

Statutory Issue Paper No. 112

Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs

STATUS

Finalized December 4, 2000

Current Authoritative Guidance for Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs: SSAP No. 16R

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

Original SSAP from Issue Paper: SSAP No. 82

Type of Issue:

Common Area

SUMMARY OF ISSUE:

1. Current statutory accounting guidance for accounting for the costs of computer software developed or obtained for internal use and web site development costs is provided in *SSAP No. 16R—Electronic Data Processing Equipment and Software* (SSAP No. 16R) and *SSAP No. 17—Preoperating and Research and Development Costs* (SSAP No. 17). However, these SSAPs do not provide specific guidance on accounting for internal use software and web site development costs.
2. GAAP guidance for these issues is established in *AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1) and *FASB Emerging Issue Task Force No. 00-2, Accounting for Web Site Development Costs* (EITF 00-2). Current statutory guidance is similar to GAAP, except that these issues are not specifically addressed.
3. The purpose of this issue paper is to address SOP 98-1 and EITF 00-2 and establish statutory accounting principles that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION:

4. This issue paper adopts SOP 98-1 paragraphs 11-42 and paragraph 93 with certain modifications. This issue paper also adopts EITF 00-2 in its entirety.
5. The modifications to SOP 98-1 are as follows:
 - a. Paragraph 11 states that the accounting for costs of reengineering activities, which often are associated with new or upgraded software applications, is not included within the scope of this SOP. This issue paper expands upon that paragraph to require that such costs shall be expensed as incurred.
 - b. Paragraph 32 is amended to require that entities who license internal-use computer software follow the operating lease provisions outlined in *SSAP No. 22—Leases* (SSAP No. 22);
 - c. Paragraph 36 is amended to require that entities follow the amortization guidelines as established in paragraph 9 of *SSAP No. 19—Furniture, Fixtures and Equipment*;

Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP No. 19);

- d. Paragraph 37 is amended to require that capitalized operating system software shall be depreciated for a period not to exceed three years. Capitalized nonoperating system software shall be depreciated for a period not to exceed five years. This treatment is consistent with the guidelines of SSAP No. 16 and *Issue Paper No. 109—Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software* (Issue Paper No. 109);
- e. Paragraph 40 is amended to require that if during the development of internal-use software, an entity decides to market the software to others, the entity shall immediately expense any amounts previously capitalized;
- f. Paragraph 41 is amended to require entities to follow the disclosure provisions outlined in paragraph 5 of SSAP No. 16 and paragraph 5 of SSAP No. 17;
- g. Paragraph 42 is amended to require an effective date of January 1, 2002; and
- h. Any software costs capitalized in accordance with this issue paper shall be deemed nonoperating system software costs. Nonoperating system software is a nonadmitted asset in accordance with SSAP No. 16.

6. In accordance with the reporting entity's capitalization policy, immaterial amounts of such costs can be expensed when incurred.

Effective Date and Transition

7. Upon adoption of this issue paper, the NAIC will release a Statement of Statutory Accounting Principle (SSAP) for comment. The SSAP will contain the adopted Summary Conclusion of this issue paper. Users of the Accounting Practices and Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will contain an effective date of years beginning on or after January 1, 2002.

DISCUSSION:

8. The modifications to SOP 98-1 were made in order to maintain consistency with current statutory accounting principles and the Statement of Concepts.
- a. Paragraph 11 states that the accounting for costs of reengineering activities, which often are associated with new or upgraded software applications, is not included within the scope of this SOP. This issue paper expands upon that paragraph to require that such costs shall be expensed as incurred. This treatment is consistent with the GAAP equivalent contained within *Emerging Issues Task Force Issue No. 97-13, Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation*.
 - b. Paragraph 32 states that even though *FASB Statement No. 13, Accounting for Leases* (FAS 13), excludes licensing agreements from its scope, entities should analogize to that Statement when determining the asset acquired in a software licensing arrangement. The concepts outlined in FAS 13 are inconsistent with the provisions of SSAP. No. 22,

therefore paragraph 32 was amended to require that licensing agreements shall be treated as operating leases;

