MEMO# 8749

March 24, 1997

PROPOSED SOP ON COSTS OF COMPUTER SOFTWARE

March 24, 1997 TO: ACCOUNTING/TREASURERS COMMITTEE No. 10-97 RE: PROPOSED SOP ON COSTS OF COMPUTER SOFTWARE

____ In December of 1996 the Accounting Standards Executive Committee (AcSEC) of the AICPA issued an Exposure Draft of a proposed Statement of Position (SOP), Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. The SOP is intended to help eliminate the diversity in accounting for these costs and to improve financial reporting for what has become a significant unrecorded asset for many companies. If adopted, the proposed SOP would require capitalization of certain costs to develop or obtain internal-use software. For purposes of amortization and impairment, capitalized costs would be treated in the same manner as other long-lived assets. The proposal would apply prospectively to all entities that follow GAAP for fiscal years beginning after December 15, 1997. While the SOP would have no direct impact on investment companies, it has been suggested that the proposal may be of interest to investment advisers and administrators, which may spend substantial resources on obtaining and developing computer software for internal use. Under current practice, many companies expense costs associated with internally developed software for both book and tax purposes. If the SOP is adopted as proposed, certain costs currently expensed for book purposes would be required to be capitalized. The following is a brief summary of the proposed SOP. A copy of the SOP may be obtained by calling the AICPA order department at 800/862-4272. If you have comments on the proposed SOP please contact the undersigned (telephone 202/2326-5851, e-mail smith@ici.org) no later than April 11. Proposed SOP To be considered internal-use software subject to the accounting requirements of the proposed SOP, software must have both the following characteristics: a) the software is acquired, internally developed, or modified solely to meet the entitys internal needs, and b) during the softwares development or modification, no plan exists to market the software externally. If an entity determines that software is for internal use, it must identify project costs that are research and development costs which should be expensed as incurred. Under the proposal, the following software costs are considered to be research and development costs: Purchased or leased computer software used in research and development activities where the software does not have alternative future uses. All internally developed internal-use software if (a) the software is a pilot project or (b) the software is used in a particular research and development project regardless of whether the software has alternative future uses. Conceptual formulation, design, and testing of possible computer software project alternatives. The proposal describes and illustrates the three general stages of computer software development: (a) the preliminary project stage, (b) the program instruction stage, and (c) the implementation stage. Costs incurred in the preliminary project stage are considered to be research and development. Certain costs of developing or obtaining internal-use software that are not considered to be research and development costs should be capitalized as a long-lived asset. Capitalization of internal-use software project costs would begin when both of the following criteria are met: management authorizes and commits to funding a computer software project and believes that it is probable that the project will be completed and the software will be used to perform the function intended, and conceptual formulation, design, and testing of possible software project alternatives have been completed. These criteria are generally met before the beginning of or during the program instruction stage described above. Costs of developing or obtaining internal use software that should be capitalized should be limited to: External direct costs of material and services consumed in developing or obtaining internal- use computer software (e.g. consulting fees and purchased software). Payroll and payroll related costs for employees who are directly associated with and who devote time to the internal-use software project (e.g., a programmers time spend coding software). Certain interest costs incurred while developing internal-use computer software. Costs of upgrades and enhancements of existing internal-use software should be capitalized as improvements only if such improvements provide significant additional functionality or significantly extend the softwares life. However, the proposal specifically states that it does not permit costs associated with modifying computer software for the year 2000 to be capitalized. Year 2000 conversion costs must be expensed as incurred. The proposal would require general, administrative, overhead, and training costs to be expensed as incurred. Maintenance costs for routine activities, such as keeping the software updated with current information should also be expensed. In addition, the costs of converting old systems to new systems are excluded from the scope of the proposal and these types of costs would continue to be expensed as incurred. 3Gregory M. Smith Director - Operations/ Compliance & Fund Accounting

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