Intangible Capital Assets FAQ

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*Capitalization threshold updated 06/30/2009

*Disclaimer: In CAFR training it was mentioned that for internally generated (developed) intangible capital assets you are not required to retroactively report all the labor, coding time, etc. (Which is true!) However, it was also mentioned that you would need to estimate the historical cost of that asset. I have some good news; you do **NOT** need to estimate the historical cost of internally generated (developed) intangible capital assets. In fact, Greg Driscoll at GASB says it is inappropriate to do so unless you can determine the actual historical cost using accepted cost accounting principles. Please contact Matt McBride for any questions you may have.

1) What was GASB's motivation for making intangible capital assets a reportable item?
Answer: GASB's objective is to reduce inconsistencies while establishing comparability in accounting and financial reporting requirements among state and local governments. Inconsistencies noted in the reporting of intangible capital assets include recognition, initial measurement, and amortization.

2) What will be the reporting threshold for intangible capital assets for the State of Idaho?
Answer: Equal to or greater than $200,000.

3) How do agencies put intangible capital assets on FAS?
Answer: Unfortunately, FAS is not currently able to handle the reporting of intangible capital assets. The Controller's Office is considering alternatives to replace FAS. Until such a system is established the SCO asks that state agencies that have intangible capital assets meeting the $200,000 threshold compile and maintain a spreadsheet or some other record of intangible capital assets within their respective agencies. Until a new statewide fixed asset system is operational, please report your intangible capital assets on an annual basis in the intangible capital assets closing package 12e. (See next question.)

4) Will the FAS replacement system support lands held for investment purposes?
Answer: The SCO will keep this aspect in mind as one of the features for any new system.

5) Do I need to report intangible capital assets for FY09 reporting and beyond if I report what my agency has for FY08 reporting?
Answer: **YES!** Until a FAS replacement is operational, the SCO will need agencies to report intangible capital assets year after year. For FY08, the 12e closing package form asks you to list all of your intangible capital assets. Towards the bottom of the closing package there is an automated subtotal box to sum the historical costs of all intangible capital assets reported.

6) Do we need to report software purchased a long time ago if we are still using it?
Answer: Yes, all intangible capital assets (that are still being used), meeting the $200,000 threshold, and acquired after June 30, 1980 will need to be reported as intangible capital assets unless it is considered internally generated (developed), then you don't have to retroactively report it. However, you may retroactively report an internally generated (developed) intangible asset if the amount is based on sound cost accounting principles that can be supported for your auditors?

7) Will agencies have to start tagging software with a property or identification number?
Answer: While physically tagging software won't be necessary (or possible), there must be a way to identify each intangible asset. If the software was purchased "off-the-shelf" an invoice number or sticker on the invoice would be an acceptable identification number. For software developed in-house, a property or identification number will need to be assigned once the software has been completed and is operational.

8) If I purchase off-the-shelf software and then install it onto my agency's system AS IS (without modifying it), would this be considered an intangible capital asset?
Answer: **YES!** Contrary to what was said in the GASB Update at April's AGA Professional Development Conference, per Greg Driscoll at GASB, ALL computer software is to be classified as an intangible capital asset, regardless of whether or not it is modified. However, if off-the-shelf software IS modified for your own application in order to make it operational, the software is then considered an internally generated intangible capital asset. GASB 51, ¶ 7, states that if more than a "minimal incremental effort" is required to make the software operational then it will be classified as an internally generated intangible capital asset. You will need to use professional judgment as to what is considered "minimal incremental effort". As a general rule, if you have to modify or change any part of the original makeup/coding of the off-the-shelf software, then you have satisfied the requirement of applying more than a "minimal incremental effort".

9) If I purchase off-the-shelf software and then install it onto my agency's system AS IS (without modifying it), am I required to retroactively report it?
Answer: YES! But remember the $200,000 reporting threshold.

10) Since we are required to retroactively report intangible capital assets, what if I am unable to determine an actual historical cost; can I use an estimated historical cost?
Answer: Yes, it is acceptable to use an estimated historical cost for intangible capital assets if you are unable to determine an actual historical cost; however, it is not acceptable to estimated historical cost for **internally** generated (developed) intangible capital assets.

11) Do we have to retroactively report internally generated intangible capital assets?
Answer: No, if an intangible asset is internally generated (developed) you do not need to retroactively report it. It is permitted though, but only if you can determine the actual historical cost using accepted cost accounting principles that can be supported for your auditors. As mentioned in the disclaimer above, it is inappropriate to estimate the historical cost of an internally generated (developed) intangible capital asset.

12) For internally generated intangible capital assets currently in development, how are capitalized labor costs during the Application Development Stage to be determined? Straight labor, develop a set rate or predetermined rate based on average salary? Would you include benefits and/or direct or indirect costs, overhead, etc.?
Answer: No guidance has been established to address how to determine the capitalized labor costs during the Application Development Stage for internally developed intangible capital assets. No guidance exists for tangible CIP projects either. However, Greg Driscoll at GASB recommends using the same method your agency uses to determine labor rates for tangible CIP projects in determining the appropriate capitalized labor cost for internally generated intangible assets. According to AICPA SOP 98-1 overhead cannot be capitalized.

13) Do we need to record construction-in-progress (CIP) for internally generated intangible capital assets (i.e. software, patents, trademarks, and copyrights)?
Answer: Please refer to GASBS 51, ¶ 45. The Board compared the nature of internally-generated intangible assets in development to be the counterpart of construction-in-process capital assets. The Board concluded that it may be more difficult to determine when outlays should begin to be capitalized in the case of an internally generated intangible asset in development than for tangible construction-in-process capital assets. As a result, the Board decided that the specified-conditions approach should be used. Please refer to the intangible asset PowerPoint slides (slides 14-18 specifically) and the decision tree regarding this approach (Preliminary Project Stage, Application Development Stage, and Post-Implementation/Operation Stage) and knowing when and when not to capitalize.

14) Along the lines with the previous question, should we put in-house software enhancements in CIP?
Answer: No, in-house software enhancements should either be capitalized or expensed (see question #16).

15) Should you capitalize software licenses?
Answer: Yes. According to GASB 51, ¶ 65: "The Board believes that outlays to acquire a license to use commercially available software that is not considered internally generated computer software will meet the description of an intangible [capital] asset and should be reported accordingly. (If the licensed software is considered internally generated computer software and, therefore, reporting of related outlays is based on the development stage approach, the Board believes that the criteria to begin capitalization of outlays related to software development are met when the government makes the decision to license the specific software. Accordingly, the licensing of the software would be an

application development stage activity, and the related outlays would be capitalized.)" Given that licensed software, (or **all** software for that matter), is an intangible capital asset and it does not have an indefinite useful life, the proper treatment is to capitalize software licenses that meet the $200,000 threshold.

16) Would monthly (quarterly, biannual, annual, etc.) modifications to software be considered maintenance? Should they be expensed, or treated as an upgrade/ improvement and capitalized?
Answer: It depends. Per GASB 51, ¶ 69, outlays of the asset modification should be capitalized if any of the following variables apply:

- **increase the capacity [**or **functionality]** (i.e. the computer software is able to perform tasks that it was previously incapable of performing, ¶15a)
- **efficiency** (i.e., an increase in the level of service provided by the computer software without the ability to perform additional tasks, ¶15b)
- **extend the useful life** of the asset beyond its previously established useful life (modifications that <u>defer</u> obsolescence)

If none of these apply, then you would expense the outlays as maintenance. These are the 3 variables that need to be analyzed while using professional judgment.

17) Since we are not required to retroactively report internally generated intangible capital assets, does that also mean we do not need to capitalize and report any modifications to the same assets that extend its useful life, efficiency, etc. that take place on or after the effective date of this statement (July 1, 2009)?
Answer: No, capitalizable modifications on existing internally generated intangible capital assets (or intangible capital assets) as of the effective date would be reportable. Depending on the particular facts, some modifications can result in the creation of a new asset rather than the extension of an existing asset. Please contact Matt McBride at 332-8805 if you are unsure.

18) How do you calculate the useful life of an intangible capital asset?
Answer: The useful life of an intangible capital asset should not exceed the economic life of the asset. If the period to which the service capacity of the asset is limited by contractual or legal provisions, the useful life should be approximated accordingly. Otherwise, an intangible capital asset should be considered to have an indefinite useful life.

