



Governmental Accounting Standards Board
of the Financial Accounting Foundation

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Intangibles Take Shape Under New GASB Proposal

To date the Governmental Accounting Standards Board (GASB) has issued 49 statements of governmental accounting standards, as well as a variety of other official pronouncements. Nevertheless, there remain a number of unexplored aspects of accounting and financial reporting. The practical consequence of uncharted territory is the absence of clear guidance for the preparers, auditors, and users of governmental financial statements, which can lead different governments to report similar transactions or items differently or result in different municipal analysts interpreting the same information differently.

One such area of accounting relates to intangible assets. Some intangible assets in the governmental arena are patents and trademarks, computer software, rights to use a water source or to remove minerals or other resources from land, and easements (the right to use land for a specific purpose, such as building a highway). GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, issued in 1999, requires governments to report the original cost of their capital assets and to depreciate that cost over the assets’ useful lives. Statement 34 defined capital assets as assets used in the operations of a government and having useful lives of more than one year, such as buildings, emergency vehicles, roads and bridges, and intangible assets. The inclusion of intangible assets prompted a slew of questions about how to know if a government had one and, if it did, how to report it. In December the GASB issued an Exposure Draft, *Accounting and Financial Reporting for Intangible Assets*, to provide clear and consistent answers to those questions.

What Is an Intangible Asset?

The GASB’s proposal identifies three basic characteristics that describe an intangible asset:

- Intangible assets lack physical substance—in other words you cannot touch them
- Intangible assets are nonfinancial in nature—they have value, but are not in a monetary form, like cash or investments

- Intangible assets can be used for multiple years.

How Should Intangible Assets Be Reported?

In general, the GASB is proposing that intangible assets with those three characteristics should be treated as capital assets; existing standards for capital assets would be applied to them. However, the Exposure Draft delves into issues that are peculiar to intangible assets. For instance, to report the historical cost of an intangible asset in the financial statements, the asset has to be *identifiable*. That means that the government can sell, rent, or otherwise transfer the asset to another party—the asset is *separable*. If it is not separable, the asset has to arise from contractual or other legal rights, such as water rights acquired from another government through a contract that cannot be transferred to another party.

Although many intangible assets are purchased or received from other parties, some are developed by a government itself, such as proprietary software systems. The cost of such assets may be incurred over a period of more than one year, rather than being incurred at a single point in time when a purchase occurs. This presents unique challenges for accounting. The GASB proposal specifies four circumstances that would have to be met in order for the outlays related to an internally generated intangible asset to be reported as a capital asset:

- The government's intention to create a specific internally generated intangible asset has been demonstrated
- The particular capacity in which the asset is expected to be used when completed has been determined
- The feasibility of completing the project so that it can be used in that capacity has been demonstrated
- The government's intention to complete or to continue the development of the asset has been demonstrated.

The proposal also presents additional detailed guidance for internally generated software.

Another particular issue related to intangible assets is the determination of their useful lives. The choice of useful life establishes the length of the period over which the asset's costs will be amortized—that is, systematically divided and reported as annual expenses. Some intangible assets, such as patents and trademarks, may cease on a certain date, but may be renewable. When determining the useful life, a government would take the possibility of renewal into account if there is evidence that it intends and will be able to renew the rights without incurring significant additional outlays. For example, if a government expects that it will pursue and be able to obtain renewal of a patent upon its expiration, and can do so without incurring significant outlays in the process, then the renewal period could be considered in determining the useful life of the patent. Some intangible assets have indefinite useful lives—essentially, there is no

point at which they cease to be useful. Although their cost would be reported as capital asset, the cost would not be amortized.

When Would the New Standards Be Effective?

The Exposure Draft proposes that governments would implement the new intangible assets standards for fiscal years ending after June 15, 2010. Earlier implementation, however, is encouraged.

How Can You Help the GASB Complete These Standards?

You can assist the GASB with the process of finalizing its intangible assets standards by reading the proposal and providing feedback. The Exposure Draft is available to download free from the GASB website, www.gasb.org. (See the links below.) The GASB poses questions about specific issues in the document, but you are free to comment on any aspect of the proposal. It is most helpful if you react to not only the aspects you disagree with, but also those that you support. In addition, it is most valuable to the GASB when respondents explain why they support or oppose a particular facet of a proposal.

An Internet-based form is available for submitting your comments. You can also submit comments by email (director@gasb.org) or by mail (sent to the address below). Email and mail submissions should be addressed to the Director of Research and Technical Activities, Project 9-4. The GASB also will be holding a public hearing at its Norwalk, CT, offices on April 3; you can attend in person or participate via telephone. Additional information about responding to the proposal or participating in the public hearing can be found in the front of the Exposure Draft.

Written comments should be submitted to:

Director of Research and Technical Activities
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