State Accounting Office of Georgia
Fiscal Leadership for Georgia

Statewide Accounting Policy & Procedure

Accounting Manual Reference:		**Effective Date:** 07/01/2009
Section:	Capital Assets	**Revision Date:** 06/30/2011
Sub-section:	Internally Generated Computer Software	

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Policy Summary:

Intangible assets, including internally generated computer software (IGCS), are considered capital assets. The Governmental Accounting Standards Board (GASB) issued GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, to establish authoritative guidance for the consistent reporting of intangible assets by governmental entities. This policy provides a specified-conditions approach to recognizing outlays and reporting intangible assets that are internally generated. Computer software is the most common internally generated intangible asset for the State of Georgia, so this policy focuses primarily on internally generated software. The policy titled *Intangibles – General* provides additional accounting guidance for recording and reporting all intangible assets.

Policy Requirements:

Accounting Requirements

Organizations included in the State of Georgia reporting entity that have internally generated intangible assets are required to comply with this policy.

Refer to the policy titled *Intangibles – General* for the basic accounting guidance related to intangible assets. Accounting for IGCS follows the same basic accounting guidance described in that policy. State organization websites are also considered computer software. If the website meets the software capitalization threshold and the description of internally generated computer software, then outlays associated with its development should be capitalized. As explained below, there are precise criteria for determining when outlays associated with the internal development of intangible assets should begin to be capitalized. This policy describes that specified-conditions approach.

Recognition and Measurement

Costs incurred in creating an internally generated intangible asset are either expensed or capitalized depending on the stage in the asset's development. In initial development, outlays incurred related to an internally generated asset should be capitalized only when ALL of the following have occurred:

- The specific objective of the project and the nature of the service capacity that is expected to be provided by the asset upon completion of the project have been determined.
- The technical or technological feasibility for completing the project so that the asset will provide its expected service capacity has been demonstrated.

- The current intention, ability, and presence of effort to complete or, in the case of a multi-year project, continue development of the intangible asset has been demonstrated.

Computer software is an intangible asset that is commonly generated internally. The above criteria are considered met for IGCS only when BOTH of the following have occurred:

- The activities of the preliminary project stage (as described below) are completed.
- Management has clearly authorized and committed to funding the software project (at least currently for a multi-year project).

Additionally, Statement No. 51 indicates that IGCS is considered internally generated when it is either:

- Developed in-house by government personnel or a contractor on behalf of the government, or
- It is commercially available software that is purchased or licensed by the government and modified using more than minimal incremental effort before being put into operation.

Activity outlays associated with developing and installing IGCS are either expensed or capitalized based on the stage of the project. Therefore it is important that personnel involved in the project carefully track outlays and categorize them into one of the following three stages, based on the nature of the activities, not the timing:

1. Preliminary project stage – Expense
    a. Conceptual formulation and evaluation of alternatives
    b. Determination of existence of needed technology
    c. Final selection of alternatives
2. Application development stage – ***Capitalize***
    a. Design of the chosen path
    b. Coding
    c. Installation to hardware
    d. Testing and parallel processing
3. Post-implementation/operation stage – Expense (even if the timing of the outlay occurs while application development is still in progress)
    a. Application user training
    b. Software maintenance

Data conversion is an activity of the application development stage only if it is necessary to make the software operational; otherwise it is an activity of the post-implementation/operation stage. Data conversion activities include:

- Purging/cleansing of existing data
- Conversion of data from legacy system to new system
- Reconciliation of data from legacy system to data in new system

Modifications of software that is already in operation are capitalized only under certain conditions. As with all IGCS, the preliminary project stage for the modification must be complete and management must have authorized funding. Additionally, the modification must result in any of the following:

- An increase in the functionality of the software
- An increase in the efficiency of the software
- An extension of the estimated useful life of the software

If the modification does not result in one of the above, associated outlays are considered maintenance and must be expensed. An extension of useful life without an increase in functionality or efficiency is expected to rarely occur.