- c. Paragraph 36 was modified to remain consistent with the amortization guidelines contained within SSAP No. 19 paragraph 9;
- d. Paragraph 37 was amended to remain consistent with the depreciable lives guidelines contained within SSAP No. 16 and the recently adopted Issue Paper No. 109;
- e. Paragraph 40 requires that if, during the development of internal-use software, an entity decides to market the software to others, the entity should follow *FASB Statement No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* (FAS No. 86). Amounts previously capitalized under this SOP should be evaluated at each balance sheet date in accordance with paragraph 10 of FAS No. 86. Capitalized software costs should be amortized in accordance with paragraph 8 of FAS No. 86. Both paragraphs 8 and 10 are rejected in SSAP No. 17 and therefore the most conservative measure is to expense such amounts immediately;
- f. Paragraph 41 includes references to various different GAAP pronouncements for its disclosure requirements. This paragraph was modified as SSAP Nos. 16 and 17 already include the pertinent disclosure requirements;
- g. Paragraph 42 indicates that SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. The paragraph was modified to allow an effective date of January 1, 2002 so as to provide ample opportunity for statutory accounting user implementation; and
- h. In order to remain consistent with the treatment of nonoperating system software, the nonadmission criteria outlined in paragraph 2 of SSAP No. 16 were included in this issue paper. In order to prevent the possible misclassification of nonoperating system software as operating software, the working group felt it was appropriately conservative to classify all software costs capitalized in accordance with this issue paper as nonoperating system software costs. The Glossary to the SSAPs defines operating and nonoperating system software as:

The operating system is a program or a series of programs controlling the data job and task management operations of a computer or a computer network through executive scheduling and monitoring. It increases the productivity of a computer installation by managing the allocation of all available computer resources including the control processing unit, main storage and input/output devices.

Nonoperating systems software such as language processors, library routines and debugging aides and other computer software are not considered operating system software.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE:

Statutory Accounting

9. In general, capitalization of software is provided for in SSAP No. 16. This issue paper provides more specific guidelines for capitalization of internal software and web site development costs. SSAP No. 16 renders the following instruction:

2. EDP equipment and software generally meet the definition of assets established in *SSAP No. 4—Assets and Nonadmitted Assets*. EDP equipment and operating system software are admitted assets to the extent they conform to the requirements of this statement. Nonoperating system software are nonadmitted assets.

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*.

4. The aggregate amount of admitted EDP equipment and operating system software (net of accumulated depreciation) shall be limited to three percent of the reporting entity's capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any EDP equipment and operating system software, net deferred tax assets and net positive goodwill.

Disclosures

5. The following disclosures shall be made in the financial statements:

- a. Depreciation and amortization expense for the period;
- b. For EDP equipment and operating system software, balances of major classes of depreciable assets, by nature or function, at the balance sheet date;
- c. For EDP equipment and operating system software, accumulated depreciation and amortization, either by major classes of depreciable assets or in total, at the balance sheet date; and
- d. A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

6. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 5 above shall be included in the annual audited statutory financial reports only.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

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

10. *AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* provides the following:

.11 Accounting for costs of reengineering activities, which often are associated with new or upgraded software applications, is not included within the scope of this SOP.

Conclusions

Characteristics of Internal-Use Computer Software

.12 For purposes of this SOP, internal-use software is software having the following characteristics:

- a. The software is acquired, internally developed, or modified solely to meet the entity's internal needs.

- b. During the software’s development or modification, no substantive plan exists or is being developed to market the software externally.

A substantive plan to market software externally could include the selection of a marketing channel or channels with identified promotional, delivery, billing, and support activities. To be considered a substantive plan under this SOP, implementation of the plan should be reasonably possible. Arrangements providing for the joint development of software for mutual internal use (for example, cost-sharing arrangements) are not substantive plans to market software for purposes of this SOP. Similarly, routine market feasibility studies are not substantive plans to market software for purposes of this SOP.

.13 An entity must meet both characteristics in paragraph .12 for software to be considered for internal use.

.14 An entity’s past practices related to selling software may help determine whether the software is for internal use or is subject to a plan to be marketed externally. For example, an entity in the business of selling computer software often both uses and sells its own software products. Such a past practice of both using and selling computer software creates a rebuttable presumption that any software developed by that entity is intended for sale, lease, or other marketing, and thus is subject to the guidance in FASB Statement No. 86.

