University of California

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

Issues Resolution Memo No. 51.3

INTANGIBLE ASSETS—COPYRIGHT, PATENT AND TRADEMARK ISSUES

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1. INTRODUCTION

GASB Statement No. 51 requires intangible assets to be classified and reported as capital assets. Examples of intangible assets include easements, water rights, timber rights, patents, trademarks, and computer software. Intangible assets can be purchased or licensed, acquired through non-exchange transactions, or internally-generated. The University must implement the requirements of the Statement for the fiscal year beginning July 1, 2009, with restatement of the previous fiscal year.

Copyrights, patents and trademarks are examples of intangible assets; however, they may also be reported as current operating expense or as investments under certain circumstances. This IRM provides guidance for the appropriate treatment of copyrights, patents and trademarks under various circumstances. It also provides guidance on the costs to be capitalized when they are classified as intangible assets.

2. CURRENT CLASSIFICATION AND TREATMENT OF COPYRIGHTS, PATENTS AND TRADEMARKS

The University's policy for capitalization of property is established in the University Accounting Manual, Chapter P-415-10, *Capitalization of Property, Plant and Equipment*. Additional guidance for the classification and treatment of intangible assets, including patents and trademarks was provided in Issue Resolution Memo (IRM) No. 18, *Approach to Intangible Assets.* The IRM was developed during the University's implementation of GASB Statement No. 34 and 35. The IRM did not identify copyrights as a type of intangible asset. It also did not require the capitalization of internal development costs associated with patents or trademarks.

3. STATEMENT NO. 51 DEFINITION OF INTANGIBLE ASSETS AND CLASSIFICATION OF COPYRIGHTS, PATENTS AND TRADEMARKS

a. Definition of Intangible Assets

Statement No. 51 defines intangible assets as assets that: 1) lack physical substance, 2) are non-financial in nature, and 3) have initial useful lives extending beyond a single reporting period (one year). Intangible assets can be purchased or licensed, acquired through non-exchange transactions, or internally-generated. Copyrights, patents and trademarks are included as examples of intangible assets in the Statement.

b. Classification as investments

Paragraph 3a of the Statement requires that asset acquired or created to directly obtain income or profit—for example, a copyright used primarily to generate royalty income—be classified as investment, and not as intangible assets. The Statement requires that the accounting and financial reporting for such assets follow authoritative guidance for investments.

In Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, GASB defines an investment as "a security or other asset acquired primarily for the purpose of obtaining income or profit." Statement No. 51 concludes that assets such as copyrights, acquired or created to directly obtain income or profit through royalties, licenses or other passive income streams generally should not be classified as capital assets; instead should be classified as investments. (Paragraph 44)

The Statement discusses copyrights as an example of assets that should be classified as investments. While the Statement does not discuss the application of concept to other assets, it is clearly applicable to patents and trademarks as well as to copyrights.

For research universities like UC, classification of copyrights, patents and trademarks as investments should be relatively rare. UC may acquire certain copyrights, patents or trademarks through purchases or donations for the purpose of generating direct come. When acquired by purchase or gift, the value of the gift or purchase should be equal to the estimated fair value of the asset. In such cases, it would be appropriate to record these acquisitions as investments (at the lower of cost or fair value). For patents generated through internal development, it would be very rate for UC to developed copyrights, patents and trademarks primarily for generating direct income or profit. In the rare case where such development is undertaken, it will be difficult if not impossible to establish a fair value based on the likely income stream with any certainty. The potential income stream will not be determinable until the income is actually realized. If the fair value passed cannot be determined, these investments must be recorded at a value of zero (lower of cost or fair value). If the investment begins to generate income at a later date, the investment value will remain at zero, since the cost of development will have been expensed in past periods and the lower of cost or fair value would still equal zero.

c. Classification as intangible assets

In Appendix C, example 2 of the Statement, the GASB discusses the classification of internally-generated patents. The example describes a research university that authorizes a research and development project to create a new medical stitch material from a combination of microfibers that has initially been found to be significantly more durable than existing stitches. The stated goal of the project is to acquire a patent for the new stitch material in order <u>to improve the quality of services provided to patients of the university hospital</u>. The example prescribed the capitalization of the research and development costs related to the development of this new medical stitch material leading to the acquisition of a patent as an intangible asset. (The full text of the example is provided in Appendix 2.)

