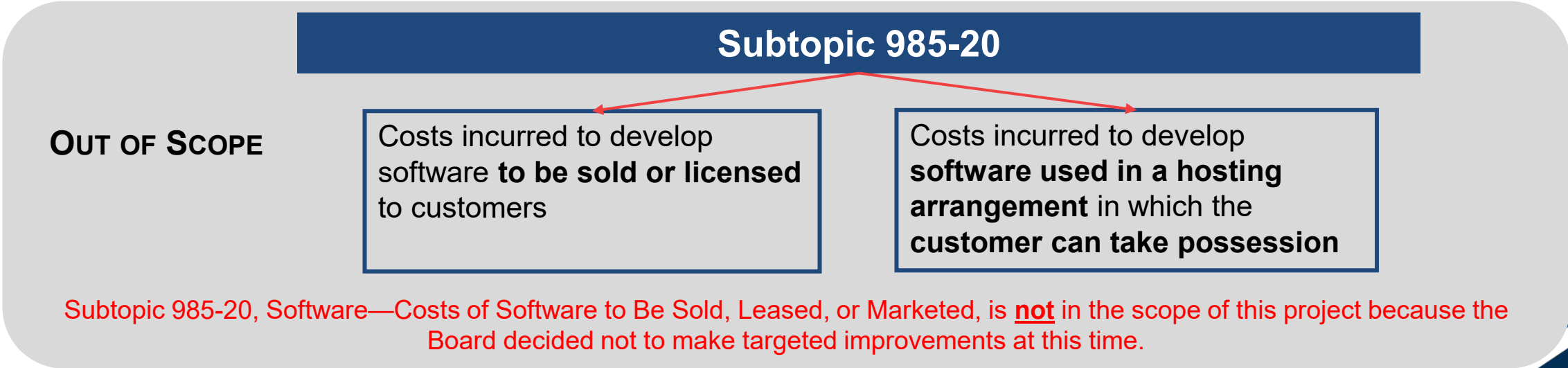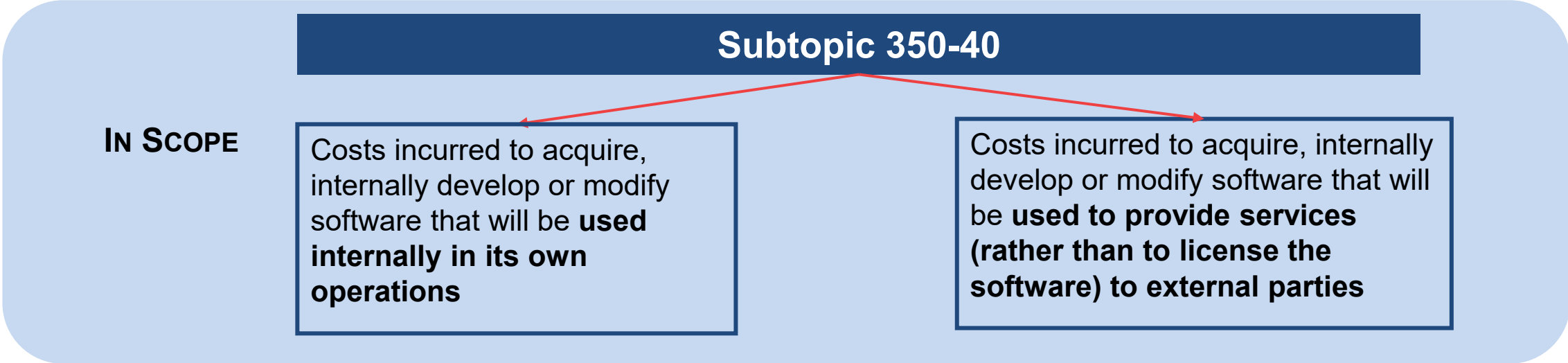
March 2024
- Decided to pursue targeted improvements to the internal-use software guidance in Subtopic 350-40, Intangibles—Goodwill and Other—Internal-Use Software

April-May 2024
- Performed outreach with practitioners and preparers to understand the operability, auditability, and potential changes to capitalization outcomes from the targeted improvements
- Performed outreach with investors on potential disclosures to enhance transparency