.15 Computer software to be sold, leased, or otherwise marketed includes software that is part of a product or process to be sold to a customer and should be accounted for under FASB Statement No. 86. For example, software designed for and embedded in a semiconductor chip is included in the scope of FASB Statement No. 86 because it is an integral part of the product. By contrast, software for internal use, though it may be used in developing a product, is not part of or included in the actual product or service sold. If software is used by the vendor in the production of the product or providing the service but the customer does not acquire the software or the future right to use it, the software is covered by this SOP. For example, for a communications company selling telephone services, software included in a telephone switch is part of the internal equipment used to deliver a service but is not part of the product or service actually being acquired or received by the customer.

.16 The Appendix [paragraph .93] provides examples of when computer software is and is not for internal use.

Stages of Computer Software Development

.17 The following table illustrates the various stages and related processes of computer software development.

Preliminary Project Stage	Application Development Stage	Post-Implementation/ Operation Stage
<ul style="list-style-type: none"> ▪ Conceptual formulation of alternatives 	<ul style="list-style-type: none"> ▪ Design of chosen path, including software configuration and software interfaces 	<ul style="list-style-type: none"> ▪ Training
<ul style="list-style-type: none"> ▪ Evaluation of alternatives 	<ul style="list-style-type: none"> ▪ Coding 	<ul style="list-style-type: none"> ▪ Application maintenance
<ul style="list-style-type: none"> ▪ Determination of existence of needed technology 	<ul style="list-style-type: none"> ▪ Installation of hardware 	
<ul style="list-style-type: none"> ▪ Final selection of alternatives 	<ul style="list-style-type: none"> ▪ Testing, including parallel processing phase 	

The SOP recognizes that the development of internal-use computer software may not follow the order shown above. For example, coding and testing are often performed simultaneously. Regardless, for costs incurred subsequent to completion of the preliminary project stage, the SOP

should be applied based on the nature of the costs incurred, not the timing of their incurrence. For example, while some training may occur in the application development stage, it should be expensed as incurred as required in paragraphs .21 and .23.

Research and Development

.18 The following costs of internal-use computer software are included in research and development and should be accounted for in accordance with the provisions of FAS No. 2:

- a. Purchased or leased computer software used in research and development activities where the software does not have alternative future uses.
- b. All internally developed internal-use computer software (including software developed by third parties, for example, programmer consultants) if (1) the software is a pilot project (that is, software of a nature similar to a pilot plant as noted in paragraph 9.h. of FASB Statement No. 2) or (2) the software is used in a particular research and development project, regardless of whether the software has alternative future uses.

Capitalize or Expense

.19 Preliminary Project Stage. When a computer software project is in the preliminary project stage, entities will likely—

- a. Make strategic decisions to allocate resources between alternative projects at a given point in time. For example, should programmers develop a new payroll system or direct their efforts toward correcting existing problems in an operating payroll system?
- b. Determine the performance requirements (that is, what it is that they need the software to do) and systems requirements for the computer software project it has proposed to undertake.
- c. Invite vendors to perform demonstrations of how their software will fulfill an entity's needs.
- d. Explore alternative means of achieving specified performance requirements. For example, should an entity make or buy the software? Should the software run on a mainframe or a client server system?
- e. Determine that the technology needed to achieve performance requirements exists.
- f. Select a vendor if an entity chooses to obtain software.
- g. Select a consultant to assist in the development or installation of the software.

.20 Internal and external costs incurred during the preliminary project stage should be expensed as they are incurred.

.21 Application Development Stage. Internal and external costs incurred to develop internal-use computer software during the application development stage should be capitalized. Costs to develop or obtain software that allows for access or conversion of old data by new systems should also be capitalized. Training costs are not internal-use software development costs and, if incurred during this stage, should be expensed as incurred.

.22 The process of data conversion from old to new systems may include purging or cleansing of existing data, reconciliation or balancing of the old data and the data in the new system, creation of new/additional data, and conversion of old data to the new system. Data conversion often occurs during the application development stage. Data conversion costs, except as noted in paragraph .21, should be expensed as incurred.

.23 Post-Implementation/Operation Stage. Internal and external training costs and maintenance costs should be expensed as incurred.

.24 Upgrades and Enhancements. For purposes of this SOP, upgrades and enhancements are defined as modifications to existing internal-use software that result in additional functionality—

that is, modifications to enable the software to perform tasks that it was previously incapable of performing. Upgrades and enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications. In order for costs of specified upgrades and enhancements to internal-use computer software to be capitalized in accordance with paragraphs .25 and .26, it must be probable that those expenditures will result in additional functionality.

