

Policy 4203

Accounting for Software Costs, Computer Systems, and Business Process Reengineering

Responsible Office	Finance	Effective Date	11/1/00
Responsible Official	Controller	Last Revision	5/1/06

Policy Sections	2
4203.1 Preliminary Project Stage	2
4203.2 Systems Development and Acquisition.....	2
4203.3 Implementation Stage	2
4203.4 Post Implementation	3
4203.5 Amortization	3
4203.6 Useful Life of Software.....	3
4203.7 Impairment	3
4203.8 Consistency of Accounting Methods.....	4
4203.9 Business Process Reengineering	4

Scope

This policy provides accounting guidance for the capitalization of all major expenses that relate, directly or indirectly, to the implementation of computer systems and business process reengineering initiatives.

Reason for the Policy

The purpose of this policy is to communicate consistent guidance in this specialized area of accounting; promote University compliance with specific guidelines issued by the Financial Accounting Standards Board (FASB); and promote proper accounting for University assets and expenses in conformity with Generally Accepted Accounting Principles (GAAP).

Policy Statement

Capital projects related to internal use of software are approved by a capital budget process.

All computer-related assets of the University (including software, infrastructure applications, systems) are eligible to be capitalized if:

- they embody a probable future benefit for more than 2 years that involves a capacity, solely or in combination with other assets, to contribute directly or indirectly to future cash flows and/or service potentials or extend the useful life of an existing asset;
- the costs of the computer-related asset and its probable benefit are identifiable and measurable in some reasonable form;
- the total eligible costs related to the project equal or exceed \$50,000.

Definitions

- Capital costs**
 Costs that have an estimable future benefit which are included on the Statement of Financial Position as assets, and amortized or depreciated over their estimated useful lives.
- Expenses**
 Costs that do not provide future benefit and are recorded directly on the Statement of Activities in the period in which the costs are incurred.

Business process reengineering

A method of reviewing a particular process to determine the most efficient use of people and technology better utilize economies of scale, time etc. to improve operations.

Policy Sections

4203.1 Preliminary Project Stage

Costs incurred during the preliminary project stage must be expensed as incurred. For purposes of this policy, the preliminary project stage includes the following activities:

- conceptual formulation of alternatives;
- evaluation of alternatives;
- determination of existence of needed technology;
- final selection of alternatives.

4203.2 Systems Development and Acquisition

A. Software Development for Major Institutional Systems

Costs incurred for the development or acquisition of software for major institutional computer systems (such as procurement, payroll, student services, general ledger and others), including software upgrades and new releases, may be capitalized if they:

- are an integral part of the system, or
- identifiably enhance the functionality of the system because of their direct relationship to it.

A major computer system becomes an asset of the University upon capitalization and shall be recorded in the same manner as other assets and amortized over its estimated useful life. In addition, the total costs of a computer system must be reasonable and should accurately reflect the value of the system.

B. Computing Infrastructure Applications and Systems

Infrastructure systems and applications may support multiple computer modules and integrated systems (such as a global security system, a data warehouse, a relational database management system and other related or similar tools). These applications may be characterized as separate systems and therefore subject to the capitalization principles set forth in section A above.

4203.3 Implementation Stage

Costs incurred to implement the chosen technological solution, including planning, may be capitalized if they relate to a system that fulfills the criteria for capitalization in accordance with this policy. This stage generally encompasses the following activities:

1. design of chosen path, including software configuration and software interface;
2. technical software coding;
3. installation of hardware;
4. testing;
5. data conversion (programs and tools only);
6. other related costs;
7. equipment.

