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Alert #159

TO: Controllers and Chief Fiscal Officers of State Departments
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FROM: Leslie M. Shenefelt
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DATE: July 11, 2005

SUBJECT: Software Capitalization policy
COFRS Cash Balances and Exhibit M
Insurance proceeds in the General Fund
DUNS numbers
Fiscal rules
New PERA requirements

Software Capitalization policy

The State Controller's Office has developed guidance for properly accounting for the purchase of computer software. The specific guidance is available on our website and is attached to this Alert. If you have any questions please contact your FAST representative.

Accounting of Costs
of Compute...

COFRS Cash Balances and Exhibit M

State agencies are required to record their June 30 bank balances on COFRS and report that balance in the Exhibit M as discussed below.

The Exhibit M shows a bank balance and a COFRS balance for all agency cash amounts that are not with the State Treasurer. In most instances, these bank accounts are deposit accounts that are swept by the State Treasurer, and except for imprest checking accounts, they should not be used for disbursements. Therefore, the potential for a variance between the bank and COFRS balance is related to deposits.

Page 87 of the March 2005 Fiscal Procedures Manual (Section 3.12 - Cash Deposits with the State Treasurer) states that "Any money remaining in the agency bank account at the end of business on June 30 must be shown on COFRS in a 10XX account and included on the agency's Exhibit M".

It has come to the State Controller's Office attention that a significant number of agencies show variances between the bank and COFRS balance on the Exhibit M. Since the June 30 bank statement for these accounts should be available before the period 13 agency close on August 2, agencies should post an entry to COFRS before close to ensure that the COFRS balance matches the June 30 bank balance – the COFRS and June 20 bank balance should be the *same*.

Insurance proceeds in the General Fund
Insurance proceeds may be accounted for in either the General Fund or in other funds. If repairs are not complete at year-end, the unspent balance may be carried forward to the following fiscal year. If accounted for in the General Fund, without intervention, unspent dollars revert to the General Fund. To prevent reversion, process an AP document by August 22, 2005 for the unspent balance, annotating the revenue source as coming from fund balance (revenue source code 9523). Please contact your FAST representative if you have questions.

DUNS numbers
When submitting the fiscal year 2004-05 Exhibit K (due September 19), state agencies will be required to provide the DUNS (Data Universal Numbering System) number of the other state agency for each federal award passed through to another state agency. See page 162 (Chapter 3, Section 5.15) of the March 2005 Fiscal Procedures Manual for more information on this and other DUNS requirements. In order to minimize the need for additional time-consuming communications between state agencies, the State Controller's Office has prepared a schedule of DUNS numbers for all state agencies. You may access this listing on the State Controller's Office website at:

http://www.colorado.gov/dpa/dfp/sco/fiscalmanual/FY05_06/manual05_06.htm.

Contact Karoline Clark (303-866-3811) if you have any questions regarding the DUNS number requirements.

Fiscal Rules

The changes to the Fiscal Rules have been adopted and are available on the website. These Fiscal Rules are final and will be effective August 1, 2005.

New PERA requirements

As a result of SB 04-257 the State is required to begin paying employer contributions on salaries paid to retirees beginning July 1, 2005. Further, SB 05-073 modified the description of employment of a retiree by a PERA employer as "engagement, hiring, retention, or other use of a service retiree in an individual capacity or of any entity owned or operated by a service retiree or affiliated party by an employer to perform any service as an employee, contract employee, consultant, independent contractor, or through any other arrangement." Basically, if you hire a PERA retiree as a contractor, vendor, consultant, or through any other arrangement, employer contributions must be paid based on the amount paid to the retiree for services rendered.

For those agencies that operate on COFRS, we are in the process of developing a system to identify payments made to retirees. For those agencies that use the central payroll system (i.e., CPPS), we are developing a process for using the CPPS system to charge the employer contribution to the appropriate agency and remit the employer contribution to PERA. Agencies will be required to enter the payments made to retirees into the CPPS system. Detailed procedures will be distributed within the next two weeks to ensure implementation by the July 29, 2005 pay date.

Accounting of Costs of Computer Software
Developed or Obtained for Internal Use

Executive Summary

The State Controller's Office is providing this guidance so that departments can identify and properly account for computer software. Examples of recently developed or purchased software include Colorado Benefits Management System (CBMS), BANNER, and Genesys.

