



# KPMG's Government Practice Webcast

GASB Statement No. 51

KPMG LLP

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# **GASB Statement No. 51 *Accounting and Financial Reporting for Intangible Assets***

## **Welcome and Introduction**

Shawn Warren, Audit Partner, KPMG LLP

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# Today's Guest Speakers

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- **Shawn Warren**
  - Audit Partner, KPMG's Government Practice
- **Greg Driscoll**
  - Audit Partner, KPMG's Department of Professional Practice
- **Andy Gottschalk**
  - IT Advisory Partner, KPMG's Government Practice

# Agenda

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- GASB Statement No. 51 Technical Discussion, Greg Driscoll
- Comments on Internally Generated Computer Software, Andy Gottschalk
- Q&A

# Background

- Project born out of questions raised over description of capital assets in Statement 34:
  - “capital assets includes 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”
- Uncertainty in practice as to what was meant by *intangible assets* in the description
- Statement 51 issued in June 2007 to reduce inconsistencies in financial reporting
- Statement 51 effective for periods beginning after June 15, 2009

# Overview

- Statement 51 addresses the following aspects of reporting intangible assets:
  - Description
  - Classification
  - Recognition
    - General recognition requirement
    - Broad approach to recognizing internally generated intangible assets
    - Specific approach to recognizing internally generated computer software
  - Measurement
    - Initial measurement
    - Amortization
  - Impairment
  - Disclosures
  - Transition provisions

# Description

- An intangible asset is an asset that possesses all of the following characteristics:
  - Lack of physical substance
  - Nonfinancial nature
  - Initial useful life extending beyond a single reporting period
- Statement generally does not provide guidance on whether a transaction results in an asset
  - Look to definition of “asset” in Concepts Statement No. 4, *Elements of Financial Statements* for guidance
  - Basis for conclusions does state that powers created through statute or inherent nature of government are not intangible assets

# Common Types of Intangible Assets

- Right-of-way easements
- Other types of easements
- Patents, copyrights, trademarks
- Land use rights
- Licenses and permits
- Computer software
  - Purchased or licensed
  - Internally generated
  - Websites

# Classification—Basic Guidance

- All intangible assets subject to Statement 51 should be classified as capital assets:
  - All existing authoritative guidance related to capital assets should be applied to these intangible assets
  - Since considered capital assets, not reported as assets in governmental fund financial statements
- Scope exceptions:
  - Intangible assets acquired or created primarily for directly obtaining income or profit
  - Capital leases
  - Goodwill from a combination transaction

# Recognition

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- An intangible asset should be recognized only if it is identifiable:
  - Asset is separable, i.e. capable of being separated and sold, transferred, licensed, etc.

-OR-

- Asset arises from contractual or other legal rights, regardless of whether rights are separable

# Internally Generated Intangible Assets

- Internally generated intangible assets (IGIA) are:
  - Created or produced by the government or an entity contracted by the government; or
  - Acquired from a third party but require more than minimal incremental effort to achieve expected service capacity
- Statement provides a specified-conditions approach to recognizing outlays associated with IGIA
- Guidance may result in capitalization of certain R&D costs previously expensed under FASB Statement No. 2

# Internally Generated Intangible Assets

- Outlays incurred related to an IGIA that is considered identifiable should be capitalized only upon the occurrence of **ALL** of the following:
  - Determination of the specific objective of the project and the nature of the service capacity that is expected to be provided by the asset upon completion of the project;
  - Demonstration of the technical or technological feasibility for completing the project so that the asset will provide its expected service capacity;
  - 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
- Outlays incurred prior to meeting the criteria should be expensed as incurred—no “recycling” of expenses

# Internally Generated Computer Software

- Specific guidance on applying the IGIA specified-conditions approach for internally generated computer software (IGCS) is provided
- IGCS is either:
  - Developed in-house by government personnel or a contractor on their behalf; or
  - Commercially available software modified using more than minimal incremental effort before being put in operation
- Guidance based on development stages similar to AICPA SOP 98-1

# Internally Generated Computer Software

- Activities associated with developing IGCS should be categorized in one of three development stages:
  - Preliminary project stage
    - Conceptual formulation and evaluation of alternatives
    - Determination of existence of needed technology
    - Final selection of alternatives
  - Application development stage
    - Design of the chosen path
    - Coding
    - Installation to hardware
    - Testing and parallel processing
  - Post-implementation/operation stage
    - Application user training
    - Software maintenance

