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Function No. 30000—Capital Asset Accounting	<b>TOPIC</b>	<b>Software and Other Intangible Assets</b>
Section No. 30300—Asset Classification	<b>DATE</b>	May 2011

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## Overview

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### Introduction

The purpose of this CAPP topic is to establish the policies by which agencies and institutions identify and report intangible assets as defined under GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, (**GASB No. 51**). Note: The use of the word “agency” or “agencies” throughout the remainder of this CAPP topic includes both agencies and institutions of higher education.

***GASB No. 51** establishes a “specific-conditions” approach to recognizing intangible assets. Agencies should ensure internal policies and procedures capture the appropriate information in FAACS (or the agency’s internal capital asset accounting system, if applicable) and provide this information for inclusion in the Comprehensive Annual Financial Report (CAFR).*

Additionally, agencies should refer to the **Authoritative Literature / Guidance for Preparation of GAAP Basis Fund Financial Statement Templates** and the **GASB No. 51 Frequently Asked Questions** on DOA’s website at [www.doa.virginia.gov](http://www.doa.virginia.gov) for additional financial reporting guidance to be considered when ensuring the appropriate information is captured for CAFR reporting.

This CAPP topic supersedes all prior capitalization limit exceptions and exemptions previously authorized by the Department of Accounts related to software or other intangible assets. The thresholds and other criteria described herein apply only to intangible assets and not to other types of capital assets.

## Policy

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### General

Intangible assets are defined as assets having *all* of the following characteristics:

- a. **Lack of physical substance.** Intangible assets are assets that do not have a physical existence. However, an intangible asset may be contained within an asset having a physical presence, such as, computer software contained on compact discs, hard-drives or tape media. Intangible assets may also be associated with other assets having a physical existence, such as, land in the case of a right-of-way easement or mineral rights.

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- b. **Non-financial in nature.** Intangible assets are non-financial in nature, and are not in a monetary form similar to cash or investment securities. Further, they are neither claims or a right to assets in monetary form similar to receivables nor prepayments for goods or services.
- c. **Useful lives or benefit periods exceeding one or more years.** Intangible assets as described in this CAPP topic are considered to have a useful life that is greater than one year. Intangible assets having a useful life of one year or less are not subject to the provisions of this CAPP topic.

Intangible assets consist of three, broadly-defined types as described below:

1. **Intangible assets generally defined as “software.”** Software intangible assets include computer “programming” or “coding language” that provide the necessary instructions for the computer hardware to perform a desired task or series of tasks. Software intangible assets include purchased “off the shelf” software, including all necessary modifications, software specifically developed by an outside contractor, and software developed internally by agency personnel, or acquired through any combination of the above. Software intangible assets are expected to be found at nearly every agency in the Commonwealth.
2. **Intangible assets associated with real property.** These include “land use rights” such as easements, right-of-ways, water rights, timber rights and mineral rights that provide specific benefits related to the real property upon which the right applies. “Land use rights” may be defined generally as rights that provide the right to control the use of the real property (right of way) or provide other benefits derived from the real property (mineral rights, etc.)

If an agency **actually owns the associated land** and the recorded land valuation already includes the “land use rights,” the intangible asset’s portion associated with the land **should not be reported separately** as it is already included in the land valuation. This type of intangible asset would likely be found at agencies that have significant land or roadway infrastructure assets.

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3. **Intangible assets that are not software or “land use rights.”** Other types of intangible assets are those intangible assets that are not specifically identified in #1 or #2 on the previous page. These other types of intangible assets are generally created through the development of intellectual property and include patents, copyrights, and trademarks. These types of intangible assets are most frequently found at agencies where there is ongoing research and development being performed, such as institutions of higher education.

Intangible assets can be purchased, including acquisition, through an installment purchase contract, acquired through a licensing agreement, acquired through non-exchange transactions such as a donation, or internally generated. Examples of intangible assets include computer software, right of ways, easements, water rights, timber rights, mineral rights, patents, copyrights and trademarks.

