UTS142.13 Appendix 3 Policy related to Computer Software

The Governmental Accounting Standards Board (GASB) recently issued GASB 51, Accounting and Financial Reporting for Intangible Assets. This Statement establishes standards of accounting and financial reporting for intangible assets, including computer software, for all state and local governments.

GASB 51 requires that all intangible assets <u>with an initial useful life beyond one year</u>, including computer software, be classified as capital assets and amortized.

<u>Types of Computer Software</u>

Computer software can be purchased, licensed, or internally generated:

- License fees that last longer than one year should also be capitalized and amortized over the license period. In the case of the Microsoft license agreement, where amounts are paid annually, these would not have to be capitalized because there is not a useful life of more than one year; therefore annual license fees would be expensed.

- DEFINE and the Financial Consolidating Reporting System (FCRS) would be an example of internally generated computer software. Commercially available software that is purchased or licensed by the institution and modified using more than incremental effort before being put into operation also is be considered internally generated for purposes of GASB 51. For example, licensed financial accounting software that the institution modifies to add special reporting capabilities would be considered internally generated. Enterprise Resource Planning (ERP) replacements would be included as internally generated software.

<u>Stages of Installing Internally Generated Computer Software</u>

The activities involved in developing and installing internally generated computer software can be grouped into the following stages:

a. Preliminary Project Stage. Activities in this stage include the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the development of the software.
b. Application Development Stage. Activities in this stage include the design of the chosen path, including software configuration and software interfaces, coding, installation to hardware, and testing, including the parallel processing phase.
c. Post-Implementation/Operation Stage. Activities in this stage include application training and software maintenance.

Internally generated software should only be capitalized when both of the following occur:

a. The activities noted in the preliminary project stage are completed
b. Management implicitly or explicitly authorizes and commits to funding, at least currently in the case of a multiyear project, the software project.

Outlays associated with activities in the preliminary project stage should be expensed as incurred. For commercially available software that will be modified to the point that it is considered internally generated, (a) and (b) above generally could be considered to have occurred upon the commitment to purchase or license the computer software.

Once the criteria above have been met, outlays related to activities in the application development stage should be capitalized. Capitalization of such outlays should cease no later than the point at which the computer software is substantially complete and operational. Outlays associated with activities in the post-implementation/operation stage should be expensed as incurred.

Outlays associated with an internally generated modification of computer software that is already in operation should be capitalized if the modification results in any of the following:

a. An increase in the functionality of the computer software, that is, the computer software is able to perform tasks that it was previously incapable of performing
b. An increase in the efficiency of the computer software, that is, an increase in the level of service provided by the computer software without the ability to perform additional tasks
c. An extension of the estimated useful life of the software.

If the modification does not result in any of the above outcomes, the modification should be considered maintenance, and the associated outlays should be expensed as incurred.

<u>UT's Current Classification and Treatment of Software</u>

When GASB 34/35 came into effect in 2002, the UT System Controller's Office provided guidance that UT institutions should follow the approach prescribed in the Statement of Position (SOP) 98-1, *Accounting for the Cost of Computer Software Developed or Obtained for Internal Use*, issued by the Accounting Standards Division of the American Institute of Certified Public Accountants (AICPA) on March 4, 1998. The SOP provided guidance on accounting for the costs of computer software developed or obtained for internal use (i.e., not to be sold or otherwise marketed.) While the SOP technically did not apply to public institutions, the basic principles were applicable and were recommended for use in accounting for software.

<u>Externally Purchased Software, Software License Costs, and Other External Costs</u>

- The university reported software as a category of equipment in capital assets through August 31, 2009. Effective September 1, 2009, intangible assets will have their own category the State Property Accounting System (SPA) and will be broken out separately from other equipment in plant fund schedules.
- Through August 31, 2009, software was capitalized if purchased computer software costs and associated external costs (e.g., external consultants) exceeded the $5,000 threshold for purchased software and $100,000 threshold for internally developed software. In February 2010, the State Comptroller's Office issued GASB 51 guidance and changed the thresholds to $100,000 for purchased software and $1,000,000 for internally developed software including ERP systems. However, the purchase price of the internally developed software should be capitalized if it exceeds $100,000 regardless of if the total project cost will exceed $1 million. This change was effective

September 1, 2009 and will be applied prospectively. Computer software capitalized before September 1, 2009 under the $5,000 and $100,000 thresholds will continue to be amortized for the remainder of their useful life.

- The capitalized costs apply to the application development costs. The preliminary project costs and post-implementation /operating costs should be expensed. Training and maintenance costs do not further the development of the software and therefore should always be expensed regardless of the stage of the software.
- Prior to the implementation of GASB Statement No. 51, the university had the option of capitalizing internal development costs of staff dedicated to the project in addition to the software purchase/development costs and external costs required to make the software operational. Upon implementation of GASB Statement No. 51 in 2010, the university should examine the internal development costs of staff dedicated full-time to the project to determine if the costs are material enough to warrant capitalization. If internal development costs of staff dedicated full-time are material, only the application development stage of the internal salaries should be capitalized.
- Software costs included with the purchase cost of hardware (not separately identified on the vendor's invoice) will be capitalized as hardware costs.
- Annual software license fees and maintenance costs should be expensed as they do not have a life of more than one year.
- Licenses where no period is mentioned (i.e., perpetual licenses) were capitalized if the cost exceeded $5,000 and the useful life of the license exceeds one year through August 31, 2009. Effective September 1, 2009, licenses where no period is mentioned (i.e., perpetual licenses) are capitalized if the cost exceeds $100,000 and the useful life of the license exceeds one year
- Beginning September 1, 2009, the State Comptroller's Office has determined that software should be recorded at the purchased or developed cost and it is inappropriate to divide the purchase price by the number of licensees/users before addressing capitalization threshold requirements.
- At every August 31 year end, software projects which are not yet implemented should be placed into Construction in Progress (CIP) until implementation is complete.
- With the exception of ERP systems, software is amortized over 60 months (5 years) unless a better estimate of useful life is available. Replacements of ERP systems should be amortized over 72 months (6 years).
- As with other capital assets, the "mid-year convention" will apply.

Amortization Issues

The useful life of an intangible asset that arises from contractual or other legal rights should not exceed the period to which the service capacity of the asset is limited by contractual or legal provisions. Renewal periods related to such rights may be considered in determining the useful life of the intangible asset if there is evidence that the institution will seek and be able to achieve renewal with limited expense relative to the service capacity expected to be obtained through the renewal.

An intangible asset should be considered to have an indefinite useful life if there are no legal, contractual, regulatory, technological, or other factors that limit the useful life of the asset. Intangible assets with indefinite useful lives should not be amortized.

Treatment in SPA

Software must be recorded separately in SPA. These intangible assets cannot be recorded in aggregate, since each item will have varying useful lives.

Effective Date and Transition

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009, or fiscal year end August 31, 2010. Accounting changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practical, for all prior periods presented. If restatement is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net assets, for the earliest period restated. In the period this Statement is first applied, the financial statements should disclose the nature of any restatement and its effect. Also, the reason for not restating prior periods presented should be explained. Since UT institutions have been following SOP 98-1 since 2002,any software acquired prior to 2002 would be fully depreciated by fiscal year 2006 based on a five year useful life, which is the useful life default of the State Property Accounting System (SPA). As a result, UT is already in general compliance with Statement 51 related to computer software. The change in threshold for software effective September 1, 2009 will be applied prospectively.

GASB Classification Flowchart - Software