.25 Internal costs incurred for upgrades and enhancements should be expensed or capitalized in accordance with paragraphs .20-.23. Internal costs incurred for maintenance should be expensed as incurred. Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements should expense such costs as incurred.

.26 External costs incurred under agreements related to specified upgrades and enhancements should be expensed or capitalized in accordance with paragraphs .20-.23. (If maintenance is combined with specified upgrades and enhancements in a single contract, the cost should be allocated between the elements as discussed in paragraph .33 and the maintenance costs should be expensed over the contract period.) However, external costs related to maintenance, unspecified upgrades and enhancements, and costs under agreements that combine the costs of maintenance and unspecified upgrades and enhancements should be recognized in expense over the contract period on a straight-line basis unless another systematic and rational basis is more representative of the services received.

.27 Capitalization of costs should begin when both of the following occur.

- a. Preliminary project stage is completed.
- b. Management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project and it is probable that the project will be completed and the software will be used to perform the function intended. Examples of authorization include the execution of a contract with a third party to develop the software, approval of expenditures related to internal development, or a commitment to obtain the software from a third party.

.28 When it is no longer probable that the computer software project will be completed and placed in service, no further costs should be capitalized, and guidance in paragraphs .34 and .35 on impairment should be applied to existing balances.

.29 Capitalization should cease no later than the point at which a computer software project is substantially complete and ready for its intended use. For purposes of this SOP, computer software is ready for its intended use after all substantial testing is completed.

.30 New software development activities should trigger consideration of remaining useful lives of software that is to be replaced. When an entity replaces existing software with new software, unamortized costs of the old software should be expensed when the new software is ready for its intended use.

Capitalizable Costs

.31 Costs of computer software developed or obtained for internal use that should be capitalized include only the following:

- a. External direct costs of materials and services consumed in developing or obtaining internal-use computer software. Examples of those costs include but are not limited to fees paid to third parties for services provided to develop the software during the application development stage, costs incurred to obtain computer software from third parties, and travel expenses incurred by employees in their duties directly associated with developing software.
- b. Payroll and payroll-related costs (for example, costs of employee benefits) for employees who are directly associated with and who devote time to the internal-

use computer software project, to the extent of the time spent directly on the project. Examples of employee activities include but are not limited to coding and testing during the application development stage.

- c. Interest costs incurred while developing internal-use computer software. Interest should be capitalized in accordance with the provisions of FASB Statement No. 34, Capitalization of Interest Cost.

General and administrative costs and overhead costs should not be capitalized as costs of internal-use software.

.32 Entities often license internal-use software from third parties. Though *FASB Statement No. 13, Accounting for Leases*, excludes licensing agreements from its scope, entities should analogize to that Statement when determining the asset acquired in a software licensing arrangement.

Multiple-Element Software Arrangements Included in Purchase Price

.33 Entities may purchase internal-use computer software from a third party. In some cases, the purchase price includes multiple elements, such as training for the software, maintenance fees for routine maintenance work to be performed by the third party, data conversion costs, reengineering costs, and rights to future upgrades and enhancements. Entities should allocate the cost among all individual elements. The allocation should be based on objective evidence of fair value of the elements in the contract, not necessarily separate prices stated within the contract for each element. Those elements included in the scope of this SOP should be accounted for in accordance with the provisions of this SOP.

Impairment

.34 Impairment should be recognized and measured in accordance with the provisions of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. Paragraph 8 of FASB Statement No. 121 requires that assets should be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. FASB Statement No. 121 guidance is applicable, for example, when one of the following occurs related to computer software being developed or currently in use:

- a. Internal-use computer software is not expected to provide substantive service potential,
- b. A significant change occurs in the extent or manner in which the software is used or is expected to be used,
- c. A significant change is made or will be made to the software program,
- d. Costs of developing or modifying internal-use computer software significantly exceed the amount originally expected to develop or modify the software.

