

CHAPTER 6. ACCOUNTING FOR INTERNAL USE SOFTWARE

6-1 Background

- A.** FASAB's Statement of Federal Financial Accounting Standards (SFFAS) 10, *Accounting for Internal Use Software*, published on October 9, 1998, modified an earlier standard, SFFAS 6, *Accounting for Property, Plant, and Equipment (PP&E)*. SFFAS 6 had prohibited the capitalization of the cost of internally developed software, unless management intended to recover the cost through user charges, and the software was to be used as general PP&E. The new standard (SFFAS 10) classified internal use software as PP&E, including software used to operate a federal entity's programs and software used to produce the entity's goods and services.
- B.** Internal use software can be purchased off-the-shelf from commercial vendors (COTS), developed by contractors with little technical supervision by the federal entity, or developed internally by the federal entity. SFFAS 10 requires the capitalization of the cost of internal use software whether it is COTS, contractor-developed, or internally developed.
- C.** SFFAS 10 provides guidance regarding the definition of software (see Appendix 1 of this policy), the phases of software development, the types of cost elements to be capitalized, the timing and thresholds of capitalization, amortization periods, accounting for impairment, and other guidance.

6-2 Responsibilities

- A.** Except for internal use software owned by Ginnie Mae, the Director of the Financial Reporting Division (FRD), Office of the Assistant Chief Financial Officer for Accounting (OACFO-Accounting), is responsible for:
 - 1. Assuring that the Office of the Chief Information Officer (OCIO) provides FRD with an allocation plan that a) identifies funding and staffing resources committed for the development of internal use software, b) determines the implementation timing for internal use software being developed, c) establishes the useful life of software and the net realizable value (if any), and d) determines the occurrence of and assigns value for enhancement or impairment of internal use software;
 - 2. Obtaining from OCIO at least annually documentation of rules and assumptions regarding cost allocations, implementation dates, useful life, net realizable value, and enhancements and impairments;

3. Assuring that the OCIO allocation plan is updated at least annually and that the plan complies with SFFAS 10 and other applicable generally accepted accounting principles (GAAP);
 4. For software being acquired as part of a capital lease, in addition to the accounting requirements of SFFAS 5 and SFFAS 6, assuring that the amortization of the leased software is performed in accordance with SFFAS 10, assuming the software cost meets the threshold of materiality.
 5. Establishing applicable accounts and initiating the corresponding accounting entries to assure that HUD's financial reports comply with the amortization requirements of SFFAS 10 and any other applicable GAAP;
 6. Updating records quarterly with data from financial transactions related to the development or acquisition of internal use software, in accordance with the allocation plan provided by OCIO;
 7. Obtaining certification from OCIO that the transactions identified are as stated in the allocation plan;
 8. Providing the journal entry with supporting documentation to the Fort Worth Accounting Center for entry into HUD's financial system;
 9. Maintaining accounts and supporting documentation for accounting entries made pursuant to this policy; and
 10. Working with the Property Management Branch (PMB), Office of Administration, to reconcile the a) pre-operational costs, b) full costs, c) materiality threshold, d) implementation date, e) useful life, f) amortization amount, g) amounts for enhancements and impairments, and h) disposal and net realizable value of internal use software records being maintained by PMB.
- B.** Except for internal use software owned by Ginnie Mae, the Office of the Chief Information Officer (OCIO) is responsible, in consultation with the FRD, OACFO-Accounting, as follows:
1. Providing FRD with an allocation plan that identifies funding and staffing resources for each software development project. OCIO is responsible for updating the allocation plan at least annually and for notifying FRD immediately of any changes in the allocation plan and the reasons for the change.
 2. On a quarterly basis, confirming with FRD the application of the allocation plan to the internal use software development transactions occurring during that month.

3. As originators of IT contracts that may involve the acquisition or development of internal use software belonging to HUD, OCIO will work with OCPO within the constraints of the Federal Acquisition Regulations to identify the contracts or sections of contracts intended to produce internal use software.
 4. For leased software, determining whether the lease is an operating lease or a capital lease. For software being acquired as part of a capital lease, the capitalization of the leased software is in accordance with this policy, assuming the software cost meets the threshold of materiality.
 5. Determining the timing of implementation, useful life, net realizable value (if any), and enhancement and impairment information of the software;
 6. Providing that information to the FRD and to the PMB; and
 7. Certifying that the information provided complies with this policy.
- C.** Except for internal use software owned by Ginnie Mae, PMB is responsible, in consultation with the FRD Director, for maintaining records for internal use software reflecting pre-operational development and acquisition costs, full costs upon implementation, date of implementation, useful life, amortization period, enhancements, impairments, and disposal. PMB is to reconcile capitalization and amortization information with the OCFO FRD on a monthly basis.
- D.** Ginnie Mae, a government corporation, is responsible for identifying, recording, amortizing and accounting for Ginnie Mae owned software in accordance with both FASB and FASAB accounting standards. Ginnie Mae's financial statements are consolidated with HUD's.