# Internally Generated Computer Software

- IGIA specified-conditions criteria are considered met for IGCS when:
  - The activities in the preliminary project stage are completed
  - Management authorizes and commits to funding the project
- For commercially available software that is IGCS, these criteria are generally considered met upon the government's commitment to purchase or license software

# Internally Generated Computer Software

- Reporting of activity outlays:
  - Preliminary project stage—expense as incurred
  - Application development stage—capitalize once criteria is met; cease capitalizing when software is operational
  - Post-implementation/operation stage—expense as incurred
- Reporting should be based upon nature of activity, not timing of its occurrence
- No specific guidance on the types of outlays that can be capitalized (e.g. direct costs vs. indirect costs)

# Internally Generated Computer Software

- Data conversion activities may include:
  - Purging/cleansing of existing data
  - Conversion of data from legacy system to new system
  - Reconciliation of data from legacy system and data in new system
- Data conversion should be considered activity of the application development stage only if necessary to make software operational—otherwise post-implementation/ operation stage
- Consider human resources system vs. vendor information database
- Statement 51 provision differs from SOP 98-1
  - Notion of ancillary charges for capital assets

# Internally Generated Computer Software

- Reporting costs of internally generated modifications of software already in operation should follow the development stage approach if the modification results in:
  - An increase in the functionality of the software
  - An increase in the efficiency of the software; or
  - An extension of the estimated useful life of the software
- If modification does not result in one of the above, associated outlays should be expensed as incurred as maintenance
- Extension of useful life without increased functionality or efficiency expected to rarely occur

# Internally Generated Computer Software Costs

## Practical Considerations

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- Need a policy
  - Do costs need to be captured
  - When to capitalize
  - What costs to capture
    - Payroll costs
    - How to determine and track

# Internally Generated Computer Software Costs

## Practical Considerations

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- Amortization period
- Timing – when to begin amortization
- The Department of Health and Human Services has issued guidance on submitting for reimbursement:
  - For those software costs capitalized; costs should be charged to the federal program when the amortization of the capitalized costs is incurred.

# Internally Generated Computer Software Costs

## Practical Considerations

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- Costs for the phases will need to be tracked
- Data conversion cost
  - To make operational
  - Otherwise post implementation

# Measurement

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- Intangible assets follow measurement guidance for capital assets:
  - Historical cost
  - If donated, estimated fair value at date of donation
- BFC provides Board's non-authoritative views as to determining fair value of donated right-of-way easements for roadways
- Intangible assets excluded from scope because acquired or created to generate income or profit generally should follow guidance for investments

# Amortization

- Existing guidance for depreciation of capital assets generally applies to amortizing intangible assets
  - No mandated maximum amortization period
- Exception for intangible assets with indefinite useful lives:
  - No factors currently exist that limit the useful life of the asset
  - A useful life that must be estimated does not mean indefinite useful life
    - Permanent right-of-way easement vs. computer software
  - Intangible assets with indefinite useful lives should not be amortized

# Amortization

- Useful life of an intangible asset that arises from contractual or legal rights should not exceed the legal term of the rights
- Renewal periods can be considered if there is evidence that:
  - Renewal will be sought and will be able to be achieved, considering any third-party consent; and
  - Any anticipated outlays related to renewal are nominal in relation to the level of service capacity expected to be obtained through the renewal

# Impairment

- The provisions of Statement 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, generally should be applied to determine impairment of intangible assets
- “Development stoppage” added to the impairment indicators in Statement 42
- An implementation guide question details examples of circumstances that may indicate impairment

# Note Disclosures

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- No note disclosure requirements specific to intangible assets
- Intangible assets should be incorporated into the capital asset note disclosures
- An implementation guide question discusses inclusion of intangible assets in major classes of capital assets

# Effective Date and Transition

- Effective date is fiscal periods beginning after June 15, 2009
- Provisions generally should be retroactively applied
- Exceptions for retroactively reporting intangible assets:
  - Permitted but not required for IGIA to the extent specified-conditions approach can be applied
  - Permitted but not required for intangible assets with indefinite useful lives at transition
  - Required for all other intangible assets acquired in fiscal years ending after June 30, 1980 by phase 1 or 2 governments
  - Encouraged but not required for all other intangible assets of phase 3 governments

# Effective Date and Transition

- Indefinite useful life provisions should be applied retroactively only if asset has indefinite useful life at transition
- Land use rights associated with property already owned by government should not be reported as intangible assets separate from the property
- Additional Statement 51 implementation guidance is included in the 2008 Comprehensive Implementation Guide

# Q & A

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# Closing Items

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KPMG's GASB STATEMENT NO. 51 WEBCAST

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