Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP No. 19);

d. Paragraph 37 is amended to require that capitalized operating system software shall be depreciated for a period not to exceed three years. Capitalized nonoperating system therefore paragraph 32 was amended to require that licensing agreements shall be treated as operating leases;

c. Paragraph 36 was modified to remain consistent with the amortization guidelines contained within SSAP No. 19 paragraph 9;

d. Paragraph 37 was amended to remain consistent with the depreciable lives guidelines contained within SSAP No. 16 and the recently adopted Issue Paper No. 109;

e. Paragraph 40 requires that if, during the development of internal-use software, an entity decides to market the software to others, the entity should follow *FASB Statement No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* (FAS No. 86). Amounts previously capitalized under this SOP should be evaluated at each balance sheet date in accordance with paragraph 10 of FAS No. 86. Capitalized software costs should be amortized in accordance with paragraph 8 of FAS No. 86. Both paragraphs 8 and 10 are rejected in SSAP No. 17 and therefore the most conservative measure is to expense such amounts immediately;

f. Paragraph 41 includes references to various different GAAP pronouncements for its disclosure requirements. This paragraph was modified as SSAP Nos. 16 and 17 already include the pertinent disclosure requirements;

g. Paragraph 42 indicates that SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. The paragraph was modified to allow an effective date of January 1, 2002 so as to provide ample opportunity for statutory accounting user implementation; and

h. In order to remain consistent with the treatment of nonoperating system software, the nonadmission criteria outlined in paragraph 2 of SSAP No. 16 were included in this issue paper. In order to prevent the possible misclassification of nonoperating system software as operating software, the working group felt it was appropriately conservative to classify all software costs capitalized in accordance with this issue paper as nonoperating system software costs. The Glossary to the SSAPs defines operating and nonoperating system software as:

> The operating system is a program or a series of programs controlling the data job and task management operations of a computer or a computer network through executive scheduling and monitoring. It increases the productivity of a computer installation by managing the allocation of all available computer resources including the control processing unit, main storage and input/output devices.
>
> Nonoperating systems software such as language processors, library routines and debugging aides and other computer software are not considered operating system software.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE:

Statutory Accounting

9. In general, capitalization of software is provided for in SSAP No. 16. This issue paper provides more specific guidelines for capitalization of internal software and web site development costs. SSAP No. 16 renders the following instruction:

2. EDP equipment and software generally meet the definition of assets established in *SSAP No. 4—Assets and Nonadmitted Assets*. EDP equipment and operating system software are admitted assets to the extent they conform to the requirements of this statement. Nonoperating system software are nonadmitted assets.

3. EDP equipment and software shall be depreciated for a period not to exceed three years using methods detailed in *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements*.

4. 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 as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any EDP equipment and operating system software, net deferred tax assets and net positive goodwill.

Disclosures

5. 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.

6. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 5 above shall be included in the annual audited statutory financial reports only.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

8. EDP equipment and software capitalized prior to January 1, 2001 shall be depreciated over the shorter of its remaining useful life or three years.

Generally Accepted Accounting Principles

10. *AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* provides the following:

.11 Accounting for costs of reengineering activities, which often are associated with new or upgraded software applications, is not included within the scope of this SOP.

Conclusions

Characteristics of Internal-Use Computer Software

.12 For purposes of this SOP, internal-use software is software having the following characteristics:

a. The software is acquired, internally developed, or modified solely to meet the entity's internal needs.

b. During the software's development or modification, no substantive plan exists or is being developed to market the software externally.

A substantive plan to market software externally could include the selection of a marketing channel or channels with identified promotional, delivery, billing, and support activities. To be considered a substantive plan under this SOP, implementation of the plan should be reasonably possible. Arrangements providing for the joint development of software for mutual internal use (for example, cost-sharing arrangements) are not substantive plans to market software for purposes of this SOP. Similarly, routine market feasibility studies are not substantive plans to market software for purposes of this SOP.

