MANAGEMENT DIRECTIVE

Commonwealth of Pennsylvania
Governor's Office

Subject: Identifying, Recording, and Reporting Computer Software as a Capital Asset	**Number:** 310.36
Date: December 10, 2009	**By Direction of:** Mary A. Soderberg, Secretary of the Budget
Contact Agency: Office of the Budget, Office of Comptroller Operations, Bureau of Financial Management, Telephone 717-425-6732	

This directive establishes policy, responsibilities, and procedures for identifying, recording, and reporting certain computer software development and modification costs as capital assets. The requirements in this directive enable the commonwealth to comply with *Governmental Accounting Standards Board (GASB) Statement No. 51, Accounting and Financial Reporting for Intangible Assets (GASB 51)*. This directive is effective retroactively to July 1, 2009.

1. **PURPOSE.** To establish policy, responsibilities, and procedures for identifying, recording, and reporting certain computer software development and modification costs as capital assets.

2. **SCOPE.** This directive applies to all departments, boards, commissions, and councils (hereinafter referred to as "agencies") under the Governor's jurisdiction. All other executive and independent agencies are urged to adopt policies as provided herein.

3. **OBJECTIVES.**

   a. To identify computer software development and modification costs subject to capitalization and account for them as capital assets in commonwealth financial records.

   b. To enable and assist agencies to identify and record costs incurred for significant computer software projects, applications, acquisitions, or modifications in commonwealth financial records.

   c. To comply with generally accepted accounting principles (GAAP), as established by GASB, related to capital asset reporting for certain computer software development and modification costs in the commonwealth Comprehensive Annual Financial Report (CAFR).

4. **DEFINITIONS.**

    a. **Agency Fixed Assets Coordinator.** An individual appointed by an agency head who possesses substantial knowledge of the SAP Asset Accounting submodule and SAP Procurement and Finance modules; has considerable experience and expertise regarding acquisition, use, and control of agency fixed assets; regularly communicates with the Office of the Budget, Office of Comptroller Operations, Bureau of Financial Management (BFM) regarding fixed assets; manages all aspects of fixed asset reporting for the agency; and is the sole agency point of contact for BFM and other agencies for fixed asset accounting and reporting matters.

    b. **Amortization.** A process of expensing the acquisition cost less the residual value of an intangible asset in a systematic manner over the useful life of the intangible asset to reflect a decline in value as a result of use or the passage of time.

    c. **Business Process Reengineering Costs.** Costs incurred in implementing a systematic, disciplined improvement approach that critically examines, rethinks, and redesigns mission-critical processes in order to achieve dramatic performance improvements in areas important to customers and stakeholders.

    d. **Capital Asset.** An asset used in operations, with an estimated useful life of more than one year and having a significant value, as defined in this directive and *Management Directive 310.14, General Capital Asset and Other Fixed Asset Accounting and Reporting in SAP*.

    e. **Commercial Off-the-Shelf (COTS) Software**. Vendor-provided source coding or a licensing arrangement with a vendor for permission to use either its or another vendor's computer software.

    f. **Computer Software.** Written programs, procedures, rules, and associated documentation pertaining to the operation of a computer system that are loaded into and stored in the computer's memory.

    g. **Data Conversion Costs.** Costs incurred to change data used by, created by, or resulting from an agency's information technology resources.

    h. **Deputy Secretary for Comptroller Operations.** Office of the Budget, Office of Comptroller Operations, Chief Accounting Officer.

    i. **Enterprise Information Technology Governance Board.** An organization created by *Executive Order 2004-08, Enterprise Information Technology Governance Board*, having responsibilities to define a strategic vision for commonwealth information technology (IT) operations; establish program priorities; approve IT planning; direct IT investments; oversee IT purchasing and policy; resolve interagency disputes; make and implement recommendations on staffing and operational issues; monitor project performance; assign project management and business process reengineering resources from the Office of Administration, Office for Information Technology to critical agency projects; and perform other duties as assigned by the Governor.

j. **Expected Useful Life.** The period of years over which an asset can be used without risk of failure, excessive maintenance, or obsolescence. The expected useful life of a software capital asset should take into consideration its anticipated service period, including any planned renewals where the costs of such renewals are nominal in relation to the level of service capacity expected through the renewals. Other factors in determining the useful life of a software capital asset include obsolescence caused by the expiration of maintenance agreements; discontinuance of periodic updates or expiration of licenses; planned transition to another platform or computer software intended to replace the existing computer software; or other legal, contractual, regulatory or technological factors that would impact the expected useful life of the software capital asset. For instance, if an agency acquires a software capital asset that includes a three-year maintenance agreement with the vendor and the agency intends to renew the maintenance agreement for a second three-year period, the useful life of the software capital asset should be established as six years.

