SACRAMENTO COUNTY	**Policy # 1302**
Subject: Intangible Assets Policy	
Responsible Department: Department of Finance	
Effective Date: 07/2010	**Revision Date:** 08/2018
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1. <u>Purpose</u>

To provide guidance on accounting for intangible assets, including internally generated intangible assets.

2. <u>Authority</u>

Governmental Accounting Standard Board (GASB) Statement No. 34; GASB Statement No. 51; GASB Statement No. 62; GASB Implementation Guide 7.9.8; State Controller's Accounting Standards and Procedures for Counties; and the Board of Supervisors approval of July 13, 2010.

3. <u>Scope</u>

Applies to all County departments/agencies included in the County's annual financial statements, except those departments/agencies specifically exempted by County policy.

Does not apply to the following intangible assets:

A. Assets acquired or created primarily for obtaining income or profit.
B. Assets resulting from capital lease transactions reported by lessees.
C. Goodwill created through the combination of a government and another entity.

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

A. It lacks physical substance. It may be contained in or on an item with physical substance, for example, software stored on a compact disc; it 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.

B. It is non-financial in nature, meaning it is not in monetary form and it does not represent a claim or right to assets or a prepayment.

C. It has an initial useful life of more than one year.

Common types of intangible assets:

- Right-of-way easements
- Other types of easements
- Land use rights, such as mineral, water, or timber rights
- Patents, copyrights, and trademarks
- Computer and Web site software – purchased, internally generated, or acquired through licensing agreements

4. Guidelines and Procedures

Guidelines for Policy

A. Management must ensure the proper accounting and reporting of capital assets that meet the definition of intangible assets as defined in GASB 34 and amended by GASB 51.

B. In addition to the specific provisions of this procedure, a department/agency must apply the general guidance of the County of Sacramento Asset Capitalization Policy, and Chapter 15, Capital Assets, of the State of California Accounting Standards and Procedures for Counties Manual.

C. The County's capitalization thresholds for intangible assets are all \$25,000, except for permanent easements with zero threshold, and computer and website software with \$100,000 threshold. All intangible assets have a useful life greater than one year, except permanent easements with no useful life. Record qualified intangible assets in the appropriate capital asset general ledger (GL). Expense non-qualified intangible assets in the expenditure accounts.

All intangible assets that are in use, meeting the thresholds criteria, and acquired after June 30, 1980, are to be reported as intangible assets. Intangible assets that are considered internally generated (developed), are not required to be retroactively reported. However, an internally generated (developed) intangible asset may be retroactively reported if the value is based on sound cost accounting principles that can be supported for auditors.

It is acceptable to use an estimated historical cost for intangible assets if you are unable to determine an actual historical cost; however, it is not acceptable to estimate historical cost for internally generated (developed) intangible assets.

If a new building is currently being constructed, once the Capital Improvement Plan (CIP) is reclassified as a capital asset, in general it is NO requirement 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.

Capitalizable modifications on existing internally generated intangible 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.

According to GASBS 51, paragraph 20, "this Statement should be applied retroactively (except for internally generated intangible assets and intangible 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."

D. Consider land use rights, such as easements, water rights, timber rights and mineral rights, obtained through the purchase or donation of land as "bundled" with the land; do not record them as separate assets.

E. Account for a land use right obtained by lease, contract or other similar agreement (without acquiring the underlying land) as a separate intangible asset. Record the obligation to make payments over the life of the agreement as a long-term liability.

F. Account for and report intangible assets acquired or created primarily for obtaining income or profit as investments.

G. Capitalize software acquired through a licensing agreement as an intangible asset, even if the license agreement refers to the arrangement as a lease. Record the obligation to make payments over the life of the agreement as a long-term liability.

H. When a computer is purchased with software already installed, it is not required to break out software vs. hardware costs, especially if the useful lives of both are the same.

When a computer software system consists of more than one module or component, apply the guidance in this procedure to each individual component or module separately rather than to the system as a whole.

Departments/agencies can value software individually or group them together depending upon the purchasing time and amount. For example, larger departments/agencies may buy 100+ computers together at one time, already equipped with software. Individually the computers and/or software are valued less than our reporting threshold. But grouped together they would be above our reporting threshold. If all items are ordered at the same time and are part of the same transaction then they should be grouped together and reported, (if their total value is equal to or greater than the $100,000 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."