Through this example and the earlier statement regarding the classification of these assets as investments, the GASB has made a differentiation in the possible classification of copyrights, patents and trademarks; the classification to be based on the purpose of the acquisition, or how the asset will be used by the institution. As stated earlier, if the purpose of the acquisition is primarily to generate passive income, the copyright (or patent or trademark or other intellectual property) is to be recorded as an investment. If the primary purpose of acquiring the copyright (or patent, trademark or other intellectual property) is to improve the quality or efficiency of the entity's operational services, it is to be classified as an intangible capital asset. While the Statement does not specifically discuss the possible classification of patents or trademarks as investments, and does not provide additional examples or discussion of copyrights or trademarks as intangible capital assets when used to improve the quality of the university's operational services, it is logical to assume that this differentiation applies to the classification of copyrights, patents, trademarks and other forms of intellectual property that may be used by the University to generate passive income or be used to improve its operational services.

d. Classification as current operating expense

In general, research and development (R&D) activities at universities are conducted to expand the general knowledge of the science (through the conduct of basic and fundamental research). Very rarely do universities undertake research and development projects with the specific purpose of creating patents, trademarks, copyrights or other forms of intellectual property specifically for use by the institution to improve its quality of operating services. It is also rare for universities to conduct research and development activities for the primary purpose of obtaining copyrights, patents or trademarks to generate royalty income. Most copyrights, patents and trademarks that are internally-generated by the University through research and development (R&D) activities. They are produced as by-products of basic, fundamental research conducted by the University to expand the knowledge of the science. Copyrights, patents or trademarks are routinely registered to recognize and protect these intellectual property developed by the University; however they do not have immediate or known fair value at the time of their creation. Thus most copyrights, patents and trademarks internally-generated by the University do not qualify as intangible assets or as investments.

Statement No. 51 does not provide guidance on the classification and treatment of copyrights, patents and trademarks when they do not qualify as intangible assets or as investments. In the absence of specific GASB guidance, we have referred to available FASB guidance. The FASB in its Statement of Financial Standard (FAS) No. 2, *Accounting for Research and Development Costs*, issued in 1974, requires the cost of research and development to be expensed as incurred.

4. University's Implementation Approach

a. Definition of copyrights, patents and trademarks classified as intangible assets.

The University will classify as intangible assets copyrights, patents and trademarks when they possess all of the following characteristics:

- Unit acquisition value of $5,000 or more
- Normal (useful) life of greater than one year
- The copyright, patent or trademark is acquired for the primary purpose of enhancing the quality of operational services of the University. Example: Copyright, patent or trademark that will be used to improve the quality of educational, research, public service or medical services provided by the University.

Copyrights, patents and trademarks classified as intangible assets will be capitalized and amortized, in accordance with established policy and procedures for capital assets.

UC will classify and report copyrights, patents and trademarks as investments when they are acquired for the primary purpose of generating passive income. Appendix 1 provides a brief discussion on recording these assets as investments.

Expenditures made to develop and acquire copyrights, patents and trademarks that are not classified as intangible assets or as investments will be recorded as operating expense, in accordance with FAS No. 2.

b. Implementation and transition issues

The overall implementation plan for the Statement is provided in IRM 51.1, *Overview of Statement No. 51 and the University's Approach for Implementation*. The issues discussed below are implementation and transition issues specific to copyrights, patents and trademarks.

1. Review of historical data

Existing UC policy requires that patents and trademarks acquired by purchase be capitalized and recorded as intangible assets. Copyrights and internally-generated or gifted patents and trademarks are currently not required to be recorded as intangible assets. There are very few items of copyrights, patents and trademarks that have been capitalized and recorded as intangible assets.

Statement No. 51 must be implemented retroactively and reported in the financial statement for the year beginning FY 2009–2010, with restatement of FY2008–2009. However, the Statement also permits the prospective implementation for certain categories of intangible assets, including internally-generated assets.