.13 An entity must meet both characteristics in paragraph .12 for software to be considered for internal use.

.14 An entity's past practices related to selling software may help determine whether the software is for internal use or is subject to a plan to be marketed externally. For example, an entity in the business of selling computer software often both uses and sells its own software products. Such a past practice of both using and selling computer software creates a rebuttable presumption that any software developed by that entity is intended for sale, lease, or other marketing, and thus is subject to the guidance in FASB Statement No. 86.

.15 Computer software to be sold, leased, or otherwise marketed includes software that is part of a product or process to be sold to a customer and should be accounted for under FASB Statement No. 86. For example, software designed for and embedded in a semiconductor chip is included in the scope of FASB Statement No. 86 because it is an integral part of the product. By contrast, software for internal use, though it may be used in developing a product, is not part of or included in the actual product or service sold. If software is used by the vendor in the production of the product or providing the service but the customer does not acquire the software or the future right to use it, the software is covered by this SOP. For example, for a communications company selling telephone services, software included in a telephone switch is part of the internal equipment used to deliver a service but is not part of the product or service actually being acquired or received by the customer.

.16 The Appendix [paragraph .93] provides examples of when computer software is and is not for internal use.

Stages of Computer Software Development

.17 The following table illustrates the various stages and related processes of computer software development.

Preliminary Project Stage	**Application Development Stage**	**Post-Implementation/ Operation Stage**
Conceptual formulation of alternatives	Design of chosen path, including software configuration and software interfaces	Training
Evaluation of alternatives	Coding	Application maintenance
Determination of existence of needed technology	Installation of hardware	
Final selection of alternatives	Testing, including parallel processing phase	

The SOP recognizes that the development of internal-use computer software may not follow the order shown above. For example, coding and testing are often performed simultaneously. Regardless, for costs incurred subsequent to completion of the preliminary project stage, the SOP should be applied based on the nature of the costs incurred, not the timing of their incurrence. For example, while some training may occur in the application development stage, it should be expensed as incurred as required in paragraphs .21 and .23.

Research and Development

.18 The following costs of internal-use computer software are included in research and development and should be accounted for in accordance with the provisions of FAS No. 2:

a. Purchased or leased computer software used in research and development activities where the software does not have alternative future uses.
b. All internally developed internal-use computer software (including software developed by third parties, for example, programmer consultants) if (1) the software is a pilot project (that is, software of a nature similar to a pilot plant as noted in paragraph 9.h. of FASB Statement No. 2) or (2) the software is used in a particular research and development project, regardless of whether the software has alternative future uses.

Capitalize or Expense

.19 Preliminary Project Stage. When a computer software project is in the preliminary project stage, entities will likely—

a. Make strategic decisions to allocate resources between alternative projects at a given point in time. For example, should programmers develop a new payroll system or direct their efforts toward correcting existing problems in an operating payroll system?
b. Determine the performance requirements (that is, what it is that they need the software to do) and systems requirements for the computer software project it has proposed to undertake.
c. Invite vendors to perform demonstrations of how their software will fulfill an entity's needs.
d. Explore alternative means of achieving specified performance requirements. For example, should an entity make or buy the software? Should the software run on a mainframe or a client server system?
e. Determine that the technology needed to achieve performance requirements exists.
f. Select a vendor if an entity chooses to obtain software.
g. Select a consultant to assist in the development or installation of the software.

.20 Internal and external costs incurred during the preliminary project stage should be expensed as they are incurred.

.21 Application Development Stage. Internal and external costs incurred to develop internal-use computer software during the application development stage should be capitalized. Costs to develop or obtain software that allows for access or conversion of old data by new systems should also be capitalized. Training costs are not internal-use software development costs and, if incurred during this stage, should be expensed as incurred.

.22 The process of data conversion from old to new systems may include purging or cleansing of existing data, reconciliation or balancing of the old data and the data in the new system, creation of new/additional data, and conversion of old data to the new system. Data conversion often occurs during the application development stage. Data conversion costs, except as noted in paragraph .21, should be expensed as incurred.

