Audit Committee, 15 March 2017

Change in accounting treatment for software systems review costs

Executive summary and recommendations

Introduction

Following their interim audit in January, the NAO have made a recommendation for a change in accounting treatment. The issue is explained in the appendix. The Executive agrees with the recommended change, and proposes to make the change in the 2016-17 accounts, and in budgets for 2017-18 onwards.

Decision

Audit Committee is asked to approve the change and recommend it to Council.

Financial implication

An extra charge of approximately £240k in the 2016-17 accounts.

Resource implication

None

Appendices

Appendix: Detail of the issue

Date of paper

21 February 2017

Appendix:
Change in accounting treatment for software systems review costs - detail

1. Since 2009 we have followed a process for major systems change projects that splits the project into two phases. "Phase 1" is a review project, which includes an examination of the current system, the alternatives, and the likely costs and benefits of the plausible alternatives. The output from the Phase 1 project is a business case for a preferred option. That preferred option may be the implementation of a major change, but the preferred option could also be retaining the existing system.

2. If a business case for a major change is accepted, the delivery of the change will be via a separate major project – "Phase 2" – subject to the same project management approvals and controls.

3. Phase 1 projects may include consultants' fees for scoping the options, high level design of possible solutions, analysing expected benefits, etc. Until now, we have capitalised those and similar costs on Phase 1 projects in the same way as we capitalise costs on Phase 2 projects of developing software for the chosen system. Both Phase 1 and Phase 2 costs are held on the balance sheet until the new system comes into use, after which they are depreciated over our normal estimated useful life of three years.

4. The NAO have recommended that we should instead expense all costs of Phase 1 projects as they are incurred.

5. The Executive agrees with this proposal. Phase 1 projects are a mixture of research and development. Research costs cannot be capitalised under IAS 38. To the extent that Phase 1 projects are development, they do not meet the criteria for recognition of an asset in IAS 38 (reproduced below) with sufficient certainty.

> An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:
> a) the technical feasibility of completing the intangible asset so that it will be available for use or sale
> b) its intention to complete the intangible asset and use or sell it
> c) its ability to use or sell the intangible asset
> d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset
> e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset
> f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

6. Phase 1 projects are deliberately separate. The work undertaken in a Phase 1 project will not necessarily lead to a recommendation to implement a major change, and such a recommendation, if made, will not necessarily be accepted. If the recommendation made in a Phase 1 project is accepted, any development work done at Phase 1 is likely to be replicated to a greater or lesser degree during the Phase 2 project.

7. Previous Phase 1 projects which are not yet fully depreciated are the Education system, the HR and Partners system, and the Registration system. The net book value of those Phase 1 projects at 31 March 2017, if we did not change the accounting treatment, would be £240k. If the change is approved, that value will be charged in 2016-17 as additional depreciation. The budget for 2017-18 and future years will reflect the change in treatment. There is no change in the treatment of Phase 2 projects.

8. The amounts involved are not material to the current or prior year accounts and are not the result of an accounting policy change. Therefore this will not result in a prior period adjustment in the 2016-17 accounts.