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January 27, 2025

Mr. Jackson Day
Technical Director
Financial Accounting Standards Board (FASB)
801 Main Avenue
Norwalk, CT 06851

Via Email to director@fasb.org

Re: File Reference No. 2024-ED400

Dear Mr. Day:

Grant Thornton LLP appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update (ASU), *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*.

We support the Board's proposed amendments to modernize the accounting guidance for internal-use software costs and to improve the transparency of an entity's cash flows related to internal-use software costs. We commend the Board for addressing stakeholders' concerns about the operability of the revenue recognition guidance as well as the diversity in practice resulting from the shift to iterative development methods. We have provided our detailed response to the Board's questions below.

Our responses to the questions in the proposed ASU

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.

We agree with the proposed amendments that make targeted improvements to Subtopic 350-40. However, we also believe that certain aspects of the proposed guidance may benefit from further clarification, as described below.

b. Are the proposed amendments clear and operable? Please explain your reasoning.

We believe the proposed amendments are clear and operable but have identified several areas that may benefit from additional amendments or clarification, in part, due to the increasing prevalence of artificial intelligence (AI) model development.

Scope

The proposed paragraph ASC 350-40-15-1A reads as follows:

> 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).

As currently drafted, the word "incorporates" may be interpreted to encompass either acquired tangible assets with integral software or acquired tangible assets that include optional (nonintegral) software, or both. We are uncertain whether the Board intends to permit the inclusion of optional software in a single unit of account with acquired tangible assets.

Additionally, we believe the phrase "apply a reasonable and consistent method" may imply an available accounting policy election. We are uncertain whether the Board intends to permit such a policy election as long as it is consistently applied, or whether the determination of the unit of account applied to these acquisitions may continue to warrant significant judgment.

Training costs

As amended, ASC 350-40-25-4 reads, "Internal and external training costs are not internal-use software development costs and shall be expensed as incurred."

While we interpret this guidance, both in the existing standard and under the proposed amendments, to refer to employee/personnel training costs, the phrase "training costs" in software development for the AI industry generally refers to the costs of training an AI model. Training is a significant and critical part of AI model development, unlike for traditional software models. Due to the recent accelerated growth of AI model development in both AI-focused and non-AI-focused entities, clarifying that the scope of the guidance in paragraph 25-4 refers only to "employee/personnel" training costs may be relevant to entities that develop AI models across many industries.

Data conversion costs

As amended, ASC 350-40-25-5 reads as follows:

> Data conversion costs, except as noted in paragraph 350-40-30-1(d), 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.

While we interpret this guidance, both in the existing standard and under the proposed amendments, to refer to the costs of converting data (such as general ledger data in an ERP system) between traditional software models, some of the terminology in this paragraph may be interpreted to refer to the data acquisition, conversion, collection, and cleansing processes inherent in AI model development. Modernizing the terminology used in paragraph 25-5 may be beneficial due to the increasing prevalence of AI model development across many industries.

Application of ASC 350-40-25-12A

Proposed paragraph 12A states, in part, the following:

> 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.

While the referenced example is helpful, we ask the Board to consider whether further clarification is warranted for determining whether application of the significant development uncertainty guidance in paragraph 12A is required. For example, it is not clear how the term "developed solution" is defined in this paragraph. Additionally, it is unclear whether any level of remaining customization decisions or other uncertainties would prevent an entity from determining that implementation of a developed solution may bypass the significant development uncertainty guidance in paragraph 12A.

Illustrative Example 2

Certain facts in Example 2 may warrant clarification. The last sentence of paragraph ASC 350-40-55-10 reads, "Additionally, on December 1, 20X1, management determines that X-Crowd no longer has novel, unique, unproven functions and features or technological innovations." However, the fact pattern presented earlier in paragraph 55-10 related to the evaluation of the software project as of February 1, 20X1 does not mention that there were any "novel, unique, unproven functions and features or technological innovations."

To remedy this, we suggest that the Board either (1) present the lack of such functions and features earlier in the fact pattern as of February 1, 20X1 (for example, as the third sentence of paragraph 55-10) and strike the last sentence of paragraph 55-10; or (2) append the fact pattern as of February 1, 20X1 to state that there were "novel, unique, unproven functions and features or technological innovations," leaving the last sentence of paragraph 55-10 as currently drafted.

