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M E M O R A N D U M

To: Chief Fiscal Officers

From: Michael G. Hudson *MGH*
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Subject: Accounting for Intangible Assets

The Governmental Accounting Standards Board (GASB) issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective for the 2010 fiscal year. Statement 51 defines an intangible asset as lacking physical substance, being nonfinancial in nature, and having a useful life extending beyond one year. Examples of intangible assets include computer software, easements, water rights, timber rights, patents, copyrights, and trademarks.

Intangible assets are sometimes internally generated rather than purchased and these assets have special guidelines for capitalization. Computer software is the most common type of internally generated intangible asset. Note that computer software which is purchased or licensed and then modified using more than minimal effort is still considered internally generated. The cost of internally generated intangibles, such as computer software, must be capitalized or expensed depending on three project stages:

1) Preliminary project stage – formulation and evaluation of alternatives, determining the existence of the needed technology, and the final selection between alternatives.
2) Application development – design of the chosen path; includes coding, installation to hardware, testing, and parallel processing.
3) Post-implementation stage – application training and software maintenance.

Stages 1 and 3 are expensed, while stage 2 is capitalized. Generally, you have not reached stage 2 unless you also have evidence of executive management support for a project along with a commitment of funding and personnel. Determining what stage you are in can be difficult for large projects. Large projects might need to be broken down into multiple modules which are capitalized separately depending on which project stage each module is in. Another problem is that some tasks will fall into a different stage depending on the project. For example, data conversion could meet stage 2 if it is necessary to make the computer software operational, but would be stage 3 if it is only for historical reporting purposes.

To account for intangible assets, the following sub-object codes have been ==established== in the Central Accounting System:

1200 19 Easements and Land Use Rights - An easement or land use right is a contractual right related to land that the State does not own that grants the State the right to use the surface of the land (easement) or water, timber or minerals for a specific purpose.

1200 20 Patents, Trademarks, and Copyrights - A patent is the grant of a property right by the U.S. Patent and Trademark Office to the inventor for an invention. A trademark is a word, name, symbol or device which is used in trade with goods to indicate the source of the goods and to distinguish them from the goods of others. A copyright is a form of protection provided to the authors of "original works of authorship" including literary, dramatic, musical, artistic and certain other intellectual works.

1200 21 Intangible Assets, Indefinite Life - An intangible asset should be considered to have an indefinite useful life, and therefore not amortized, if there are no legal, contractual, regulatory, technological, or other factors that limit the useful life of the asset.

1200 22 Intangible Assets in Progress - The costs of an ongoing project to develop an internally generated intangible asset.

1200 25 Capitalized Software - The cost of capitalizable ($5000 or more) software, regardless of whether it is referred to by the vendor as a purchase, license, lease, rental, maintenance agreement or other terminology. Any "maintenance" charges involving the modification of software or other professional services should be coded to 0800 07. Websites are considered computer software. This code should be used for software regardless of what type of equipment it is installed on, including computers, telecommunications equipment, cellular and satellite phones. Noncapitalizable software (less than $5000) should be coded to 0900 44.

The following sub-object has been ==changed== in the Central Accounting System:

0900 44 - Non-capitalized Software The cost of non-capitalized software (less than $5000), regardless of whether it is referred to by the vendor as a purchase, license, lease, rental, maintenance agreement or other terminology. Any "maintenance" charges involving the modification of software or other professional services should be coded to 0800 07. This code should be used for software regardless of what type of equipment it is installed on, including computers, telecommunications equipment, cellular and satellite phones. The cost of capitalizable software ($5000 or more) should be coded to 1200 25.

The following balance sheet codes have been ==established== in the Central Accounting System to account for intangible assets:

1600 Easements and Land Use Rights - An easement or land use right is a contractual right related to land that the State does not own that grants the State the right to use the surface of the land (easement) or water, timber or minerals for a specific purpose.

1625 Software - The cost of capitalizable ($5000 or more) software, regardless of whether it is referred to by the vendor as a purchase, license, lease, rental, maintenance agreement or other terminology. Websites are considered computer software. This code includes all software regardless of what type of equipment it is installed on, including computers, telecommunications equipment, cellular and satellite phones. The amount booked should include all project costs incurred during the application development stage as defined in GASB Statement 51. These project costs may include the purchase of base software from a vendor, professional services, employee salaries, and other budget expenditures.

1660 Patents, Trademarks, and Copyrights - A patent is the grant of a property right by the U.S. Patent and Trademark Office to the inventor for an invention. A trademark is a word, name, symbol or device which is used in trade with goods to indicate the source of the goods and to distinguish them from the goods of others. A copyright is a form of protection provided to the authors of "original works of authorship" including literary, dramatic, musical, artistic and certain other intellectual works.

1661 Intangible Assets, Indefinite Life - An intangible asset should be considered to have an indefinite useful life, and therefore not amortized, if there are no legal, contractual, regulatory, technological, or other factors that limit the useful life of the asset.

1662 Intangible Assets in Progress - The accumulated cost of an ongoing project to create an internally generated intangible asset. When complete, the asset should be reclassified to the appropriate intangible asset balance sheet account.

1630 Amortization of Easements and Land Use Rights – Total amount of accumulated amortization for easements and land use rights.

1655 Amortization of Software - Total amount of accumulated amortization for software.

1690 Amortization of Patents, Trademarks and Copyrights - Total amount of accumulated amortization for patents, trademarks, and copyrights.

Capitalization procedures for intangible assets are the same as for any other capital asset not inventoried by the State Auditor. Payment vouchers should include a Comptroller property number in the format of Qxxx-yyyyyyy where xxx is the agency number and yyyyyyy is a unique series of numbers and letters assigned by the department. The property record for each Comptroller property number is stored in the Central Accounting System in the GCAS and GCAD tables and reported monthly to each department. Note that for software projects, the base software could be purchased from a vendor under object 1200 22, but then modified using professional services 0800 07 as well as payroll costs under objects 0100 and 0200. While the Comptroller property number can be coded on the 1200 and 0800 payment vouchers, journal entries will be required to capitalize the payroll costs.

With two exceptions, GASB 51 applies retroactively; therefore any material intangible assets acquired in previous fiscal years must be booked by the end of the thirteenth period of fiscal year 2010. The two exceptions are that internally generated intangible assets and intangible assets with an indefinite life do not have to be retroactively booked.

This memo is not intended to be a substitute for a complete reading of GASB 51 and the Implementation Guide questions for GASB 51 nor do we believe we can anticipate every situation departments will have to deal with when accounting for intangible assets. To discuss specific situations, please contact Phyllis Zimmerman at 353-3722 or by email at phyllis.zimmerman@comptroller.alabama.gov.