.35 Paragraph 10 of FASB Statement No. 121 requires that “if the asset is not expected to provide any service potential to the entity, the asset shall be accounted for as if abandoned or held for disposal in accordance with the provisions of paragraph 15 of [FASB Statement No. 121].” When it is no longer probable that computer software being developed will be completed and placed in service, the asset should be reported at the lower of the carrying amount or fair value, if any, less costs to sell. The rebuttable presumption is that such uncompleted software has a fair value of zero. Indications that the software may no longer be expected to be completed and placed in service include the following:

- a. A lack of expenditures budgeted or incurred for the project
- b. Programming difficulties that cannot be resolved on a timely basis
- c. Significant cost overruns
- d. Information has been obtained indicating that the costs of internally developed software will significantly exceed the cost of comparable third-party software or software products, so that management intends to obtain the third-party software or software products instead of completing the internally developed software

- e. Technologies are introduced in the marketplace, so that management intends to obtain the third-party software or software products instead of completing the internally developed software
- f. Business segment or unit to which the software relates is unprofitable or has been or will be discontinued.

Amortization

.36 The costs of computer software developed or obtained for internal use should be amortized on a straight-line basis unless another systematic and rational basis is more representative of the software's use.

.37 In determining and periodically reassessing the estimated useful life over which the costs incurred for internal-use computer software will be amortized, entities should consider the effects of obsolescence, technology, competition, and other economic factors. Entities should consider rapid changes that may be occurring in the development of software products, software operating systems, or computer hardware and whether management intends to replace any technologically inferior software or hardware. Given the history of rapid changes in technology, software often has had a relatively short useful life.

.38 For each module or component of a software project, amortization should begin when the computer software is ready for its intended use, regardless of whether the software will be placed in service in planned stages that may extend beyond a reporting period. For purposes of this SOP, computer software is ready for its intended use after all substantial testing is completed. If the functionality of a module is entirely dependent on the completion of other modules, amortization of that module should begin when both that module and the other modules upon which it is functionally dependent are ready for their intended use.

Internal-Use Computer Software Marketed

.39 If, after the development of internal-use software is completed, an entity decides to market the software, proceeds received from the license of the computer software, net of direct incremental costs of marketing, such as commissions, software reproduction costs, warranty and service obligations, and installation costs, should be applied against the carrying amount of that software. No profit should be recognized until aggregate net proceeds from licenses and amortization have reduced the carrying amount of the software to zero. Subsequent proceeds should be recognized in revenue as earned.

.40 If, during the development of internal-use software, an entity decides to market the software to others, the entity should follow FASB Statement No. 86. Amounts previously capitalized under this SOP should be evaluated at each balance sheet date in accordance with paragraph 10 of FASB Statement No. 86. Capitalized software costs should be amortized in accordance with paragraph 8 of FASB Statement No. 86. A pattern of deciding to market internal-use software during its development creates a rebuttable presumption that any software developed by that entity is intended for sale, lease, or other marketing, and thus is subject to the guidance in FASB Statement No. 86.

Disclosures

.41 This SOP does not require any new disclosures; disclosure should be made in accordance with existing authoritative literature, including *Accounting Principles Board (APB) Opinion No. 12, Disclosure of Depreciable Assets and Depreciation*; *APB Opinion No. 22, Disclosure of Accounting Policies* (for example, amortization methods); FASB Statement Nos. 2 and 121; and *SOP 94-6, Disclosure of Certain Significant Risks and Uncertainties*.

Effective Date and Transition

.42 This SOP is effective for financial statements for fiscal years beginning after December 15, 1998, and should be applied to internal-use computer software costs incurred in those fiscal years for all projects, including those projects in progress upon initial application of this SOP. Earlier application is encouraged in fiscal years for which annual financial statements have not been issued.

Appendix

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Examples Illustrating When Computer Software Is for Internal Use

1. A manufacturing entity purchases robots and customizes the software that the robots use to function. The robots are used in a manufacturing process that results in finished goods.
2. An entity develops software that helps it improve its cash management, which may allow the entity to earn more revenue.
3. An entity purchases or develops software to process payroll, accounts payable, and accounts receivable.
4. An entity purchases software related to the installation of an online system used to keep membership data.
5. A travel agency purchases a software system to price vacation packages and obtain airfares.
6. A bank develops software that allows a customer to withdraw cash, inquire about balances, make loan payments, and execute wire transfers.
7. A mortgage loan servicing entity develops or purchases computer software to enhance the speed of services provided to customers.
8. A telecommunications company develops software to run its switches that are necessary for various telephone services such as voice mail and call forwarding.
9. An entity is in the process of developing an accounts receivable system. The software specifications meet the company's internal needs and the company did not have a marketing plan before or during the development of the software. In addition, the company has not sold any of its internal-use software in the past. Two years after completion of the project, the company decided to market the product to recoup some or all of its costs.
10. A broker-dealer entity develops a software database and charges for financial information distributed through the database.
11. An entity develops software to be used to create components of music videos (for example, the software used to blend and change the faces of models in music videos). The entity then sells the final music videos, which do not contain the software, to another entity.
12. An entity purchases software to computerize a manual catalog and then sells the manual catalog to the public.
13. A law firm develops an intranet research tool that allows firm members to locate and search the firm's databases for information relevant to their cases. The system provides users with the ability to print cases, search for related topics, and annotate their personal copies of the database.