Any such edits to ASC 350-40-55-10 would also need to be applied to the analysis presented in paragraph 55-11 accordingly.

c. Would the proposed amendments clarify and improve the application of Subtopic 350-40? Please explain your reasoning.

We believe the proposed amendments would help clarify and improve the application of Subtopic 350-40. In particular, the removal of the stages of software development should improve the application of Subtopic 350-40 for entities that deploy common nonlinear software development processes. Under the current guidance, some entities struggle to categorize their software development costs into the prescribed development stages.

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.

We anticipate at least some decrease in capitalized internal-use software costs, primarily associated with the evaluation of the probable-to-complete recognition threshold. We believe this outcome is appropriate for two key reasons. First, the inclusion of the recognition threshold is conceptually sound and consistent with the conceptual framework, as detailed in FASB Concept Statement No. 8, particularly paragraph E35, which acknowledges that many activities undertaken with the expectation of obtaining an economic benefit in the future do not generate a recorded asset because their economic benefit may be especially uncertain. Second, including the proposed ASC 350-40-25-12A(a) factor as part of the evaluation of the probable-to-complete recognition threshold, while not equating to the technological feasibility concept in ASC 985-20, would make internal-use software capitalization at least somewhat more consistent with the capitalization of software to be sold. Such consistency was, in fact, one of the Board's stated objectives related to this project (as noted in paragraph BC18). We concur with this objective.

e. What costs would be incurred to apply the proposed amendments? If significant, please describe the nature and magnitude of costs, differentiating between one-time costs and recurring costs, as well as whether you expect the proposed amendments to result in any reduction of costs.

We respectfully defer to financial statement preparers to answer this question.

f. Alternatively, would you have preferred that the Board further pursue the single model as described in paragraphs BC45–BC49? Please explain your reasoning.

We believe the single model has technical merits. However, we are unable to conclude as to whether the benefits of implementing such a model would outweigh the costs.

Question 2: The proposed amendments would remove all references to software development project stages throughout Subtopic 350-40. As a result, the proposed amendments would require all entities to determine when to begin capitalizing software costs by evaluating whether (a) management has authorized and committed to funding the software project and (b) the probable-to-complete recognition threshold has been met. Do you foresee any operability or auditability concerns with removing the references to project stages? Please explain your reasoning.

We believe the proposed amendments to remove references to software development project stages is an improvement to the internal-use software guidance. We do not foresee any significant operability or auditability concerns related to the removal of references to project stages, since software development processes consistent with these defined stages are currently not common practice in our experience.

We further recommend removing paragraph ASC 350-40-55-4 in its entirety, which, under the proposed amendments, retains references to the timing of software development activities. Such guidance does not appear necessary given the other proposed amendments to ASC 350-40.

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.**

We respectfully defer to financial statement preparers with respect to operability.

We believe that evaluating and auditing the existence of a significant development uncertainty could present an incremental auditing challenge, particularly with respect to the determination of whether any significant performance requirements must still be identified or substantially revised. The timing of the material finalization of significant performance requirements, as well as the determination of the significance of remaining performance requirements or expected edits, may require considerable judgment, which can lead to auditability challenges.

Additionally, evaluating and auditing whether there are novel, unique, unproven functions and features or technological innovations could, in some cases, require significant judgment or complex engineering determinations.

On the other hand, other areas of current U.S. GAAP also require the application of substantial judgment, the determination of "significance," and the auditing of determinations made by technical experts. Therefore, we believe that audit practitioners would be able to overcome the auditability concerns related to significant development uncertainties. Additionally, we believe illustrative Example 2 within the proposed amendments provides helpful details that would assist practitioners with judgments related to significant performance requirements.

b. **The proposed amendments would define performance requirements as what an entity needs the software to do (for example, functions or features). Is the definition of performance requirements clear and operable? Please explain your reasoning.**

We believe the definition of *performance requirements* within the proposed amendments may benefit from further clarification and specificity. Proposed Example 2 references "how" the application would accomplish its defined objective as a performance requirement, which we interpret to mean the method by which the software would function. If it is the Board's intent to include the determination of "how" the application would accomplish its defined objective, it may be helpful to include language to this effect in the glossary definition of *performance requirements*. Additionally, it would be helpful for proposed Example 2 to provide further detail related to the remaining undefined functionality as of February 1, 20X1.

