VOLUME 4, CHAPTER 27: "INTERNAL USE SOFTWARE"

SUMMARY OF MAJOR CHANGES

Changes are identified in this table and also denoted by blue font.

Substantive revisions are denoted by an asterisk (*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by ***bold, italic, blue, and underlined font***.

The previous version dated August 2018 is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
All	Administrative updates to include clarifying language in accordance with Department of Defense Financial Management Regulation Revision Standard Operating Procedures.	Revision
Throughout	Deleted references and tables related to Capital Leases. Capital Leases are discussed in ***Chapter 26***, "Accounting for Leases".	Deletion
1.1	Refined the definition of General Property, Plant, and Equipment.	Revision
2.1.4.3	Updated the internal use software definition based on FASAB Technical Release 16: "Implementation Guidance for Internal Use Software", footnote 4.	Revision
2.3.1	Added clarifications for when capitalization starts.	Revision
2.4	Moved "Alternative Valuation Methodology for Establishing Opening Balances for Internal Use Software" to paragraph 2.4, (previously Annex 2).	Revision
2.5.5	Moved specific cost treatment from Valuation section 2.3 to Recognition section 2.5. Valuation is full cost. However, recognition differs based on criteria described in section.	Revision
Annex 2	Moved Software Development Life-Cycle Phases section Annex (previously 2.3.2) to provide additional clarity.	Revision
Annex 3	Moved Software Development Methods section to Annex (previously 2.3.3) to provide additional clarity.	Revision

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CHAPTER 27

INTERNAL USE SOFTWARE

1.0   GENERAL

*1.1   Purpose

1.1.1. This chapter prescribes the Department of Defense (DoD) accounting policy for Internal Use Software (IUS), which is a subset of General Property, Plant, and Equipment (PP&E). General PP&E, per Statement of Federal Financial Accounting Standards *(SFFAS) 10*, "Accounting for Internal Use Software," includes IUS and consists of tangible and intangible assets that (1) have an estimated service life of two years or more; (2) are not intended for sale in the ordinary course of business; and (3) are intended to be used or available for use by the entity.

1.1.2. The IUS general ledger accounts are listed in the government-wide United States Standard General Ledger (USSGL) contained in *Volume 1, Chapter 7*. The accounting entries for these accounts and the DoD Standard Chart of Accounts are specified in the *DoD USSGL Standard Transaction Library*. Unless otherwise stated, this chapter is applicable to all DoD Components, including Working Capital Fund (WCF) activities.

1.2   Authoritative Guidance

The accounting policy and related requirements prescribed by this chapter are in accordance with the applicable provisions of:

1.2.1. Federal Accounting Standards Advisory Board (FASAB) *SFFAS 1*, "Accounting for Selected Assets and Liabilities;"

1.2.2. FASAB *SFFAS 4*, "Managerial Cost Accounting Standards and Concepts;"

1.2.3. FASAB SFFAS 10, "Accounting for Internal Use Software;"

1.2.4. FASAB *SFFAS 50*, "Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, and SFFAS 23, and Rescinding SFFAS 35;"

1.2.5. FASAB *SFFAC 5*, "Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements;"

1.2.6. FASAB *SFFAC 7*, "Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording;"

1.2.7. FASAB Technical Release *(TR) 13*, "Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment;"

1.2.8. FASAB *TR 14*, "Implementation Guidance on the Accounting for the Disposal of General Property, Plant & Equipment;"

1.2.9. FASAB *TR 15*, "Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation;"

1.2.10. FASAB *TR 16*, "Implementation Guidance for Internal Use Software;"

1.2.11. FASAB *TR 17*, "Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment;"

1.2.12. FASAB *TR 18*, "Implementation Guidance for Establishing Opening Balances;"

1.2.13. FASAB *TR 23*, "Omnibus Technical Release Amendments 2024: Conforming Amendments to Technical Releases 10, 16, 20, and 21;"

1.2.14. Office of Management and Budget (OMB) *Circular No. A-136*, "Financial Reporting Requirements;"

1.2.15. *Treasury Financial Manual (TFM) Volume1, Part 2, Chapter 4700* "Federal Entity Reporting Requirements for the Financial Report of the United States Government;"

*   1.2.16. *DoD Instruction (DoDI) 5000.75*; "Business Systems Requirements and Acquisition;"

1.2.17. *DoDI 5000.76*; "Accountability and Management of Internal Use Software (IUS)."

2.0   ACCOUNTING FOR IUS

2.1   Definition

2.1.1. "Software" includes the application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system or program. Most often, software is an integral part of an overall system(s) having interrelationships between software, hardware, personnel, procedures, controls, and data. IUS is software that:

2.1.1.1. Is acquired or developed to meet the entity's internal or operational needs (*intended purpose*); and

2.1.1.2. Is a stand-alone application, or the combined software components of an information technology (IT) system that can consist of multiple applications, modules, or other software components integrated and used to fulfill the entity's internal or operational needs (*software type*).

2.1.2. IUS can be:

      2.1.2.1. Purchased from commercial off-the-shelf (COTS) vendors and be ready for use with little or no changes;

      2.1.2.2. Internally developed by employees of DoD, including new software and existing or purchased software that is modified with or without a contractor's assistance; or

      2.1.2.3. Contractor-developed software that a DoD Component paid a contractor to design, program, install, and implement, including new software and the modification of existing or purchased software.

2.1.3. IUS includes software that is:

      2.1.3.1. Used to operate an entity's programs (e.g., financial and administrative software, including that used for project management);

      2.1.3.2. Used to produce the entity's goods and to provide services (e.g., maintenance work order management and loan servicing); and

      2.1.3.3. Developed or obtained for internal use and subsequently provided to other Federal Entities with or without reimbursement.

2.1.4. Integrated (embedded) software is not IUS.

      2.1.4.1. IUS excludes computer software that integrates with and is necessary for operating General PP&E, rather than performing an application. DoD Components must consider such software as part of the PP&E of which it is an integral part, and must capitalize and amortize accordingly. They must use the aggregate cost of the hardware and software to determine whether to capitalize or expense the costs. In situations where software and the hardware on which it runs have independent service lives, they must determine the useful life of the software independently of the useful life of the hardware. They must determine this on a case-by-case basis and document the rationale.

      2.1.4.2. Software used in conjunction with the operation of equipment is not the same as the integrated or embedded software and can be considered IUS if all of the following criteria apply:

            2.1.4.2.1. The software was developed separately from the equipment;

            2.1.4.2.2. The software is not required for the equipment to perform its core purpose and functions; and

            2.1.4.2.3. The quantity of equipment items on which the software will be installed is unknown.

*   2.1.4.3. Additionally, software developed separately and installed on several assets at different times may be treated as a separate IUS asset, rather than integrated or embedded software. For example, anti-ballistic missile software installed on multiple radar systems at different times can be treated as a separate IUS asset if the software meets the capitalization threshold (see subparagraph 2.5.5 for capitalization thresholds).

2.1.5. DoD Components may purchase IUS as part of a package of products and services (e.g., training, maintenance, data conversions, reengineering, site licenses and rights to future upgrades and enhancements). They must allocate costs based on the relative fair values of the IUS and the services if the costs are not readily separable between the IUS and the services on the invoice. They must capitalize the cost of the IUS (assuming it meets the capitalization criteria) and expense the cost of the training/maintenance. They must expense non-IUS costs (e.g., training and maintenance services) that are not susceptible to allocation between maintenance and relatively minor enhancements.

2.1.6. SFFAS 1 defines materiality as the degree to which omitting or misstating an item in a financial statement is likely to change or influence the judgment of a reasonable person relying on the information.