19) <u>Tangible</u> capital assets physically deteriorate with time and cease providing service, however, what would decrease the service capacity of (intangible) software?
Answer: Per GASB ¶ 70, "because computer software is intangible, it does not deteriorate physically; rather, **obsolescence** is what decreases the service capacity of computer software. [Therefore, only modifications that <u>defer</u> obsolescence should be considered to extend the useful life of software.]"

20) Do we need to report obsolete software if purchased after 1980?
Answer: If the software is no longer being used (or is being used but considered internally generated) then you don't need to retroactively report it.

21) Would a website be considered an intangible capital asset?
Answer: **YES,** however, the intangible capital asset must still meet the $200,000 threshold to be reportable.

22) Since we're going to capitalize cost that used to be expensed are there any prior period adjustments?
Answer: According to GASBS 51, ¶ 20, "this Statement should be applied retroactively (except for internally generated intangible capital assets and intangible capital assets with indefinite useful lives) by restating financial statements, if practical, for all prior periods presented. If restatement is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net assets, fund balances, or fund net assets as appropriate, for the earliest period restated. In the period this Statement is first applied, the financial statements should disclose the nature of any restatement and its effect."

23) If a new building is currently being constructed, once the CIP is reclassified as a capital asset, would you break out any intangible asset costs (e.g. computer lab with software) and separate them from the rest of the tangible building costs?
Answer: In general it is NOT required to break out such intangible asset costs for a project. An exception to this would be if the software in the new building was internally developed. In this case it would be appropriate to track the costs associated with this development using the specified-conditions approach, and to expense and capitalize the appropriate activities.

24) What subobject should be used to record intangible capital assets?
Answer: The SCO is in the process of creating subobjects to record intangible capital assets. SCO will notify you when they are operational.

25) The Implementation Guide for intangible capital assets is due out in 2009. Will GASB release portions of it as they are completed, or just all at once?
Answer: GASB plans to include 35 intangible asset questions in the next version of the Implementation Guide, due out in either August or September of 2008.

26) Since intangible capital assets will now need to be capitalized instead of expensed, does that mean we will have to include any capital project outlays as part of our Capital Outlay budget to present to the Legislature for appropriation?
Answer: No. Per Idaho Code, Section 67-3511(3) appropriation for operating outlay may be transferred to capital outlay; however, capital outlay cannot be transferred to operating outlay.

27) When you buy new computer(s) with software already installed, should you break out software costs vs. hardware costs, to differentiate between intangible capital assets and tangible capital assets?
Answer: In general, it is NOT required to break out software vs. hardware costs, especially if the useful lives of both are the same.

28) Should agencies value software individually or group them together? For example, our larger agencies will buy 100+ computers together, already equipped with software. Individually the computers and/or software are valued less than our reporting threshold. But grouped together they would definitely be above our reporting threshold.
Answer: If all items were ordered at the same time and were part of the same transaction then they should be grouped together and reported, (if their total value is equal to or greater than the $200,000 threshold). Invoices should not be split to avoid reporting. According to GASB Implementation Guide 7.9.8, "capitalization policies adopted by a government should find an appropriate balance between ensuring that all material capital assets, collectively, are capitalized and minimizing the cost of recordkeeping for capital assets. It may be appropriate for a government to establish a capitalization policy that would require capitalization of certain types of assets whose individual acquisition costs are less than the threshold for an individual asset. Computers, classroom furniture, and library books are assets that may not meet the capitalization policy on an individual basis, yet might be considered material collectively."

29) In Idaho, Agency 1 created and maintains software that is paid for and used by Agency 2. Which entity owns and reports the software?
Answer: The particular facts for a given situation must be examined on a case by case basis. In this particular case, it appears that Agency 2 may have hired or contracted with Agency 1 to develop the software for them. Therefore, Agency 2 would report the software since they are paying for and getting the benefit from using the software.

30) Similar to question #29, Agency 1 purchased a computer that is located and used by an employee at Agency 2. Who should report the computer?
Answer: Similar to question #29, in this example Agency 2 is using or deriving the benefit from the software, so they would generally report it. However, this example differs from question # 29 in that Agency 1 purchased it, not Agency 2; without knowing all the facts, it is possible that perhaps Agency 1 could report the computer as a donation to Agency 2. Once again, the particular facts must be examined and professional judgment must be used.