Question 4: The proposed amendments would require an entity to classify cash paid for capitalized software costs accounted for under Subtopic 350-40 as investing cash outflows in the statement of cash flows and to present those cash outflows separately from other investing cash outflows, such as those related to property, plant, and equipment (PP&E). Similar to cash paid for internally developed PP&E, cash paid for software costs could include certain expenditures related to employee compensation.

a. **For preparers and practitioners, are the proposed presentation requirements operable in terms of systems, internal controls, or other similar considerations? What auditing challenges, if any, do you foresee related to the proposed presentation requirements? Please explain your reasoning.**

We do not foresee any significant auditing challenges related to the cash flow classification proposal.

b. **For investors, would the proposed presentation requirements provide decision-useful information? How would this information be used in your investment and capital allocation decisions? Please explain your reasoning.**

We respectfully defer to investors to answer this question.

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.

ASC 350-40-45-2 requires entities to classify the capitalized implementation costs of a hosting arrangement that is a service contract in the same line item in the statement of financial position where a prepayment of the fees for the associated hosting arrangement would be presented. Unless this balance sheet classification requirement is also amended for capitalized implementation costs, we believe it would be inconsistent to present the cash flows associated with such costs in a separate section of the statement of cash flows.

We believe that it would be appropriate to change the classification of cash flows from capitalized implementation costs of a hosting arrangement if the classification of the related amounts capitalized in the statement of financial position were also amended to be consistent with other capitalized internal-use software.

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)?

We respectfully defer to financial statement preparers to comment on the costs of the disclosure alternatives. Rollforwards of capitalized software costs (both internal and external) are frequently already produced by preparers to support financial reporting and/or audit requirements.

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?

We respectfully defer to investors to answer this question.

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?

We respectfully defer to investors to answer this question.

Question 6: The proposed amendments would supersede the guidance in Subtopic 350-50 and incorporate website-specific development costs guidance from that Subtopic into Subtopic 350-40.

a. **Would the proposed amendments be operable, and do you foresee any auditability challenges?**

We believe the proposed amendments are operable, and we do not foresee any auditability challenges.

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

We do not believe the proposed amendments would have a significant effect on practice since the guidance is largely unchanged and, in our experience, infrequently applied.

c. **The Board considered but dismissed an approach that would have retained Subtopic 350-50 and replaced any reference to stages in Subtopic 350-50 with the term activities (for example, replace costs incurred in the planning stage with costs incurred during planning activities). Would you prefer this approach, and would it be more operable and auditable? Please explain your reasoning.**

We agree with the Board's approach to incorporate relevant sections of Subtopic 350-50 into Subtopic 350-40, in part, due to the infrequency of the application of ASC 350-50.

Question 7: The proposed amendments could be applied either prospectively or retrospectively. For preparers and practitioners, are the proposed transition requirements operable, and do you foresee any auditability challenges? Please explain your reasoning. If the proposed transition requirements are not operable, please explain what transition method would be more appropriate and why.

We believe applying the proposed amendments, either on a prospective or retrospective basis, is operable. Additionally, we do not foresee any auditability challenges with respect to the transition requirements.

Question 8: In evaluating the effective date, how much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities be different from the effective date for public business entities? Should early adoption be permitted? Please explain your reasoning.

We respectfully defer to financial statement preparers to answer this question.

Question 9: The proposed amendments would apply to all entities, including private companies. Do you agree? Are there any private company considerations, in the context of applying the guidance in the Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies, that the Board should be aware of in developing a final Accounting Standards Update? Please explain your reasoning.

We believe the proposed amendments should apply to all entities, primarily because the use of nonlinear software development techniques, in our experience, does not appear to be less prevalent for private versus public entities.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Christine Janis (christine.janis@us.gt.com) or Sandy Heuer (sandy.heuer@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP