KPMG

October 13, 2015

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548

RE: Proposed Federal Financial Accounting Technical Release, *Implementation Guidance for Internal Use Software*

Dear Ms. Payne:

We appreciate the opportunity to respond to the proposed Federal Financial Accounting Technical Release (TR), *Implementation Guidance for Internal Use Software* – the exposure draft (ED). We recognize the Accounting and Auditing Policy Committee's (AAPC) efforts to develop this technical release based on its mission to assist the federal government in improving financial reporting by timely identifying, discussing, and recommending solutions to accounting issues within the framework of existing authoritative literature. We generally agree with clarification and new concepts contained in paragraphs 11-25 (Applying Existing Standards to Current Development Models) and the new software development methods and associated guidance contained in paragraphs 26-34 (Guidance on Applying SFFAS 10 to Certain New IUS Developments). However, we believe that in a few instances the guidance contained in the ED conflicts with Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*, or where the guidance, as stated, is not clear. Therefore, we have the following comments and suggested revisions.

1. Paragraph 9 of the ED states that paragraphs 12, 13, 14, 17, and 18 of TR 5, *Implementation Guidance on Statement of Federal Financial Accounting Standards 10*, are rescinded. TR 5 contains six questions regarding the implementation of SFFAS 10. We believe that the concepts included in the responses for questions 1, 2, 4, and 6 (paragraphs 5-8, 12-14, and 17-18) from TR 5 are incorporated in the ED. Because TR 5 and the ED have similar titles and four of the six questions included in TR 5 are also addressed in the ED, we recommend that the ED supersede TR 5 in its entirety. We also recommend that the guidance included with questions 3 and 5 from TR 5 be evaluated for continuing relevance and, if appropriate, incorporated into the ED.

2. Paragraph 10 of the ED suggests that research and development and integrated software are within the scope of internal use software (IUS), as defined in SFFAS 10, but are excluded from this ED. However, these topics are already excluded from the scope of SFFAS 10. Software research and development is accounted for under SFFAS 8, *Supplementary Stewardship Reporting*, as noted in the Basis for Conclusions (paragraph 40) of SFFAS 10 and integrated software is accounted for under SFFAS 6, *Accounting for Property, Plant, and Equipment*, as noted in paragraph 22 of SFFAS 10. Therefore, to avoid confusion regarding the scope of the ED, as defined in paragraph 10, we recommend the following adjustment (deleted content struck-through):

> 10. This TR applies to all internal use software that meet the definition of IUS as described in SFFAS 10.~~, except for the following:~~
> ~~a. Software to be used in research and development where the software will not have an alternate future use, and~~
> ~~b. Integrated software (SFFAS10 paragraph 22) unless the software is developed separately and could be installed on a number of different general property, plant, and equipment (PP&E) assets at different times.[4]~~

3. Paragraph 12 of the ED describes the software development phases as defined in SFFAS 10. Paragraph 16 of SFFAS 10 states (emphasis added), "capitalized costs **should** include the full cost (direct and indirect costs) incurred during the software development phase." However, we believe the terminology used in paragraph 12 of the ED could allow the expensing of those costs that meet the criteria of software development. Therefore, to avoid an unintended change to the standards, we recommend the following adjustment to paragraph 12 (new content underscored; deleted content struck-through):

> 12. **Development Phases**: SFFAS 10 presents three phases of software development that follow a linear approach to an IUS project: the preliminary design phase, the software development phase, and the post-implementation/operational phase. ~~Generally,~~ It states that costs incurred during the development phase ~~are to~~ should be capitalized, while the ~~and~~ costs incurred in other phases ~~are to~~ should be expensed. However, software may not always be developed under this linear approach and capitalization decisions absent distinct phases are more difficult. Regardless of timing, the cost incurred for development phase activities, described in paragraphs 11 and 13 of SFFAS 10, should be capitalized regardless of timing. ~~or expensed based on their substance rather than their phase.~~

4. Paragraph 13 of the ED describes cost estimation techniques that may be developed to trace the costs to outputs in accordance with SFFAS 4, *Managerial Cost Accounting Standards and Concepts*. We believe that it would be useful to also reference TR 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment, and Allocation*, and state that the guidance contained in TR 15 can be applied to IUS.