Examples Illustrating When Computer Software Is Not Internal Use

14. An entity sells software required to operate its products, such as robots, electronic game systems, video cassette recorders, automobiles, voice-mail systems, satellites, and cash registers.
15. A pharmaceutical company buys machines and writes all of the software that allows the machines to function. The pharmaceutical company then sells the machines, which help control the dispensation of medication to patients and help control inventory, to hospitals.
16. A semiconductor entity develops software embedded in a microcomputer chip used in automobile electronic systems.
17. An entity purchases software to computerize a manual catalog and then sells the computer version and the related software to the public.

18. A software company develops an operating system for sale and for internal use. Though the specifications of the software meet the company's internal needs, the company had a marketing plan before the project was complete. In addition, the company has a history of selling software that it also uses internally and the plan has a reasonable possibility of being implemented.
 19. An entity is developing software for a point-of-sale system. The system is for internal use; however, a marketing plan is being developed concurrently with the software development. The plan has a reasonable possibility of being implemented.
 20. A telecommunications entity purchases computer software to be used in research and development activities.
 21. An entity incurs costs to develop computer software for another entity under a contract with that other entity.
11. EITF 00-2 provides the following:

EITF 00-2 ISSUE

1. Companies are incurring significant costs to develop Internet web sites. These companies may be "Internet" companies, traditional "brick and mortar" companies, or service companies. The web sites may be used to promote or advertise products or services, supplant manual processes or services, sell products (including software) or services, or to do a combination of all three. Further, due to rapid changes in technology, new uses for web sites are being developed. Diversity in practice exists in accounting for web site development costs. Some entities capitalize web site development costs, others expense such costs, and still others capitalize some of those costs and expense the rest.
2. The issue is how an entity should account for costs incurred to develop a web site.

EITF 00-2 DISCUSSION

3. The Task Force discussed the accounting for web site development costs and reached the following consensus.

Costs Incurred in the Planning Stage

4. Planning stage activities are described in detail in Exhibit 00-2A. The Task Force reached a consensus that, regardless of whether the web site planning activities specifically relate to software, all costs incurred in the planning stage should be expensed as incurred.

Costs Incurred in the Web Site Application and Infrastructure Development Stage

5. As described in Exhibit 00-2A, the web site application and infrastructure development stage involves acquiring or developing hardware and software to operate the web site. The cost of hardware is outside the scope of this Issue. SOP 98-1 provides guidance for distinguishing between internal-use software and software to be sold, leased, or otherwise marketed. A key aspect of the definition of internal-use software is that it excludes software for which a plan exists or for which a plan is being developed to market the software externally. The Task Force reached a consensus that all costs relating to software used to operate a web site should be accounted for under SOP 98-1 unless a plan exists or is being developed to market the software externally, in which case the costs relating to the software should be accounted for pursuant to Statement 86. Fees incurred for web site hosting, which involve the payment of a specified, periodic fee to an Internet service provider in return for hosting the web site on its server(s) connected to the Internet, generally would be expensed over the period of benefit.

Costs Incurred to Develop Graphics

6. For purposes of this Issue, graphics involve the overall design of the web page (use of borders, background and text colors, fonts, frames, buttons, and so forth) that affect the "look and feel" of the web page and generally remain consistent regardless of changes made to the content. The Task Force reached a consensus that graphics are a component of software and that the costs of developing initial graphics should be accounted for pursuant to SOP 98-1 for internal-use software, and pursuant to Statement 86 for software marketed externally. Modifications to graphics after a web site is launched should be evaluated to determine whether the modifications represent maintenance or enhancements of the web site. The accounting for maintenance and enhancements is discussed in paragraph 8.

