Statutory Issue Paper No. 16

Electronic Data Processing Equipment and Software

STATUS
Finalized March 16, 1998

Original SSAP: SSAP No. 16; Current Authoritative Guidance: SSAP No. 16R

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. The current statutory guidance provides that some states permit recording electronic data processing (EDP) equipment and operating system software as admitted assets. This is subject to limitations such as a percentage of total assets, minimum purchase price, and period of depreciation. Application system software may be expensed when purchased, or established as a nonadmitted asset and written off over a period of years not to exceed the software's expected useful life.

2. GAAP requires purchases of EDP equipment and software to be capitalized and depreciated over the expected useful lives of the assets, except for software purchased or leased for research and development purposes, which is required to be expensed at acquisition. There is no authoritative literature in GAAP that addresses capitalization of software developed for internal use, and industry practice is mixed. This issue paper establishes a framework for the accounting and reporting of EDP equipment and software that is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. EDP equipment and software generally meet the definition of an asset in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*. EDP equipment and operating system software are admitted assets to the extent they conform to the requirements of this issue paper. Nonoperating system software meet the criteria defining nonadmitted assets; accordingly, such assets shall be reported as nonadmitted assets and charged against surplus.

4. EDP equipment and software shall be depreciated for a period not to exceed three years using methods detailed in *Issue Paper No. 67—Depreciation of Property and Amortization of Leasehold Improvements*.

5. The aggregate amount of admitted EDP equipment and operating system software (net of accumulated depreciation) shall be limited to three percent of the reporting entity's capital and surplus, excluding from capital and surplus any EDP equipment and operating system software, net deferred tax assets and net positive goodwill, as of the financial statement date.

6. The following disclosures shall be made in the financial statements:

   a. Depreciation and amortization expense for the period;

   b. For EDP equipment and operating system software, balances of major classes of depreciable assets, by nature or function, at the balance sheet date;

c. For EDP equipment and operating system software, accumulated depreciation and amortization, either by major classes of depreciable assets or in total, at the balance sheet date; and

d. A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

DISCUSSION

7. *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* states that an asset not readily available to satisfy policyholder obligations *"shall be recorded as a nonadmitted asset and charged against surplus."* This is consistent with the Statement of Concepts, which states that a reporting entity's *"ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due*."

8. EDP equipment and operating system software meet the criteria defining admitted assets because they generally have a resale value. The limitation of the depreciation period to three years is deemed appropriate due to the current evolutionary period for such equipment and software. Additionally, the limitation on the amount of EDP equipment and operating system software which may be admitted in an amount not to exceed three percent of capital and surplus (as adjusted by EDP equipment and operating system software, net deferred tax assets and net positive goodwill) is consistent with the conservatism concept of the Statement of Concepts.

9. Nonoperating system software is not considered readily available to satisfy policyholder obligations, particularly due to the nature of internally developed EDP software and the modifications made to purchased EDP software, that make it tailored for use only on the owner's computer system, thereby rendering it unable to be readily resold. Nonadmitting nonoperating software is also consistent with the conservatism concept of the Statement of Concepts.

Drafting Notes/Comments

- *FASB Statement No. 2, Accounting for Research and Development Costs* (FAS 2), FASB Interpretation No. 6, *Applicability of FASB Statement No. 2 to Computer Software* (FIN 6) and *FASB Statement No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed* (FAS 86) are addressed in *Issue Paper No. 17—Preoperating and Research and Development Costs*.
- Furniture, fixtures & equipment are addressed in *Issue Paper No. 19—Furniture, Fixtures and Equipment*.
- Leases and sale-leaseback transactions are addressed in *Issue Paper No. 22—Leases*

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

10. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chap93 T 0.0009 nP29 -1.15perdting id su

routines and debugging aides and other computer software are not considered operating system software and may not be recognized as admitted assets.

11. Chapter 9, Nonadmitted Assets, states: "*application systems software may be expensed when purchased or established as a nonadmitted asset and written off over a period of years not to exceed the software's expected useful life.*"

12. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies contains similar guidance.

13. In most states the depreciated value of EDP equipment and its related operating software is an admitted asset, generally subject to several restrictions. The restrictions could include the following: requiring permission from the insurance commissioner of the state of domicile, setting a minimum amount that can be capitalized as an asset, establishing a maximum depreciable life (such as 10 years for hardware and five years for software) and limiting the amount that may be admitted to a percentage of total admitted assets or capital and surplus. Applications software is typically nonadmitted.

Generally Accepted Accounting Principles

14. GAAP requires purchases of long-lived equipment to be capitalized at their historical cost and depreciated over the expected useful life of the assets by recording a monthly charge against current income, in accordance with *Accounting Research Bulletin No. 43*, *Restatement and Revision of Accounting Research Bulletins* (ARB 43), Chapter 9, *Depreciation*. This treatment is consistent with the matching concept of GAAP, which requires revenues and expenses to be recognized over the period in which they are earned or incurred.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies, Chapters 8 and 9
- Accounting Practices and Procedures Manuals for Life and Accident and Health Insurance Companies, Chapters 8 and 9
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 67—Depreciation of Property and Amortization of Leasehold Improvements*

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