6-3 Determination of Cost

- A.** FASAB defines the system development phases of internal use software as:
1. Preliminary Design Phase,
 2. Software Development Phase, and
 3. Post-Implementation or Operational Phase.
- B.** Capitalizable costs include:
1. For internally developed software, capitalized cost should include the full cost (direct and indirect) incurred during this phase. This amount should be limited to costs incurred after:
 - a. Management authorizes and commits to a computer software project, believes that it is more likely than not that the project will be completed, and the software will be used to perform the intended function during an estimated service life of 2 years or more, and

- b. The completion of the conceptual formulation, design, and testing of possible software project alternatives, which are part of the preliminary design phase.
2. Costs for new software (e.g., salaries for programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies) and documentation manuals.
3. For COTS software, the amount paid to the vendor for the software.
4. For contractor-developed software, the amount paid to the contractor to design, program, install, and implement the software.
5. Material internal costs incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use.
6. The cost of software that serves both internal and stewardship purposes.
7. The collective cost for bulk purchases of software programs and modules or components of a total software system, for which federal entities have established threshold and guidance showing that period cost would be distorted or asset values understated by expensing the purchase of numerous copies or components of the software system.
8. Acquisition cost of enhancements to existing internal use software and modules thereof, when it is more likely than not that the enhancements will result in significant additional capabilities.
9. For bundled products and services, federal entities should allocate the capitalizable and noncapitalizable costs of the package among individual elements on the basis of a reasonable estimate of their relative fair values.
10. Exclusions:
 - a. Data conversion cost;
 - b. Costs incurred after final acceptance testing has been successfully completed at each site where the software is to be installed;
 - c. For bundled products and services, costs that are not susceptible to allocation between maintenance and relatively minor enhancements;
 - d. The cost of minor enhancements resulting from ongoing systems maintenance (the purchases of enhanced versions of software for a nominal charge are properly expensed in the period incurred);
 - e. Cost incurred solely to repair a design flaw or to perform minor upgrades that may extend the useful life of the software without adding capabilities; and

- f. Computer software that is integrated into and necessary to operate general PP&E, rather than to perform an application (such software should be considered part of the PP&E of which it is an integral part and should be capitalized and depreciated accordingly).

C. Impairments

1. If OCIO becomes aware that the capabilities, functions, or uses of operational software have become significantly reduced, or if the software is no longer expected to provide substantive service potential and will be removed from service:
 - a. The amount of impairment must be determined by OCIO, in consultation with and for approval by the FRD Director, in accordance with SFFAS 10.
 - b. The timing and amount must be reported to the FRD and to the PMB in the Office of Administration (OA).
 - c. For software that will be removed from use, OCIO must also determine and report the Net Realizable Value (NRV), if any, so that the amount of the loss can be recognized and the NRV transferred to an appropriate asset account by the FRD, via an adjusting entry made by the FWAC, until the software is removed and sold or disposed of.
2. For developmental software, if OCIO concludes that it is no longer more likely than not that the software (or a module thereof) will be completed and placed into service, this conclusion should be reported to the FRD and to the PMB, and the accumulated book value should be reduced to reflect the expected NRV, if any. These amounts should be reported to the FRD, and the loss should be recognized.

D. Amortization

1. OCIO shall, in consultation with the FRD Director, determine the useful life of the software in a systematic and rational manner. The estimated useful life used for amortization should be consistent with that used for planning the software's acquisition.
2. Amortization of each module or component of a software project should begin upon successful testing. OCIO is responsible for notifying the FRD Director and PMB when that testing is complete, marking the date of implementation for that software. For modules that are dependent on completion of other modules, amortization should begin when both modules have successfully completed testing.
3. OCIO should notify the FRD Director and PMB of any additions to the book value or changes in the useful life of software. No adjustments should be made

by FRD to previously recorded amortization; all changes shall be made prospectively.

E. Disclosures

1. OCIO should provide FRD with sufficient documentation to report material changes to the consolidated balance sheet and other required financial statements.
2. With regard to software as part of the general PP&E for HUD, FRD should disclose amounts related to the following categories in the financial statements:
 - a. Cost, associated amortization, and book value,
 - b. Estimated useful life for each major class of software, and
 - c. Method of amortization.

