

## EITF ABSTRACTS

Issue No. 97-13

**Title:** Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation

**Date Discussed:** November 20, 1997

**References:** APB Opinion No. 17, *Intangible Assets*  
APB Opinion No. 20, *Accounting Changes*  
Proposed AICPA Statement of Position, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, dated December 17, 1996  
AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*

### ISSUE

To take advantage of new capabilities in electronic commerce and advances in computer technologies and to solve existing year 2000 software problems, many entities are entering into consulting contracts that combine business process reengineering and information technology transformation. Consulting services may encompass software development, software acquisition, software implementation, training, and ongoing support. Business process reengineering may be a component of some of those activities.

Information technology transformation projects that involve software packages (sometimes called enterprise software) recently have been undertaken by entities that must *reengineer* their business processes to connect into that software rather than modify that software to connect into their existing business processes. The transformation project may also include the installation of new computer hardware, the purchase of new office equipment, furniture, or work stations, and the physical reconfiguration of the work area.

This Issue does not address or change current accounting practices for internal-use software, which AcSEC is currently considering in a proposed SOP. [Note: See STATUS section.]

The issues are:

1. How an entity should account for third-party or internally generated costs associated with projects that combine business process reengineering activities and information technology transformation
2. How the total costs of a business process reengineering consulting contract performed by a third party should be allocated to the project's various individual activities.

### **EITF DISCUSSION**

The Task Force reached a consensus that the cost of business process reengineering activities, whether done internally or by third parties, is to be expensed as incurred. This consensus also applies when the business process reengineering activities are part of a project to acquire, develop, or implement internal-use software. This consensus does not change the accounting for internal-use software development costs or the acquisition of property and equipment.

The following third-party or internally generated costs typically associated with business process reengineering activities should be expensed as incurred:

1. Preparation of request for proposal.
2. Current state assessment: The process of documenting the entity's current business process, except as it relates to current software structure. This activity is sometimes called *mapping, developing an "as-is" baseline, flow charting, and determining current business process structure.*
3. Process reengineering: The effort to reengineer the entity's business process to increase efficiency and effectiveness. This activity is sometimes called *analysis, determining "best-in-class," profit/performance improvement development, and developing "should-be" processes.*

4. Restructuring the work force: The effort to determine what employee makeup is necessary to operate the reengineered business processes.

The Task Force observed that personnel, both internal and third party, involved with *current state assessment, process reengineering, and restructuring the work force* usually have backgrounds in business function, business control, internal audit, internal control, and so forth. Although some personnel involved in these activities may have information technology and software application expertise, the focus of this effort is on process rather than software systems.

Task Force members observed that the table in Exhibit 97-13A may be helpful in applying the above consensus.

The Task Force noted that costs typically associated with the acquisition or the construction of property and equipment phase of a business process reengineering should be accounted for in accordance with the entity's existing policies for accounting for productive assets.

The Task Force also reached a consensus that when a third party is used to complete a business process reengineering project, the total consulting contract price (or the sum of the linked contracts with the same vendor) should be allocated to each activity based on the relative fair values of those separate activities. The allocation should be based on the objective evidence of the fair value of the elements in the contract, not necessarily the separate prices stated within the contract for each element.

The Task Force also reached a consensus that if costs were previously capitalized for the business process reengineering activities identified above, then any remaining

unamortized portion of those identifiable costs should be written off in the quarter that contains November 20, 1997 and reported like a cumulative effect of a change in accounting principle as described in paragraph 20 of Opinion 20. For purposes of determining this adjustment, the Task Force observed that certain situations may require the use of reasonable estimates to allocate the total costs between the various business process reengineering activities and other assets (such as software).

## **STATUS**

On March 4, 1998, the AICPA issued SOP 98-1.

No further EITF discussion is planned.

**Exhibit 97-13A**

**APPLICATION OF THE EITF CONSENSUS ON ISSUE 97-13 TO A BUSINESS  
PROCESS REENGINEERING/INFORMATION TECHNOLOGY  
TRANSFORMATION PROJECT**

The following table sets forth the accounting for typical components of a business process reengineering/information technology transformation project based on whether the item should be:

- a. Expensed as incurred in accordance with the Task Force consensus
- b. Expensed as incurred in accordance with the proposed SOP on internal-use software\*
- c. Capitalized in accordance with the proposed SOP on internal-use software\*
- d. Capitalized as part of the cost of acquiring a fixed asset in accordance with a company's existing policy.

**(Note:** Letters in the grid refer to the corresponding guidance listed above.)

<u>Steps</u>	<u>Third Party</u>		<u>Internal</u>	
	<u>Expense</u>	<u>Capitalize</u>	<u>Expense</u>	<u>Capitalize</u>
<b>Business process reengineering and information technology transformation:</b>				
Preparation of request for proposal (RFP)	a		a	
Current state assessment	a		a	
Process reengineering	a		a	
Restructuring work force	a		a	
<b>Preliminary software project stage activities:</b>				
Conceptual formulation of alternatives	b		b	
Evaluation of alternatives	b		b	
Determination of existence of needed technology	b		b	
Final selection of alternatives	b		b	

\*This information is provided for illustrative purposes only. Inclusion of these items in the table does not result in the ability or need to adopt the guidance in the proposed SOP before that statement is finalized. Further, to capitalize software under the proposed SOP other criteria must be met (for example, management's commitment of funds). [Note: See STATUS section.]

<b>Steps</b>	<b>Third Party</b>		<b>Internal</b>	
	<b><u>Expense</u></b>	<b><u>Capitalize</u></b>	<b><u>Expense</u></b>	<b><u>Capitalize</u></b>
<b>Application development stage activities:</b>				
Design of chosen path, including software configuration and software interface		c		c
Coding		c		c
Installation to hardware		c		c
Testing, including parallel processing phase		c		c
Data conversion costs:				
a. Costs to develop or obtain software that allows for access of old data by new system		c		c
b. All other data conversion processes	b		b	
Training	b		b	
<b>Post-implementation/operation stage activities:</b>				
Training	b		b	
Application maintenance	b		b	
Ongoing support	b		b	
<b>Acquisition of fixed assets:</b>				
Purchase of new computer equipment, office furniture, or work stations		d	N/A	N/A
Reconfiguration of work area—architect fees and hard construction costs		d		d