U.S. Department of Transportation
Office of the Secretary of Transportation

Memorandum

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Subject: CFO-2010-004 Policy on Internal Developed Software

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To: Heads of Operating Administrations, Chief Financial Officers

PURPOSE

This policy sets forth guidance to classify and report costs incurred for DOT internal use software projects, including the conditions to be met and the circumstances that must exist for the disposition of applicable financial transactions and events.

AUTHORITY/REFERENCES

Chief Financial Officer Act (CFO) of 1990.

Department of Transportation (DOT) Financial Management Policies Manual, April 2008.

Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Standards (SFFAS) #10 Accounting for Internal Use Software, issued June 1998.

FASAB Technical Release #5 Implementation Guidance on SFFAS #10, issued May 14, 2001.

FASAB SFFAS #6 Accounting for Property, Plant and Equipment, issued June 1996.

FASAB SFFAS #4 Managerial Cost Accounting Concepts and Standards, issued July 1995.

Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, June 2009.

BACKROUND

The CFO Act of 1990 and OMB Circular A-136 require Federal agencies to prepare and submit annual financial statements for audit. DOT prepares a Balance Sheet, a Statement of Net Cost, a Statement of Changes in Net Position and a Statement of Budgetary Resources.

To ensure that transactions are properly recorded and the statements are prepared in accordance with current government accounting standards relative to internal use software, the following policy is implemented.

FASAB #10 -- Accounting for Internal Use Software categorizes costs into three categories for projects meeting the capitalization threshold.

1. Preliminary Design phase. These costs are expensed.
2. Software/Application Development phase. These costs are capitalized.
3. Post Implementation phase. These costs are expensed.

REQUIREMENTS

DOT will capitalize or expense the cost of planning, developing and operating internally used software as follows:

A. Software Life Cycle Phases.

Preliminary Design Phase. DOT will expense costs incurred in the preliminary design phase. These are costs incurred prior to the commencement of application development phase and include:

- Requirements gathering
- Conceptual formulation of alternatives
- Evaluation of alternatives
- Determination of existence of needed technology
- Final selection of alternatives

Application Development Phase. DOT will capitalize costs incurred in the application development phase of an internal use software project with aggregate development costs that meet or exceed the capitalization threshold of $200,000. Capitalized costs shall be limited to costs incurred after completion of the preliminary design phase. These costs incurred, both internal and external, to develop the software and include:

- Design of chosen path
- Software configuration
- Software interfaces
- Coding/programming
- Installation to hardware
- Initial security certification and accreditation (C&A)
- Testing to include unit, system, acceptance, integration and parallel processing, as applicable.

DOT will capitalized the full cost, both direct and indirect, of developing an internal use software application. Accordingly, DOT will capitalize internal costs incurred to include payroll and payroll related (benefits) costs of employees who are directly associated with and who devote time to the internal use software project. Travel expenses incurred by employees in their duties directly associated with developing the software will be capitalized. Capitalized internal costs include project management and earned value management activities and the development of technical documentation, enterprise architecture documentation, user manuals and initial training material (although the cost of mass producing such items should be expensed). Capitalized internal costs will also include indirect costs, such as project management and administrative personnel costs, rent, supplies and utilities, reasonably allocable to the internal use software project.

DOT will capitalize direct costs of materials and services consumed in developing or obtaining software, such as fees paid to third parties for services and costs incurred to obtain software from third parties.

DOT will also capitalize the cost incurred to acquire, purchase or obtain tools or other software to access or convert from the old system to the new system as long as the software project meets or exceeds the incurred cost capitalization threshold. However, costs incurred related to data conversion from the old system to the new system should be expensed (see paragraph K below).

The cutoff for capitalization of development costs ends with the successful completion of user acceptance testing when the software is ready for use. Costs incurred after final acceptance testing will be expensed. Where the software is to be installed at multiple sites, capitalization should cease at each site after testing is complete at that site.