.23 Post-Implementation/Operation Stage. Internal and external training costs and maintenance costs should be expensed as incurred.

.24 Upgrades and Enhancements. For purposes of this SOP, upgrades and enhancements are defined as modifications to existing internal-use software that result in additional functionality—

that is, modifications to enable the software to perform tasks that it was previously incapable of performing. Upgrades and enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications. In order for costs of specified upgrades and enhancements to internal-use computer software to be capitalized in accordance with paragraphs .25 and .26, it must be probable that those expenditures will result in additional functionality.

.25 Internal costs incurred for upgrades and enhancements should be expensed or capitalized in accordance with paragraphs .20-.23. Internal costs incurred for maintenance should be expensed as incurred. Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements should expense such costs as incurred.

.26 External costs incurred under agreements related to specified upgrades and enhancements should be expensed or capitalized in accordance with paragraphs .20-.23. (If maintenance is combined with specified upgrades and enhancements in a single contract, the cost should be allocated between the elements as discussed in paragraph .33 and the maintenance costs should be expensed over the contract period.) However, external costs related to maintenance, unspecified upgrades and enhancements, and costs under agreements that combine the costs of maintenance and unspecified upgrades and enhancements should be recognized in expense over the contract period on a straight-line basis unless another systematic and rational basis is more representative of the services received.

.27 Capitalization of costs should begin when both of the following occur.

a. Preliminary project stage is completed.
b. Management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project and it is probable that the project will be completed and the software will be used to perform the function intended. Examples of authorization include the execution of a contract with a third party to develop the software, approval of expenditures related to internal development, or a commitment to obtain the software from a third party.

.28 When it is no longer probable that the computer software project will be completed and placed in service, no further costs should be capitalized, and guidance in paragraphs .34 ive basi]TJ0.5pi and use computer software project, to the extent of the time spent directly on the

e. Technologies are introduced in the marketplace, so that management intends to obtain the third-party software or software products instead of completing the internally developed software

f. Business segment or unit to which the software relates is unprofitable or has been or will be discontinued.

Amortization

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

.37 In determining and periodically reassessing the estimated useful life over which the costs incurred for internal-use computer software will be amortized, entities should consider the effects of obsolescence, technology, competition, and other economic factors. Entities should consider rapid changes that may be occurring in the development of software products, software operating systems, or computer hardware and whether management intends to replace any technologically inferior software or hardware. Given the history of rapid changes in technology, software often has had a relatively short useful life.

.38 For each module or component of a software project, amortization should begin when the computer software is ready for its intended use, regardless of whether the software will be placed in service in planned stages that may extend beyond a reporting period. For purposes of this SOP, computer software is ready for its intended use after all substantial testing is completed. If the functionality of a module is entirely dependent on the completion of other modules, amortization of that module should begin when both that module and the other modules upon which it is functionally dependent are ready for their intended use.

Internal-Use Computer Software Marketed

.39 If, after the development of internal-use software is completed, an entity decides to market the software, proceeds received from the license of the computer software, net of direct incremental costs of marketi

Effective Date and Transition

.42 This SOP is effective for financial statements for fiscal years beginning after December 15, 1998, and should be applied to internal-use computer software costs incurred in those fiscal years for all projects, including those projects in progress upon initial application of this SOP. Earlier application is encouraged in fiscal years for which annual financial statements have not been issued.

Appendix

.93

Examples Illustrating When Computer Software Is for Internal Use

1. A manufacturing entity purchases robots and customizes the software that the robots use to function. The robots are used in a manufacturing process that results in finished goods.
2. An entity develops software that helps it improve its cash management, which may allow the entity to earn more revenue.
3. An entity purchases or develops software to process payroll, accounts payable, and accounts receivable.
4. An entity purchases software related to the installation of an online system used to keep membership data.
5. A travel agency purchases a software system to price vacation packages and obtain airfares.
6. A bank develops software that allows a customer to withdraw cash, inquire about balances, make loan payments, and execute wire transfers.
7. A mortgage loan servicing entity develops or purchases computer software to enhance the speed of services provided to customers.
8. A telecommunications company develops software u2 Tw 20.88[(8.)-0,24 Tc various27(A phoonliof servisu whi
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   sytioes.