2.1.7. Additional definitions can be found in Annex 1.

Figure 27-1.   IUS is Generally One Component of an IT System
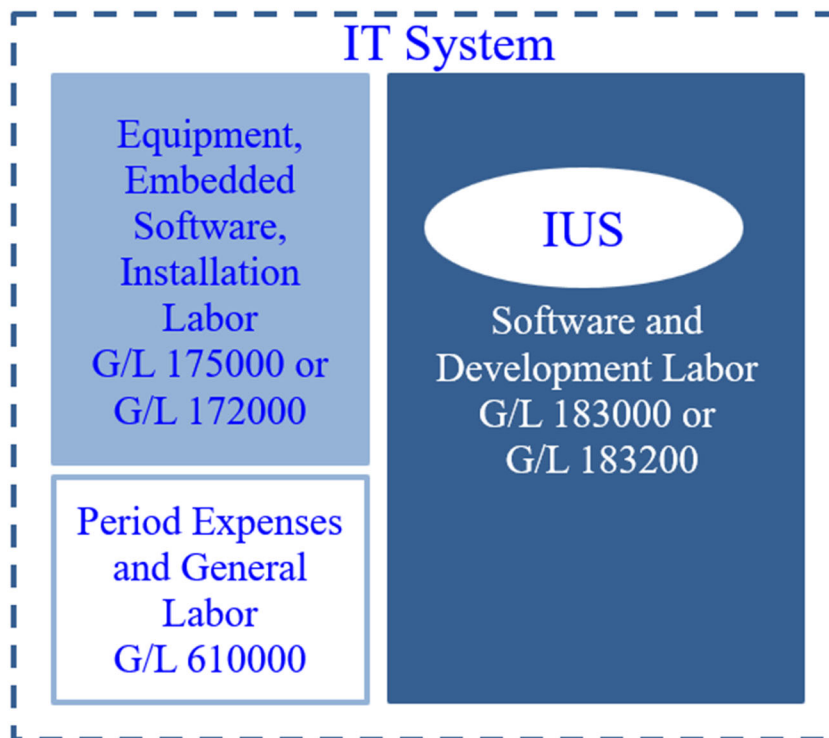
2.2   USSGL Accounts

     2.2.1.   The DoD Components must record IUS transactions to general ledger accounts in the financial statements required by the Treasury and other reporting requirements mandated by Congress and OMB. The *USSGL* Transaction Library outlines detailed posting transactions, and the DoD Standard Chart of Accounts provides detailed account descriptions. The DoD standard Chart of Accounts is located on the Office of the Deputy Chief Financial Officer (ODCFO) *Standard Financial Information Structure* webpage.

     2.2.2. DoD Components may elect to create subaccounts within their general ledger systems to track software under development at a detailed level; however, the internal subaccounts must summarize to one USSGL/DoD account.

     2.2.3. Management must retain adequate supporting source documentation for entries in accordance with *Volume 1, Chapter 9*, "Financial Records Retention."

2.3   Valuation

*   2.3.1. Record the acquisition and other costs necessary to make the software operable.

     2.3.1.1. DoD Components calculate the cost of COTS software by adding the actual purchase price of the COTS license to any costs incurred to place the software in service or otherwise make the software ready for use.

     2.3.1.2. The cost of contractor-developed software includes the amount paid to the contractor to design, program, install, and implement new software or to modify existing or COTS software, plus any costs incurred to implement or otherwise make the software ready for use.

     2.3.1.3. The costs of internally developed software must include the full cost incurred. Full cost includes both direct and indirect costs of new software (e.g., salaries of programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies and overhead) and technical documentation.

     2.3.1.4. Considering economic feasibility, a cost estimation technique could be developed to trace the costs to outputs based on the SFFAS 4, paragraph 124, provision that "[in] principle, costs should be assigned to outputs in one of the methods listed in the order of preference:

     2.3.1.4.1. Directly tracing costs wherever economically feasible;

     2.3.1.4.2. Assigning costs on a cause-and-effect basis; and

     2.3.1.4.3. Allocating costs on a reasonable and consistent basis.

*2.4   Alternative Valuation Methodology for Establishing Opening Balances

     2.4.1.   Establishing Opening Balances for Internal Use Software

        2.4.1.1.   The alternative valuation method for establishing opening balances for IUS described in FASAB SFFAS 50, "Establishing Opening Balances for General Property, Plant and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35" is available only once to each reporting entity. Therefore, prior to the establishment of IUS opening balances, DoD Components must validate that they are prepared to account for and comply with the recognition, measurement, presentation, and disclosure requirements for IUS in accordance with FASAB SFFAS 10, "Accounting for Internal Use Software."

        2.4.1.2.   DoD Components must identify any IUS that they have capitalized prior to establishing opening balances, including capitalized development costs. All DoD Components that have not previously undergone a financial statement audit where they received an unmodified (i.e., "clean") audit opinion will exclude the value of all IUS, including development costs, from opening balances of General Property, Plant, and Equipment on their Balance Sheet. This means that DoD Components who have not undergone a financial statement audit where they received a "clean" audit opinion will adjust their capitalized IUS, including development costs and opening balances to zero in the year the DoD Component makes an unreserved assertion. A DoD Component that has received a "clean" audit opinion should continue to account for IUS, including development costs, in accordance with FASAB SFFAS 10 and will not reduce their balances to zero.

        2.4.1.3.   Entries in the DoD Component accounting systems/records to record IUS opening balances at zero are subject to the reporting requirements under paragraph 13 of FASAB SFFAS 21, "Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources". Accordingly, reflect the entries as a change in accounting principle. Document and support any adjustments to assist ongoing audit efforts.

     2.4.2.   Financial Statement Disclosure Requirements

    DoD Components who adjust their opening IUS balances must disclose in their financial statements that they used an alternative valuation method in establishing their opening balances. They must include a disclosure in the financial statements describing the use of the alternative valuation method in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are in accordance with Generally Accepted Accounting Principles. An unreserved assertion is an unconditional statement.

     2.4.3.   Prospective Accounting for Internal Use Software

        2.4.3.1.   DoD Components must capitalize IUS costs for IUS in-service and IUS in development in accordance with the provisions of FASAB SFFAS 10 after recording the opening balances at zero as described in paragraph 2.4.1.2. This capitalization requirement includes IUS development costs incurred after the establishment of opening balances for projects started prior

to the establishment of opening balances. DoD Components must have sufficient source documentation to support the capitalized amounts of IUS based on actual historical cost. DoD Components must apply the provisions of FASAB SFFAS 10 regarding amortization and impairment to any unamortized capitalized cost of the IUS.

        2.4.3.2. DoD Components must fully implement the systems, internal controls, processes and procedures to be compliant with accounting for IUS under FASAB SSFAS 10. They must also periodically review and update the documentation of the systems, processes, and procedures as needed.

2.5   Recognition

    2.5.1. DoD Components must recognize all acquired IUS for accountability and financial reporting purposes. Recognition requires the proper accounting treatment (expense or capitalization with amortization) and the reporting of capitalized amounts and accumulated amortization on the appropriate DoD Component's financial statements. The capitalizable cost phase begins after the entity has completed all preliminary planning, designing, coding, and testing activities that are necessary to establish that the IUS can meet the design specifications. Capitalize IUS that has a useful life of two years or more and meets the capitalization criteria described in subparagraph 2.5.5. Expense IUS items with a cost below the capitalization threshold; except for IUS items acquired as part of a qualifying bulk purchase (see subparagraph 2.5.8). Expense data conversion and training cost in the period incurred.

    2.5.2. Recognition Responsibility

        2.5.2.1. The DoD Component's financial reporting responsibility can be determined using two-tier criteria:

            2.5.2.1.1. Exclusive/sole Use. When a DoD Component is the exclusive/sole user of capitalized IUS, it will report the IUS on its Balance Sheet. If there is no exclusive/sole user, the DoD Component must apply the second criteria.

            2.5.2.1.2. Control. If an exclusive/sole user does not exist, the DoD Component that controls the IUS will have financial reporting responsibility. Evidence of control can include funding the software maintenance, exercising access control, and prioritizing enhancements.

        2.5.2.2. DoD Components that possess and/or control IUS items that materially contribute to the Component's mission must maintain accounting and financial reporting for such items, regardless of the organization that originally acquired or provided the funding for the items. If a DoD Component prepares financial statements, it must appropriately recognize IUS in its financial statements.

2.5.3. Recognition Uncertainty

2.5.3.1. It is important that the overall accounting records of the DoD and the Federal Government are not duplicative. In situations where doubt exists as to which DoD Component should recognize an item, DoD Components involved must reach an agreement with the other applicable DoD Components or Federal agencies as to which entity will recognize the item. DoD Components must document the process used to reach this agreement and the terms of the agreement in a memorandum of agreement, which will serve as supporting documentation.

2.5.3.2. If DoD Components cannot reach an agreement, they must refer the matter to the ODCFO, Office of the Under Secretary of Defense (Comptroller) for resolution. DoD Components must submit requests for resolution with adequate supporting documentation to assist in resolving the matter, and they should send these requests through the Financial Management and Comptroller of their respective Military Department or Defense Agency.

2.5.4. Recognition Timing

2.5.4.1. Recognition of the COTS IUS for financial reporting purposes must occur no later than the technical acceptance of the software.

2.5.4.2. Record IUS in development anticipated to meet capital criteria in the IUS in Development account during the design, development, and testing, phases. Annex 2 describes the various phases of software development. After completing technical acceptance testing, DoD Components must recognize the IUS asset, transfer capital costs to the IUS account, and establish accountability in the APSR.

2.5.4.2.1. Larger and more complex software systems, such as Enterprise Resource Planning systems, are developed and placed in service over time. For each module or component of a software project, when a module or component has been successfully tested, move costs from IUS in Development to Internal Use Software, and begin amortization.

2.5.4.2.2. If the use of a module is dependent on the completion of another module(s), move costs from IUS in Development to IUS when both that module and the other module(s) have successfully completed testing.