The “specific-conditions” approach provides agencies with the criteria for recognizing intangible assets and improves financial reporting by reducing accounting and financial reporting inconsistencies between reporting entities. The establishment of this authoritative guidance addresses issues specific to the unique characteristics of intangible assets.

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### Exceptions

The provisions of **GASB No. 51** apply to all intangible assets possessing the above criteria **except** for the following:

1. Intangible assets that are acquired or created primarily for the purpose of directly obtaining income or profit. Authoritative guidance related to investments should be referenced to determine the appropriate reporting for these intangible assets.
  2. Intangible assets resulting from capital lease transactions that are reported as leases.
  3. Goodwill created through the combination of government and another non-governmental entity.
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## Procedures

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### Classification

All intangible assets subject to the provisions of **GASB No. 51** and having a cost (or estimated cost) of \$100,000 or greater should be classified as capital assets and recorded in FAACS or the agency's internal capital asset accounting system (using the agency's internally developed materiality threshold). This includes all intangible assets whether purchased, donated or internally developed. Additional reporting conditions for internally-generated intangible assets, including software, are outlined in *later* sections of this topic.

*If an agency subsequently identifies a potential intangible asset that has not been previously reported, contact DOA immediately to discuss.*

*Please note that individual agencies that prepare financial statements are responsible for identifying an appropriate scope for those individual statements, and it is likely the statewide scope of \$100,000 is inappropriate for the individual agency reporting.*

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### Internally Generated Intangible Assets

Intangible assets are considered **internally generated if they are created or produced by the agency or an entity contracted by the agency, or if they are acquired from a third party but require more than minimal incremental effort** (defined as 10% or more of the purchase amount) on the part of the agency to begin to achieve their expected level of service capacity.

Outlays incurred in the development of an internally generated intangible asset that are identifiable should be capitalized only upon the occurrence of all of the following:

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- a. 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.
- b. Demonstration of the technical or technological feasibility for completing the project so that the intangible asset will provide its expected service capacity.
- c. 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.

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### **Internally Generated Computer Software**

Computer software should be considered internally generated if it is developed in-house by agency personnel or by a third-party contractor on behalf of the agency.

During the development stage, evaluate the expenditures to determine whether capitalization appears appropriate. Record the applicable capitalizable expenditures as Construction in Progress. To ensure appropriate financial control of Construction in Progress, project numbers should be assigned to identify related expenditures.

Commercially available software purchased or licensed by an agency that requires modification by agency personnel or a third party and the cost incurred for the modification equals or exceeds ten percent of the total software acquisition cost before being placed into operation should be considered internally generated for purposes of **GASB No. 51**. For example, licensed financial accounting software that the agency modifies to provide special reporting capabilities and the cost of the modification equals or exceeds ten percent of the software purchase price would be considered internally generated.

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**The activities involved in developing and installing internally generated computer software can be grouped into the following stages:**

**Preliminary Project Stage— Costs incurred during this stage are not capitalized.** These costs include the following activities:

- a. Conceptual formulation of alternatives
- b. Evaluation of alternatives
- c. Determination of existence of needed technology
- d. Final selection of alternatives

**Application Development Stage—Costs incurred during this stage involve both internal and external costs incurred to develop the software and are capitalized.**

These costs include the following activities:

- a. Design of chosen path, including software configuration & software interfaces
- b. Coding
- c. Installation to hardware
- d. Testing, including the parallel processing phase
- e. Data conversion— only to the extent that the data is necessary to make the computer software operational.

**Post-Implementation/Operation Stage—Costs incurred during this stage are not capitalized.**

These costs include the following:

- a. Training
- b. Application maintenance
- c. Data conversion— data, such as historical, not necessary to make the software operational, but desirable from a management perspective.

For internally-generated computer software, the criteria for internally generated intangible assets should be considered to be met only when both the following occur:

- a. The activities noted in the Preliminary Project Stage are completed.
- b. Management implicitly authorizes and commits to funding, at least currently in the case of a multiyear project, the software development project.