I. Computer software is a common type of intangible asset that is often internally generated. Computer software should be considered internally generated if it is developed in-house by the government's personnel or by a third-party contractor on behalf of the government. Commercially available software that is purchased or licensed by the government and modified using more than minimal incremental effort before being put into operation also should be considered internally generated. Any of the following activities would satisfy the "modified using more than minimal incremental effort" criterion: changing code, changing fields, adding special reporting capabilities, and testing any changes.

J. Amortize intangible assets with a limited life on a straight-line basis. Do not amortize intangible assets with an indefinite life.

K. When a department/agency sells or retires an intangible asset, remove the asset and accumulated amortization from the GL control accounts and subsidiary property ledger and recognize any gain or loss arising from the disposition.

Procedures for Policy

A. Recognition

Recognize an intangible asset only if it is identifiable. Consider an intangible asset as identifiable if it is either (1) separable, meaning the asset is capable of being separated from the department/agency and sold, transferred, licensed, etc.; or (2) the asset arises from contractual or other legal rights.

B. Land Use Rights Bundled with Property

Ownership of property comprises a bundle of rights that includes the right to control the use of the property. Do not report land use rights such as easements, water rights, timber rights and mineral rights obtained through the purchase or donation of land as separate assets. Although the individual rights included in the bundle of rights are separable and intangible in nature, collectively they represent the ownership of the land.

C. Land Use Rights Accounted for Separately

Account for land use rights obtained by lease, contract or other similar agreement (without acquiring the underlying land) as separate intangible assets. Record the department's/agency's obligation to make payments over the life of the agreement as a long-term liability. Land use rights that may be obtained from a third party through a legal agreement include:

a. The right to access land, such as an easement, right of way.
b. The right to explore or exploit natural resources, such as timber, mineral, or water rights.

D. Intangible Assets Acquired or Created to Obtain Income

Assets acquired or created primarily to obtain income or profits are not subject to this policy. For example, this policy does not apply to a copyright acquired or created by a public university that the university uses primarily to generate royalty income.

However, when a department/agency uses an intangible asset, such as a trademark, both in its operations and to obtain revenues, professional judgment is required. To determine the primary purpose of the intangible asset, consider the amount of revenue expected to be generated versus the service capacity gained by using the intangible asset in the department’s/agency's operations.

E. Internally Generated Intangible Assets

Consider intangible assets "internally generated" if the department/agency or an entity contracted by the department/agency creates or produces the assets. Also, consider assets acquired from a third party as internally generated if the assets require more than minimal additional effort on the part of the department/agency to achieve the desired service capacity

Under the "specified-conditions" approach, a department/agency capitalizes outlays associated with the development of internally generated intangible assets only when all of the following conditions occur:

a. The department/agency has determined the specific objective of the project and the service capacity expected upon completion of the project.
b. The department/agency has determined that it is technologically feasible to complete the project.
c. The department/agency has demonstrated that it intends to complete the project (or in the case of a multi-year project, to continue development of the intangible asset).

This approach provides a safeguard against the capitalization of outlays that may become impaired in the future because the department/agency terminated the project.

Expense outlays incurred prior to meeting the above criteria. Capitalize outlays incurred subsequent to meeting the criteria.

F. Internally Generated Computer Software
When a department/agency develops computer software in-house, by department/agency personnel or by a third-party contractor, consider it internally generated. Commercially available software (purchased or licensed from a third party) that requires more than minimal additional effort to put into operation is also internally generated.

The following three stages represent activities associated with developing and installing internally generated computer software:

Preliminary Project Stage	**Application Development Stage**	**Post-implementation/ Operation Stage**
Conceptual formulation of alternatives	Design of chosen path, including software configuration and software interfaces	Application training
Evaluation of alternatives	Coding	Software maintenance
Determination of existence of needed technology	Installation of hardware	
Final selection of alternatives	Testing, including parallel processing phase	

Preliminary Project Stage: When a computer software project is in the preliminary project stage, departments/agencies should take the following actions:

a. Decide how to allocate resources- e.g., determine if programmers should develop a new accounts receivable subsidiary system or direct their efforts toward correcting existing problems in the current accounts receivable system.
b. Determine the performance requirements for the computer software project- e.g., through a user needs analysis.
c. Determine the system requirements for the computer software project and if the technology needed to achieve performance goals exists.
d. Explore alternative means of achieving specific performance goals- e.g., evaluating internal development of the computer software against purchase and modification of commercially available software.
e. Select a vendor, if a department/agency chooses to purchase software.

f. Select a consultant (internal or external) to assist in software development or installation.

For internally generated computer software, consider the criteria below to be met only when both of the following actions have occurred:

a. The activities in the preliminary project stage are complete, and
b. Management implicitly or explicitly authorizes and commits to fund the software project (at least currently in the case of a multi-year project).