2.5.4.2.3. For example, a DoD Component may develop an accounting software system containing three modules: a general ledger, an accounts payable sub-ledger, and an accounts receivable sub-ledger. In this example, each module could be analyzed to determine whether it could be treated as a separate IUS asset. Specifically, if the module provides economic benefit through distinct, substantive functionality, and meets the tests for capitalization threshold, ownership, and eligibility for capital treatment, then the module could be treated as a separate IUS asset.

2.5.4.3. For IUS assets acquired by a contractor on behalf of a DoD Component (i.e., the DoD Component that will ultimately hold title/license to the assets), recognize the software upon completion of the technical acceptance testing by the contractor performing the

service, or by the DoD Component. Record contract financing payments (e.g., progress payments, performance-based payments, and commercial interim payments) made to a contractor prior to completion of final technical acceptance testing in a Software in Development account until the IUS is placed in service. Capitalize upon completion of technical acceptance testing.

*   2.5.5. Capitalization Threshold, Criteria, and Cost Treatment

         2.5.5.1. The current IUS capitalization threshold for all DoD Components is $250,000. However, DoD Intelligence Community Entities may elect to use a capitalization threshold of $1 million. The capitalization threshold described above is for financial reporting purposes. The requirement for accountability of IUS is discussed in subparagraph 2.5.12.

         2.5.5.2. Capitalize IUS if it meets the following criteria for General PP&E:

         2.5.5.2.1. Useful life of two years or more;

         2.5.5.2.2. Intended for use or being available for use by the entity;

         2.5.5.2.3. Not intended for sale in the normal course of business; and

         2.5.5.2.4. Total cost is greater than the capitalization threshold.

         2.5.5.3. DoD Components must apply the treatment of costs based on the nature of the costs incurred, not the exact sequence of the work. Annex 2 provides IUS project phases, activities, deliverables, and accounting treatment.

         2.5.5.3.1. Capitalize direct labor costs of government employee and contractor project teams (e.g., programmers, engineers, managers) incurred during the Design/Development and Testing/Implementation Phase as part of the costs of the software project. Project managers and/or program managers must track direct labor costs and allocate to individual software projects. The allocation methodology used must be consistent between projects and must be auditable.

         2.5.5.3.2. Expense indirect labor costs for Program Management Office personnel overseeing more than one software project when immaterial compared with the overall costs of a software project. Decisions regarding the materiality of indirect labor costs, when such costs are expensed, must be justified, documented, and must be auditable. If determined material to a software project or projects, allocate costs based on a distribution methodology that is consistently applied, documented, and auditable.

         2.5.5.3.3. Overhead costs are costs associated with rent, utilities, building maintenance, and supplies that are essential to the overall accomplishment of a software project. In many instances, overhead costs are immaterial when compared with the overall costs of a project. If determined immaterial, expense these costs and document the expense justification. If determined material to a project or projects, allocate costs based on a consistent and documented distribution methodology that is auditable.

2.5.5.3.4. DoD components must evaluate contractor costs to determine the correct treatment. Such determination is based on the type of work performed by the contractors. Annex 2 breaks down the criteria to expense or capitalize various work activities.

2.5.5.3.5. Expense data conversion costs as incurred for internally developed, contractor-developed, or COTS software, including the cost to develop or obtain software that allows for access or conversion of existing data to the new software. Such costs may include the purging or cleansing of existing data, reconciliation or balancing of data, and the creation of new or additional data.

2.5.5.3.6. Capitalize the cost of development of technical documentation and manuals and expense costs of mass-producing manuals in the period incurred.

2.5.5.4. The capitalized costs of internally developed software should be limited to costs incurred:

2.5.5.4.1. After the DoD Component authorizes and commits to a software project and believes that it is more likely than not that the project will be completed and the software will be used to perform the intended function(s), and it will have an estimated service life of two years or more; and

2.5.5.4.2. After the completion of the planning and requirements phase (i.e., project evaluation, concept testing, and evaluation of alternatives) as evidenced by a documented approval decision.

2.5.5.5. Technical acceptance testing is testing undertaken to verify if a software product meets technical specifications. Capitalize technical acceptance testing costs. After technical acceptance, expense operational testing, evaluation, and other functional testing.

2.5.5.5.1. If the software consists of multiple individual components or modules, the capitalization phase must end for each component/module after technical acceptance testing is complete for that component/module.

2.5.5.5.2. In some development practices, teams conduct acceptance testing for each iteration within an IUS development before moving forward to the next iteration and may not always conduct final acceptance testing. The DoD Component should identify a pre-determined agency milestone such as the go-live or in-service date, which is equivalent to a final technical acceptance test for capitalization cut-off purposes.

2.5.5.6. Capitalize the amounts paid to a COTS vendor for the software. Capitalize amounts paid to a contractor to design, program, install, and implement contractor-developed software. Capitalize material internal costs incurred by the Federal Entity to implement the COTS or contractor-developed software and otherwise to make it ready for use.

2.5.6. Documentation

2.5.6.1. DoD Components must assign a dollar value (i.e., recorded cost) to the IUS when recording the acquisition of IUS in the Accountable Property System of Record (APSR) and/or accounting system. Appropriate documentation must be available to support the dollar value. Paragraph 3.2 includes a complete discussion of supporting documentation related to IUS.

2.5.6.2. To establish proper PP&E financial control when acquiring IUS from another DoD Component or Federal Agency, the acquiring DoD Component must request from the losing DoD Component or other Federal Agency, the necessary source information and financial transfer documents, to include a unique identifier(s) for the software(s); location; original acquisition cost(s); cost of enhancements; the date the software was developed, or acquired; the estimated useful life; the amount of accumulated amortization; and other relevant information linked to that software. If this information is not available, the gaining and losing entities must develop and document a reasonable estimate to support the financial transfer of the software.

2.5.6.3. Capitalized IUS costs must have sufficient supporting documentation as discussed in paragraph 3.2, including support for costs incurred in the development of the IUS. DoD Components must provide narratives, software architectural documentation, user manuals, and other similar documents to substantiate whether they treat the IUS as separate IUS assets, supporting the functionality of the components/modules of a software system.

2.5.7. Joint Ventures

If two or more entities, including at least one entity outside of the DoD, develop the IUS through a joint venture, the DoD Component must capitalize the IUS asset if it meets the criteria for capitalization, based on its share of the development cost in relation to the capitalization threshold. The DoD Component only capitalizes the portion it funded if it meets the criteria for capitalization.

2.5.8. Bulk Purchases of Software Applications/Programs

2.5.8.1. Bulk purchases must be considered if they materially affect the fiscal year financial statements during which they were purchased. Bulk purchases of software with an aggregate cost that exceeds the capitalization threshold must be capitalized.

2.5.8.2. When multiple acquisitions of the same IUS application(s)/programs (for example spreadsheets, word processing programs, etc.) or modules or components of a software system are made as part of a single contract within a fiscal year, the purchases must be added together to determine whether they meet the capitalization threshold. Purchases made on a single contract during separate fiscal years are to be considered separately. DoD Components must not split bulk purchases into multiple transactions with the intent of avoiding capitalization.

2.5.8.3. Bulk purchases of licensed IUS with terms less than two years in length do not need to be considered for capitalization. Table 27-1 provides capitalization guidelines for bulk purchase licenses.

2.5.9. Software Licenses

2.5.9.1. Software licenses grant the license holder the right to use the software for a specific time period. After this period expires, the license holder must renew the license or purchase a new one to continue using the software. License agreements to use software come in many forms and vary in length of the license period. Software licenses can be term or perpetual.

2.5.9.1.1. Term licenses provide DoD Components the right to use IUS for a specified period of time. Capitalize or expense term licensed IUS per criteria in Table 27-1.

2.5.9.1.2. Perpetual software licenses allow the DoD Component to use the software indefinitely in exchange for an upfront cost, which they can pay as a one-time payment or finance over a set period. Apply capitalization criteria if the license is perpetual, to determine to capitalize or expense.

2.5.9.2. If one of the following criteria applies, the IUS can be expensed:

2.5.9.2.1. The license term is less than two years;

2.5.9.2.2. The license cost (excluding any maintenance agreements) is less than the capitalization threshold; or

2.5.9.2.3. The aggregate cost of a bulk license purchase (excluding any maintenance agreements) is less than the capitalization threshold. See subparagraph 2.5.8 for guidance related to bulk purchases of software.

2.5.9.3. A license agreement may include executory costs for maintenance and technical support. DoD Component judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. DoD Components may also want to consider having each license agreement specifically identify the various costs throughout the license life cycle, for example, initial license, maintenance, and enhancement.

2.5.9.4. Additional guidance regarding accounting for license agreements includes:

2.5.9.4.1. Expense maintenance costs agreed to as part of the initial license agreement in the period they are incurred;

2.5.9.4.2. Expense "True-up" costs associated with unlimited license agreements or enterprise licenses that may occur (depending on the agreement terms) at the end of each year to reconcile and account for the actual quantity of users; and

2.5.9.4.3. Expense software upgrades from annual maintenance and security assurance agreements, do not capitalize as enhancements or separate assets.

