

# Accounting for Computer Software

## Background

USM has elected to follow the recommendations outlined in NACUBO Advisory 99-7 and adopt the provisions of SOP 98-1 “**Accounting for the Costs of Computer Software Developed or Obtained for Internal Use**”.

## Purpose

NACUBO has reviewed certain accountability issues pertaining to the recognition and measurement of costs associated with developing or acquiring computer software intended for **internal use**. The American Institute of Certified Public Accounts (AICPA) issued Statement of Position (SOP) 98-1 in April 1998, which provides guidance concerning this issue. SOP 98-1 provides guidance on accounting by all nongovernmental entities, including not-for-profit organizations, for the costs of computer software developed or obtained for **internal use** and provides guidance for determining whether computer software is for **internal use**. Given the latitude provided by the FASB, GSB, and AICPA, NACUBO adopts SOP 98-1 as the industry standard and makes it applicable to public not-for-profit higher education institutions.

## Applicability

This position paper applies to all public higher education institutions.

## Scope

This position paper addresses the adoption by NACUBO of SOP 98-1 as an industry standard for public no-for-profit higher education institutions.

## Significance

The adoption of SOP 98-1 will provide industry wide comparability in the area of account for the costs of computer software developed or obtained for internal use. The adoption will also provide interim guidance to public not-for-profit higher education institutions that desire to capitalize the costs of computer software developed or obtained for internal use and want to be consistent and comparable within the industry.

**Internally Developed Computer Software for Internal Use** must have the following characteristics:

- The software is developed internally or modified solely to meet the entity’s internal needs.
- During the software’s development or modification, no substantive plan exists or is being developed to market it externally.

There are three stages of computer software development: the preliminary project stage, the application development stage, and the post-implementation & operation stage. The following table lists examples of types of costs for each phase.

*Stages of Computer Software Development*

COST ACCUMULATION PHASE		
Preliminary Project Stage	Application Development Stage	Post-Implementation/ Operation Stage
Conceptual Formulation of alternatives	Design of chosen path, including software configuration and software interfaces	Training
Evaluation of alternative	Coding	Application Maint.
Determination of existence of needed technology	Installation to hardware	
Final selection of alternatives	Testing, including parallel processing phase	

Internal and external costs incurred during the preliminary stage should be expensed.

Internal and external costs incurred to develop **internal-use** software during the application development stage should be capitalized. Costs to develop or obtain software that allows for access or conversion of old data by new systems should also be capitalized.

In order for costs of specified upgrades and enhancements to internal use computer software to be capitalized, it must be reasonably assured that those expenditures will result in additional functionality.

Capitalization of costs should begin when both:

- a. Preliminary project stage is completed.
- b. Management commits to funding a computer software project and it is probable that the project will be completed and the software will be used to perform the function intended.

Allowable capitalizable costs include only the following:

- a. External direct costs of materials and services consumed in developing or obtaining internal-use computer software. (Examples of those costs included but are not limited to fees paid to third parties for services provided to develop the software during the application development stage, costs incurred to obtain software from third parties, and travel expenses incurred by employees in their duties directly associated with developing software.)
- b. Payroll and payroll-related costs (for example, costs of employees benefits) for internal-use computer software project, to the extent of the time spent directly on the project (Examples of employees activities include but are not limited to coding and testing during the application development stage.)
- c. Interest costs incurred while developing internal-use computer software (Interest should be capitalized in accordance with the provision of FASB Statement No. 34, Capitalization of Interest Cost.)

### **Summary of Statement No. 34**

#### *Capitalization of Interest Cost (Issued 10/79)*

##### **Summary**

This Statement establishes standards for capitalizing interest cost as part of the historical cost of acquiring certain assets. To qualify for interest capitalization, assets must require a period of time to get them ready for their intended use. Examples are assets that an enterprise constructs for its own use (such as facilities) and assets intended for sale or lease that are constructed as discrete projects (such as ships or real estate projects). Interest capitalization is required for those assets if its effect, compared with the effect of expensing interest, is material. If the net effect is not material, interest capitalization is not required. However, interest cannot be capitalized for inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis.

The interest cost eligible for capitalization shall be the interest cost recognized on borrowings and other obligations. The amount capitalized is to be an allocation of the interest cost incurred during the period required to complete the asset. The interest rate for capitalization purposes is to be based on the rates on the enterprise's outstanding borrowings. If the enterprise associates a specific new borrowing with the asset, it may apply the rate on that borrowing to the appropriate portion of the expenditures for the asset. A weighted average of the rates on other borrowings is to be applied to expenditures not covered by specific new borrowings. Judgment is required in identifying the borrowings on which the average rate is based.

Capitalization should cease when all substantial testing is completed. General and administrative costs and overhead costs should not be capitalized as costs of internal-use software.

The useful life for internal-use software is 10 to 15 years.