POSITION PAPER: CAPITALIZATION AND AMORTIZATION OF SOFTWARE PURCHASES

Purpose: Statement of Position (SOP) 98-1, Accounting for the Costs of Software Developed or Obtained for Internal Use, issued by the AICPA provides guidance regarding the capitalization and amortization of software. NACUBO Advisory Report 1999-7 recommended the adoption of the provisions of SOP 98-1 for all higher education institutions. The TBR previously decided not to adopt the provisions of SOP 98-1 due to limited amounts of software purchases but agreed to review when a new administrative system was purchased.

Background: The TBR signed a contract with SunguardSCT (SCT) in December, 2004 for the licensing of the Banner Software System. In accordance with its previous recommendation, the TBR has reviewed and determined that the provisions of SOP 98-1 will be followed for this and future software purchases.

Issues:

1. Expenditures to be Capitalized:

Paragraph 31a of SOP 98-1 indicates that “External direct costs of materials and services consumed in developing or obtaining internal-use computer software” are to be capitalized. Paragraph 21 states “Training costs are not internal-use software development costs, and, if incurred during this state, should be expenses as incurred”. Paragraph 22 states “Data conversion often occurs during the application development stage. Data conversion costs, except as note in paragraph 21, should be expensed as incurred”. Paragraph 25 states “Internal costs incurred for maintenance should be expensed as incurred”.

Recommendations:

It is recommended that all costs paid to SCT for the software as well as costs paid directly to SCT for implementation services are to be capitalized. Internal costs for training, data conversion, etc. should be expensed. All costs paid to SCT for maintenance should be expensed.

2. Amortization Method and Period:

Paragraph 36 states “The costs of computer software developed or obtained for internal use should be amortized on a straight-line basis unless another systematic and rational basis is more representative of the software’s use.” Paragraph 37 states “In determining and periodically reassessing the estimated useful life over which the costs incurred for internal-use computer software will be amortized, entities should consider the effects of obsolescence, technology, competition, and other economic factors”.

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Recommendations:

The current contract with SCT is for five years with an option to renew for an additional five years. In obtaining TSSBA funding for the software purchase, an estimated useful life of 10 years was used. The current SCT system has been in place for approximately 20 years. Since the contract is currently for no more than 10 years and that is the estimated life used for TSSBA purposes, it is recommended that the straight line method be used with an estimated useful life of 10 years.

3. When to Begin Amortization:

Paragraph 38 states “For each module or component of a software project, amortization should begin when the computer software is ready for its intended use, regardless of whether the software will be placed in service in planned stages that may extend beyond a reporting period. For purposes of this SOP, computer software is ready for its intended use after all substantial testing is completed”. TBR will be implementing the software over a four year period in stages. There is no specific breakdown of software costs between the various components. Training costs will be spread over the four years with all institutions sharing costs based on the cost allocation formula that has been approved by TBR Presidents regardless of actual implementation dates.

Recommendation:

In accordance with Paragraph 38, it is recommended that amortization begin the year in which the first module is placed in service. To be consistent with TBR depreciation policy, a full year of amortization is to be charged regardless of the actual implementation date. Implementation costs paid to SCT after that date should be capitalized in accordance with Issue 1 above with amortization over the remaining estimated useful life.

4. Other Software

Other software with a cost of $100,000 or greater should be capitalized in accordance with the provisions of this position paper and guidance in SOP 98-1. Software with a cost under $100,000 should be expensed unless the institution determines, and provides justification, for capitalizing. For example, if an institution purchases a separate software package to support the Banner system (example Luminous Premier), it may be appropriate to capitalize the cost even if less than $100,000 since it is directly related to the Banner system.

Written by David Collins