2.5.10. Cloud and Other Subscription-Based Services

2.5.10.1. A cloud computing service is any resource that is accessible over the Internet. It has the following essential characteristics: on-demand self-service, broad network access, resource pooling, rapid elasticity, and measured service. The most common cloud service resources are: software as a service, platform as a service, and infrastructure as a service. Cloud services can take a number of forms. To determine whether the arrangement includes capitalized IUS, the DoD Component will need to examine the nature of the arrangement and apply the capitalization criteria.

2.5.10.2. When a DoD Component pays regular subscription fees to access and use software from a non-DoD entity, it should expense subscription costs in the period incurred. This scenario is a service and does not constitute an IUS asset for the DoD Component.

2.5.10.3. A subscription arrangement using a cloud with a non-DoD entity can result in DoD-owned IUS if the using DoD Component takes possession, or has the ability to take possession of a software application without incurring a significant penalty. DoD Components must capitalize this IUS if it meets the capitalization criteria as described in subparagraph 2.5.6.

2.5.10.4. When a cloud or subscription arrangement exists between DoD Components, the Component that owns the software (see subparagraph 2.4.1) will report it as IUS. The subscribing DoD Component(s) will expense any fees paid for the service in the period incurred.

2.5.10.5. If a cloud computing arrangement includes a software license, the customer must account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the Table 27-1 criteria discussed in subparagraph 2.5.9. SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license. The entity that develops and owns the software, platform, or infrastructure used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform, or infrastructure must account for the software in accordance with SFFAS 10 and the full cost/inter-entity cost requirements of SFFAS 4.

2.5.11. Shared Services

2.5.11.1. Shared services means a mission or support function provided by one business unit to other business units within or between organizations. The funding and resourcing of the service is shared and the providing entity effectively becomes an internal/external service provider.

2.5.11.2. There are three types of shared service structures in the Federal Government:

2.5.11.2.1. <u>Intra-agency</u>. Intra-agency shared services include those provided within the boundaries of a specific organization such as a Federal Department or Agency, to that organization's internal units. Intra-agency shared services would be those between one DoD Component and another DoD Component.

2.5.11.2.2. <u>Inter-agency</u>. Inter-agency shared services are those provided by one Federal Organization to other Federal Organizations that are outside of the provider's organizational boundaries. Inter-agency shared services would be those between one DoD Component and another Federal Agency/Organization outside of DoD.

2.5.11.2.3. <u>Commercial</u>. Commercial shared services are those provided by private vendors.

2.5.11.3. For intra-agency shared services, a cost allocation methodology could be developed in accordance with SFFAS 4, paragraphs 120-125. Additional guidance on cost allocation methodology can be found in ***Chapter 19***. For inter-agency shared services and commercial shared services, the service provider entity that owns (receives funding/responsible for maintaining) the software must account for the software in accordance with SFFAS 10. In the event that the entity receiving the service (the customer) has the contractual right to take possession of the software at any time during the hosting period without significant penalty, and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software, then the customer must account for the software in accordance with SFFAS 10.

2.5.11.4. If the shared service arrangement includes a software license, the DoD Component must account for the software license element of the arrangement consistent with the acquisition of their other software licenses, as discussed in subparagraph 2.5.9. SFFAS 10 is not applicable to a shared service arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license.

2.5.12. Accountable Records of IUS

DoD Components must establish accountable records for all government IUS. Account for IUS which meets the criteria for capitalization in an APSR. DoD Components must also establish and maintain accountability records for IUS which does not meet the criteria for capitalization in either an APSR or approved managerial system through disposition or transfer. Managerial systems must contain all general data elements contained in a data-compliant APSR. In addition, managerial systems must document controls and procedures in place that are sufficient to withstand potential audit scrutiny and support the audit requirement of a complete universe of assets. The primary Accountable Property Officer (APO) or designated delegate should grant managerial system approval. See DoDI 5000.76.

2.6   IUS Enhancements

2.6.1. An IUS enhancement is a modification to an existing IUS that provides it with significant additional capabilities and enables the software to perform tasks that it was previously

incapable of performing. DoD Components must capitalize an enhancement that increases the capability of the IUS when its cost meets or exceeds the capitalization threshold. Criteria to capitalize enhancements to IUS differs from that of other PP&E; expense changes that merely extend the useful life or improve efficiency, irrespective of the cost. Even though the DoD component expenses the costs associated with extending the useful life, it must extend the amortization of any previously capitalized amount to reflect the new useful life period. Capitalizable enhancements normally require new software specifications and may require a change to all or part of the existing software specifications. For example, DoD Components should capitalize the cost of modifying existing software for making ad hoc queries, if it requires new software specifications and/or changes to existing software specifications and it also exceeds the capitalization threshold. In addition, the DoD Components should expense the nominal charges paid for enhanced versions of software in the period incurred.

2.6.2. Evaluate modules together as one enhancement if one module is dependent upon another to function. DoD Components must amortize all costs of an enhancement that they have capitalized based on the IUS capitalization criteria, including any costs they carry over or allocate from the original software, over the enhancements' estimated useful life, which should not exceed five years.

2.6.3. DoD Components must begin to accumulate costs for enhancements when these enhancements are more likely than not to produce new capabilities; and the project phase in which the costs are being incurred and the nature of the cost meets the criteria for capitalization treatment set out in Annex 2; and the estimated total cost of the enhancement meets the IUS capitalization threshold. When the development of the enhancement takes place over multiple periods, the costs will accumulate in account 183200 (IUS in Development) until the completion of the enhancement (see subparagraph 2.8.3 on placed-in-service dates), at which time the costs are moved to account 183000 (Internal Use Software).

2.6.4. DoD Components must separately account for enhancements in a manner that allows them to specifically identify and support each capitalized enhancement made to the IUS.

2.6.5. Expense an enhancement to IUS that meets or exceeds the capitalization threshold to correct a design flaw, and in effect doubles its useful life, in the period incurred, unless the enhancement adds new capabilities to the software. However, the useful life of the IUS is subject to adjustment and must reflect the enhancement. Knowledgeable personnel must determine and document the additional useful life, which should not exceed five years added to the existing useful life.

2.6.6. Expense the cost of minor enhancements resulting from ongoing systems maintenance or incurred solely to repair a design flaw without adding additional capabilities in the period incurred. Examples of minor enhancements include updating data tables, web-enabling, customizing reports, or changing graphic user interfaces. Expense enhancements that extend the useful life of the software without adding significant capabilities. However, in instances where the useful life of IUS is extended, DoD Components must adjust the amortization period as described in subparagraph 2.6.5.

2.6.7. A specific software development project may include expenditures for enhancements and maintenance that cannot be easily separated but may be reasonably and consistently allocated. One approach that can be used is a ratio, based on the projected development phase activities work hours relative to other types of work. Apply the ratio to determine the expenditures to capitalize when the expenses meet the other capitalization criteria. Apply the basis for allocating costs consistently and in accordance with GAAP.

2.6.8. Retain documentation related to IUS enhancement decisions, such as the justification for capitalizing the enhancement, a change of useful life, and the amount to capitalize. Specific documents that support these decisions can vary by organization and asset but could include an analysis from software developers or a cross-functional review team that defines the enhancement's impact on functionality and useful life.

2.6.9. Only capitalize the cost of enhancements to more than one IUS asset as identified by a unique identifier, when performed under a single contract or work order that cannot be specifically identified by asset if the allocated cost per IUS equals or exceeds the appropriate DoD capitalization threshold and the enhancements are more likely than not to add additional capability to the existing software.

2.6.10. When a single IUS goes under more than one enhancement and the enhancements are part of one overall effort to increase the software's functionality, and/or useful life; the sum of the costs of the enhancements must be capitalized if the summed costs equal or exceed the appropriate DoD capitalization threshold. This is required even when the enhancements are funded separately. The enhancements must be capitalized when the determination has been made that it is more likely than not that the enhancements will result in new significant capabilities.

2.7   Maintenance and Repair

2.7.1. Maintenance and repair costs are not capital enhancements, regardless of whether the cost equals or exceeds the DoD capitalization threshold. Maintenance and repairs are activities directed toward keeping IUS assets in an acceptable condition so that they continue to provide services and achieve their expected useful life. Maintenance and repair activities include subsequent security accreditations (not included in user acceptance testing); software diagnostics; repair processing and/or performance failures; updates to documentation; minor software updates; minor corrections to design flaws; and other activities needed to preserve or maintain the software. Maintenance and repairs, as distinguished from enhancements, exclude activities directed towards expanding the capacity of IUS or otherwise upgrading it to serve needs different from, or significantly greater than, its current use.

