

Statutory Issue Paper No. 109

Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software

STATUS

Finalized September 12, 2000

Current Authoritative Guidance for Depreciation of Nonoperating System Software: SSAP No. 16R

This issue paper may not be directly related to the current authoritative statement.

Original SSAP from Issue Paper: SSAP No. 79

Type of Issue:

Common

SUMMARY OF ISSUE

1. *SSAP No. 16—Electronic Data Processing Equipment and Software* (SSAP No. 16) requires depreciation of all electronic data processing (EDP) equipment and software for a period not to exceed three years. This requirement is applicable to both operating and nonoperating system software.
2. The purpose of this issue paper is to amend SSAP No. 16 to allow the depreciation of nonoperating system software over the lesser of its useful life or five years rather than three years. The conclusions outlined in this issue paper are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. This issue paper amends paragraph 3 and 8 of SSAP No. 16. The following guidance shall be followed for depreciation of EDP equipment, operating system software and nonoperating system software.
4. EDP equipment and operating system software shall be depreciated over the lesser of its useful life or three years. Nonoperating system software shall be depreciated over the lesser of its useful life or five years. In either case, the methods detailed in *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements* shall be used.

Effective Date

5. EDP equipment and operating system software capitalized prior to January 1, 2001 shall be depreciated over the lesser of its remaining useful life or three years. Nonoperating system software capitalized prior to January 1, 2001 shall be depreciated over the lesser of its remaining useful life or five years.

DISCUSSION

6. A different amortization period for nonoperating system software, often called “applications software,” was not discussed during the initial drafting of SSAP No. 16. The amortization period for admitted EDP and software was discussed as part of the overall debate about whether any or all EDP and operating systems software should be an admitted asset. Amortization of nonoperating system software over a five year period does not violate the Statement of Concepts as illustrated below:

- a. Allowing amortization of nonoperating system software over its useful life by an appropriate method requires an insurer to appropriately recognize the expense and its income effect over time;
- b. The statutory accounting concept of conservatism is served by continuing to nonadmit nonoperating system software. It is not violated by allowing amortization over a longer period of time than three years if that period is no longer than the software's useful life; and
- c. Implementation of SSAP No. 16 as drafted may adversely affect companies and regulators by requiring insurers to accelerate expense recognition in a manner that was not foreseen. A number of states allow amortization of admitted EDP equipment and software over periods as long as 10 years, and current statutory accounting (prior to implementation of SSAP No. 16) provides the option of amortizing nonoperating systems software over its useful life. In addition, the initial draft of Issue Paper No. 16 allowed depreciation of nonadmitted EDP and software against net income as the estimated economic benefit expired. In 1999 insurers made significant purchases of nonoperating system software, in many cases to ensure that the software was not subject to the "year 2000 problem."

7. SSAP No. 16 currently requires EDP equipment and software capitalized prior to January 1, 2001 to be depreciated over the lesser of its remaining useful life or three years; therefore it is important that this issue paper be implemented concurrently with the effective date of SSAP No. 16.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

8. SSAP No. 16 paragraphs 3 and 8:
 3. EDP equipment and software shall be depreciated for a period not to exceed three years using methods detailed in *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements*.
 8. EDP equipment and software capitalized prior to January 1, 2001 shall be depreciated over the shorter of its remaining useful life or three years.

Generally Accepted Accounting Principles

9. GAAP does not address the issue of different depreciation periods for operating and nonoperating system software.

Drafting Notes/Comments

- *AICPA Statement of Position 98-1: Accounting for Costs of Computer Software Developed or Obtained for Internal Use* will be addressed in a separate issue paper.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 16—Electronic Data Processing Equipment and Software*
- *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements*