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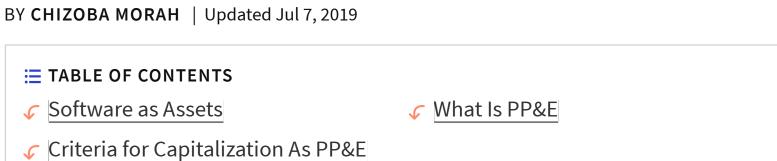
How is Computer Software Classified as an Asset?

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Computer software can be considered a long-term asset that falls under <u>fixed</u> <u>assets</u> like buildings and land. However, there are times when <u>software</u> should not be considered a long-term asset. In this article, we'll review the accounting standards that are in place to classify computer software.

Software as Assets

Intangible assets are typically nonphysical assets used over the longterm. Intangible assets are often intellectual assets, and as a result, it's difficult to assign a value to them because of the uncertainty of the future benefits.



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PP&E refers to <u>long-term assets</u>, such as equipment that is vital to a company's operations and has a definite physical component. Under most circumstances, computer software is classified as an intangible asset because of its nonphysical nature. However, accounting rules state that there are certain exceptions that permit the classification of computer software, such as PP&E (property, plant and equipment).

Below are the accounting standards that describe how and when computer software should be classified as PP&E:

- Financial Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 10, Accounting for Internal Use Software.
- Governmental Accounting Standards Board (GASB) Statement No. 51, Accounting and Financial Reporting For Intangible Assets.

What Is PP&E

It's important that we first define the accounting standard for PP&E. According to <u>SFFAS No. 6</u>, tangible assets are classified as PP&E if:

- They (assets) have estimated useful lives of 2 years or more.
- They are not intended for sale in the ordinary course of operations. • They have been acquired or constructed with the intention of being used or
- being available for use by the entity.

Criteria for Capitalization As PP&E

There are rules that are applied to determine whether or not software must be capitalized as PP&E or expensed. If software meets the criteria of property, plant, and equipment as stated above, it can be classified as PP&E. According to SFFAS No. 10:

> "Entities should capitalize the cost of software when such software meets the criteria for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods and services."

- Management has some discretion since there are no dollar amount thresholds for the cost of computer software whether it's internal or new software.
- Capitalization thresholds should be established by management in accordance with PP&E guidelines. For example, for a bulk software purchase, both the bulk cost and the <u>useful life</u> of the software should be included in the calculation. If it is contractor-developed software, the amount paid to the vendor for development and implementation should be classified.
- Capitalization of software doesn't include software that is an integral part of property, plant, and equipment. According to <u>SFFAS No. 10</u> section 38 & 39; it states:

"For example, if the software is a part of a weapons systems, it would not be capitalized but included in the cost of investing in that weapons system. On the other hand, software used to accumulate the cost of acquiring that weapons system or to manage and account for that item would meet the criteria for general PP&E and should be capitalized."

• The capitalization cutoff is not determined by an amount but rather when the testing stage of the software has been completed. According to <u>SFFAS</u> <u>10</u>, paragraph 20:

> "Costs incurred after final acceptance testing has been successfully completed should 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."

It's important to review the financial accounting standards before making any decisions on whether to expense or capitalize computer software as PP&E. This article only touches on a few of the key topics. Many other instances may have different accounting standards that might need to be applied such as cloud computing, multi-use software, developmental software, and shared software between divisions.

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