2.7.2. When determining whether to capitalize the IUS, do not include the costs of maintenance agreements purchased with a software license in the historical cost of the IUS. If DoD Components cannot distinguish maintenance costs from the cost of the license itself, they must use reasonable and documented estimating methods. Do not capitalize upgrades included in annual maintenance and security assurance agreements.

2.8   Amortization

2.8.1. Amortization is the systematic and rational allocation of the acquisition cost of IUS, over its estimated useful life. The DoD recovery periods (useful life) for IUS amortizable assets are set out in Table 27-2. During the planning phase of IUS development, determine the useful life based on how long the IUS is expected to provide economic benefit or service potential to the DoD Component. The decision regarding the useful life must be documented and made with input from personnel who are familiar with the software's technical characteristics and planned use. Amortize IUS acquired for research and development with no alternative future use over the period of the project as opposed to the normal life-cycle amortization.

2.8.2. Amortize the recorded cost of IUS and enhancements to IUS, which have been capitalized according to the guidance in Annex 2. Reflect such capitalized amounts, as well as associated amounts of accumulated amortization and amortization expense, in DoD Component's financial statements.

2.8.3. DoD Components must document the placed-in-service dates for both acquired IUS and developed IUS. Documentation of placed-in-service dates is critical in determining when to start amortization of capitalized IUS costs. IUS is considered placed in service when final technical acceptance testing is completed. The point at which this milestone is reached can vary for different types of software acquisitions.

     2.8.3.1. For IUS acquired through a Major Automated Information System acquisition program, the Full Deployment Decision date made by the Milestone Decision Authority will serve as the placed-in-service date.

     2.8.3.2. Use the Initial Operational Capability (IOC) date for other IUS system acquisitions, as the placed-in-service date. The system's Capability Development Document (CDD) and/or Capability Production Document (CPD) often define the IOC. DoD Components can use other supporting documents for acquisitions that do not require a CDD or CPD.

     2.8.3.3. Use the alternate placed-in-service date if knowledgeable parties within a DoD Component determine that a placed-in-service date other than the ones listed in subparagraphs 2.8.3.1 and 2.8.3.2 better aligns with the completion of final technical acceptance testing for a specific software acquisition. However, the DoD Components must document and justify the decision.

2.8.4. Successfully complete final acceptance testing before beginning amortization for the IUS asset. This criteria is necessary, especially for internally developed software but also for contractor-developed and COTS software because testing plays a major role for software assets by demonstrating that the software product can meet the requirements and the need for a clear point for ending the developmental phase.

2.8.5. When replacing the IUS with new software, expense the unamortized cost of the old IUS when the new IUS successfully completes testing. No adjustments will be made to the

previously recorded amortization. Treat any additions to the book value or changes in useful life prospectively. Account for the change during the period of the change and future periods.

2.8.6. Account for all IUS in an APSR. Figure 27-2 provides a decision tree to assist in determining what elements of an IUS project should be capitalized for financial reporting purposes.

2.8.7. The program office must retain proper supporting documentation to justify the estimated useful life of the program. Examples of proper documentation are engineering estimates, operational requirements documents, mission needs statements, commercial industry-equivalent information, contracts, and acquisition documents (such as the Select Acquisition Report). See paragraph 3.2 for additional information on supporting documentation requirements.

2.8.8. In the case of IUS assets, after the successful completion of the final technical acceptance testing described in subparagraph 2.8.4, the event that triggers the calculation of amortization is the date the asset is installed and placed in service (regardless of whether it is actually used). In the case of internally developed IUS, record the costs of developing the IUS that is capitalizable in the IUS in Development account (183200) but do not amortize until the software is placed in service, at which time transfer the balance (total capitalizable development costs) to the IUS account (183000). Begin amortization when the testing of a module or component is successful. If the use of a module is dependent on the completion of another module(s), the movement from account 183200 to account 183000 will take place and amortization will begin when both that module and the other module(s) have successfully completed testing and are placed-in-service.

2.8.9. DoD policy permits the use of only the straight-line method of amortization. Calculate straight-line amortization expense based on the recorded cost divided equally among accounting periods during the software's useful life based on recovery periods in Table 27-2. The salvage value for all capitalized IUS for the DoD Components should be zero.

2.8.10. Retain the IUS asset in APSR if it remains in use longer than its estimated useful life, as well as the accounting records, and reflect both its recorded cost and accumulated amortization until disposition of the software.

2.8.11. WCF activities are required to recognize and amortize IUS assets in accordance with the guidance in this chapter without regard to whether such assets are procured through a WCF activity's Capital Purchase/Investment Program budget or whether amortization for such assets is included in rates charged to customers. The recognition of IUS assets and the amortization of such assets by WCF activities therefore may be different for financial statement reporting purposes than the amortization amounts used for WCF rate development and budget presentation. All IUS asset amortization of WCF activities must be recognized as an expense on the Statement of Net Cost, reflected in the Statement of Changes in Net Position, included in accumulated amortization amounts on the Balance Sheet, and reported in the "Defense Working Capital Fund Accounting Report [Accounting Report (Monthly) 1307] (AR(M)1307)." Accounting Report 1307 is described in ***Volume 6A, Chapter 15***. Amortization recorded on IUS assets that were not acquired nor will be replaced through the use of Defense WCF resources must be classified as non-

recoverable for rate-setting purposes and reported appropriately on the AR(M)1307. Defense WCF rates charged to customers are based on guidance in ***Volume 2B*** and ***Volume 11B***.

Figure 27-2.   Capitalization Decision Tree

Use the following decision tree for IUS Purchased from Commercial Off-the-Shelf Vendors; IUS Internally Developed by DoD and IUS Developed by a Third Party on Behalf of DoD.
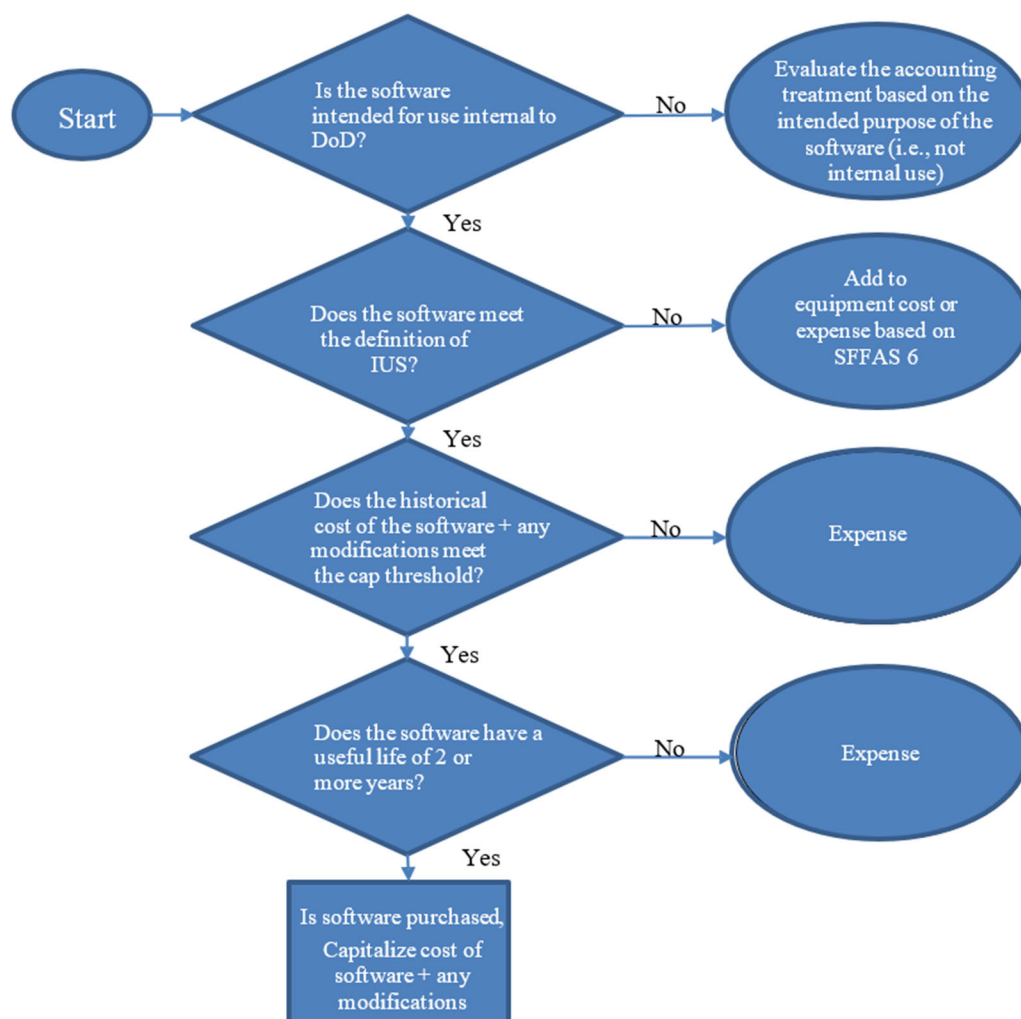
2.9   Impairment

      2.9.1. Impairment must be recognized and measured when one of the following occurs and is related to post-implementation/operational IUS assets:

            2.9.1.1. The IUS asset is no longer expected to provide substantive service potential and will be removed from service; or

2.9.1.2. A significant reduction occurs in the software's or software module's capabilities, functions, or uses.

2.9.2. If the impaired software is to remain in use, the loss due to impairment must be measured as the difference between the book value and either:

2.9.2.1. The cost to acquire software that would perform similar remaining functions (i.e., the unimpaired functions) or, if that is not feasible;

2.9.2.2. The portion of the book value attributable to the remaining functional elements of the software.

2.9.3. Recognize the loss upon impairment and reduce the book value of the asset accordingly. If the criteria listed in subparagraph 2.9.2 cannot be determined, the DoD Component should continue to amortize the book value over the remaining useful life of the software. Document and retain this decision and associated analyses.