The implementation of the Statement will require the identification and verification of historical data for the following categories of copyrights, patents and trademarks classified as intangible assets. Where required, historical data, including acquisition cost (estimated fair value for items received by gift) and estimated useful life must be determined for each copyrights, patents and trademarks that meet the definition of intangible assets.

Summary of Historical Data Required for Implementation of the Statement

Category of Intangible Assets	Historical Data Required
Copyrights	
Purchased or Gifted	Yes – Identify known copyrights used to enhance operational services acquired between July 1, 1980 – June 30, 2008.
Internally Developed	No – historical data is not required by Statement No. 51
Patents	
Purchased or Gifted	Yes – however, UC has recorded purchased and gifted patents as intangible assets. No additional historical analysis is needed.
Internally Developed	No – historical data is not required by Statement No. 51
Trademarks	
Purchased or Gifted	Yes – however, UC has recorded purchased and gifted trademarks as intangible assets. No additional historical data is needed.
Internally Developed	No – historical data is not required by Statement No. 51

2. Assignment of CAANs

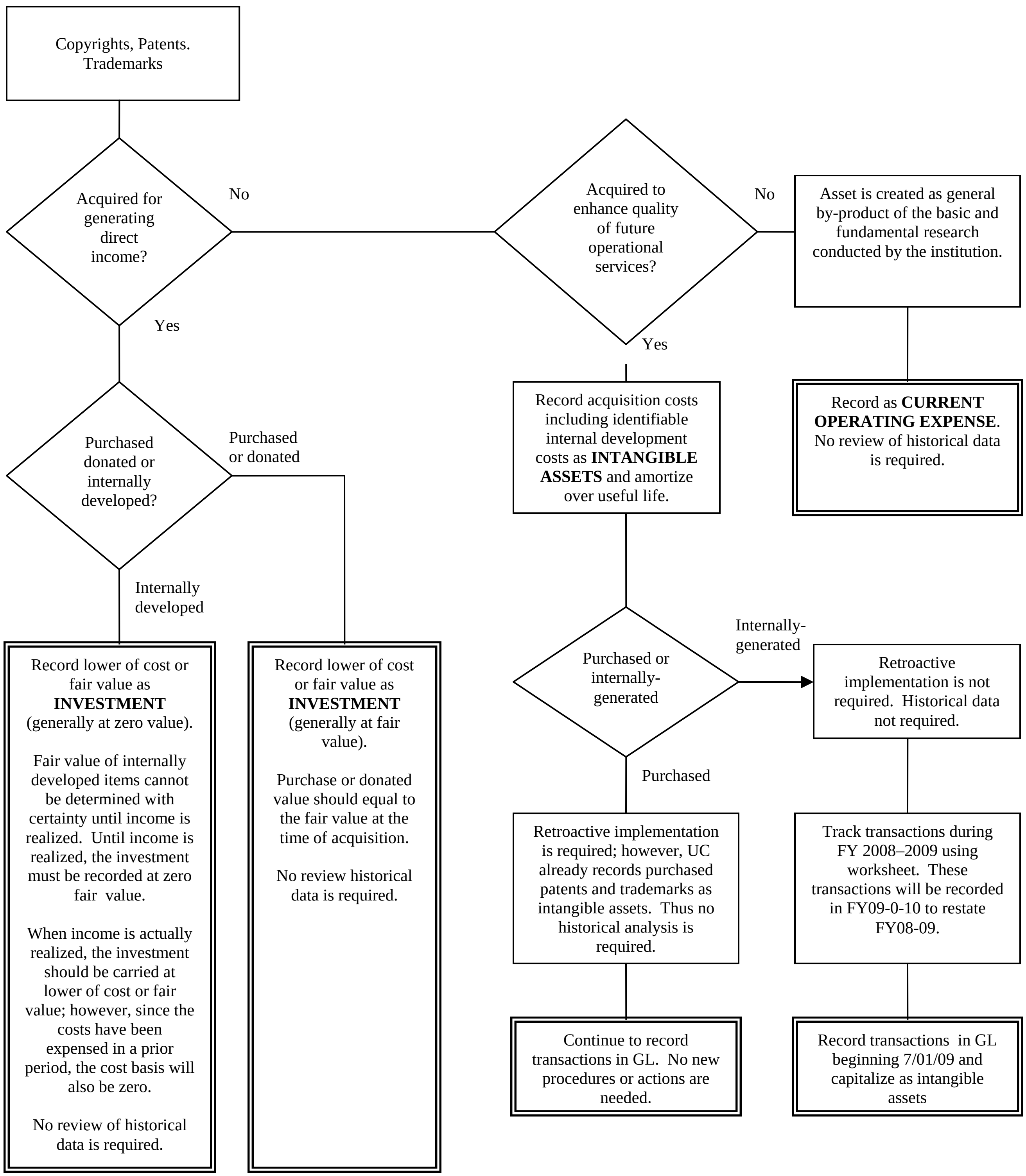
When specific copyrights, patents or trademarks are identified as intangible assets (during the review of historical data or as new acquisitions are evaluated), UC must assign a unique CAAN for each asset. A unique CAAN is necessary in order to assign a specific useful life to each item. These intangible assets cannot be recorded in aggregate, since each item will have varying useful lives.

