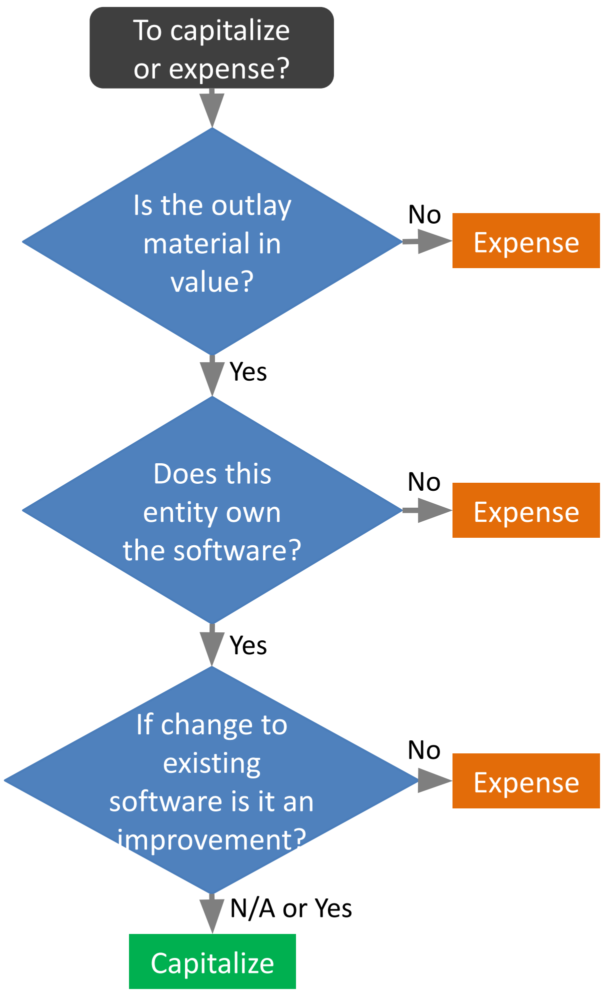
Financial Accounting Manual for Fed Reserve Banks

Appendix D. Software Accounting Guidance Overview

Appendix D of Financial Accounting Manual for Federal Reserve Banks covers accounting guidance to determine the appropriate accounting treatment for internal use software (including internally developed, purchased from vendor, and significantly modified) and cloud computing arrangements.



Is the outlay material in value?

For an outlay to be capitalized, it should be material in value, which, for purposes of recognizing assets, is defined as equal to or greater than the following capitalization thresholds:

Capitalization Thresholds	Software Acquisition Type
$100,000 or more	Internally developed software
	Implementation costs for cloud computing arrangements that does not contain a software license
	Bulk purchase of low cost licenses where license term is > 1 year
$25,000 or more	Externally purchased software

When software development occurs over several years, each element (a component or module) should be analyzed to determine whether it should be treated as a separate asset.

Does this entity own the software?

To capitalize, the entity must have ownership of the software by controlling future economic benefits and regulate access to the benefit, which is typically indicated in the contract.

If change to existing software is it an improvement providing additional capabilities?

To be considered an improvement rather than maintenance it must meet one of the following:

1. The quantity of output or operating efficiency of the asset is significantly increased, or
2. The quality of output is significantly increased

Capitalize Examples	Expense Examples
Augmenting existing business functions with new features and functions	Updating of flags and thresholds
Building completely new business functions	Updating field lengths and comment fields
Creating new screens and reports for new features or business functions	Reformatting of reports including the inclusion/ exclusion of existing data fields
Converting to a new platform, include converting to the cloud environment	Modifying layout of screens
	Changes to facilitate a new operating system version
Building a new interface	Installing fixes and patches

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Appendix D. Capitalizable Cost Rules, Useful Lives & Impairments

Capitalizable Costs

Costs incurred during software development or implementation of a cloud computing arrangement are capitalized or expensed depending on the project stage – preliminary, development, and post-implementation.

	Preliminary Stage	Development Stage	Post-Implementation Stage
	Includes activities related to: • Evaluation and selection of alternatives, • Selection of vendors and consultants, and • Build of prototype or proof of concept.	Includes activities related to: • Designing configuration & software interfaces, • Coding, testing, and installation of software, • Development of user guides.	Includes activities such as: • Maintenance to fix problems, and • Training of internal and external users.
Capitalize	None	• Materials and service costs (e.g., Consulting fees), including travel costs & oversight • Preparation of developer guide, • Functional & non-functional testing	Software maintenance contracts that are executed when the software is installed (when costs exceed the FAM thresholds for prepaids and deferred charges)
Expense	All costs associated with preliminary stage activities	• General & admin costs • Parallel testing, & end-user testing/ training • Purging, cleansing & conversion of historical data	All costs associated with post-implementation stage activities except maintenance costs. This includes integration costs to reinstall existing software on new hardware.

Assigning a Useful Life to a Software Asset & Regular Evaluation

A software asset is amortized over its useful life, and should begin when the software is ready for its intended use (i.e., substantial testing complete rather than placed in production). The useful life/ amortization period should reflect the circumstances for each specific asset. FAM set the maximum useful life to be 5 years, and anything longer requires board approval.

At a minimum, each Bank should assess annually the useful lives of software. If there is a need to change the useful life or amortization period due to the effects of obsolescence, technology, and other economic factors, then revisions are made prospectively. As such, the current net book value is amortized over the revised remaining useful life.

Impairment and Write-offs of Software Assets & Dev Costs

When a new asset is substituting/ replacing an existing asset, then the former element, if previously treated as a separate asset, should be removed from the books and expensed.

Significant events or changes in operating circumstances may warrant a review to determine if an asset value should be impaired. Such circumstances would include if a software is not expected to provide substantial service potential.

When it is no longer probable that a software project will be completed, no further costs should be capitalized and any costs that have been capitalized should be written off.

For additional information about this Regulatory brief or Botsford Associates Financial Services Regulatory Practice, and how we can help you, please contact:

Jon Block
Managing Partner
Financial Services
NYC: 917.647.3434 / TOR: 416.915.0438
jblock@botsford.com

Andrew Moreira
Managing Director - Consulting
Financial Services
NYC: 917.722.0939 / TOR: 647.361.4404
amoreira@botsford.com

Gordon Wong
Managing Director - Advisory
Financial Services
NYC: 917.722.1200 ext 319 / TOR: 437.253.4933
gwong@botsford.com