2.9.4. If the impaired IUS asset is to be removed from use, measure the loss as the difference between the book value and the Net Realizable Value (NRV), if any. Recognize the loss upon impairment and reduce the book value of the asset accordingly. Transfer the NRV, if any, to an appropriate asset account until the software is disposed of and the amount is realized.

2.9.5. When it is more likely than not that a developmental software project will not be completed, no further costs are to be capitalized and any costs that have been capitalized must be expensed. Indications that the software development may no longer be completed include:

2.9.5.1. The expenditures are neither budgeted nor incurred to fund further development;

2.9.5.2. The discontinuance of the business segment for which the software was designed;

2.9.5.3. The inability to resolve programming difficulties timely;

2.9.5.4. A decision to obtain COTS software instead and abandon the current software development; or

2.9.5.5. Major cost overruns occur.

2.9.6. When an IUS developmental software project is suspended pending management's evaluation as to whether to resume or terminate the project, the software development cost may remain capitalized in an IUS in Development account (USSGL 183200) as long as it is more likely than not that the developmental software project will eventually be completed and the cost incurred or expected to be incurred meets the capitalization threshold. Reevaluate the status of the project periodically and write off capitalized costs if management concludes that it is more likely than not that the software will not be placed in service in the future.

2.9.7. Recognize and report the loss from impairment, if any, in the Statement of Net Cost in the period in which the DoD Component concludes that the impairment is both (1) a significant decline in service utility and (2) expected to be permanent. Include such losses in program costs or costs not assigned to programs. A general description of the IUS for which an impairment loss is recognized, the nature (e.g., damage or obsolescence) and amount of the impairment and the financial statement classification of the impairment loss must be disclosed in the notes to the financial statements in the period the impairment loss is recognized if the amount is significant to the financial statements.

2.9.8. Report the impairment loss net of any associated recovery of the net realizable value when the recovery and loss occur in the same fiscal year. Report recoveries reported in subsequent fiscal years as revenue or other financing source as appropriate. Disclose the amount and financial statement classification of recoveries in the notes to the financial statements.

2.9.9. Account for the costs incurred to replace or restore the lost service utility of impaired IUS remaining in use in accordance with applicable standards (i.e., recognized according to the nature of the costs incurred and the appropriate capitalization threshold).

2.10 Removal/Disposal

2.10.1. In TR 14, FASAB defines removal from service as an event that terminates the use of a General PP&E asset. DoD Component Heads must establish and maintain effective policies and procedures for the removal (disposal or transfer) of IUS assets. Removal from service may occur because of a change in the manner or duration of use, change in technology or obsolescence, damage by natural disaster, or identification as excess to mission needs. Removal from service must be considered other than permanent unless (1) the asset's use is terminated and (2) there is documented evidence of the DoD Component's decision to permanently remove the asset from service. If only one of the two business events has occurred, permanent removal from service has not occurred (i.e., the removal is considered other than permanent).

2.10.2. If an IUS's normal use is terminated (i.e., it no longer provides service in the operations of the entity) but the DoD Component has not yet decided to permanently remove the IUS from service, the removal from service is considered other than permanent. Other than permanent removal from service is evidenced by activities such as continuing low-level maintenance to sustain the IUS in a recoverable status or until reutilization efforts are exhausted. For example, IUS taken out of service on a temporary basis is considered other than permanently removed from service. In such cases, the recorded cost of the IUS will remain in the IUS account (USSGL 183000). There is no change in the reported value for IUS that has been other than permanently removed from service and the IUS must continue to be amortized. Amortization charges to expense for IUS will continue to be recorded in USSGL 183900.

2.10.3. If (1) an IUS's use is terminated and (2) the DoD Component has documented its decision to permanently remove the IUS from service, the removal from service must be accounted for as permanent. Permanent removal from service is evident from the DoD Component's documented decision to dispose of an IUS by selling, recycling, or donating the IUS. The recorded cost as well as the accumulated amortization of an IUS permanently removed from service must

be removed from the accounts in which they are reported, and the IUS must be recorded at its NRV in a General Property, Plant and Equipment Permanently Removed But not Yet Disposed account (USSGL 199500). USSGL account 199500 is defined in the DoD Standard Reporting Chart of Accounts under the DoD Account Definitions tab as the NRV of General PP&E that is permanently removed from service but not yet disposed of and is reclassified in accordance with FASAB TR 14, paragraphs 10 and 12. NRV is the estimated amount that can be recovered from disposing of the asset less estimated costs of completion, holding, and disposal. Any difference between the net book value of the asset and its expected NRV must be recognized as a gain or loss. Any gain should be recorded in the Gains on Disposition of Assets – Other account (USSGL 711000); any loss should be recorded in the Losses on Disposition of Assets – Other account (USSGL 721000). The expected NRV should be evaluated at the end of each fiscal year and any change in NRV should be recognized as a gain or loss. IUS permanently removed from service is no longer amortized.

2.10.4. When an IUS is disposed of (e.g., by selling, recycling, donating, or destruction) the IUS must be written off from the financial records and financial statements and the difference between any disposal proceeds and the IUS's net book value must be recognized as a gain or loss as described in subparagraph 2.10.3. In such case, if the DoD Component receives a consideration (e.g., cash) for the disposal, a receipt of cash should be recorded in the Fund Balance with Treasury account (USSGL 101000). If the funds (consideration received) are not apportioned to the DoD Component, the fund must be transferred to miscellaneous receipts of the Treasury. There will be no consideration received for a donation. The disposal start date is the calendar date of a legally enforceable and recognizable obligation to complete the disposal action. For transfers and sales, this represents the date on which the instrument is endorsed or operation is ceased, whichever comes later. For natural disasters, this represents the actual date of the incident.

2.10.5. Upon authorized disposition, APOs are responsible for ensuring that all IUS asset dispositions and transfers are properly recorded in the APSR or managerial system, including updating the asset's status to "Disposed," recording the date and method of disposition. The reason for disposition or transfer of IUS assets must be properly documented. The APO retains all supporting documentation per record retention policies. Refer to DoD Instruction 5000.76 for additional information.

3.0 ADDITIONAL CONSIDERATIONS

3.1 Use of Canceled Treasury Account Symbol

3.1.1. The Treasury's Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS) is a data collection system that replaces the reporting functionalities of Federal Agencies Centralized Trial-Balance System I and II, Intragovernmental Fiduciary Confirmation System and Intragovernmental Reporting and Analysis System as the primary means for DoD Components to report their trial balance data to the Treasury. Capitalized assets are required to be reported and remain in GTAS after the original purchasing Treasury Account Symbol (TAS) has expired and been canceled. If a capitalized asset has not been moved to a "C" TAS as described in 3.1.2. GTAS will provide a "C" TAS on the GTAS Super Master Account File (SMAF) for

each fund family represented on the SMAF. The system-generated "C" TAS will have three components: the three-digit agency identifier, availability type "C", and a four-digit main account.

    3.1.2. All DoD Components must use the "C" availability type TAS to report capitalized assets. Assets may be moved to a C TAS at any time from the purchase date to the date the original purchasing fund is canceled. (Refer to the TFM, Part 2, Chapter 4700 for additional information.)

    3.1.3. To transfer an asset to a C TAS:

        3.1.3.1. Use the USSGL account transaction E510 to transfer-out the asset from the purchasing fund account.

        3.1.3.2. Use USSGL account transaction E606 to transfer-in the asset into the appropriate C TAS.

3.2   Supporting Documentation

    Entries to record financial transactions in accounting system general ledger accounts and/or the supporting subsidiary accountable property records and/or systems must:

    3.2.1. Be supported by source documents that reflect all transactions affecting the DoD Component's investment in the IUS.

        3.2.1.1. Support all acquisitions, whether by purchase, transfer from other agencies, donation, or other means, as of the date the DoD Component takes custody of the IUS. The documents listed in Table 27-3, where applicable, must be readily available to support the changes in asset value or physical attributes because of new acquisition or capital enhancement.