6-4 Financial Reporting

A. Internal control

1. The FRD Director will assure that accounting entries related to internal use software are in compliance with SFFAS 10 and GAAP.
2. The FRD Director will review at least annually the assumptions and processes provided by OCIO reflecting the practices and determination by that office of costs associated with developing and implementing internal use software.

B. The FRD will prepare entries to record the various events that occur in the life cycle of software development, implementation, removal, and disposal, based on information received from the OCIO. Those entries will subsequently be entered into the HUD accounting system by the Fort Worth Accounting Center.

1. Allocation of costs to Internal Use Software in Development
 - a. Assuming overhead costs have been placed in an Applied Overhead account
 - b. Debit: Account 1832 Internal-Use Software in Development
Credit: Account 6600 Applied Overhead
Credit: Account 6610 Cost Capitalization Offset
2. Upon moving development software into production
 - a. Moves appropriate amounts from Work In Progress to Asset account
 - b. Debit: Account 1830 Internal-Use Software
Credit: Account 1832 Internal-Use Software in Development
3. Amortization of capitalized software costs

- a. Amortization begins when projects are moved from Work In Progress to Asset account
 - b. Debit: Account 6710 Depreciation, Amortization, and Depletion
Credit: Account 1839 Accumulated Amortization on Internal Use Software
4. Impairments
- a. To record the write-off of assets (other than investment)
 - b. Debit: Account 7210 Losses on Disposition of Assets - Other
Debit: Account 1839 Accumulated Amortization on Internal Use Software
Credit: Account 1830 Internal Use Software
Credit: Account 1832 Internal Use Software in Development
5. Enhancements
- a. To record added capabilities due to enhancements
 - b. Debit: Account 1830 Internal Use Software
Credit: Account 1010 Fund Balance with Treasury
6. Removal of software from production
- a. To recognize the removal of software from production, i.e., no longer being utilized
 - b. For a loss:
Debit: Account 1839 Accumulated Amortization on Internal Use Software
Debit: Account 7210 Losses on Disposition of Assets - Other
Credit: Account 1830 Internal Use Software
Credit: Account 3310 Cumulative Results of Operations
 - c. For a gain:
Debit: Account 1839 Accumulated Amortization on Internal Use Software
Debit: Account 3310 Cumulative Results of Operations
Credit: Account 1830 Internal Use Software
Credit: Account 7110 Gains on Disposition of Assets - Other
7. Sale of modules or components upon retirement of software
- a. In addition to the accounting entries above, for retirement of software, if the software is considered to have a Net Realizable Value (NRV), an account is created to represent the software as a surplus asset to be sold.

- b. At time of retirement
Debit: Account 1522 Inventory Held in Reserve for Future Sale (NRV)
Credit: Account 1830 Internal Use Software
- c. At time of sale
Debit: Account 1110 Undeposited Collections
Credit: Account 1010 Fund Balance with Treasury

Debit: Account 5100 Revenue from Goods Sold
Credit: Account 1522 Inventory Held in Reserve for Future Sale

6-5 Implementation

- A.** This policy will become effective upon approval and publication. It is to be applied for all internal use software in development or in operation during the fiscal year in which it is approved. The following paragraphs pertain to the first time implementation of this policy.
- B. Materiality**
 - 1. Because materiality is connected to other amounts reported in the financial statements, the materiality threshold for internal use software will be established by the FRD in accordance with the standards set for internal use software assets attributed to HUD.
 - 2. Software costs that do not reach the materiality threshold will be expensed.
 - 3. Projected acquisition costs can be used to help determine materiality. However, for cases near the threshold, it may be necessary to track the developmental costs over a period of time until the full cost is known.
- C. Existing Operational Software**
 - 1. OCIO will assemble an inventory of operational software showing expected remaining useful life and NRV, if any.
 - 2. For operational software for which some of the costs have already been capitalized, this policy should be applied to any unamortized costs.
 - 3. For all existing operational software, the provisions of this policy with regard to enhancements and impairments will apply.
- D. Developmental Software**
 - 1. OCIO will assemble an inventory of software currently being developed or acquired showing projected costs, projected implementation date, projected useful life, and estimated costs incurred, both prior to this fiscal year and during this fiscal year.

2. The FRD Director will determine the most suitable method for establishing amounts for capitalization and amortization of existing software and software in development so as to provide the most accurate accounting possible for the associated accounts. Assumptions made in order to make this determination will be reflected in the notes to the financial statements.