June 2024
- The Board completed initial deliberations
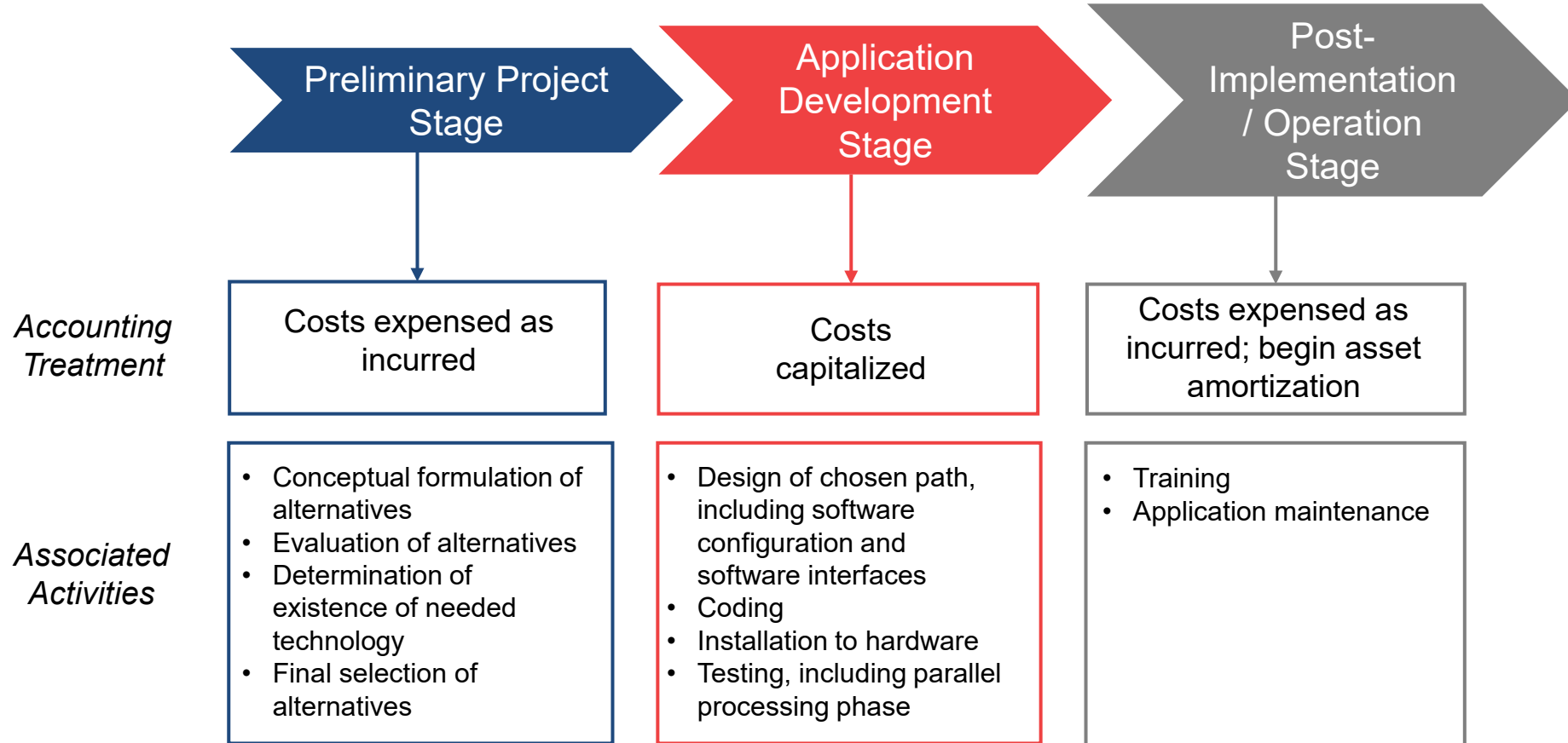- Began drafting a proposed Accounting Standards Update for vote by written ballot

Fall 2024
- Proposed Accounting Standards Update expected to be issued with 90-day comment period

Project Scope

Subtopic 350-40

IN SCOPE

Costs incurred to acquire, internally develop or modify software that will be **used internally in its own operations**

Costs incurred to acquire, internally develop or modify software that will be **used to provide services (rather than to license the software) to external parties**

Subtopic 985-20

OUT OF SCOPE

Costs incurred to develop software **to be sold or licensed** to customers

Costs incurred to develop **software used in a hosting arrangement** in which the **customer can take possession**

Subtopic 985-20, Software—Costs of Software to Be Sold, Leased, or Marketed, is **not** in the scope of this project because the Board decided not to make targeted improvements at this time.

Subtopic 350-40
Intangibles – Goodwill and Other – Internal-Use Software

	Preliminary Project Stage	Application Development Stage	Post-Implementation / Operation Stage
Accounting Treatment	Costs expensed as incurred	Costs capitalized	Costs expensed as incurred; begin asset amortization
Associated Activities	• Conceptual formulation of alternatives • Evaluation of alternatives • Determination of existence of needed technology • Final selection of alternatives	• Design of chosen path, including software configuration and software interfaces • Coding • Installation to hardware • Testing, including parallel processing phase	• Training • Application maintenance

Targeted Improvements to Subtopic 350-40
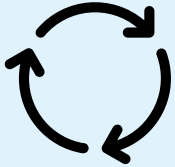
Remove all references to a prescriptive and sequential software development method
- The same guidance would apply, regardless of software development method

Add consideration of significant development uncertainties if the project <u>does not clearly meet</u> the starting capitalization threshold
- Whether the software being developed is novel or unique, or has unproven functions, features, or technological innovations
- Whether the entity has determined the significant performance requirements (what it needs the software to do)

Incorporate website-development guidance
- Incorporate website-specific guidance from Subtopic 350-50, Intangibles—Goodwill and Other—Website Development Costs, into the internal-use software guidance

Specify starting capitalization threshold
- Entities would be required to begin capitalizing when:
  - Management has authorized and committed to funding the software project
  - It is probable that the project will be completed and the software will be used to perform the function intended

Require separate statement of cash flows presentation
- Cash paid for capitalized internal-use software costs would be included as a separate investing cash outflow

Retain existing disclosures
- Property, plant, and equipment, notes to financial statements, risks and uncertainties, and research and development disclosures would continue to apply
- No additional disclosures would be required

Transition

The proposed amendments may be applied prospectively or retrospectively.

Prospective Application

- Apply to software costs relating to new and in-process projects that are incurred on or after the effective date

Retrospective Application

- Determine the cumulative effect of applying the proposed amendments to all software costs as though they had been applied in previous periods; present adjusted prior period financial statements
- Make an offsetting adjustment to the opening balance of retained earnings (or other appropriate component of equity or net assets) as of the beginning of the earliest period presented for the cumulative effect of the change

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