        3.2.1.2. Support all disposals or retirements as of the date the IUS leaves the custody of the DoD Component to provide an adequate audit trail for the disposal of an asset. The execution of certain disposal events will generate financial or administrative accountability transactions. These documents, where applicable, must be readily available to support disposals:

            3.2.1.2.1. 'Declaration of excess' document;

            3.2.1.2.2. Approval documentation for the disposal;

            3.2.1.2.3. Original acquisition documents;

            3.2.1.2.4. Legal instruments (such as a license agreement or contract) to indicate a legal obligation to dispose of an asset;

            3.2.1.2.5. Document showing the disposal start date;

            3.2.1.2.6. Receipt documentation; and

3.2.1.2.7. Transfer documents for transferred assets or as otherwise stated.

3.2.1.3. Retain documents that support the recorded cost of IUS assets by the DoD Component in accordance with the requirements contained in Volume 1, Chapter 9, or as otherwise stated. Maintain documentation (original documents and/or hard and electronic copies of original documentation) in a readily available location during the applicable retention period to permit the validation of information pertaining to the asset such as the purchase cost, purchase date, and cost of enhancements. The documentation must also be linked to the appropriate unique identifier(s). Supporting documentation may include, but is not limited to, the documentation as outlined in this subparagraph. DoD Component asset managers will maintain all applicable documentation for the retention period outlined in Volume 1, Chapter 9.

3.2.2. Include sufficient information indicating the quantity (as applicable would include the number of seats for which the IUS asset is loaded; the number of licenses; and/or the number of copies of a computer disk purchased), location, and unit cost (as measured consistently with the criteria for quantification) of the IUS. Designate the accountable property records to be of maximum assistance in making procurement and utilization decisions, including decisions related to identifying potential excess IUS that may be available for reuse, transfer to other DoD Components, or made available for disposal in accordance with current DoD regulations and other regulatory requirements.

3.2.3. Identify and classify IUS that was capitalized, recorded in the APSR and accounting system, and reported in the financial statements.

3.2.4. Be based on the same documents, to ensure that entries to the accounting and accountable property records are the same. This will ensure that the property accountability records are integrated and subsidiary to the accounting system and those records can be reconciled with the accounting system.

3.2.5. Include documents used to accumulate the cost of developmental projects. Each document must link to the appropriate asset unique identifier. For a listing of those costs that may be incurred during the development, see Annex 2.

3.2.6. Include all IUS possessed by the Department (to include property held by others) and IUS of others held by DoD through seizure, forfeiture, loss, or abandonment.

3.2.7. Provide information to identify and account for capitalized enhancements to IUS.

3.3   Reporting Requirements

DoD Components with IUS should reference a note on the Balance Sheet that discloses information about the reported IUS assets. See ***Volume 6B, Chapter 10*** for the specific reporting requirements.

Table 27-1.   Capitalization is Dependent on Term and Aggregate Purchase Amount

Bulk Purchased License Terms	Aggregate Purchase Amount	Guidance
License Term < 2 years	N/A	Expense
License Term = / > 2 years or Perpetual	Under capitalization threshold	Expense
License Term = / > 2 years or Perpetual	Equal to or exceeding capitalization threshold*	Capitalize
*Maintenance agreements included in the purchase of licenses are not to be considered part of the cost for this determination.		

Table 27-2.   DoD Recovery Periods for Amortizable IUS Assets

DOD RECOVERY PERIODS FOR AMORTIZABLE IUS ASSETS (IUS is capitalized only if it meets the capitalization threshold)	
Description of IUS Assets	Recovery Period
Capitalized IUS	2, 3, 4, 5 or 10 Years*
Licenses	Term of the license agreement
Perpetual Licenses	5 Years
IUS Upgrades	Not capitalized**
Enhancements	Not more than 5 years***
* The useful life will be determined during the planning phase of the asset's development based on the length of time it is expected to have economic benefit or service potential to the DoD Component. ** The amortization period of an IUS must be adjusted (not extending more than 5 years) if minor upgrades resulting from ongoing systems maintenance or repair of a design flaw extend the useful life of the software without adding additional capabilities. The cost of the upgrades should be expensed in the period incurred. Also, note the upgrades that do add additional capabilities would be considered enhancements and would be capitalized and amortized if they meet the capitalization criteria in subparagraph 2.5.6. ***See paragraph 2.6 on the criteria for capitalizing versus expensing of IUS enhancements.	

Table 27-3.   Supporting Documentation for IUS Acquisition

Evidence	Examples
Unique Identification	Assignment of a unique identifier
Project Approval	Such as, but not limited to, a Work Order
Obligation on Behalf of the Government	Such as, but not limited to: 1. For contracts, contract modifications, or change orders: • Statement of Work; • Dollar Amount of Contract; • Location; • Source of Funds; • Parties to the Contract; and • Signature Page [Signature of All Parties]. 2. Documentation of labor hours; 3. Approved Work Order.
Payment Submitted	Such as, but not limited to: 1. Approved the last invoice reflecting the total amount submitted for payment and received to date; 2. Evidence of in-house development costs, including labor; 3. Indirect Costs incurred internally by the gaining activity that relates to the new acquisition or capital enhancement.
Acceptance	Such as, but not limited to: 1. DoD **DD Form 250** Material Inspection and Receiving Report; 2. Executed acquisition document and appraisal results for the donated IUS; 3. Signed agreement for software licenses; 4. A signoff document confirming key development milestones such as technical acceptance tests are met; 5. Documents to support the amount that has been expensed versus capitalized during the software development phase. 6. Executed reversionary document; and 7. Transfer letter and documents for transferred assets.

Annex 1.   Definitions and Examples
The following Table A1-1 contains common terms as they are generally defined by information technology and software programming professionals. It also includes scenarios relevant to IUS.

Table A1-1.   Definitions and Examples

Definition	Classified as IUS?	Capitalization	DoD Examples**
Access Control Software			
This type of software, which is external to the operating system, provides a means of specifying who has access to a system and the specific capabilities authorized users are granted.	No	Include equipment costs	CA-ACF2, RACF
Application Software			
A software program that performs a specific function directly for a user and can be executed without access to system control, monitoring, or administrative privileges.	Yes	Yes - When capitalization criteria is met	Microsoft Excel, Adobe Photoshop
Cloud – Public			
A cloud-based environment that is generally external to the Department with infrastructure owned and managed by a third party. Public cloud services are generally subscription-based.	No	No	Dropbox
Cloud – Private			
A cloud based environment that is generally internal to the Department and used solely by DoD Components.	Yes	Yes – When the capitalization criteria is met, the DoD Component that controls the IUS has financial reporting responsibility	DISA milCloud
Database Management System (DBMS)			
Computer software applications that interact with the user, other applications, and the database itself to capture and analyze data.	Yes	Yes - When capitalization criteria is met	Oracle Enterprise Manager

**DoD examples provided may or may not be capitalized

Definition	Classified as IUS?	Capitalization	DoD Examples**
Enterprise Resource Planning System			
Commercial software that integrates business information flowing through the Component. ERP systems contain functional modules (e.g., financial, accounting, human resources, supply chain, and customer information) that are integrated within the core system or interfaced with external systems.	Yes – portions of ERP systems are IUS (excluding any hardware acquired as part of the system)	Yes – portions of ERP systems are capitalized	Navy ERP, GFEBS, LMP, DAI
Firmware			
A program recorded in permanent or semi-permanent computer memory.	No	May be capitalized as part of general equipment depending on applicable capitalization criteria being met	Radar system software, lathe software
Freeware / Open Source Software (OSS)			
Software that is offered at no cost.	No	No	Internet browser
Hardware			
The physical components of IT, include computers, peripheral devices such as printers, disks, and scanners, cables, switches, and other IT equipment.	No	May be capitalized as general equipment depending on applicable capitalization criteria being met	Router, Server, Modem, Switch
License – Annual			
A software license that must be renewed annually to continue using the software.	Yes	No - an annual license does not meet the useful life criteria of 2 years for capitalization	Microsoft Lync, VMWARE vSphere
License – Perpetual			
A software license that gives the Department the right to use the software in perpetuity.	Yes	Only if it meets the capitalization threshold	SAP Chrystal Reports