Costs Incurred to Develop Content

7. Content refers to information included on the web site, which may be textual or graphical in nature (although the specific graphics described in paragraph 6, above, are excluded from content). For example, articles, product photos, maps, and stock quotes and charts are all forms of content. Content may reside in separate databases that are integrated into (or accessed from) the web page with software, or it may be coded directly into the web pages. The Task Force observed that the accounting for web site content involves issues that also apply to other forms of content or information that are not unique to web sites. Accordingly, the Task Force concluded that the accounting for content should be addressed as a separate EITF Issue.

Costs Incurred in the Operating Stage

8. As described in Exhibit 00-2A, costs incurred during the operating stage include training, administration, maintenance, and other costs to operate an existing web site. The Task Force reached a consensus that the costs of operating a web site should not be accounted for differently from the costs of other operations; that is, those costs should be expensed as incurred. However, costs incurred in the operation stage that involve providing additional functions or features to the web site should be accounted for as, in effect, new software. That is, costs of upgrades and enhancements that add functionality should be expensed or capitalized based on the general model of SOP 98-1 (which requires certain costs relating to upgrades and enhancements to be capitalized if it is probable that they will result in added functionality) or, for software that is marketed, Statement 86 (which applies its software capitalization model to "product enhancements," which include improvements that extend the life or significantly improve the marketability of a product). The Task Force observed that the determination of whether a change to web site software results in (a) an upgrade or enhancement, if internal-use software, or (b) a product enhancement, if externally marketed software, is a matter of judgment based on the specific facts and circumstances. The Task Force also observed that SOP 98-1 indicates that entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements must expense such costs as incurred.

Transition

9. The consensus in this Issue are effective for web site development costs incurred for fiscal quarters beginning after June 30, 2000 (including costs incurred for projects in process as of the beginning of the quarter of adoption of these consensus). Earlier application is encouraged. The Task Force observed that an entity may elect to adopt the consensus as a cumulative effect of a change in accounting principles in accordance with Opinion 20.

10. Exhibit 00-2A illustrates the application of the above-described consensus to specific web site development costs.

EITF 00-2 STATUS

11. No further EITF discussion is planned.

EXHIBIT 00-2A
APPLICATION OF THE EITF CONSENSUSES ON ISSUE 00-2

<i>Planning Stage</i>	
Web Site Development Activity	Accounting Required by Issue 00-2
a. Develop a business, project plan, or both. This may include identification of specific goals for the web site (for example, to provide information, supplant manual processes, conduct e-commerce, and so forth), a competitive analysis, identification of the target audience, creation of time and cost budgets, and estimates of the risks and benefits.	Expense as incurred.
b. Determine the functionalities (for example, order placement, order and shipment tracking, search engine, e-mail, chat rooms, and so forth) of the web site.	Expense as incurred.
c. Identify necessary hardware (for example, the server) and web applications. Web applications are the software needed for the web site's functionalities. Examples of web applications are search engines, interfaces with inventory or other back-end systems, as well as systems for registration and authentication of users, commerce, content management, usage analysis, and so forth.	Expense as incurred.
d. Determine that the technology necessary to achieve desired functionalities exists. Factors might include, for example, target audience numbers, user traffic patterns, response time expectations, and security requirements.	Expense as incurred.
e. Explore alternatives for achieving functionalities (for example, internal versus external resources, custom-developed versus licensed software, company-owned versus third-party-hosted applications and servers).	Expense as incurred.
f. Conceptually formulate and/or identify graphics and content (refer to "Graphics and Content Development Stages" for further discussion).	Expense as incurred.
g. Invite vendors to demonstrate how their web applications, hardware, or service will help achieve the web site's functionalities.	Expense as incurred.
h. Select external vendors or consultants.	Expense as incurred.
i. Identify internal resources for work on the web site design and development.	Expense as incurred.
j. Identify software tools and packages required for development purposes.	Expense as incurred.
k. Address legal considerations such as privacy, copyright, trademark, and compliance.	Expense as incurred.