5. The second sentence of paragraph 17 of the ED states (emphasis added), "When establishing the capitalization threshold for IUS, the federal entity **should** include both qualitative and quantitative considerations." The requirements in paragraph 24 (Capitalization Thresholds) of SFFAS 10 reference the importance of establishing capitalization thresholds that avoid understating asset values. Therefore, we believe that the intent of SFFAS 10 paragraph 24 was to consider quantitative matters when establishing capitalization thresholds. However, we also appreciate the importance of qualitative considerations and, therefore to avoid an unintended change to the standards, recommend the following revisions to paragraph 17(new content underscored; deleted content struck-through):

> **Capitalization Threshold:** SFFAS 10 paragraph 24 states, "Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system." When establishing the capitalization threshold for IUS, the federal entity should ~~include both qualitative and quantitative considerations~~ consider whether period cost would be distorted or asset values understated by expensing the purchase of such IUS assets. This consideration may include both qualitative and quantitative considerations. Qualitative considerations could be applied to IUS assets that require special management attention because of their importance to the agency mission;

high development, operating, or maintenance costs; high risk; high return; or their significant role in the administration of agency programs, finances, property, or other resources

6. The first sentence of paragraph 24 of the ED states (emphasis added), "When a **software project** is suspended pending management's evaluation as to whether to resume or terminate the project, the software development costs may remain capitalized as long as a **reasonable chance**[8] exists that the software project will eventually be completed and the cost incurred or expected to be incurred meets the capitalization threshold." The phrase "software project" is not the same terminology that is used in paragraph 31 of SFFAS 10, which uses "developmental software." In addition, the phrase "reasonable chance" is not defined in FASAB literature and footnote 8 makes reference to the phrase "more likely than not", which is used in paragraph 31 of SFFAS 10. Therefore, to avoid any confusion that may result from using different terms in the TR and the related SFFAS, we recommend the following revisions to the first sentence of paragraph 24 (new content underscored; deleted content struck-through):

> When a developmental software project is suspended pending management's evaluation as to whether to resume or terminate the project, the software development costs may remain capitalized as long as ~~a reasonable chance[8] exists~~ it is more likely than not that the developmental software project will eventually be completed and the cost incurred or expected to be incurred meets the capitalization threshold.

7. Paragraph 27 of the ED provides guidance regarding IUS in the cloud computing environment. The guidance addresses accounting by the customer and the developer/owner. As a result, to make the guidance in the paragraph easier to understand, we recommend breaking it into two paragraphs as follows:

> 27. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in SFFAS 5 and SFFAS 6, and as discussed in paragraph 24 of this TR. SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license.

> 27a. The entity that develops and owns the software, platform or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform or infrastructure should account for the software in accordance with SFFAS 10.

In addition, we believe that the guidance provided in the last sentence of paragraph 27 is incomplete. For example, if the funding to develop cloud computing is shared among 5 entities with Entity A being assigned overall responsibility for maintaining the software, platform, or infrastructure, Entity A would account for the cloud computing in accordance with SFFAS 10. However, it is unclear what costs Entity A should capitalize. Would such costs equate to the amount that Entity A funded or would it also include the costs funded by the other 4 entities to capture the full cost of the cloud computing development? To avoid inconsistent application of the guidance, we recommend the following revision to the last sentence of paragraph 27 (new content underscored):

If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform or infrastructure should account for the software in accordance with SFFAS 10 and the full cost/inter-entity cost requirements of SFFAS 4, *Managerial Cost Accounting Standards and Concepts*.

If you have questions about our response, please contact Ms. Amanda Nelson at 202-533-5560 or aenelson@kpmg.com.

Sincerely,

KPMG LLP