

## GASB 51 Accounting and Financial Reporting for Intangible Assets

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### Overview of GASB 51

The Governmental Accounting Standards Board (GASB) issued Statement No. 51, Accounting and Financial Reporting for Intangible Assets ("GASB 51" or the "Statement") in June 2007, which establishes accounting and financial reporting requirements for intangible assets in an effort to enhance comparability of such assets between state and local governments.

All state and local governments that have intangible assets are in the scope of GASB 51, although treatment of these assets can differ depending on what phase the government is considered. This Statement is effective for financial statements for periods beginning after June 15, 2009. This paper provides a summary of GASB 51 and highlights how Baker Tilly can assist clients with the implementation of the Statement.

### Introduction

Governments possess many types of assets that could be considered intangible assets, including easements, water rights, and computer software. Intangible assets can be purchased or licensed, acquired through nonexchange transactions (often the case for easements), or internally generated. Inconsistencies in the reporting of these assets, especially in recognition, initial measurement, and amortization have occurred due to a lack of specific authoritative guidance. The purpose of this Statement is to establish accounting and financial reporting requirements to reduce these inconsistencies, and increase comparability among state and local governments.

### Scope and applicability

An intangible asset is an asset that possesses all of the following characteristics:

- > *Lack of physical substance.* An asset may be contained in or on an item with physical substance, for example, a compact disc in the case of computer software. An asset also may be closely associated with another item that has physical substance, for example, the underlying land in the case of a right-of-way easement. These modes of containment and associated items should not be considered when determining whether or not an asset lacks physical substance.
- > *Nonfinancial nature.* In the context of this Statement, an asset with a nonfinancial nature is one that is not in a monetary form similar to cash and investment securities, and it represents neither a claim or right to assets in a monetary form similar to receivables, nor a prepayment for goods or services.
- > *Initial useful life extending beyond a single reporting period.*

If an asset is acquired or created primarily for obtaining a profit, or is an asset resulting from capital lease transactions reported by lessees, this Statement does not apply. Additionally, any goodwill created does not apply to this Statement.

### Classification

All intangible assets under this Statement should be classified as capital assets. The provisions in this Statement should be applied to intangible assets in addition to existing guidance for capital assets.

**The requirements of this Statement are effective for financial statements for period beginning after June 15, 2009.**

## Recognition

Intangible assets should be recognized in the statement of net assets *only* if it is identifiable. The asset is considered identifiable when either of the following two conditions is met:

- > *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.

## Internally generated intangible assets

In the past, internal programming costs were generally capitalized along with the cost of modified software. With the implementation of this Statement, the rules for capitalization of these costs have been modified. Internally generated means the government or an entity contracted by the government created the product, or if the government purchased the asset from a third party but required more than an incremental effort on the government's behalf to achieve the intended use.

The general rules of GASB 51 require that outlays incurred related to the development of an internally generated intangible asset should be capitalized **only on the occurrence of all of the following:**

- > Determination of the specific objective of the project and the nature of the service capacity on completion of the project;
- > Demonstration of the technical 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.**

GASB 51 requires the grouping of developing and installing internally generated software into these 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, and testing, including the parallel processing phase. This includes data conversion if necessary to make the computer software operational.
- > **Post implementation/operation stage:** Activities in this stage include application training and software maintenance.

The criteria for capitalizing internally generated software as described above should be considered met **only when BOTH of the following occur:**

- > The activities noted in the preliminary project stage are completed
- > Management implicitly or explicitly authorizes and commits to funding the project

Thus, if the criteria have been met, then costs in each category should be treated as follows:

Cost type	Description	Accounting treatment
<b>Preliminary project stage</b>	Conceptual formulation and evaluation of alternatives, determination of existence of needed technology and final selection of alternatives	<b>Expense</b>
<b>Application development stage</b>	Path design including software configuration and interfaces, coding, hardware installation and testing and data conversion	<b>Capitalize</b>
<b>Post implementation/ operation stage activities</b>	Application training and software maintenance	<b>Expense</b>

Outlays associated with an internally generated modification of computer software that is already in operation should be capitalized if the modification increases the software functionality, efficiency, level of service or extends its useful life.

### Specific costs for the project and their treatment under GASB 51

The following table shows the accounting treatment for specific costs in regards in a typical software development and implementation project.

CostType	Preliminary	Application development	Post implementation/ operation	Accounting treatment
<b>Internal programming</b>	>			<b>Expense</b>
<b>Internal programming</b>		>		<b>Capitalize</b>
<b>Internal programming</b>			>	<b>Expense</b>
<b>Project management</b>	>			<b>Expense</b>
<b>Project management</b>		>		<b>Capitalize</b>
<b>Project management</b>			>	<b>Expense</b>
<b>Cost of capital</b>		>		<b>Capitalize</b>
<b>Backfill of positions<sup>(A)</sup></b>				<b>Not Eligible</b>
<b>Database conversion</b>		>		<b>Capitalize</b>
<b>Training</b>			>	<b>Expense</b>

(A) – Backfill positions would not be eligible for capitalization to the project. However, the person holding the original position should charge their time to the project as necessary then their time would fall under the accounting rules above.

## Specific amortization issues

An intangible asset is 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. A permanent right-of-way easement is an example of an intangible asset that should be considered to have an indefinite useful life. *Intangible assets with indefinite useful lives should not be amortized.* If changes in factors and conditions result in the useful life of an intangible asset no longer being indefinite, the asset should be tested for impairment. The carrying value of the intangible asset, if any, following the recognition of any impairment loss should be amortized in subsequent reporting periods over the remaining estimated useful life of the asset.

## Impairment indicator

GASB Statement No. 42 provides guidance for reporting impairment, with paragraph nine specifically listing indicators of impairment. This Statement further elaborates on indicators of internally generated intangible assets. Development stoppage, such as stoppage of development of computer software due to changes in management's priorities, is a common indicator. If this occurs, these impaired assets should be reported at the lower of carrying value or fair value.

## Effective date and transition

The requirements of this Statement are effective for financial statements for period beginning after June 15, 2009. Accounting changes adopted to adhere to the requirements of this Statement should be retroactively applied by restating financial statements, if practical. If the entity deems a restatement is not practical, the cumulative effect of this Statement should be reported as a restatement of beginning net assets, and the financial statements should disclose the nature of any restatement, its effect, and the reason for not restating prior periods.

For governments that were classified as phase 1 or phase 2 governments under GASB Statement No. 34, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except those considered to have indefinite useful lives as of the effective date of this Statement, and those considered internally generated. For phase 3 governments, retroactive reporting is encouraged but not required.

Retroactive reporting is not required but is permitted for intangible assets considered to have indefinite useful lives as of the effective date of this Statement and those considered to be internally generated. If an asset with an indefinite life is retroactively reported, the provisions of the Statement should only be applied to intangible assets previously subject to amortization. Accumulated amortization related to these assets should be restated to reflect the fact that these assets are not to be amortized.

We welcome the opportunity to meet with you to discuss how we can help you meet your business goals. For more information or any questions you might have on this topic, please contact Nicolle Belden at [nicolle.belden@bakertilly.com](mailto:nicolle.belden@bakertilly.com) or 608 240 2683.