INTERNALLY GENERATED INTANGIBLE ASSETS 8635

(Revised 06/2011)

Intangible assets are considered internally generated if they are created or produced by the department or an entity contracted by the department, or if they are acquired from a third party but require more than minimal incremental effort on the part of the department to begin to achieve their expected level of service capacity.

Outlays incurred in the development of an internally generated intangible asset that are identifiable should be capitalized only upon the occurrence of all of the following:

> a. Determination of the specific objective of the project and the nature of the service capacity that is expected to be provided by the intangible asset upon the completion of the project.
>
> b. Demonstration of the technical or technological feasibility for completing the project so that the intangible asset will provide its expected service capacity.
>
> c. Demonstration of the current intention, ability, and presence of effort to complete or, in the case of a multiyear project, continue development of the intangible asset.

Only outlays incurred subsequent to meeting the above criteria should be capitalized. Outlays incurred prior to meeting those criteria should be expensed as incurred.

INTERNALLY GENERATED COMPUTER SOFTWARE

Computer software should be considered internally generated if it is developed in-house by department personnel or by a third-party contractor on behalf of the department.

Computer software is a type of intangible asset that is often internally generated. During the development stage, evaluate the expenditures to determine whether capitalization appears appropriate. Record the applicable capitalizable expenditures as Internally Generated Intangible Assets In Progress, General Ledger Account 2430.

Commercially available software purchased or licensed by a department that requires modification using “more than incremental effort” before being put into operation should be considered internally generated. For example, licensed financial accounting software that the department modifies to provide special reporting capabilities would be considered internally generated.

(Continued)

(Continued)
INTERNALLY GENERATED INTANGIBLE ASSETS **8635** (Cont. 1)
(Revised 06/2011)

The activities involved in developing and installing internally generated computer software can be grouped into the following stages:

Preliminary Project Stage— **Costs incurred during this stage are not capitalized**.

These costs include the following activities:

a. Conceptual formulation of alternatives
b. Evaluation of alternatives
c. Determination of existence of needed technology
d. Final selection of alternatives for development

Application Development Stage—**Costs incurred during this stage involve both internal and external costs incurred to develop the software and are capitalized.**

These costs include the following activities:

a. Design of chosen path, including software configuration and software interfaces
b. Coding
c. Installation to hardware
d. Testing, including the parallel processing phase
e. Data conversion— only to the extent that the data is necessary to make the computer software operational.

Post-Implementation/Operation Stage—**Costs incurred during this stage are not capitalized**.

These costs include the following:

a. Training
b. Application maintenance
c. Data conversion— data, such as historical, not necessary to make the software operational, but desirable from a management perspective.

For internally generated computer software, the criteria for internally generated intangible assets should be considered to be met only when *both* the following occur:

a. The activities noted in the Preliminary Project Stage are completed.
b. Management implicitly authorizes and commits to funding, at least currently in the case of a multiyear project, the software development project.

(Continued)

(Continued)
INTERNALLY GENERATED INTANGIBLE ASSETS **8635** (Cont. 2)
(Revised 06/2011)

Once the criteria for internally generated intangible assets have been met, outlays related to activities in the Application Development Stage should be capitalized. Capitalization of such outlays should cease no later than the point at which the computer software is substantially complete and operational. Outlays associated with activities in the Post-Implementation/Operation Stage should be expensed as incurred.

INTERNALLY GENERATED MODIFICATION OF COMPUTER SOFTWARE

Outlays associated with an internally generated modification of software that is already in operation should be capitalized when all internally generated software intangible assets criteria have been met if the modification results in any of the following:

a. An increase in the functionality of the computer software, that is, the computer software is able to perform tasks that it was previously incapable of performing.
b. An increase in the efficiency of the computer software, that is, an increase in the level of service provided by the computer software without the ability to perform additional tasks.
c. An extension of the estimated useful life of the software.

If the modification does not result in any of the above outcomes, the modification should be considered maintenance, and the associated outlays should be expensed as incurred.

The following costs should be expensed as incurred:

- Internal and external costs during the preliminary project stage.
- Training during all project stages.
- Data conversion costs are normally considered part of the post implementation/operations stage unless they are determined to be necessary to make the computer software operational.
- Internal costs incurred for maintenance.
- General, administrative, and overhead costs.
- Maintenance costs in post implementation/operation stage.

(Continued)

(Continued)
INTERNALLY GENERATED INTANGIBLE ASSETS **8635** (Cont. 3)
(Revised 06/2011)

The following costs should be capitalized and amortized over the useful life:

- Internal and external costs incurred to develop internal use computer software during the application development stage.
- External direct costs of materials and services consumed in developing or obtaining software. Examples include fees 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.
- Payroll and payroll-related costs such as benefits for employees who are directly associated with and who devote time to the computer software project, to the extent of the time spent directly on the project. Examples include coding and testing during the application development stage.

Methods for determining total cost should be retained as a record of the asset value.