FIN-6.09 - Capitalization of Computer Software Developed or Obtained for Internal Use

CAPITALIZATION OF COMPUTER SOFTWARE DEVELOPED OR OBTAINED FOR INTERNAL USE
Administrative Rule Adopted by Council
ARC-FIN-6.09

Purpose
The purpose of this administrative rule is to establish minimum standards for the capitalization of expenses incurred for the purchase or development of computer software for internal use.

Authority
Authority for this administrative rule is established in the City Charter and City Code. This administrative rule has been approved by the City Council.

Monitoring
The Accounting Division of the Office of Management and Finance (Accounting Division) will periodically monitor bureaus to assess compliance with the minimum standards of this rule. When instances of non-compliance are identified, bureaus will be required to develop and implement a corrective action plan. The Accounting Division will provide assistance to bureaus, if requested, to develop this plan. The Controller will report all instances of non-compliance annually to the City Council.

Definitions

"Capital Assets" means tangible or intangible assets having significant value that are used in operations and that have initial useful lives extending beyond a fiscal year. Capital assets include land, improvements to land, buildings, equipment, infrastructure and work in progress. See the Capital Asset Policy (currently under development) for more detailed information regarding capital assets and the capitalization threshold.

"Computer Software Developed or Obtained for Internal Use" means computer software purchased from a commercial vendor, internally developed, or contractor-developed to meet the City's internal needs. This administrative rule does not cover proper accounting for the costs of computer software developed to be sold, leased or otherwise marketed.

"Preliminary Project Stage" means the earliest stage of a software development or selection project, during which the alternatives are being evaluated but no decision has been made as to which strategy or vendor to use. Typical activities during this phase include assembling the evaluation team, evaluating proposals from vendors and the final selection of alternatives.

"Application Development Stage" means the stage of a software development or selection project during which the design, coding, installation and testing of new software occurs. The stage begins once management has authorized and committed to funding the project, and it is considered probable that the project will be completed and put to its intended use. The application development stage concludes when the software is complete and ready for use.

"Post-Implementation/Operation Stage" means the stage that begins once the software is put into use. It includes training and subsequent maintenance of the software.

"Governmental Fund" means a self-balancing set of accounts through which most governmental functions are financed. Governmental funds use modified accrual accounting, and the focus is on the financial position of

the fund, and changes to that position. Governmental funds include the General, Special Revenue, Capital Projects, Debt Service and Permanent funds.

"Proprietary Fund" means a self-balancing set of accounts through which a government's business-type functions are financed. Proprietary funds use accrual accounting, and determine net income, similar to organizations in the private section. Proprietary funds include Enterprise and Internal Service funds.

Treatment of Project Costs

1. The decision to capitalize or expense the costs of obtaining computer software is based on the stage of computer software acquisition or development and the nature of the costs incurred.
2. Costs of projects during the application development stage shall be capitalized. Typical costs include direct materials or services contributing to the project, payroll and payroll-related costs for employees directly associated with the project, testing costs and installation costs. General and administrative costs, training costs, data conversion costs with the exception of data conversion software, maintenance costs and overhead shall not be capitalized but shall be expensed as incurred.
3. Interest costs incurred by proprietary funds during the development process shall be capitalized. Interest costs incurred by governmental funds during the development process shall not be capitalized.
4. Costs of projects in the preliminary project stage or the post-implementation/ operation stage shall be expensed as incurred.
5. The cost of upgrades and enhancements to capitalized computer software shall be capitalized only if the upgrades or enhancements provide additional functionality.
6. Capitalized software is included in the capital assets of individual proprietary funds, and in the government-wide statement of net assets for software held in a bureau in a governmental fund.

Amortization

1. The capitalized cost of the computer software shall be amortized over the estimated useful life of the software.
2. Estimated useful lives shall be based on City useful life schedules. Useful lives must be applied consistently by all bureaus.
3. Amortization will be calculated using a convention of zero amortization during the fiscal year of acquisition and a full year's amortization charge in the fiscal year of retirement.
4. The costs of computer software developed or obtained for internal use will be amortized on a straight-line basis.
5. Zero residual value is to be used for all capitalized software.
6. Amortization is reported as an operating expense for proprietary funds. Amortization expense is reported only at the government-wide level for software amortized in governmental funds.

Disposal of Software
If existing software is retired from use, any unamortized costs of the old software shall be expensed.

History
Resolution No. 36248
Adopted by Council September 1, 2004.