Post Implementation Phase. DOT will expense the costs incurred in the post implementation phase. These costs include training, data conversion and application maintenance.

DOT will expense the costs of software and related business process reengineering activities.

DOT will expense those software costs associated with terminated projects or subprojects, including the cost of maintaining such software until the time of disposal.

DOT will expense software that is deemed impaired as soon as it is considered impaired.

B. COTS software. DOT will capitalize the amount paid to a vendor to acquire title or copyright (not license) to COTS software for a software project with development costs incurred of $200,000 or more.

C. Contractor developed software. DOT will capitalize the amount paid to a contractor to design, program, install or implement software for a software project with aggregate development costs incurred of $200,000 or more. This includes the amount paid to a contractor to modify COTS or existing software and to otherwise make software ready for use.

D. Internally developed software. DOT will capitalize the costs incurred (both direct and indirect) to develop internal use software for a software project with aggregate development costs incurred of $200,000 or more. This includes the costs incurred for DOT personnel to modify COTS software or contractor developed software and to otherwise make software ready for use.

E. Integrated Software. Computer software that is integrated into (embedded) and necessary to operate equipment, rather than perform an application, will be considered part of the equipment of which it is an integral part and will be capitalized and depreciated accordingly (e.g., airport radar and computer-operated lathes). The aggregate cost of the hardware and software should be used to determine whether to capitalize or expense the costs.

F. Bundled Products and Services. The cost of software purchased as part of a package of products and services (e.g., training, maintenance, data conversion, reengineering, site licenses, and rights to future upgrades and enhancements) shall be allocated as capitalizable and non-capitalizable (expensed) costs based on a reasonable estimate of the value of the individual products or services. Costs that are not susceptible to allocation between maintenance and relatively minor enhancements should be expensed.

G. Licenses. Generally, DOT will expense software licenses or maintenance fees incurred to use or maintain software. Software licenses can cover periods ranging from the entire estimated service life of the software to annual or more frequent periods and are considered similar to leases. In such cases, lease accounting concepts will govern. DOT will evaluate software licenses and multiyear service contracts that are similar to leases in accordance with the lease capitalization standards [To be classified as a capital lease, one of the following criteria must be met: the lease transfers ownership at the end of the term; the lease contains a bargain purchase option; the lease term is equal to 75 percent or more of the estimated useful life of the leased asset; or the present value of the minimum lease payments is equal to or greater than 90 percent of the fair value of the leased asset]. For leases and hence software licenses purchases, the general property, plant and equipment capitalization threshold of $25,000 will apply.

H. Bulk purchases. DOT will account for bulk purchases of the same software acquired under the same contract as a group and subject to the $200,000 threshold for capitalization purposes. If the same software package is purchased under two or more contracts, costs shall be accounted for and thresholds applied separately. Software acquired through separate contracts shall be accounted for separately.

I. Maintenance costs. DOT will expense all maintenance costs.

J. Service contracts. DOT will expense all service contracts.

K. Data conversion costs. DOT will expense all data conversion costs. These costs include the purging or cleansing of existing data; reconciling or balancing old data to data in a new system; creation of new/additional data and conversion of the old data to the new system.

L. Enhancements. Upgrades and enhancements normally require new software specification and change to all or part of the existing software.

a. DOT will capitalize the cost of upgrades or enhancements to existing internal use software when it is more likely than not that it will result in significant additional capabilities or functionality.

b. DOT will expense the costs of upgrades or enhancements resulting from ongoing maintenance that merely extend the useful life or capacity of the software.

REPORTING

A. Internal use software capitalizable costs will be accumulated as work in process until final acceptance testing has been successfully completed. DOT will accumulate all capitalizable costs in United States Standard General Ledger (USSGL) account 1832 - Internal-Use Software in Development. This account is reflected on the Balance Sheet line item General property, plant and equipment (PP&E). All items deemed 'expenses' incurred during the project will be recorded in USSGL account 6100 – Operating Expenses/Program Costs (other than amortization costs) and will be reported on the Statement of Net Cost. At the end of each financial reporting period, the balance in USSGL account 1832 will be displayed in the footnotes as a separate line item, 'Internal Use Software in Development.'

