State Accounting Office of Georgia
Fiscal Leadership for Georgia

Statewide Accounting Policy & Procedure

Accounting Manual Reference:	**Effective Date:** 07/01/2009
Section: Capital Assets	**Revision Date:** 06/30/2011
Sub-section: Intangibles – General	

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Policy Summary:

Capital assets are required to be accounted for and reported as required by generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) includes the following description of capital assets in Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments*:

> "Capital assets include land, easements, buildings…and all other tangible and intangible assets that are used in operations, and that have initial useful lives extending beyond a single reporting period." This reference has created questions as to whether and when intangible assets should be considered capital assets for financial reporting purposes.

The GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, in June 2007. The objective of this statement is to establish uniform accounting and financial reporting requirements for intangible assets. The statement requires that certain intangible assets, including those that are internally generated, be recognized as capital assets. Therefore, this policy provides accounting and reporting guidelines for intangible assets as required by GAAP.

The following intangible assets are outside the scope of this policy:

- Those acquired or created primarily for obtaining income or profit.
- Those resulting from capital lease transactions of lessees (refer to NCGA Statement 5).
- Goodwill created through the combination of a government and another entity.

Policy Requirements:

State of Georgia organizations that are included in the State reporting entity and that have intangible assets are required to comply with this policy.

Accounting Requirements

At the fund level, intangible assets are recorded using the basis of accounting that is appropriate for the fund. At the government-wide level, intangible assets are considered capital assets and are therefore recorded as capital assets.

An intangible asset is capitalized on the accrual basis of accounting in state organizations' accounting records if it meets all of the following conditions:

- It is owned by the state organization and held for operations, not for resale.
- It has a useful life that exceeds one year.
- It meets the capitalization threshold.

The following chart provides a list of intangible assets, capitalization thresholds and useful lives for users of the statewide financial system (asset management module). Users of other asset management systems should establish similar parameters. If a state organization determines that a shorter useful life is appropriate for software, then the method for estimating the useful life must be formally documented by the organization, as required by the *Capital Assets – General* policy.

Intangible Asset Description and Capitalization Threshold Schedule

ASSET DESCRIPTION	COST THRESHOLD*	USEFUL LIFE
Software	$1 million	10 years
Easements	$100,000	20 years
Water Rights	$100,000	20 years
Timber Rights	$100,000	20 years
Mineral Rights	$100,000	20 years
Patents	$100,000	20 years
Trademarks	$100,000	20 years
Copyrights	$100,000	20 years

* See OMB Circulars A-21 (educational institutions), A-87 (state and local governments), or A-122 (non-profit organizations) for the capitalization thresholds for federal funds reporting purposes.

Recognition and Measurement

<u>General Recognition Requirements</u>:

An intangible asset should be recognized only if it is identifiable, capable of being separated and sold, transferred or licensed. Assets that arise from contractual or other legal rights, regardless of whether or not the rights are separable, are also considered intangible assets. Intangible assets follow the measurement guidance for capital assets: historical cost, or if donated, estimated fair value at date of donation.

Ownership of land includes the right to control its use and therefore embodies a bundle of rights such as water, timber, mineral, right-of-way, etc. The individual rights that come with land ownership should be valued in the aggregate and reported as the tangible asset – land. Land use rights that do not include ownership of the underlying property should be valued and reported as intangible assets.

GASB Statement No. 51 requires retroactive reporting for intangible assets except for those considered to have indefinite useful lives as of the effective date and those that would be considered internally generated. Restatement of prior periods presented is required if practical. If restatement of prior periods is not practical, the cumulative effect of applying the statement, if any, should be reported. If determining the actual historical cost of intangible assets is not practical because of insufficient records, then organizations should report the estimated historical cost for intangible assets acquired in fiscal years ending after June 30, 1980.

Amortization:
Amortization is the accounting process of allocating the intangible asset's capitalized cost to expense in a systematic and rational manner to those periods expected to benefit from the use of the asset. Amortization is not a matter of valuation but a means of cost allocation. Intangible assets are not amortized on the basis of a decline in their fair market value, but on the basis of systematic charges to expense. An intangible asset that has an indefinite useful life is not amortized if there are no legal, contractual, regulatory, technological, or other factors that limit its useful life. If any of these limitations exist, the intangible asset is amortized over its estimated useful life. The straight-line amortization method (historical cost less residual value, divided by useful life) will be used by all State organizations. If an organization recognized and amortized any intangible assets with indefinite useful lives prior to adopting Statement No. 51, it must restate its beginning balance to eliminate the prior period expense and reduce the related accumulated amortization.

