

EARLY IMPRESSIONS

FASBs' Proposed Accounting Standard Update (ASU) (Sub-topic 350-40)

Accounting for and Disclosure of Software Costs



FOREWORD

ASC 350-40 provides an explicit guidance on costs incurred for computer software developed or obtained for internal use. Subtopic 350-40 on Internal-Use Software, illustrates various stages of software development to define the accounting principles for such costs i.e., whether they are to be expensed or capitalized.

In recent times, there has been a significant increase in the number of companies making material investments in Internal Use software costs. One of the key challenges in accounting for software development costs arises from continuous technological change in practices around software development, which largely follows an agile development process wherein the development may not follow the distinct project stages contemplated in ASC 350-40. Consequently, significant judgment is required in this area. How a company accounts for such costs i.e., whether they are expensed or capitalized, can have a major impact on the operating results of the reporting company.

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On October 29, 2024, the FASB issued a proposed Accounting Standards Update (ASU) to update the guidance on accounting for internal-use software. On May 7, 2025, after discussions and deliberations on software cost accounting changes, FASB has issued directions to staff to finalize targeted improvements to improve the internal-use software accounting guidance in ASC 350-40. The proposed amendment is intended to introduce new capitalization considerations and eliminate existing software project stage accounting guidance.

This publication summarizes the requirements of Proposed ASU towards **Accounting for and Disclosure of Software Costs** which may be relevant for all entities that incur internal-use software costs, including website development costs. The Board decided that the amendments will be effective for all entities for annual reporting periods (including interim reporting periods within those annual reporting periods) beginning after December 15, 2027.

We sincerely hope you find the enclosed publication informative. We will be happy to participate in any discussions required to clarify our views enclosed in the attached publication. We look forward to hearing from you.

Thank you.

Yours faithfully

For Uniquis Consultech Inc.



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BACKGROUND

Under the existing guidance on accounting of cost incurred towards internal use software, FASB's ASC Subtopic 350-40, illustrates various stages of development i.e. the preliminary project stage, the application development stage, and the post-implementation stage. Whether cost incurred need to be expensed off or capitalized is dependent upon nature of the costs and the project stage to which it relates. Applying this guidance is challenging, particularly in an iterative development environment.

Following summarizes the existing accounting principles related to costs incurred in different stages of software development:

Preliminary project stage

Conceptual formulation and evaluation of alternatives, determination of existence of required technology and final selection of alternatives. Costs incurred during the preliminary project stage shall be expensed as incurred.

Application development stage

Design of chosen path, including technology configuration and interfaces, coding, installation to hardware, testing, including parallel processing phase. Costs incurred to develop internal-use computer software and to develop or obtain software that allows for access to or conversion of old data by new systems shall be capitalized. However, training costs and other data conversion costs shall be expensed.

Post-implementation/operation stage

Training costs and maintenance costs incurred during the post implementation stage shall be expensed as incurred.

ASC 350-40 further states that upgrades and enhancements are modifications to existing asset which result in additional functionality. For costs related to specified upgrades and enhancements to internal use software to be capitalized, it must be probable that those expenditures will result in additional functionality.

The proposed amendments **eliminate** references to the aforesaid prescriptive and **sequential stages of software development** in existing GAAP and require the same recognition guidance for all software within the scope of Subtopic 350-40. The improvement is intended to align the recognition requirements for internal-use software costs with those requirements for software that is licensed, sold, or otherwise externally marketed.

What's not changing...

- Existing accounting requirements for external-use software (i.e. software to be sold or licensed);
- Type of internal-use software costs can be capitalized (e.g. data conversion/migration, training and software maintenance costs will continue to be expensed as incurred); or
- Cessation of internal-use software cost capitalization (i.e. when the software is 'substantially complete and ready for its intended use')

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HIGHLIGHTS OF PROPOSED AMENDMENTS TO SUB-TOPIC 350-40

A. Recognition Principles

Software development Cost Capitalization threshold

As per the existing guidance, software development costs incurred for internal-use software are capitalized once the preliminary project stage is complete. With the key focus to remove all references to a sequential software development method (referred to as “project stages”) throughout Subtopic 350-40, the proposed ASU instead provides the following two criteria in ASC 350-40-25-12 that must be met for entities to commence **capitalizing software costs**:

- Management, with the relevant authority, implicitly or explicitly **authorizes and commits** to funding a computer software project. **(Criterion 1)**
- 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’). **(Criterion 2)**

With a shift in software development process from a sequential/linear process in orientation with several stages to agile software development basis (i.e., lightly planned and completed through a series of shorter time-frame development sprints), there is need to align the guidance as proposed by ASU which can be applied to all types software development.