Specific types of costs generally incurred during the implementation stage are:

- **Purchased Software:** The cost to purchase software.
- **Personnel Costs:** Large-scale computer projects may entail the use of both employees and external consultants to design and implement the system. The costs of both directly allocable internal employees and external consultants who are directly dedicated to the development and implementation of the computer project may be capitalized.
- **Travel, Lodging, and Other Similar Expenses:** To qualify for capitalization, travel, lodging and similar expenditures shall be directly allocable to a specific system or application that meets the University's criteria for capitalization. When applying this condition, one should determine that such costs are incremental and theoretically could have been avoided if the project was not undertaken. Individuals providing direct services to the system would normally incur these types of expenses qualifying for capitalization.
- **Interest expense:** Interest expense will be capitalized on software development projects consistent with the University's policy for interest capitalization on long-term projects.
- **Training:** Training programs should be conducted on a continuous basis, and the related costs should be recognized as an integral component of the University's operating budget and **are not** capitalized.
- **General and Administrative Expenses:** General and administrative expenses **are not** to be allocated and capitalized as part of the cost of a software development project.
- **Equipment:** Equipment should be purchased, managed and capitalized in accordance with the University equipment policy (Policy [4209](#)). A major computer system implementation may have many smaller pieces of equipment which individually **may not** be capitalized, but as a group form an integral part of a system implementation and can be capitalized as part of that system.

4203.4 Post Implementation

Modifications to existing software and annual costs associated with the ongoing maintenance, management and usage of computer systems and related infrastructure applications should be recognized as operating expenses in the period in which such costs are incurred. These costs do not qualify for capitalization.

4203.5 Amortization

For each module or component of a software project, amortization should begin when the computer software is ready for its intended use and placed in service.

4203.6 Useful Life of Software

In determining the estimated useful life over which the costs incurred for internal-use computer software will be amortized, departments should consider the effects of obsolescence, technology, competition and other economic factors on useful life. Departments should especially consider if rapid changes are likely to occur in the development of software products, software operating systems, or computer hardware and whether the University intends to replace any technologically obsolete software or hardware. The Controller approves the useful life proposed by departments.

4203.7 Impairment

FASB Statement No. 121 establishes guidance on recognizing and measuring impairments of long lived assets such as computer software costs. Impairment in the value of the cost basis of internal use computer software can occur when:

- internal-use computer software is not expected to provide substantive service potential;
- a significant change occurs in the extent or manner in which the software is expected to be used;
- a significant change is made to the software program (this would generally be an enhancement);

- costs of developing or modifying internal-use computer software significantly exceed the amount originally expected to develop or modify the software.

Departments and project managers should contact the Controller's Office to discuss the proper accounting treatment to be applied if it is believed that a computer-related asset under their jurisdiction has become impaired.

4203.8 Consistency of Accounting Methods

In order to ensure a consistent and meaningful financial presentation, all qualifying new computer systems (including infrastructure applications) that exceed \$50,000 in costs should be capitalized and amortized over their useful lives. The Controller's Office will establish the appropriate useful life of the system. For funding purposes, if current year operating funds are available to support the development costs of such systems, these funds can be set aside and used to pay the related amortization in future periods.

4203.9 Business Process Reengineering

Costs incurred by the University to reengineer a business process must be expensed as incurred, in accordance with specific FASB requirements. The reengineering encompasses the following activities:

- **Current State Assessment:** Current state assessment is the process of documenting the entity's current business process. This activity is sometimes called "mapping", "developing an 'as-is' baseline", "flow charting", and "determining current business process structure".
- **Process Reengineering:** Process reengineering is the effort to reengineer the entity's business process so as to increase efficiency and effectiveness. This activity is sometimes called "analysis", "determining best-in-class", "profit/performance improvement development", and "developing 'should-be' processes".
- **Restructuring Work Force:** Restructuring the work force is the effort to determine what employee makeup is necessary to operate the reengineered business processes.

If process reengineering takes place concurrently with a system implementation, the Controller will establish reasonable methods for accounting for them separately.

Special Situations/Exceptions

Any exceptions to this policy must be approved by the Controller.

Contacts

Subject	Contact	Phone
Interpretation of policy	Associate Controller for Financial Reporting	432-5527
	Controller	432-5524

Revision History

First Issued 11/00.

The official version of this information will only be maintained in an on-line web format. Any and all printed copies of this material are dated as of the print date. Please make certain to review the material on-line prior to placing reliance on a dated printed version.