Impairments:
The provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, generally should be applied to determine impairment of intangible assets. 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. Statement No. 51 adds "development stoppage" to the impairment indicators of Statement No. 42.

Basis of Accounting
Funds that operate on a statutory basis must convert their accounting activity to the modified accrual and/or accrual bases of accounting for the Comprehensive Annual Financial Report (CAFR). Proprietary and fiduciary funds that do not operate on a statutory basis use the accrual basis of accounting throughout the year.

- Statutory Basis for Budgetary Compliance Reporting
  The purchase of an intangible capital asset is recorded as an expenditure on the statutory basis of accounting. The expenditure is recognized at the earlier of either the time the funds are encumbered (i.e., when purchase orders or other contractual obligations to procure goods or services have been executed), or the time the goods, services, rights, etc. have been received. Accruals are required at year-end for unencumbered goods and services received but not processed through the accounts payable subsystem. Also, a reclassification from encumbrance liability to accounts payable is required for any encumbered purchases that are received by year-end but not yet processed through the accounts payable subsystem.

- Converting to Modified Accrual Basis for CAFR Reporting
  Any ending encumbrance liability balance related to intangible assets is eliminated under the modified accrual basis of accounting, and beginning fund balance is increased by the prior year encumbrance liability balance related to intangible assets. The offsetting change in the encumbrance liability is recorded as an expenditure to recognize the current year impact on expenditures for intangible assets activity. A decrease in the encumbrance liability results in an increase to expenditures, and an increase in the encumbrance liability results in a decrease to expenditures.

- Converting to Accrual Basis for CAFR Reporting
  Governmental fund activity must be adjusted to the full accrual basis of accounting for year-end government-wide reporting purposes. Intangible assets that were reported as expenditures in governmental funds under the modified accrual basis of accounting must be capitalized if outlays exceed the capitalization threshold and amortized if the useful life is not indefinite. Capitalization and amortization adjustments are also required for other funds that operate on a statutory basis (certain proprietary and fiduciary funds).

- Accrual Basis for Funds Not Reporting on a Statutory Basis
  Activity in proprietary and fiduciary funds that do not operate on a statutory basis is reported throughout the year using the full accrual basis of accounting. Acquisitions that exceed the capitalization threshold are recorded as assets, not as expenses, and amortized if the useful lives are not indefinite. Separate asset profiles are maintained in the asset management module of the statewide financial system for funds that must be reported on the accrual basis.

Disclosure Requirements
There are no ongoing note disclosure requirements specific to intangible assets. Intangible assets are incorporated into the capital asset note disclosures. However, if during the implementation phase of Statement No. 51, an organization cannot restate prior periods presented for retroactive reporting purposes, it must:

- Calculate the cumulative effect of applying the statement,
- Restate its beginning net assets, fund balances or fund net assets by the cumulative effect for the earliest period possible, and
- Disclose the nature and effect of the restatement and the reasons for not restating prior periods presented.

General Accounting Procedures:
Identifying Transactions
To ensure compliance with the provisions of Statement No. 51, State of Georgia organizations must:

- Establish controls to ensure the proper identification of intangible assets.
- Ensure that intangible asset transactions are recorded in compliance with this policy and the related policies in the Capital Assets section of the Accounting Policy Manual.

Note: If an intangible asset was acquired or created primarily for obtaining income or profit, then it should be accounted for as an investment rather than a capital asset.

Accounting Transactions and Journal Entries
A comprehensive example of intangible asset acquisition and amortization entries is provided in the Attachment. The example demonstrates the entries required for the statutory basis of accounting and those required for converting to the other bases of accounting. As with other capital asset transactions, the asset management module of the statewide financial system generates entries to reverse the expenditure/encumbrance activity and to reflect the capital asset transactions. Organizations in the State of Georgia reporting entity should coordinate with the SAO financial reporting group to convert from the statutory basis of accounting to the modified accrual and full accrual bases of accounting.

Year-End Accounting Procedures
Those State reporting organizations that record day-to-day transactions on a basis of accounting that varies from the GAAP reporting basis requirements must identify and provide to the State Accounting Office reconciling differences between the bases of accounting. This process enables the conversion to the appropriate GAAP basis of accounting for GAAP financial reporting purposes. The year-end

reporting package, as provided by SAO, accommodates the process of the identification and submission of these differences. Timely completion of each form facilitates the conversion process.

The SAO financial reporting group will request information about intangible assets as part of the Capital Assets forms in its year-end reporting forms package.

Authority:
- GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, (paragraph 19)
- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*
- Other SAO capital assets policies

Applicability:
This policy applies to all organizations included in the State of Georgia reporting entity. At these organizations, all personnel who have capital asset reporting or administrative responsibilities should be knowledgeable of this policy, including users and administrators of the asset management financial modules or systems.