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Once the criteria for internally generated software intangible assets have been met, outlays related to activities in the Application Development Stage should be capitalized. Capitalization of such outlays should cease no later than the point at which the computer software is substantially complete and operational. Outlays associated with activities in the Post-Implementation Stage should be expensed as incurred. Construction in Progress (CIP) should be recorded for capitalizable expenditures made during the Application Development Stage. Upon the conclusion of the software development project, the CIP should be reversed and the internally generated software asset should be recorded as a separate asset using the “infrastructure” category and appropriate nomenclature codes. CAPP Topic No. 30310 provides additional information for recording CIP.

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### **Internally Generated Modification of Computer Software**

Outlays associated with an internally generated modification of software that is already in operation should be capitalized when all internally generated software intangible assets criteria have been met if the modification results in any of the following:

- a. An increase in the functionality of the computer software, that is, the computer software is able to perform tasks that it was previously incapable of performing.
- b. An increase in the efficiency of the computer software, that is, an increase in the level of service provided by the computer software without the ability to perform additional tasks.
- c. An extension of the estimated useful life of the software.

**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.**

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### Examples

**Software or licenses purchased and placed into operation without modifications exceeding ten percent of the software purchase price should be considered an intangible asset.** This type of computer software is not considered to be internally generated, and therefore, the entire purchase price of the software is capitalized as there should not be any outlays incurred by the agency for the Application Development Stage for this type of intangible asset. Generally, commercially available software that is not considered internally generated will meet the description of an intangible asset.

**An agency purchases commercially available computer software through a ten-year license agreement.** Under the agreement terms, the agency is required to make annual payments to the software vendor for the right to use the software over the life of the agreement. Under these circumstances, this qualifies as an intangible asset. For illustrative purposes, assume the cost is \$100,000 annually. The software should be capitalized for the total cost of \$1,000,000. For financial statement reporting, a \$1,000,000 long-term liability is also recorded. As the annual payments are made, both the asset is amortized and the liability is reduced by \$100,000.

**An agency purchases commercially available computer software through a ten-year license agreement.** Under the agreement terms, the agency is required to make a lump sum payment at the beginning of the agreement. Under these circumstances, this qualifies as an intangible asset, and the total amount paid must be capitalized and amortized over the ten-year period.

Agencies may have **maintenance contracts with the software vendor** where the agency pays an annual fixed fee that covers all required maintenance and any minor unspecified upgrades issued during the year by the vendor, such as those required to fix newly identified software “bugs.” Outlays for normal routine software maintenance should not be capitalized and should be expensed as incurred.

**Significant upgrades to the software**, such as an upgrade to a newer version of the software, should be capitalized if the external modifications result in an increase in the functionality or efficiency of the software or the estimated useful life.

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**Websites** are considered software, and agencies should determine whether the website(s) meet the description of internally generated computer software. The outlays associated with internally generated website(s) development should be capitalized based on the Application Development Stage expenditures for the website(s) utilizing the *\$100,000 statewide capitalization threshold for CAFR reporting. The agency must utilize the appropriate capitalization threshold if individual financial statements are prepared.*

Agencies may develop **software that has multiple modules**, including financial reporting, procurement and human resources. These modules may be developed on individual timelines and will likely become operational at different points. Generally, each module has its own development cycle as it relates to the Application Development Stage and Post–Implementation Stage, and therefore, the guidance for internally generated software should be applied to each module of the system rather than the system as a whole.

Agencies may enter into a **licensing agreement for computer software** that will be considered internally generated. The payments made to the vendor are for multiple components, including use of software, development of modifications for agency operation, training users of the software routine system maintenance, and rights to future upgrades and modifications. The outlays associated with each part of the agreement should be allocated among each of the individual elements, and the guidance for internally generated software should be applied.

If an agency owns property that contains “land use rights,” such as water rights, timber rights and mineral rights, typically these are comprised as a **“bundle of rights”** that is included within the ownership rights to the tangible asset. The individual rights included in the “bundle of rights” are separable and intangible in nature; however, collectively they represent the ownership of the tangible asset. Therefore, the value of the individual rights in a “bundle of rights” included within the property ownership should remain aggregated and reported as a tangible capital asset such as land.