- Proposed amendment to change the cost capitalization threshold will result in commencement of software development cost capitalization solely by assessing the remaining criteria in Section 350-40-25 irrespective of software development method used (i.e. agile, waterfall, a hybrid of those, or otherwise).
- Once Criterion 1 and Criterion 2 are fulfilled all software development costs would be capitalized. Before (1) and (2) are met, all software development costs would be expensed as incurred.
- Elimination of the existing staging guidance will result in consistency requiring the same recognition threshold for all internal-use software, regardless of the development method.
- Some of the judgments eliminated may be replaced with new judgments around the ‘probable-to-complete’ threshold.

KEY PROVISIONS

CRITERION 1

Management, with the relevant authority, implicitly or explicitly authorizes and commits to funding.

IMPLEMENTATION MATTERS

- For example:
 - 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.

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KEY PROVISIONS

CRITERION 2

Probable-to-complete recognition threshold

IMPLEMENTATION MATTERS

- As per proposed ASU, this criterion would not be met when there is “significant uncertainty associated with the development activities of the software (referred to as ‘significant development uncertainty’).”
- The proposed ASU provides the following factors that may be indicative of significant development uncertainty:
 - The software being developed has novel, unique, unproven functions and features or technological innovations, or
 - The significant performance requirements (such as functions or features) of the computer software have not been identified, or the significant performance requirements continue to be substantially revised.

It is also emphasized that uncertainty related to the development of novel or unproven software should be resolved through coding and testing.

- The probable-to-complete recognition threshold is not met until the significant development uncertainty has been resolved.
- Board clarified that for certain internal-use software projects e.g. to customize and implement established third-party software such as enterprise resource planning (ERP) implementations, evaluation of the two indicators related to significant development uncertainty may not be necessary.
- It is also clarified by Board in the basis for conclusions that the proposed amendments do not require an entity to identify and resolve all of the software’s performance requirements before it begins to capitalize software development costs but, rather, only those performance requirements that are ‘significant’ and/or are significant and continue to be substantially revised. In other words, entity should not defer eligible cost capitalization for either-
 - minor performance requirements that have not yet been determined, or
 - significant performance requirements subject only to further minor revision.

- The FASB expects that the amendments could result in less software development costs qualifying for capitalization for software developed for revenue-generating activities that will be delivered via cloud computing or software-as-a-service arrangements.
- This is because as per the proposed amendments entities would require to apply judgment in determining whether the software being developed has “novel, unique, unproven functions and features or technological innovations” or uncertainties related to significant performance requirements that make completion of the project improbable.
- This may be more common for software developed for revenue-generating activities than for software developed only for an entity’s internal use [e.g., an ERP system]).

B. Other Application Matters

a. Presentation and disclosure requirements

Disclosures will now be required under ASC 360-10 for all software costs capitalized under ASC 350-40, regardless of how they are presented in the balance sheet (e.g. as intangible assets or PP&E).

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b. Effective date and transition¹

- The amendments in proposed ASU are effective for annual reporting period beginning after December 15, 2027, and interim reporting periods in fiscal years beginning after December 15, 2027. Early adoption is permitted.
- The amendment will be applied using an alternative transition approach that requires:
 - Prospective transition to software costs incurred for new projects and in-process projects for which capitalization has not begun as of the adoption date.
 - Modified retrospective transition to software costs incurred for in-process projects for which capitalization has begun as of the adoption date. For these projects, an entity should derecognize any previously capitalized costs 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 adoption date, if the entity determines that, as of the adoption date, it is not probable that the project will be completed and the software will be used to perform the function intended in accordance with the new guidance.

Transition disclosures will be required under ASC 250 based on the transition method selected.

c. Applicability

The proposed amendments shall apply to all entities, including private companies.

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¹ The Board directed the staff to draft a final Accounting Standards Update which may be expected late Q3 2025.

SUMMARY OF THE ILLUSTRATIONS ADDED IN PROPOSED ASU AS A NEW GUIDANCE

The examples below illustrate the application of ASC 350-40 as amended by the proposed ASU-

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:

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- 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.

For more information on the FASB's decision, see the [press release](#) on the FASB's website.

A TEAM THAT YOU CAN TRUST TO DELIVER



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