Items of intangible assets, including copyrights, patents and trademarks will be reported by the campuses to the Office of the President annually in the CFS-AST file. This file is used to gather the information on capital assets to determine the annual depreciation and amortization for the year. Changes required for the preparation and submission of the CFS-AST file, if any, will be identified and announced by UCOP–Financial Management.

c. Summary

GASB Statement No. 51 requires the classification of copyrights, patents and trademarks as intangible assets under specific circumstances. For UC, these circumstances should be very rare. In most cases, the cost of research and development associated with the internal development of copyrights, patents and trademarks will continue to be expensed as in the past. The following flowchart summarized the classification and reporting criteria and the transitional data collection requirements for these assets.

d. Summary Flowchart—Statement No. 51 Classification of Copyrights, Patents, Trademarks



APPENDIX 1: FULL TEXT OF EXAMPLE 2, APPENDIX C OF GASB STATEMENT NO. 51

Illustrations – Example 2
Recognition of an Internally-Generated Patent

Assumptions

Through its College of Medicine, Douglass State University conducts research on developing medical instruments and supplies that improve the effectiveness and efficiency of surgical procedures. A general area of the university's research is in the area of supplies used to close surgical incisions, such as stitches and staples. After months of exploratory research in this area, university researchers discover a combination of microfibers that when applied in the form of a stitch proved in initial tests to be significantly more durable than existing stitches and would dissolve upon the natural healing of the wound. The university researchers believed that these new stitches would be especially effective in surgeries requiring large incisions.

In February 2013, the data accumulated from the research described above were presented to the research committee of the board of the College of Medicine. Based on the presentation, the committee formally authorized 5 full-time researchers and $12 million to fund personnel and other outlays for a project to develop the new material for the stitches. The goal of the project would be to acquire a patent for the new stitch material. Based on other patent that the college has acquired in the past and the type of stitches currently used in practice, the committee believes that the technological advancements of the new stitch supported by the patent would improve the quality of services provide to patients of the hospital operated by the College of Medicine.

Recognition

The university should begin to capitalize outlays associated with the development of the project and acquisition of the related patent in its statement of net assets upon the authorization of resources by the research committee (February 2013). At this point, the specified-conditions criteria for recognizing internally-generated intangible assets appear to be met. The objective of the project has been identified as the acquisition of a patent related to the creation of a new stitch material formed from a combination of specific microfibers. The university has determined that the patent would provide service capacity through the improvement of services provided to patients of its hospital. The initial tests and other general research performed provide a basis for the technical feasibility of the creation of the new stitch material. Lastly, the research committee's commitment of personnel and the $12 million to fund the outlays of the project demonstrate the university's current intention, ability, and presence of effort to continue or complete the work needed to acquire the patent. No outlays associated with the project incurred prior to meeting the specified conditions in February 2012 should be capitalized; those outlays should have been expensed as incurred.