Intangible Assets Policy

Authority:
GASB Statement 51
GASB Comprehensive Implementation Guide

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Policy:
Intangible assets of State agencies and component units should be capitalized according to the following thresholds:

- $1,000,000 – Internally generated computer software (application development costs only)
- $100,000 – All other intangible assets (including purchased or licensed computer software)

Intangible assets with a cost equal to or greater than the threshold and a useful life of two or more years should be capitalized. Assets costing below the threshold should be expensed (Note: For entities with separately issued financial statements, if the application of the above thresholds would result in the financial statements being materially misstated, lower thresholds may need to be considered and established by the individual entity). When an internally generated computer project spans more than one year, the total application development costs of the project should be considered when applying the capitalization threshold, not the outlays incurred in individual years (Note: a project would include a modification to existing software).

> Example: An agency completed an internally generated computer project in two years. The application development outlays were $700,000 and $600,000 in year one and year two, respectively. The agency should capitalize these outlays, beginning in year one, since the total application development costs exceed the threshold. At the end of year two, the agency should have capitalized $1,300,000 as computer software in development.
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> Example: An agency has an internally generated computer software program that was placed into service in 2006. The program had total application development costs of $2.5 million. The program was not capitalized since retroactive application was not required. In 2010, the agency modified the program to increase its functionality. The application development outlays of the modification were $600,000. The agency should not capitalize the modification since it is below the threshold (Note: if the outlays were $1.1 million, the agency would capitalize the modification).

Agencies that acquire a site license to install software on multiple computers (e.g., Microsoft Office) should apply the capitalization threshold on a per unit basis (i.e., cost of the site license divided by the number of authorized users). The capitalization threshold for internally generated computer software should not be applied on a per unit basis.

<u>Retroactive Reporting</u>
Retroactive reporting is required for intangible assets, except as follows. Retroactive reporting is not required for 1) internally generated intangible assets, including those in development as of the effective date of this policy and 2) intangible assets with an indefinite estimated useful life as of the effective date of this policy.

Intangible assets are considered internally generated if they are created or produced by the government or an entity contracted by the government, or if they are acquired from a third party but require more than minimal incremental effort on the part of the government to begin to achieve their expected level of service capacity.

Computer software is a common type of intangible asset that is often internally generated. Computer software should be considered internally generated if it is developed in-house by the government's personnel or by a third-party contractor on behalf of the government. Commercially available software that is purchased or licensed by the government and modified using more than minimal incremental effort before being put into operation also should be considered internally generated. Any of the following activities would satisfy the "*modified using more than minimal incremental effort*" criterion: <u>changing code, changing fields, adding special reporting capabilities, and testing any changes</u>.

Accounting Guidance:
Intangible assets should be classified as capital assets, except that intangible assets acquired or created primarily for the purpose of directly obtaining income or profit should be classified as investments (e.g. copyright donated to a university to generate income). Existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to intangible assets, as applicable. Additionally, before an intangible asset can be recognized in the financial statements, it must meet one or both of the following criteria:

- The asset is separable, that is, the asset is capable of being separated or divided from the government and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability.

- The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

If the types of intangible assets reported by a government differ in nature and usage, then they should not be reported collectively as a single major class of capital assets (e.g., intangible assets). For example, the nature and usage of patents differs from that of right-of-way easements such that they should not be aggregated in the same major class of capital assets.

<u>Internally Generated Intangible Assets</u>
Capitalization of internally generated capital assets can only occur after ALL of the following conditions have been met:

- Determination of the specific objective of the project and the nature of the service capacity that is expected to be provided by the intangible asset upon the completion of the project,

- Demonstration of the technical or technological feasibility for completing the project so that the intangible asset will provide its expected service capacity, and

- Demonstration of the current intention, ability, and presence of effort to complete or, in the case of a multiyear project, continue development of the intangible asset.

Only outlays incurred subsequent to meeting the above criteria should be capitalized. Outlays incurred prior to meeting those criteria should be expensed as incurred.

<u>Specific Application to Computer Software</u>
The activities involved in developing and installing internally generated computer software can be grouped into the following stages:

- *Preliminary Project Stage*. Activities in this stage include the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the development of the software.

- *Application Development Stage*. Activities in this stage include the design of the chosen path, including software configuration and software interfaces, coding, installation to hardware, testing, including the parallel processing phase, and data conversion needed to make the software operational.

- *Post-Implementation/Operation Stage*. Activities in this stage include application training, data conversion that is beyond what is strictly necessary to make the software operational, and software maintenance.

All outlays associated with activities in the preliminary project stage should be expensed as incurred.

All outlays related to activities in the application development stage should be capitalized, provided the following conditions are met: 1) the outlays were incurred subsequent to the completion of the preliminary project stage and 2) management authorizes and commits to funding (either implicitly or explicitly), at least through the current period. (Note: When these two conditions are satisfied, the above criteria for internally generated intangible assets are considered to be met). For commercially available software that will be modified to the point that it is considered internally generated, these two conditions generally are met at the time a government makes the commitment to purchase or license the computer software. Capitalization of such outlays should cease once the software is substantially complete and operational (i.e., ready for use).

All outlays associated with activities in the post-implementation/operation stage should be expensed as incurred.

The activities within the three stages of development may occur in a different sequence. The recognition guidance for outlays associated with internally generated computer software should be applied based on the nature of the activity, not the timing of its occurrence. For example, outlays associated with application training activities that occur during the application development stage should be expensed as incurred.

If an agency is developing an enterprise resource planning (ERP) system with multiple modules, the guidance for reporting outlays based on the stages of software development should be applied for each individual module of the system rather than the system as a whole.

An improvement to existing computer software must do at least one of the following to qualify for capitalization:

- Increase the software's functionality,
- Increase the software's efficiency, or
- Extend the software's estimated useful life.

If the modification does not result in any of the above outcomes, the modification should be considered maintenance, and the associated outlays should be expensed as incurred. If a maintenance contract covers all required maintenance and any unspecified upgrades issued during the year by the vendor, the unspecified upgrades should be considered maintenance.

For commercially available software acquired through a licensing agreement requiring multi-year payments, a long-term liability representing the agency's obligation to make payments under the contract should also be reported. If no interest rate is stated in the licensing agreement, the long-term liability does not have to be discounted. The provisions of FASB Statement 13, *Accounting for Leases*, do not apply to licensing agreements.

Amortization

An intangible asset should be considered to have an indefinite useful life if there are no legal, contractual, regulatory, technological, or other factors that limit the useful life of the asset (e.g., permanent right-of-way easement). Intangible assets with indefinite useful lives should not be amortized.

Intangible assets with limited useful lives (e.g., by legal or contractual provisions) should be amortized over their estimated useful lives. Amortization of computer software should begin when the program is placed into service. Renewal periods related to such provisions may be considered in determining the useful life of the intangible asset if the government expects to exercise the renewal option and any anticipated outlays to be incurred as part of achieving the renewal are nominal (in relation to the level of service capacity obtained through the renewal).

Impairment Indicator

A common indicator of impairment for internally generated intangible assets is development stoppage, such as stoppage of development of computer software due to a change in the priorities of management. Internally generated intangible assets impaired from development stoppage should be reported at the lower of carrying value or fair value, assuming the stoppage was considered to be permanent (see GASB Statement 42).

Common Types of Intangible Assets

- Computer software
  - Purchased or licensed
  - Internally generated
  - Websites
- Easements
- Land use rights (e.g., water, timber, and mineral rights)

  Note: land use rights associated with property already owned by an agency should not be reported as intangible assets separate from the property
- Patents, copyrights, and trademarks