**DoD examples provided may or may not be capitalized.

Definition	Classified as IUS?	Capitalization	DoD Examples**
Middleware			
Computer software that provides services to software applications beyond those available from the operating system.	Yes	Yes - If the system it is part of meets capital criteria	Linux Kernel
Portal			
A web-based application that provides personalization, single sign-on, and content aggregation from different sources, and hosts the presentation layer of information systems.	Yes	Yes – When capitalization criteria is met	Audit Response Center (ARC) Tool
Simulation Software			
Based on the process of modeling a real or proposed system with a set of mathematical formulas that allows the user to observe an operation before performing it.	Yes	Yes – When capitalization criteria is met	F-35 Lightning II Training Software
Operating System			
The software that controls the execution of other computer programs, schedules tasks, allocates storage, manages the interface to peripheral hardware, and presents a default interface to the user when no application program is running.	No	Include in equipment costs	Windows, Linux
System / IT System			
The term "system" by itself is not limited to any specific resource. A system may be any two resources that work together to produce a specific outcome. Internal use software may or may not be one component of an overall "system".	Yes – software components of a system or IT system are IUS	Yes - When capitalization criteria are met	Navy ERP, GFEBS, DAI, CAMIS, OMIS-A
Utility Program			
System software designed to perform a particular function or system maintenance.	No	Include in equipment costs	CD burner, Disk defragmenter, virus scan
Web Application			
An application that is accessed via the web over a network.	Yes (assuming it is owned by a DoD Component)	Yes - When capitalization criteria is met	Outlook Webmail

**DoD examples provided may or may not be capitalized.

*Annex 2.   The Software Development Life-Cycle (SDLC)

1.0   SDLC Phases Include Planning, Development, and Operations.

Generally, capitalize costs incurred during the development phase and expense costs incurred in the planning and operations phases. IUS development under other methods, such as agile software developments, may not follow this linear approach, and capitalization decisions absent distinct phases are more difficult. Regardless of timing, capitalize or expense the cost incurred for development phase activities based on their substance/task activity rather than their phase. Table A3-1 depicts the three phases with a linear sequential paradigm.

1.1   In the Preliminary Design phase, DoD Components will most likely do the following:

1.1.1. Make strategic decisions to allocate resources between alternative projects at a given time. (e.g., decide whether to develop a new IUS asset or fix existing IUS problems);

1.1.2. Determine performance requirements

1.1.3. Invite vendors to perform demonstrations of how their software will fulfill a DoD Component's needs.

1.1.4. Explore alternative means of achieving specified performance requirements. For example, should a DoD Component make or buy the software? Should the software run on a mainframe or client-server system?

1.1.5. Determine if technology exists to meet requirements.

1.1.6. Select a vendor if a DoD Component chooses to obtain COTS software.

1.1.7. Select a consultant to assist in the software's development or installation.

1.2   In the Development phase, the DoD Components may:

1.2.1. Use a system to manage the project;

1.2.2. Track and accumulate life-cycle cost and compare it with performance indicators;

1.2.3. Determine the reasons for any deviations from the performance plan and take corrective actions;

1.2.4. Test the deliverables to verify that they meet the specifications.

1.3   In the Operations phase, the DoD Components may:

1.3.1. Operate and maintain the IUS asset and provide user training.

1.3.2. Convert data from the old system to the new system;

1.3.3. Compare asset usage with the original plan; and/or

1.3.4. Track SDLC cost and compare it with the original plan.

1.3.5. Capitalize costs of enhancements to the IUS if they meet the capital enhancement requirements.

2.0.   Capital Versus Expense IUS Activities.

Many government and contractor personnel conduct a variety of activities throughout the SDLC for various IUS programs and contracts. Capitalize some costs associated with these activities as part of the cost of the IUS and expense other costs. Capitalization decisions follow the activity regardless of the software development method (e.g., waterfall, prototyping, agile, or spiral). Software development methods are described in Annex 3. When reviewing contracts and budget documentation, take care to distinguish between activities to determine to capitalize or expense.

Table A2-1.   Traditional IUS SDLC Phases, Tasks, and Accounting Treatment

Project Phase	Task	Treatment
Planning	Project Evaluation	Expense
	Concept testing	Expense
	Evaluation of alternatives	Expense
	Project approval	Expense
Development	Design and Configuration	Capitalize
	Coding	Capitalize
	Installation to Hardware	Capitalize
	Direct personnel costs	Capitalize
	Technical Acceptance Testing	Capitalize
	Quality assurance testing	Capitalize
	Documentation	Capitalize
	Indirect and Overhead costs	Allocate*
	Data conversion software	Expense
Operations	Testing	Expense
	Training	Expense
	Data conversion	Expense
	Help desk	Expense
	Enhancement	See "IUS Enhancements", section 2.6.
	Maintenance/Bug Fix	Expense
*Expense or capitalize indirect and overhead costs depending on 1) the materiality to overall costs of individual IUS development projects, and 2) the phase in which the costs are incurred.		

*Annex 3.   Software Development Methods

1.1   Software development methods are ever-evolving, with new methods and techniques being introduced over time. Included in the following subparagraphs are several descriptive examples of common software development methods.

      1.1.1. <u>Linear/Waterfall Software Development Method</u>. The linear/waterfall software development method is a sequential design process, used in software development in which progress is seen as flowing steadily downwards (like a waterfall) through the software development phases. The linear/waterfall software development method follows the phases outlined in Annex 2 in sequence, whereas the other software development methods as can move between phases during the life of the development. Regardless of the development method (e.g., waterfall, prototyping, agile, or spiral), the capitalization decisions follow the tasks identified.

      1.1.2. <u>Prototyping Software Development Method</u>.   The prototyping software development method is a system development method in which a prototype (an early approximation of a final system or product) is built, tested, and then reworked as necessary until an acceptable prototype is finally achieved from which the complete system or product can be developed. This model works best in scenarios where not all the project requirements are known in detail ahead of time. An iterative, trial-and-error process takes place between the developers and the users.

      1.1.3. <u>Agile Software Development Method</u>. The agile software development method is a group of software development methods in which requirements and solutions evolve through collaboration between self-organizing, cross-functional teams.

        1.1.3.1. In an agile project, working software is deployed in iterations of typically one to eight weeks in duration, each of which provides a segment of functionality. Initial planning regarding cost, scope, and timing is usually conducted at a high level, and the project status is primarily evaluated based on software demonstrations.

        1.1.3.2. The IUS development phases listed in Annex 2 could be applied to agile development projects on an iteration basis. If an iteration developed meets the module or component asset description in accordance with subparagraph 2.5.4.2.1 and the capitalization cut-off period described in subparagraph 2.5.5.5.2, then it could be treated as an individual IUS project. If the number of iterations is dependent on the outcomes of multiple processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure.   Any future incremental releases that result in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with paragraph 2.6.

      1.1.4. <u>Spiral Software Development Method</u>. The spiral software development method combines the features of the waterfall and prototyping incremental models, but with more emphasis placed on risk analysis and management.

       1.1.4.1. The spiral methodology projects are typically separated into phases like the waterfall method: planning, risk analysis, engineering, and evaluation. However, they are broken up into incremental releases of the product, or incremental refinement each time around the spiral and through continuously analyzing the requirements and improving the definition and implementation. At each iteration around the cycle, the project is improved and extended.

       1.1.4.2. The IUS development phases listed in subparagraph Annex 2 could be applied to a spiral development project on a process iteration basis. If an iteration developed meets the module or component asset description in accordance with subparagraph 2.5.4.2.1 and the capitalization cut-off period described in subparagraph 2.5.5.5.2, then it could be treated as an individual IUS project. If the number of iterations is dependent on the outcomes of multiple spiral processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure. Any future incremental releases that result in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with paragraph 2.6.

1.2   <u>Cross-Functional IUS Reviews</u>. Software development can be complex and accounting decisions often require a measure of judgment and expertise found throughout an organization. Examples of these decisions can include identifying assets that meet the IUS definition, determining the point at which an IUS project is more likely than not to be completed, whether an enhancement should be capitalized, and determining the useful life. DoD Components will ensure that key stakeholders from the IUS program, acquisition, and accounting organizations have adequate visibility into the major milestones throughout the acquisition process to make these decisions. This could take the form of an IUS acquisition review board, consisting of knowledgeable stakeholders who assess pending and active IUS projects to make such decisions. It could also include leveraging portfolio management processes already in place at some DoD Components. Stakeholders will meet periodically and with enough frequency to make timely decisions concerning the IUS and the decisions will be documented. Additional cross-functional decisions and deadlines for making them are found in Table A3-1. This review activity can also serve as a key control.

Table A3-1.   Cross-Functional Review Decisions and Timeline

Decision	Decision Timeline
Identify potential IUS	During the budget process and not later than end of the planning phase
Determine that it is more likely than not that the IUS project will be completed	Prior to the completion of the planning phase
Assign a useful life	Prior to the end of final technical acceptance testing
Confirm that the cost has been correctly accumulated and assigned to the asset	Prior to the end of final technical acceptance testing
Confirm that indirect costs have been appropriately allocated	Prior to the end of final technical acceptance testing
Assign an in-service date	Upon completion of final technical acceptance testing
Decision	**Decision Timeline**
Identify potential capital enhancements	During the budget process and not later than end of the planning phase

Management Oversight Decisions
• Impairment
• Evaluation of suspended projects
  o More likely than not the project will be completed
  o More likely than not the project will be cancelled
	On-going