Definitions:
Intangible Asset – An asset that lacks physical substance, is non-financial in nature, and has an initial useful life extending beyond one year. Intangible assets are either acquired through purchase, license, or donation; or internally generated within the agency.

Useful Life – The period during which an asset is expected to provide service to the government. If the life is defined by contractual or legal rights, the period should not exceed the expected service period. Renewal periods may be considered in setting the useful life, if there is evidence that the government will request and obtain renewals at nominal cost.

Examples of intangible assets include the following:
Computer Software – The ownership or right to use computer programs that control the functioning of computer hardware and other devices. Computer software comprises both operating systems and application programs. Computer software is the most common type of intangible asset that is internally generated. Computer software is considered internally generated if it is developed in-house or by a third party contractor on the State's behalf. Commercially available software that is purchased or licensed but is modified using more than minimal effort is also considered internally generated. Websites are considered intangible assets, and they may also be internally generated. Refer to the *Capital Assets – Internally Generated Computer Software* sub-section of the Accounting Policy Manual for more comprehensive guidance.

Easement/Right of Way – The right to use the land of another party for a particular purpose.

Water Rights – The right to draw water from a particular source, such as a lake, irrigation canal, or stream.

Timber Rights – The right to cut and remove trees from the property of another party.

Mineral Rights – The right to draw minerals from a particular source, such as lake or stream.

Patent – The right to exclude others from making, using, offering for sale, selling or importing an invention. Patents are issued by the U.S. Patent and Trademark Office.

Copyright – A form of protection provided to the authors of "original works of authorship" including literary, dramatic, musical, artistic, and certain other intellectual works, both published and unpublished. Copyrights are registered by the Copyright Office of the Library of Congress.

Trademark – 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. Trademarks used in interstate or foreign commerce may be registered with the U. S. Patent and Trademark Office.

Attachment

Intangible Asset Example – Conversion from Statutory Basis of Accounting to Other Bases

Assumptions:

- $1500 purchase order for intangible asset executed during year 1:
  $700 portion received and processed by accounts payable (AP) in year 1; balance processed by AP in year 2
  $200 portion received by end of year 1 but not processed by AP until year 2
  $600 portion to be received in year 2
- Acquired asset has a 10 year useful life
- Straight-line amortization recognized once asset is in service ($150 per year beginning year 2)

Basis of Accounting	Journal Entry / Year-End Balance Descriptions	Governmental, Proprietary & Fiduciary Funds that Operate on a Statutory Basis		Proprietary & Fiduciary Funds that Operate Only on the Full Accrual Basis	
	Debit / (Credit)	Year 1	Year 2	Year 1	Year 2
Statutory Basis:					
Execute purchase order	Expenditure	1,500	-		
	Encumbrance Liability	(1,500)	-		
Process voucher through AP	Expenditure	700	800		
	Accounts Payable	(700)	(800)	N/A	N/A
Reduce Encumbrance	Encumbrance Liability	700	800		
	Expenditure	(700)	(800)		
At year-end accrue received/ not processed-reverse next year	Encumbrance Liability	200	(200)		
	Accounts Payable	(200)	200		
Year-end balances	Expenditure/Fund Balance	1,500	1,500		
	Accounts Payable	(900)	(1,500)		
	Encumbrance Liability	(600)	-		
Modified Accrual Basis: The change in the encumbrance liability is offset to expenditure:					
Reverse ending encumbrance	Encumbrance Liability	600	-		
	Expenditure	(600)	-	N/A	N/A
Adjust beginning fund balance for prior year encumbrance bal	Expenditure	-	600		
	Beginning Fund Balance	-	(600)		
Year-end balances	Expenditure/Fund Balance	900	1,500		
	Accounts Payable	(900)	(1,500)		
Full Accrual Basis:					
Establish asset	Fixed Asset (includes CIP)	900	600	900	600
	Expenditure	(900)	(600)		
	Accounts Payable			(900)	(600)
Adjust beginning net assets to reestablish prior year intangible asset balances	Fixed Assets	-	900	N/A	N/A
	Accumulated Amortization	-	-		
	Beginning Net Assets	-	(900)		
Record amortization (assume full year in 1st year of svc)	Amortization Expense	-	150	-	150
	Accumulated Amortization	-	(150)	-	(150)
Year-end balances	Expense/Net Assets	-	150	-	150
	Accounts Payable	(900)	(1,500)	(900)	(1,500)
	Fixed Asset - Gross	900	1,500	900	1,500
	Accumulated Amortization	-	(150)	-	(150)