This guidance is based on Statement of Position (SOP) 98-1, issued by the Accounting Standards Executive Committee on March 4, 1998. The American Institute of Certified Public Accountants (AICPA) did not make SOP 98-1 applicable to government; however, pending guidance on software capitalization from the Governmental Accounting Standards Board (GASB), the State Controller has decided to apply the main provisions of SOP 98-1 to achieve consistency in capitalization within the State.

SOP 98-1 defines internal use software and categorizes the development into phases. The general treatment of costs for each phase is summarized below:

Phases: General treatment of costs:

- Preliminary Project Stage   Expensed
- Application Development Stage   Capitalized
- Post Implementation/Operation Stage   Expensed

Implementation Timing

All state entities are required to implement SOP 98-1 as interpreted in this guidance beginning July 1, 2005. In addition, state entities should capitalize in accordance with this guidance the current and historical project costs for any internal use software projects that were in process in fiscal year 2005.

Definitions

Internal Use Computer Software - Internal use computer software has both of the following characteristics:

1. The software is acquired, internally developed, or modified solely to meet the entity's internal needs, and
2. During the software's development or modification, no substantive plan exists or is being developed to market the software externally

Preliminary Project Stage – Includes determination of system requirements, development of alternatives, vendor demonstrations of their software, evaluation of alternatives, and final selection of alternatives.

Application Development Stage – Includes software configuration and interface, coding, installation of hardware, testing, and data conversion.

Post-Implementation/Operation Stage – Includes training and maintenance costs.

Upgrades and enhancements – Includes modifications to existing internal use software that result in additional functionality – modifications to enable the software to perform tasks that it was previously incapable of performing.

Internal Costs – Costs paid to employees or other organizations within the entity, for example, payroll costs and programming costs of internal programmers.

External Costs – Costs paid to outside vendors, for example, software licenses.

Estimated Useful Life – The period over which the internal use computer software will be amortized. In assessing estimated useful life, entities should consider the effects of obsolescence, technology, competition, and other economic factors. Given the history of rapid changes in technology, software often has had a relatively short useful life.

Costs to be Expensed

The following costs should be expensed as they are incurred:

- Internal and external costs incurred during the preliminary project stage
- Training during all project stages
- Data conversion costs (except if the costs are for software for data conversion as noted in the section Costs to be Capitalized below)
- Internal costs incurred for maintenance
- General and administrative costs and overhead costs
- Maintenance costs in post implementation/operation stage

Costs to be Capitalized

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
- Costs to develop or obtain software that allows for access or conversion of old data by the new system
- External direct costs of materials and services consumed in developing or obtaining internal use software. Examples include 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.
- Payroll and payroll-related costs such as 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 include coding and testing during the application development stage.
- Interest costs incurred while developing internal use computer software

Multiple Element Software Arrangements Included in Purchase Price

Where the price of internal use computer software from a third party includes multiple elements, the entity should allocate the costs among all individual elements. Examples of these elements are training, maintenance fees, and data conversion. 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. The separate elements should be accounted for in accordance with the provisions of this guidance and SOP 98-1.

Timing of Capitalization

Capitalization of costs should begin when both of the following occur:

1. Preliminary project stage is completed, and
2. Management 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.

Capitalization should cease no later than the point at which a computer software project is substantially complete and ready for its intended use – after all substantial testing is completed.

Amortization

For each module or component of a software project, amortization should begin when the computer software is ready for its intended use – after all substantial testing is completed.

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

Upgrades and Enhancements

Costs for upgrades and enhancements that are material in relation to total project costs, should be capitalized or expensed using the same guidelines used for internal use

software described in this guidance and SOP 98-1. Costs for upgrades and enhancements that are not material should be expensed as incurred.

Impairment

Impairment should be recognized and measured in accordance with the provision of GASB Statement No. 42.

Internal Use Software Marketed

If, after the development of internal use software is completed, an entity decides to market the software, the entity should consult SOP 98-1 for the appropriate accounting treatment.

Split Funded Projects

Internal use software projects that are funded from more than one funding source should follow this guidance.