Amortization

As with all intangible assets, amortization is the accounting process of allocating the intangible asset's capitalized cost to expense in a systematic and rational manner to those periods expected to benefit from the use of the asset. The straight-line depreciation method (historical cost less residual value, divided by useful life) will be used by all State organizations, but intangible assets with indefinite useful lives should not be amortized. For ICGS only capitalized outlays from the application development stage will be amortized.

Impairments

The provisions of Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, generally should be applied to determine impairment of intangible assets. A common indicator of impairment for internally generated intangible assets is development stoppage, such as stoppage of development of computer software due to a change in the priorities of management. Internally generated intangible assets impaired from development stoppage should be reported at the lower of carrying value or fair value.

Basis of Accounting

Funds that operate on a statutory basis must convert their accounting activity to the modified accrual and/or accrual bases of accounting for the Comprehensive Annual Financial Report (CAFR). Proprietary and fiduciary funds that do not operate on a statutory basis use the accrual basis of accounting throughout the year.

- Statutory Basis for Budgetary Compliance Reporting
  Outlays for IGCS are recorded as expenditures on the statutory basis of accounting. The expenditure is recognized at the earlier of either the time the funds are encumbered (i.e., when purchase orders or other contractual obligations to procure goods or services have been executed), or the time the goods, services, rights, etc. have been received. Accruals are required at year-end for unencumbered goods and services received but not processed through the accounts payable subsystem. Also, a reclassification from encumbrance liability to accounts payable is required for any encumbered purchases that are received by year-end but not yet processed through the accounts payable subsystem.

- Converting to Modified Accrual Basis for CAFR Reporting
  Any ending encumbrance liability balance related to IGCS is eliminated under the modified accrual basis of accounting, and beginning fund balance is increased by the prior year encumbrance liability balance related to IGCS. The offsetting change in the encumbrance liability is recorded as an expenditure to recognize the current year impact on expenditures for IGCS activity. A decrease in the encumbrance liability results in an increase to expenditures, and an increase in the encumbrance liability results in a decrease to expenditures.

- Converting to Accrual Basis for CAFR Reporting
  Governmental fund activity must be adjusted to the full accrual basis of accounting for year-end government-wide reporting purposes. IGCS application development stage outlays that were reported as expenditures in governmental funds under the modified accrual basis of accounting must be capitalized if outlays exceed the capitalization threshold and amortized if the useful life is not indefinite. Similar capitalization and amortization adjustments are also required for other funds that operate on a statutory basis (certain proprietary and fiduciary funds).

- Accrual Basis for Funds Not Reporting on a Statutory Basis
  Activity in proprietary and fiduciary funds that do not operate on a statutory basis is reported throughout the year using the full accrual basis of accounting. IGCS application development stage outlays that exceed the capitalization threshold are recorded as assets, not as expenses, and amortized if the useful lives are not indefinite. Separate asset profiles are maintained in the asset management module of the statewide financial system for funds that must be reported on the accrual basis.

Disclosure Requirements
There are no note disclosure requirements specific to internally generated intangible assets. Disclosure of these assets is incorporated into the capital asset note disclosure.

General Accounting Procedures:
Identifying Transactions
With IGCS it is particularly important that outlays be properly categorized into the appropriate project stage as described above. Only outlays categorized as application development stage are capitalized; other outlays are expensed. Types of outlays to be capitalized during the application development stage include:

- External direct costs of materials and services (e.g., third party fees for services)
- Costs to obtain software from third parties
- Travel costs incurred by employees in their duties directly associated with development
- Internal payroll and payroll-related costs of employees directly associated with or devoting time to designing, coding, installing or testing/parallel processing
- For proprietary funds only, interest costs incurred during the application development

Additional guidance to assist with the capitalize-or-expense determination includes:

