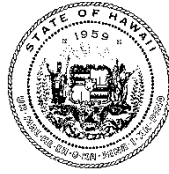


NEIL ABERCROMBIE  
GOVERNOR




Dean H. Seki  
Comptroller  
Maria E. Zielinski  
Deputy Comptroller

**STATE OF HAWAII**  
**DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES**  
P.O. BOX 119, HONOLULU, HAWAII 96810-0119

February 27, 2014

**COMPTROLLER'S MEMORANDUM NO. 2014-07**

TO: Heads of Departments and Agencies  
ATTN: Fiscal Offices  
FROM: Dean H. Seki, Comptroller   
SUBJECT: Accounting for Internally Generated Computer Software

This memorandum provides guidance on accounting for internally generated computer software in accordance with Governmental Accounting Standards Board (GASB) Statement No. 51 - Accounting and Financial Reporting for Intangible Assets.

**SCOPE**

GASB Statement No. 51 defines internally generated computer software as:

- Software created in-house by State personnel
- Software created by a contractor on behalf of the State
- Commercially available software that is purchased or licensed and requires more than minimal incremental effort before being put into operation

**ACCOUNTING FOR SOFTWARE DEVELOPMENT STAGES AND ACTIVITIES**

Accounting for activities involved in developing and installing internally generated computer software shall be as follows:

1. Preliminary Project Stage – Preliminary project stage activities include:
  - Conceptual formulation
  - Evaluation of alternatives
  - Determination of the existence of the needed technology
  - Final selection of alternatives

Preliminary project stage activities shall be expensed as incurred.

2. Application Development Stage – Application development stage activities include:

- Design of the chosen path including software configuration and software interfaces
- Coding
- Installation of hardware
- Testing, including the parallel processing phase
- Data conversion required to make the software operational

Activities in the application development stage should be capitalized when:

- a. Activities noted in the preliminary project stage are completed and
- b. Management implicitly or explicitly authorizes and commits to funding, at least current funding in the case of a multiyear project

For commercially available software that will be modified to the point it is considered internally generated, (1) and (2) above could generally be considered to have occurred upon the State's commitment to purchase or license the software.

Activities in the application development stage should be expensed prior to the preliminary project stage being completed and management authorizing and committing to funding. In addition, activities in the application development stage should be expensed subsequent to the point at which the software is substantially complete and operational.

3. Post-Implementation/Operation Stage – Post-implementation/operation stage activities include:

- Application training
- Software maintenance
- Data conversion that is not required to make the software operational

Activities in post-implementation/operation stage should be expensed as incurred.

While activities may occur in a sequence different from that outlined above, the determination of whether the outlays should be expensed or capitalized is based on the nature of the activity, not the timing of its occurrence. For example, outlays for application training activities that occur during the application development stage should be expensed.

### **ACCOUNTING FOR MODIFICATIONS TO INTERNALLY GENERATED COMPUTER SOFTWARE**

Modification to internally generated computer software, already in operation, should be capitalized if any of the following apply:

1. There is an increase in functionality
2. There is an increase in efficiency, that is, an increase in the level of service provided by the computer software without the ability to perform additional tasks
3. There is an extension of the software's estimated useful life

Modifications that do not meet any of the criteria outlined above should be expensed as incurred.

### **DETERMINING USEFUL LIFE**

Internally generated software should be amortized over its useful life. The useful life of software arising from contractual or other legal rights should not exceed the period to which the service capacity of the asset is limited by contractual or legal provisions. Renewal periods may be considered in determining useful life if there is evidence that the State will seek and be able to achieve renewal and that the anticipated outlays to be incurred as part of achieving the renewal are nominal in relation to the level of service capacity expected to be obtained through the renewal. Such evidence should consider the required consent of a third party and the satisfaction of conditions required to achieve the renewal, as applicable.

As with all assets, internally generated software shall only be capitalized if its useful life is greater than one year.

### **REPORTING INTERNALLY GENERATED COMPUTER SOFTWARE ON INVENTORY**

The amount to be inventoried is determined by whether the costs incurred are considered capitalizable costs or costs that should be expensed. Only capitalizable costs are included in the acquisition cost, which shall be inventoried if the total cost meets the State's inventory-reporting threshold. All other costs shall be expensed.

The responsible department shall maintain appropriate documentation to support amounts capitalized, expensed, and inventoried which may include, but not be limited to:

- Contracts
- Purchase orders
- Meeting minutes or other documentation to support determination of the project phases, activities, and useful life
- Time records to support capitalization of internal payroll cost

Should you have any questions regarding this memorandum, your staff may call Mr. Wayne M. Horie, Accounting System Administrator, at 587-0600.

<b>COMPONENTS OF COMPUTER SOFTWARE DEVELOPMENT Per GASB Statement No. 51</b>		
<b>Activities</b>	<b>Expensed</b>	<b>Capitalized</b>
<b>Preliminary Project Stage</b>		
• Conceptual formulation	X	
• Evaluation of alternatives	X	
• Determination of the existence of needed technology	X	
• Final selection of alternatives	X	
<b>Application Development Stage</b>		
• Design of chosen path including software configuration and interfaces	XX	XX
• Coding	XX	XX
• Installation of hardware	XX	XX
• Testing, including the parallel processing phase	XX	XX
• Data conversion required to make software operational	XX	XX
<b>Post-Implementation/Operation Stage</b>		
• Application training	X	
• Software maintenance	X	
• Data conversion not required to make software operational	X	
<b>Modifications to Internally Generated Computer Software</b>		
• Modifications that increase functionality		X
• Modifications that increase efficiency		X
• Modifications that extend the software's useful life		X
• Modifications other than those listed above	X	

XX =

Capitalize if:

1. Activities in the preliminary project state are complete and
2. Management implicitly or explicitly authorizes and commits to funding and
3. Useful life is greater than one year

Expense if:

1. Criteria to capitalize above is not met
2. Prior to management authorizing and committing to funds
3. Subsequent to the point at which the software is substantially complete and operational