HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation
1
Costs of modifying existing software

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

Reference: *Framework for the preparation and presentation of financial statements*

SSAP 17 *Property, plant and equipment*

ISSUE

1. Enterprises may incur considerable costs in modifying existing software systems. In particular, such costs are incurred in order to enable them to continue to operate as intended after the turn of the millennium (often referred to as "software 2000 costs").

2. The issues are:

   (a) whether such costs may be capitalised; and if not,

   (b) when such costs should be recognised as an expense.

3. This Interpretation does not address:

   (a) the costs of modifying software produced for sale;

   (b) purchases of replacement software;

   (c) enhancements of the system beyond those necessary to enable the systems to continue to perform as anticipated; and

   (d) the recognition of impairment losses relating to existing computer software.

CONCLUSIONS

4. Costs incurred in order to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of existing software systems, in particular to enable them to operate as intended after the turn of the millennium, should be recognised as an expense as the restoration or maintenance work is carried out.

BASIS FOR CONCLUSIONS

5. In accordance with paragraphs 87 and 88 of the Framework (and applying the rationale of SSAP 17 paragraphs 24 to 28 by analogy), subsequent costs for modifying existing software systems should be recognised as an expense when they are incurred unless (a) it is probable that those costs will enable the software to generate specifically attributable future economic benefits in excess of its originally assessed standard of performance and (b) those costs can be measured and attributed to the asset reliably. The conditions for capitalisation are not met for costs incurred in order to modify existing software systems to enable them to operate as intended the turn of the millennium.

6. In accordance with paragraph 89 of the Framework, a liability is recognised in the balance sheet when (a) it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and (b) the amount at which the settlement will take place can be measured reliably. A liability is not recongnised if expenditure relates to benefits that have yet to be received. The fact that an expenditure may be necessary for the enterprise to continue in business does not create a legal or constructive obligation towards an external party. A liability is, therefore, recognised only as the word related to the modification of existing software is performed by third parties. It is not appropriate to recognise such costs as provisions or other liabilities in periods prior to those when the work is carried out based, for example, on commitments made or contracts entered into with third parties.

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