Web Site Application and Infrastructure Development Stage	
Web Site Development Activity	Accounting Required by Issue 00-2
	The discussion of web site application and infrastructure development assumes that any software is developed for the entity's internal needs and no plan exists or is being developed to market the software externally (refer to paragraph 12 of SOP 98-1). Software for which a plan exists or is being developed to market the software externally is subject to Statement 86, and costs associated with the development of that software should be expensed until technological feasibility is established (refer to paragraph 4 of Statement 86).
a. Acquire or develop the software tools required for the development work (for example, HTML editor, software to convert existing data to HTML form, graphics software, multimedia software, and so forth).	Apply SOP 98-1. Costs incurred to purchase software tools, or costs incurred during the application development stage for internally developed tools, generally should be capitalized unless they are used in research and development and (1) do not have any alternative future uses or (2) are internally developed and represent a pilot project or are being used in a specific research and development project (see paragraph 18 of SOP 98-1).
b. Obtain and register an Internet domain name.	Generally, capitalize pursuant to paragraph 24 of APB 17.
c. Acquire or develop software necessary for general web site operations, including server operating system software, Internet server software, web browser software, and Internet protocol software.	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
d. Develop or acquire and customize code for web applications (for example, catalog software, search engines, order processing systems, sales tax calculation software, payment systems, shipment tracking applications or interfaces, e-mail software, and related security features).	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
e. Develop or acquire and customize database software and software to integrate distributed applications (for example, corporate databases and accounting systems) into web applications.	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
f. Develop HTML web pages or develop templates and write code to automatically create HTML pages.	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
g. Purchase the web and application server(s), Internet connection (bandwidth), routers, staging servers (where preliminary changes to the web site are made in a test environment), and production servers (accessible to customers using the web site). Alternatively, these services may be provided by a third party via a hosting arrangement.	Acquisitions of servers and related hardware infrastructure are outside the scope of this Issue. Payments for hosting arrangements should be expensed over the period of benefit.

h. Install developed applications on the web server(s).	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
i. Create initial hypertext links to other web sites or to destinations within the web site. Depending on the site, links may be extensive or minimal.	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
j. Test the web site applications (for example, stress testing).	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.

Graphics and Content Development Stages	
Web Site Development Activity	Accounting Required by Issue 00-2
a. Create initial graphics for the web site. Graphics include the design or layout of each page (that is, the graphical user interface), color, images, and the overall "look and feel" and "usability" of the web site. Creation of graphics may involve coding of software, either directly or through the use of graphic software tools. The amount of coding depends on the complexity of the graphics.	Apply SOP 98-1. Initial graphics are part of the software and generally should be capitalized pursuant to paragraph 21 of SOP 98-1.
b. Create content or populate databases. Content may be created or acquired to populate databases or web pages. Content may be acquired from unrelated parties or may be internally developed.	To be addressed in a future EITF Issue.
c. Enter initial content into the web site. Content is text or graphical information (exclusive of graphics described in (a) above) on the web site which may include information on the entity, products offered, information sources that the user subscribes to, and so forth. Content may originate from databases that must be converted to HTML pages or databases that are linked to HTML pages through integration software. Content also may be coded directly into web pages.	Apply SOP 98-1. Paragraph 22 of SOP 98-1 specifies that "data conversion costs" should be expensed as incurred. Similarly, costs to input content into a web site generally should be expensed as incurred. Software used to integrate a database with a web site generally should be capitalized pursuant to paragraph 21 of SOP 98-1.

Operating Stage	
Web Site Development Activity	Accounting Required by Issue 00-2
a. Train employees involved in support of the web site.	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.
b. Register the web site with Internet search engines.	Expense as incurred. These expenditures represent advertising costs and are expensed as incurred pursuant to paragraph 26 of SOP 93-7.
c. Perform user administration activities.	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.
d. Update site graphics (for updates of graphics related to major enhancements, refer to (h), below).	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.

e. Perform regular backups.	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.
f. Create new links.	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.
g. Verify that links are functioning properly and update existing links (that is, link management or maintenance).	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.
h. Add additional functionalities or features.	Apply SOP 98-1. Generally, capitalize if they meet the definition of "upgrades and enhancements" in paragraph 24 of SOP 98-1.
i. Perform routine security reviews of the web site and, if applicable, of the third-party host.	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.
j. Perform usage analysis.	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP 98-1.

RELEVANT LITERATURE:**Statutory Accounting**

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 16—Electronic Data Processing Equipment and Software*
- *SSAP No. 17—Preoperating and Research and Development Costs*
- *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements*
- *SSAP No. 22—Leases*
- *Issue Paper No. 109—Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software*

Generally Accepted Accounting Principles

- *AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*
- *EITF 00-2, Accounting for Web Site Development Costs*