k. **Internally Generated Software**. Computer software developed in-house, using agency labor or resources, or by a third-party contractor on behalf of the agency. COTS software that is purchased or licensed by an agency and modified by agency personnel or a third-party contractor is considered internally generated software if the costs incurred for the modification exceed 10% of the total COTS software acquisition cost. Activities involved in developing and installing internally generated software are defined by three stages:

  (1) **Preliminary Project Stage**. Activities including the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the development of the computer software. This stage includes any costs incurred prior to approval by the Enterprise Information Technology Governance Board.

  (2) **Application Development Stage**. Activities relating to the design of the chosen path, including configuration and interfaces, coding, installation to hardware, and testing, including the parallel processing phase. This includes costs incurred subsequent to approval by the Enterprise Information Technology Governance Board and prior to the post-implementation/operation stage.

  (3) **Post-Implementation/Operation Stage.** Activities including application/user training and any other training related to or necessary to develop a specific computer software project or application, as well as software maintenance costs.

l. **Low Value Asset.** An asset not meeting the criteria of a general capital asset or proprietary fund capital asset (as defined by *Management Directive 310.14, General Capital Asset and Other Fixed Asset Accounting and Reporting in SAP*) but which is tracked as an asset in SAP.

m. **SAP Asset Accounting Submodule.** A subsystem of the SAP R/3 Financial Accounting (FI) module designed to manage and supervise individual aspects of fixed assets, including the purchase and sale of fixed assets, depreciation, and investment management.

n. **SAP Project System.** A component of the SAP R/3 system designed to support the planning, control, execution, and monitoring of long-term, highly-complex projects with defined goals.

o. **Software Capital Asset.** COTS software or internally generated software used in commonwealth operations, with an initial useful life extending beyond a single fiscal year, and with qualified, capitalizable costs exceeding $1 million.

p. **Training Costs.** Costs incurred to educate, instruct or enable agency or other personnel to create, modify, configure, integrate, or operate computer software applications.

5. **POLICY.**

a. Effective July 1, 2009, software capital asset costs must be identified, recorded, and reported in accordance with this directive. All computer software costs less than the software capital asset reporting threshold of $1 million may be recorded in SAP by classifying them as low value assets in accordance with *Management Directive 310.14, General Capital Asset and Other Fixed Asset Accounting and Reporting in SAP.*

b. The SAP Project System must be used to record software capital asset costs. Requests to waive this provision must be submitted with justification to the Office of Budget, Office of Comptroller Operations, Deputy Secretary for Comptroller Operations. Non-SAP systems may be used to record software capital asset costs only upon receipt of an approved waiver from the Deputy Secretary for Comptroller Operations.

c. Costs of COTS or internally generated software acquired or created primarily for the purpose of directly obtaining income or profit (e.g., computer software created or developed for sale to the public) must not be capitalized.

d. When reporting internally generated software costs, only the application development stage costs shall be reported as software capital asset costs. Preliminary project stage costs and post-implementation/operation stage costs shall not be reported as software capital asset costs.

e. Software capital asset costs must not include:

(1) Business process reengineering costs;

(2) Training costs; or

(3) Data conversion costs, unless the data conversion is necessary to make the computer software operational.

f. Outlays associated with the modification of computer software currently in operation, whether completed with internal resources or by an outside contractor, must be capitalized if they meet the definition of software capital assets and they result in either:

(1) An increase in the functionality of the computer software;

(2) An increase in the efficiency of the computer software; or

(3) An extension of the estimated useful life of the computer software.

g. Software capital asset costs must be amortized over the expected useful life of the asset.

h. If the costs of central, statewide systems (such as SAP) used by multiple agencies are to be allocated or billed to federal programs, the costs of such systems must be capitalized and amortized in the commonwealth statewide indirect cost allocation plan, in accordance with this directive and *OMB Circular A-87, Cost Principles for State, Local and Indian Tribal Governments (OMB Circular A-87)*. This process of capitalizing and amortizing the costs of central, statewide systems shall be coordinated through the Office of Budget, Office of Comptroller Operations, Deputy Secretary for Comptroller Operations.

i. All centralized, statewide projects where software capital asset costs may be allocated or billed to federal programs as a direct or indirect cost shall have a planned accounting and billing allocation methodology completed and submitted to the commonwealth's cognizant federal agency, the U.S. Department of Health and Human Services, Division of Cost Allocation, after approval of the Office of Budget, Office of Comptroller Operations, Deputy Secretary for Comptroller Operations.

