

## Military Equipment Valuation Project

### *Accounting for Internal Use Software*

#### Description of Issue

Paragraph 2 of Statement of Federal Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*, defines the cost of internal use software as:

- Software used to operate an entity's programs (e.g., financial and administrative software, including that used for project management),
- Software used to produce the entity's goods and to provide services (e.g., air traffic control and loan servicing), and
- Software that is developed or obtained for internal use and subsequently provided to other federal entities with or without reimbursement.

Paragraph 15 of SFFAS No. 10 states that entities should capitalize the cost of software when such software meets the criteria for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods and services. Volume 4, Chapter 6 of the Financial Management Regulation (FMR) states that internal use software should be capitalized if it has a useful life of two years or more and the cost of the software equals or exceeds the DoD capitalization threshold of \$100,000.

DoD uses software for a broad range of purposes, ranging including functions such as the operation of weapons systems, command, control, and communications, and accounting and budgetary control. At issue is what criteria should be applied to determine (1) the software to be valued as part of the military equipment valuation (MEV) project and (2) how software classified as MEV is to be valued.

#### Discussion

The FMR states that internal use software does not include software integrated in military equipment nor does it include software used in Special Test Equipment. The FMR also states that computer software that is integrated into and necessary to operate General PP&E, rather than perform an application, shall be considered part of the PP&E of which it is an integral part and capitalized and depreciated accordingly (e.g., airport radar and computer operated lathes). The FMR further states that, except for the exclusions presented above, all software that is used for operational or other internal use should be capitalized as internal use software. The inference is that non-integrated software is to be valued separately.

The SFFAS No. 10 definition of internal use software is extremely broad. The first definition of internal use software contained in SFFAS No. 10:

“software used to operate an entity’s programs (e.g. financial and administrative software, including that used for project management),”

encompasses software that is not unique to DoD, but rather could be found in any Federal entity. Every entity must use software of some type to enable it to discharge its budgetary, accounting, human resource, and other managerial and administrative responsibilities. While software of this type is not necessarily interchangeable among entities, the basic functionality required of this type of software is similar because the software is intended to satisfy a body of legislative and regulatory requirements common to all entities.

The second definition of internal use software contained in SFFAS No. 10:

“software used to produce the entity’s goods and to provide services (e.g., air traffic control and loan servicing),”

encompasses software that is mission-oriented and, therefore, unique to an individual entity. Software of this type is intended to enable DoD to achieve its mission, namely “providing military forces needed to deter war and protect our country”.

SFFAS No. 10 does not require, nor even suggest, that internal use software be characterized and/or reported by purpose, such as administrative internal use software or mission-support internal use software. Further, Office of Management and Budget Bulletin No.01-09, *Form and Content of Agency Financial Statements*, does not address the reporting of internal use software.

### **Recommendation**

Based on the foregoing discussion, software that is part of (i.e., integrated into) property, plant, or equipment (PP&E), such as software integrated into a building to run heating, ventilation, and cooling systems or software integrated into weapons systems, should not be capitalized separately as internal use software, but rather should be included in the capitalized cost of the PP&E of which it is a part. Currently, software integrated into military equipment is being addressed as part of the Military Equipment Valuation Project.

All other software that satisfies the criteria for characterization as internal use software should be accumulated and reported in a single General Property, Plant, and Equipment category, “Internal Use Software”. Components are responsible for the identification, valuation, and reporting of internal use software using the criteria documented in Volume 4, Chapter 6 of the Financial Management Regulation.