18. A software company develops an operating system for sale and for internal use. Though the specifications of the software meet the company's internal needs, the company had a marketing plan before the project was complete. In addition, the company has a history of selling software that it also uses internally and the plan has a reasonable possibility of being implemented.
19. An entity is developing software for a point-of-sale system. The system is for internal use; however, a marketing plan is being developed concurrently with the software development. The plan has a reasonable possibility of being implemented.
20. A telecommunications entity purchases computer software to be used in research and development activities.

EXHIBIT 00-2A
APPLICATION OF THE EITF CONSENSUSES ON ISSUE 00-2

Planning Stage	
Web Site Development Activity	**Accounting Required by Issue 00-2**
a. Develop a business, project plan, or both. This may include identification of specific goals for the web site (for example, to provide information, supplant manual processes, conduct e-commerce, and so forth), a competitive analysis, identification of the target audience, creation of time and cost budgets, and estimates of the risks and benefits.	Expense as incurred.
b. Determine the functionalities (for example, order placement, order and shipment tracking, search engine, e-mail, chat rooms, and so forth) of the web site.	Expense as incurred.
c. Identify necessary hardware (for example, the server) and web applications. Web applications are the software needed for the web site's functionalities. Examples of web applications are search engines, interfaces with inventory or other back-end systems, as well as systems for registration and authentication of users, commerce, content management, usage analysis, and so forth.	Expense as incurred.
d. Determine that the technology necessary	

Web Site Application and Infrastructure Development Stage	
Web Site Development Activity	**Accounting Required by Issue 00-2**
	The discussion of web site application and infrastructure development assumes that any software is developed for the entity's internal needs and no plan exists or is being developed to market the software externally (refer to paragraph 12 of SOP 98-1). Software for which a plan exists or is being developed to market the software externally is subject to Statement 86, and costs associated with the development of that software should be expensed until technological feasibility is established (refer to paragraph 4 of Statement 86).
a. Acquire or develop the software tools required for the development work (for example, HTML editor, software to convert existing data to HTML form, graphics software, multimedia software, and so forth).	Apply SOP 98-1. Costs incurred to purchase software tools, or costs incurred during the application development stage for internally developed tools, generally should be capitalized unless they are used in research and development and (1) do not have any alternative future uses or (2) are internally developed and represent a pilot project or are being used in a specific research and development project (see paragraph 18 of SOP 98-1).
b. Obtain and register an Internet domain name.	Generally, capitalize pursuant to paragraph 24 of APB 17.
c. Acquire or develop software necessary for general web site operations, including server operating system software, Internet server software, web browser software, and Internet protocol software.	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
d. Develop or acquire and customize code for web applications (for example, catalog software, search engines, order processing systems, sales tax calculation software, payment systems, shipment tracking applications or interfaces, e-mail software, and related security features).	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
e. Develop or acquire and customize database software and software to integrate distributed applications (for example, corporate databases and accounting systems) into web applications.	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
f. Develop HTML web pages or develop templates and write code to automatically create HTML pages.	Apply SOP 98-1. Generally, capitalize pursuant to paragraphs 21 and 31 of SOP 98-1.
g. Purchase the web and application server(s), Internet connection (bandwidth), routers, staging servers (where preliminary changes to the web site are made in a test environment), and production servers (accessible to customers using the web site). Alternatively, these services may be provided by a third party via a hosting arrangement.	Acquisitions of servers and related hardware infrastructure are outside the scope of this Issue. Payments for hosting arrangements should be expensed over the period of

Accounting for the Costs of Computer Softw

e. Perform regular backups.	Apply SOP 98-1. Generally, expense as incurred pursuant to paragraph 23 of SOP