Accordingly, expense outlays connected with activities in the preliminary project stage as incurred. For commercially available software that the department/agency will modify and consider internally generated, consider (a) and (b) above to have occurred when the department/agency commits to purchase or license the computer software.

Application Development Stage: Once the department/agency meets the criteria in above, capitalize outlays related to activities in the application development stage. Capitalization stops no later than the point at which the computer software is substantially complete and operational.

Data conversion costs qualify as an activity of the application development stage only to the extent data conversion is necessary to make the computer software operational. Otherwise, treat data conversion as an activity of the post-implementation operation stage. Data conversion activities include purging or cleansing of existing data, conversion of data from the old system to the new system, and reconciliation of the data from the old system to the data in the new system.

Post-Implementation/Operation Stage: Expense outlays associated with activities in the post-implementation/operation stage as incurred.

The activities within the stages of development of internally generated computer software may occur in a different order than discussed above. For example, training staff to use the new system may occur during the application development stage. Regardless of the order of activities, base the decision to capitalize or expense outlays on the nature of the activity, not the timing of its occurrence.

G. Software Modifications, Upgrades, or Enhancements

Capitalize outlays for modification of computer software already in operation according to page 8, if the modification results in any of the following:

a. An increase in the functionality of the computer software; e.g., the software performs tasks that it was previously incapable of performing.
b. An increase in the efficiency of the software; e.g., an increase in the level of service provided by the software without the ability to perform additional tasks.
c. An extension of the estimated useful life of the software.
   NOTE: Modifications that extend useful life alone without adding capacity or efficiency are rare events. Generally, an extension of useful life is the result of underestimating the original useful life. When determining the useful life, consider how maintenance activities may affect the serviceability of the software.

   If the software modification does not result in any of these outcomes, account for the modification as maintenance and expense the related outlays as incurred.

   In theory, outlays for a maintenance contract that covers required maintenance and any unspecified upgrades should be allocated between the upgrades that meet the conditions discussed above and all other upgrades/maintenance provided by the vendor. As a practical matter, departments/agencies may choose to establish a policy that treats all unspecified upgrades as maintenance and expense the related costs as incurred.

H. Computer Software with Multiple Components

A department/agency may enter into a licensing agreement for computer software with multiple components that the department/agency considers internally generated (e.g., the license to use the software; modifications to meet the department's/agency's requirements; training; routine systems maintenance; and rights to future upgrades and modifications). The department/agency must allocate the outlays associated with the agreement among all the individual elements based on the guidance in this policy. For example, capitalize outlays to obtain the software license as part of the application development stage and expense outlays to train the users as part of the post-implementation/operation stage.

I. Software Licensing Agreements

Software licensing agreements are not subject to Capital Leases, even if the agreement is referred to as a "lease." Departments/agencies must capitalize the software and report it as an intangible asset. They must also record a long-term liability to recognize the obligation to make annual payments over the life of the contract.

According to GASB 51, 1J 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 $100,000 threshold.

J. Capitalized Interest

When a proprietary fund finances the acquisition of an internally generated intangible asset, the interest capitalization requirements apply. Interest capitalization starts on the date of the borrowing and continues until the date that the asset is ready for its intended use. Interest earned during this period on unspent borrowings reduces the amount the department/agency capitalizes. Capitalized interest is not included as part of the cost of assets purchased with resources from governmental funds.

K. Useful Life

The useful life of an intangible asset that arises from contractual or legal rights must not exceed the legal term of the rights. Consider renewal periods when determining the useful life of an intangible asset, if the department/agency plans to seek a renewal and the anticipated costs will be minimal. If the expected outlay for renewal is more than minimal, the department/agency must account for the resulting transaction as a new intangible asset.

Consider an intangible asset to have an indefinite 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 with an indefinite life. Do not amortize intangible assets with indefinite lives. If changes occur that cause the useful life of an intangible asset to no longer be indefinite, the department/agency must test the asset for impairment. Amortize the carrying value of the intangible asset, if any, following the recognition of an impairment loss over the remaining estimated useful life of the asset.

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 defer obsolescence should be considered to extend the useful life of software.]"

If the software is no longer being used (nor is being used but considered internally generated) then you don't need to retroactively report it.

L. Impairment
A common indicator of impairment occurs when the department/agency stops development due to a change in priorities. Report internally generated intangible assets impaired by development stoppage at the lower of carrying value or fair value.

5. Review

Review annually and revise for any changes in guidance from the aforementioned authorities above.