During the current year, Alpha Software Company began and completed the creation of the new Houdini computer software program for sale to customers. Alpha incurred a total project cost of $10 million prior to marketing the software to consumers. Of this amount, $7 million was spent creating the product design and working model of Houdini that provided certainty that the software could be produced as designed. The remaining $3 million was spent performing final testing, debugging, minor coding adjustments, fine-tuning, and creating master copies. You are asked for your advice about how to account for the $10 million of research and development costs – expense it, capitalize it, or some combination of both.

The computer software cost of $7 million that is incurred prior to reaching technological feasibility should be expensed as research and development. (FASB, 2012, ASC para. 985-20-25-1) Technological feasibility is reached when "all planning, designing, coding, and testing activities that are necessary to establish that the product can be produced to meet its design specifications" have been completed such as creating a detailed program design or a working model and product design. (FASB, 2012, ASC para. 985-20-25-2) The remaining costs of $3 million incurred after reaching technological feasibility should be capitalized. (FASB, 2012, ASC para. 985-20-25-3)

985-20-25-1 All costs incurred to establish the technological feasibility of a computer software product to be sold, leased, or otherwise marketed are research and development costs. Those costs shall be charged to expense when incurred as required by Subtopic 730-10.

985-20-25-2 For purposes of this Subtopic, the technological feasibility of a computer software product is established when the entity has completed all planning, designing, coding, and testing activities that are necessary to establish that the product can be produced to meet its design specifications including functions, features, and technical performance requirements. At a minimum, the entity shall have performed the activities in either (a) or (b) as evidence that technological feasibility has been established:

a. If the process of creating the computer software product includes a detail program design, all of the following:

1. The product design and the detail program design have been completed, and the entity has established that the necessary skills, hardware, and software technology are available to the entity to produce the product.

2. The completeness of the detail program design and its consistency with the product design have been confirmed by documenting and tracing the detail program design to product specifications.

3. The detail program design has been reviewed for high-risk development issues (for example, novel, unique, unproven functions and features or technological innovations), and any uncertainties related to identified high-risk development issues have been resolved through coding and testing.

b. If the process of creating the computer software product does not include a detail program design with the features identified in (a), both of the following:

1. A product design and a working model of the software product have been completed.

2. The completeness of the working model and its consistency with the product design have been confirmed by testing.

985-20-25-3 Costs of producing product masters incurred subsequent to establishing technological feasibility shall be capitalized. Those costs include coding and testing performed subsequent to establishing technological feasibility.

Purpose Paragraph

You have requested that our firm provide Alpha Software Company advice about whether the costs to produce the Houdini software should be expensed or capitalized. **Our recommendation is that your company should expense $7 million in the current year as research and development, and capitalize the remaining $3 million which will be amortized in future periods.**

Detail Paragraph

The costs Alpha incurred prior to reaching technological feasibility should be expensed and the remaining costs should be capitalized. Alpha incurred a total of $10 million of research and development costs to produce the software. Of this amount, the $7 million incurred to create the product design and working model of the Houdini software prior to reaching technological feasibility should be expensed in the current period. (FASB, 2012, ASC para. 985-20-25-1) Technological feasibility is reached when "all planning, designing, coding, and testing activities that are necessary to establish that the product can be produced to meet its design specifications" have been completed. (FASB, 2012, ASC para. 985-20-25-2) The remaining costs of $3 million incurred to perform final testing, debugging, minor coding adjustments, fine-tuning, and creating master copies should be capitalized. (FASB, 2012, ASC para. 985-20-25-3)

Case Brief

Relevant Facts
Accounting Issue(s)
Authoritative Literature Citation(s)
Conclusion(s)
Support for Conclusion(s)

Attachments and Schedules

Include the important numbers and data in the text of the document so that the reader doesn't have to look for it in the schedule or attachment.