Once the asset is deemed complete and final acceptance testing has occurred, the capitalizable costs will be transferred from USSGL account 1832 to USSGL account 1830 - Internal Use Software. DOT will amortize the asset over its estimated useful life provided the estimated useful life is for a period of not less than two years. Software with an estimated useful life of less than two years will be expensed. The straight line method of amortization should be used. Amortization expense will be recorded both as an expense in USSGL account 6710 - Depreciation, Amortization, and Depletion and as a contra asset amount in USSGL account 1839 - Accumulated Amortization on Internal-Use Software. At the end of each financial reporting period, the assets and the related amortization will be reported on Balance Sheet as part of PP&E and in the footnotes as 'Internal Use Software.' The amortization expense will be reported on the Statement of Net Cost.

B. Modules of a software project will be amortized when the module has been successfully tested. If a module is dependent on the completion of another module(s), amortization begins when all modules necessary for operational use have successfully completed user testing.

C. The software will remain in the general property, plant, and equipment accounts as long as it remains in service of DOT operations, even when the software has been fully amortized. Conversely, both the capitalized amount (recorded in SGL 1830) and the accumulated amortization (recorded in SGL 1839) amounts should be removed from the books when the asset is no longer used in the service of DOT operations. At that time, the software will be recorded to an appropriate asset account at its net realizable value until the time of disposal.

APPLICABILITY/DELEGATIONS/EXCEPTION

This policy applies to all DOT Operating Administrations (OAs).

Effective immediately, this policy supersedes previously issued policy on internal use software.

Immaterial amounts do not apply, otherwise there are no exceptions.

APPENDIX A – DEFINITIONS

Amortization – The gradual extinguishment of an intangible asset's recorded value through a systematic allocation over its projected useful life.

Capitalization – The classification and carry-forward of all or a portion of an asset's cost into one or more future periods when its benefits or proceeds will be realized.

Capitalization threshold –The criteria applied for determining whether an asset should be capitalized or expensed.

Commercial off-the-shelf software (COTS) – COTS is software which is ready-made and available for sale, lease, or license to the general public. The term often refers to computer software or hardware systems and may also include free software with commercial support. COTS purchases are alternatives to in-house developments.

Contractor-developed software – Software that an entity is employing a contractor to design, program, install and implement -- including new software and existing or purchased software that have been modified.

Depreciation – The systematic and rational allocation of a tangible asset's cost, less its estimated salvage or residual value, over its estimated useful life.

Direct Cost – The cost of resources directly consumed by and specifically identified with an activity. Direct cost is assigned to activities by the direct tracing of resource units consumed.

Expense – Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity.

Full Cost – The full cost of an output produced by a responsibility segment is the sums of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities.

Indirect Cost – The cost of resources that are jointly or commonly used to produce two or more types of output but are not specifically identifiable with any of the outputs, e.g., general administrative services, general research and technical support, security, rent, employee health and recreation facilities, and operating and maintenance cost for buildings, equipment and utilities. Such costs can be assigned to the output on a cause and effect basis or allocated on a reasonable and consistent basis.

Internal Use Software – Software that is purchased from commercial vendors "off-the-shelf," internally developed, or contractor-developed solely to meet the entity's internal or operational needs.

Internally developed software – Is software that employees of an entity are actively developing, including new software and existing or purchased software that is being modified with or without the assistance of contractors.

License – Is a legal instrument governing the usage or redistribution of software.

Software –The application and operating system programs, procedures, rules and any associated documentation pertaining to the operation of a computer system.

Useful life – Is the normal operating life in terms of utility to the owner.