- General and administrative costs and overhead expenditures associated with software development should not be capitalized.
- Data conversion activities should be expensed unless there is clear and fully documented evidence that the data is more than informational and truly instrumental to making the software operational. If a decision is made to capitalize certain data conversion costs, then documentation must include an explanation of how the data conversion serves to make the software operational. For example, when developing a human resources system, the effective processing of payroll transactions is dependent on the transfer of information, such as pay rates, payroll withholding data, and employee direct deposit information, from the legacy system before the new system will be operational. However, a database system containing vendor information and performance feedback may be less reliant on converted legacy data to be considered operational, because the data provided by such a system may be more informational in nature and not essential to undertaking current procurement transactions. Additionally, once a system is implemented and deemed operational, then the input of any new data (e.g., changes in pay rates) is considered an operational activity, not a capitalizable outlay.
- If a software system consists of a series of modules (for example, an enterprise resource planning (ERP) system with procurement, human resources, and financial reporting modules) and each module has its own development cycle, then the cost analysis should be conducted separately for each module.
- Once an application is implemented and operational at any State of Georgia organization (or a subset thereof), then outlays related to rolling out the application to additional organizations in the State should be accounted for as post-implementation expenses, assuming that the organizations do not need to make significant modifications to the application to make it functional at their locations. Essentially, each subsequent implementation at additional

organizations is analogous to a data conversion, training, or business process change effort that is in the post-implementation, operational stage.

Accounting Transactions and Journal Entries
Refer to the policy titled *Intangibles – General* for a comprehensive example of the journal entries required for IGCS transactions that are capitalized as part of the application development stage. The example demonstrates the entries required for the statutory basis of accounting, as well as those required for converting to the other bases of accounting. Preliminary project stage and post-implementation / operation stage activities are recorded as expenditures/expenses in the same manner as all other non-capital outlays.

Specific accounts for information technology activities have been established for users of the statewide financial system that is managed and maintained by SAO. Refer to the Reporting > Chart of Accounts and Definitions page of the SAO website for the most current Chart of Accounts. Organizations that do not use the statewide financial system should maintain an accounting structure that provides a similar level of detail.

Year-End Accounting Procedures
Those State reporting organizations that record day-to-day transactions on a basis of accounting that varies from the GAAP reporting basis requirements must identify and provide to the State Accounting Office reconciling differences between the bases of accounting. This process enables the conversion to the appropriate GAAP basis of accounting for GAAP financial reporting purposes. The year-end reporting package, as provided by SAO, accommodates the process of the identification and submission of these differences. Timely completion of each form facilitates the conversion process.

The SAO financial reporting group will request information about intangible assets as part of the Capital Assets forms in its year-end reporting forms package.

Authority:
- GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, (paragraph 19)
- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*
- Comprehensive Implementation Guide (2008 – 2009), Chapter Z (Other Implementation Guidance), Section Z.51 (Statement No. 51 , *Accounting and Financial Reporting for Intangible Assets*)
- Other SAO capital assets policies

Applicability:
This policy applies to all organizations included in the State of Georgia reporting entity. At these organizations, all personnel who have capital asset reporting or administrative responsibilities should be knowledgeable of this policy, including users and administrators of the asset management financial systems. Additionally, information technology (IT) personnel, specifically those involved with the internal development of computer software and similar intangible assets, should be knowledgeable of the policy.

Definitions:
Computer Software – The ownership or right to use computer programs that control the functioning of computer hardware and other devices. Computer software comprises both operating systems and application programs. Computer software is the most common type of intangible asset that is internally generated. Computer software is considered internally generated if it is developed in-house or by a third

party contractor on the State's behalf. Commercially available software that is purchased or licensed but is modified using more than minimal effort is also considered internally generated. Websites are considered intangible assets, and they may also be internally generated.

Internally Generated – A term frequently applied to intangible assets (such as software) and meaning created or produced by a government or its contractor, or if acquired from a third party, requiring more than minimal effort to attain the expected level of service capacity.

Specified-Conditions Approach – An approach that spells out the precise criteria for determining when outlays associated with the internal development of intangible assets should begin to be capitalized. Outlays incurred prior to meeting the criteria would be expensed as incurred. Outlays incurred once the asset is operational (post-implementation) would also be expensed as incurred, unless a modification meets certain criteria for capitalization. Only outlays incurred for activities of the development stage would be capitalized.

Useful Life – The period during which an asset is expected to provide service to the government. If the life is defined by contractual or legal rights, the period should not exceed the expected service period. Renewal periods may be considered in setting the useful life, if there is evidence that the government will request and obtain renewals at nominal cost.