j. When multi-agency projects are undertaken to develop computer software that may be used across federally funded programs, affected agencies should contact their respective cognizant federal agencies to determine how such costs can be charged to the respective federal programs. Agencies may be required to modify their departmental indirect cost allocation plans or federal billing methodologies to claim the pro rata share of annual amortization costs for the software capital asset under federal programs.

k. Software capital asset costs chargeable to federal programs shall be accumulated and documented in accordance with the provisions of *OMB Circular A-87*. The cost principles specified in *OMB Circular A-87* should also be used for guidance in determining and supporting state-funded software capital asset costs.

6. **RESPONSIBILITIES.**

a. **Secretary of the Budget.** Develop and oversee policy for identifying, recording, and reporting software capital assets.

b. Office of Budget, Office of Comptroller Operations, Deputy Secretary for Comptroller Operations.

    (1) Review agency requests for waivers in accordance with Section 5.b. of this directive and respond to agency requests with approval or disapproval.

    (2) Review planned accounting and billing methodologies for centralized, statewide projects where software capital assets can be allocated or billed to federal programs as direct or indirect costs:

        (a) If approved, forward the approved methodology to the U.S. Department of Health and Human Services, Division of Cost Allocation for review.

        (b) If disapproved, notify the agency of the reason for disapproval.

c. Office of the Budget, Office of Comptroller Operations, Bureau of Financial Management.

    (1) Assist agencies in developing a methodology to identify, record, and report software capital asset costs.

    (2) Instruct and assist agencies in interpreting this directive and *GASB 51*.

    (3) Assist agencies in establishing controls and procedures to ensure compliance with this directive and *GASB 51*.

    (4) Prepare appropriate financial statement disclosures for inclusion in the commonwealth CAFR.

d. Agency Heads.

    (1) Ensure suitable and sufficient controls and procedures are established and implemented to comply with this directive.

    (2) Ensure the agency fixed assets coordinator works with agency IT, procurement, and budget staff, Office of Comptroller Operations staff, auditors, and others to ensure compliance with this directive, agency controls and procedures, and all required accounting information.

    (3) Direct the use of the SAP project system to separately identify software capital assets.

    (4) Request a waiver from the Office of Budget, Office of Comptroller Operations, Deputy Secretary for Comptroller Operations if the agency has a system other than the SAP project system that is capable of recording both COTS and internally generated software capital costs.

    (5) Ensure the agency has established the appropriate software capital asset costs, useful life, and accounting information in the SAP Asset Accounting submodule.

(6) Ensure all supporting documentation, source documents, and other records pertaining to software capital assets are compiled and maintained in accordance with applicable records retention and disposition schedules.

e. Agency Fixed Assets Coordinator. Verify quarterly that all software capital assets have been identified, recorded, and reported in the SAP Asset Accounting submodule.

7. PROCEDURES.

a. Action by: Agency Head.

(1) Incorporate into the IT planning process an evaluation and assessment of projects that are approved by the Enterprise Information Technology Governance Board to identify software capital assets that must be recorded in accordance with this directive.

(2) Implement a process to ensure costs associated with IT projects that meet the definition of software capital assets are appropriately identified, recorded, and reported using the SAP project system. Conversely, ensure costs associated with IT projects that do not meet the definition of software capital assets are not recorded as such.

(3) If necessary, submit a waiver request to the Office of Budget, Office of Comptroller Operations, Deputy Secretary for Comptroller Operations prior to the inception of a project, including justification for using the non-SAP system; specific information detailing what systems, methodologies, and procedures will be used to capture, record, and report software capital asset costs according to the requirements of this directive and *OMB Circular A-87*; and the processes for recording such costs in the SAP Asset Accounting submodule.

b. Action by: Agency Fixed Assets Coordinator. Verify quarterly that all agency software capital assets have been identified, recorded, and reported in the SAP Asset Accounting submodule.

c. Action by: Office of the Budget, Office of Comptroller Operations, Bureau of Financial Management.

(1) Upon request, provide training and assistance to agencies in the identification, capture, recording, and reporting of software capital asset costs and their amortization.

(2) Work with agencies to ensure that software capital asset costs are properly reported in the commonwealth CAFR.

(3) Coordinate the development and submission of any central, statewide software capital asset projects to the commonwealth's cognizant federal agency for review upon approval of the project by the Enterprise Information Technology Governance Board and prior to the application development stage of each project.