The above examples are illustrative only and do not represent all *possible* situations that affect intangible assets. For additional information, refer to the **GASBS No. 51 Frequently Asked Questions** available on DOA’s website at [www.doa.virginia.gov](http://www.doa.virginia.gov). Click on the Financial Statement Directives link.

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### Tests for Intangible Assets

1. Does the agency have assets that meet the above intangible asset criteria?
2. If the agency does NOT have any assets that meet the intangible asset criteria, the agency must communicate in writing to DOA that there are no intangible assets that are required to be reported.
3. Does the agency have intangible assets that have an indefinite useful life?
4. Determine if any intangible asset with an indefinite useful life has been (amortized) depreciated.
5. If the intangible asset that has an indefinite useful life has been depreciated, it must be *reported*. Contact DOA if the agency has any intangible assets with indefinite useful lives that *have not been previously reported*. DOA will provide additional guidance.
6. If the agency has other intangible assets, the agency should apply remaining tests to determine proper reporting of these intangible assets.
7. Does the agency have any intangible assets that have not been documented in FAACS, on the agency’s financial statement template, or separate communication submitted to DOA?
8. Do these assets equal or exceed the *\$100,000 statewide* materiality thresholds?
9. If YES, the agency should ensure that the assets are properly recorded in FAACS, on the agency’s financial statement template, or separate communication submitted to DOA. Generally, all intangible assets should be recorded in FAACS using the “infrastructure” category and new nomenclatures for intangible assets. (See CAPP Topic No. 30310.) However due to system limitations, intangible assets having indefinite useful lives (i.e., do not depreciate) cannot be entered in FAACS as “infrastructure”. Contact DOA for assistance in recording any intangible assets having indefinite useful lives or whenever there is a question about the appropriate classification and nomenclature that should be used.
10. Does the agency have assets that meet the internally generated computer software criteria?
11. If YES, the agency should ensure that the assets are properly recorded in FAACS or other financial statement directive attachment. Agencies/institutions that do not use FAACS should record all intangible assets using the “infrastructure” category. However if system limitations exist that prevent the use of the “infrastructure” category for intangible assets having indefinite useful lives (i.e., do not depreciate) the agency/institution must identify any intangible assets that are recorded using other asset categories.

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## Internal Control

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### General

Each agency and institution should implement cost beneficial internal control procedures to ensure that:

- Capital assets purchased with federal grant funds are recorded appropriately in FAACS.
  - Assets are properly classified for financial reporting purposes.
  - Controls are in place to exclude the depreciation of capitalized assets purchased with Federal grant funds from the indirect cost recovery plan.
  - Assets are properly classified for financial reporting purposes.
  - Recordkeeping procedures exist that account for assets.
  - Assets are safeguarded against damage or theft.
  - A periodic inventory is performed of assets.
  - Assets are recorded in a timely manner.
  - Assets are adequately safeguarded and controlled.
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## Records Retention

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### General

Fiscal records related to managing capital assets should be retained for a period of two years plus current fiscal year, or until audited, whichever is greater. However, for pending, ongoing, or unresolved litigation, audits or claims, retain documentation until completion, resolution, or negotiation of settlements.



Destruction of records must be in accordance with policies and procedures of the Records Management Section, The Library of Virginia.

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## DOA Contact

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**Contact**            Assistant Director, Financial Reporting  
 (804) 225-2257  
**FAX**            (804) 225-2430  
        finrept@doa.virginia.gov

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## Subject Cross References

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**References**        CAPP Topic No. 30105—*Introduction*  
CAPP Topic No. 30305—*Capitalized or Controlled Assets*  
CAPP Topic No. 30310—*Asset Categorization*  
CAPP Topic No. 30505—*Physical Inventory*  
CAPP Topic No. 31105—*Federal Requirements*  
CAPP Topic No. 70325—*Data Entry*

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