

## **UTS142.13 Appendix 2 Policy Related to Copyright, Patent and Trademark Issues**

### **1. Introduction**

Governmental Accounting Standards Board (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 fiscal year 2010, with restatement of the previous fiscal year.

Copyrights, patents and trademarks (collectively, “intellectual Property”) are examples of intangible assets; however, they may also be reported as current operating expense or as investments under certain circumstances. This policy provides guidance for the appropriate treatment of Intellectual Property 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 Intellectual Property**

Prior to the implementation of GASB Statement No. 51, The University of Texas System did not identify Intellectual Property as a type of intangible asset and did not require the capitalization of internal development costs related to these assets.

### **3. Statement No. 51 Definition of Intangible Assets and Classification of Intellectual Property**

#### ***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 GASB Statement 51 requires that assets 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 GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, defines an investment as “a security or other asset acquired primarily for the purpose of obtaining income or profit.” GASB 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 but instead should be classified as investments. While the Statement does not discuss the application of this concept to other assets, it is equally applicable to patents and trademarks as well as to copyrights.

For research universities like UT, classification of Intellectual Property as investments should be relatively rare, however, UT may acquire certain copyrights, patents or trademarks through purchases or donations for the purpose of generating direct income. 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.

For patents generated through internal development, it would be very rare for UT to develop Intellectual Property primarily for generating direct income or profit. In the rare case where such development is undertaken, these patents should be classified as INVESTMENTS and should be recorded at cost and cannot be marked to fair value at each year end because the authoritative guidance for investments (GASB 31) does not cover investments, like patents, that do not have a readily determinable fair value.

### ***c. Classification as intangible assets***

In Appendix C, example 2 of GASB Statement No. 51, 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 to improve the quality of services provided to patients of the university hospital. 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.

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 Intellectual Property with the classification to be based on the purpose of the acquisition, or how the asset will be used by the institution. Patents may be classified as intangible assets only if the patents are an asset and if the intent of the creation of the patent was specifically to improve the quality of the University's future operating services. GASB Concepts Statement No. 4, Elements of Financial Statements, defines an asset as a resource with "present service capacity" that the government presently controls. "Present service capacity", is defined as an asset's "existing capability to enable the government to provide services, which in turn enables the government to fulfill its mission." Most patents owned by UT are internally-generated, and are the by-product of research conducted by the University to expand the basic and fundamental knowledge of the sciences. It is UT's policy to routinely apply for patents to protect the intellectual property created by the University's research activities; however, research is normally not conducted for the primary purpose of obtaining the patents for operational use or for passive income generating purposes. Expanding the basic and fundamental knowledge of the sciences and protecting the intellectual property created by the University's research activities do not provide "present service capacity" and thus does not meet the definition of an intangible asset. Therefore, most patents owned by UT do not meet the definition of an intangible asset.

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 R&D projects with the specific purpose of creating patents, 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 R&D activities for the primary purpose of obtaining copyrights or patents to generate royalty income. Most copyrights and patents that are internally-generated by the University through R&D activities are produced as by-products of basic, fundamental research conducted by the University to expand the knowledge of the science. Copyrights and patents 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 and patents internally-generated by the University do not qualify as intangible assets or as investments.

Trademarks are developed to brand the institution and make the institution recognizable to the general public. Trademarks typically are not developed to improve its quality of operating services or for the primary purpose of generating royalty income, thus most trademarks do not qualify as intangible assets or as investments.

Statement No. 51 does not provide guidance on the classification and treatment of Intellectual Property 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. Implementation Approach**

***a. Definition of Intellectual Property classified as intangible assets.***

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

- Acquisition value of \$100,000 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.

Intellectual Property classified as intangible assets will be capitalized and amortized in accordance with established policy and procedures for capital assets. Internally-generated costs shall include the internal development costs as well as the administrative costs required to obtain the Intellectual Property. These instances should be very rare at UT.

UT will classify and report Intellectual Property (e.g., copyrights, patents and trademarks) as investments when they are acquired for the primary purpose of generating passive income. Patents classified as INVESTMENTS should be recorded at cost, if purchased or internally developed, or at the donor value, if donated. These investments cannot be marked to fair value at each year end because the authoritative guidance for investments (GASB 31) does not cover investments, like patents, that do not have a readily determinable fair value.

Expenditures made to develop and acquire Intellectual Property 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 issues discussed below are implementation and transition issues specific to Intellectual Property.

### **1. Review of historical data**

Statement No. 51 is effective for the year beginning FY 2009–2010, with restatement of FY2008–2009, however, the Statement permits the prospective implementation for certain categories of intangible assets, including internally-generated assets. Prior to the implementation of GASB Statement No. 51, The University of Texas System did not identify Intellectual Property as a type of intangible asset and did not require the capitalization of internal development costs related to these assets.

The implementation of the Statement required the identification and verification of historical data for purchased or gifted Intellectual Property classified as intangible assets or investments. Historical data for internally-generated Intellectual Property is not required. UT had no Intellectual Property that qualified as intangible assets or as investments for restatement purposes.

### **2. Treatment in SPA**

When specific copyrights, patents or trademarks are identified as intangible assets, these intangible assets must be recorded separately in the State Property Accounting System (SPA). These intangible assets cannot be recorded in aggregate, since each item will have varying useful lives.

## ***c. Summary***

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

reporting criteria for these assets.

**d. GASB Classification Flowchart - Copyrights, Patents, Trademarks**

