



PERSPECTIVE

The Hard Truth on Soft Assets

BY JUSTIN MARLOWE

One of the hottest topics in public finance today is, oddly enough, a four-year-old governmental accounting standard on an esoteric procurement arrangement for information technology (IT) services. That sounds uneventful, but this new standard has grabbed more than its share of attention because it raises some challenging questions about how we should think about “public infrastructure.”

At the height of the COVID 19 pandemic in May 2020, the Governmental Accounting Standards Board (GASB) finalized Statement No. 96, Subscription-Based Information Technology Arrangements. This statement was meant to address a growing gap between the way states and localities procure information technology systems, and the actual financial implications of that procurement.

From the 1970s through the early 2010s, government information technology systems were capital investments. States and local governments bought and maintained their own computers, servers, and other hardware. Those investments were essential to bring the public’s business into the digital world.

With time the IT landscape shifted. Governments stopped owning IT hardware and started leasing it through complex, long-term, enterprise-wide contracts. They didn’t own those assets, but they were, in fact, physical IT assets that required care and attention. Even though the procurement shifted from owning to leasing, IT infrastructure still looked like and, importantly, was accounted for like roads, bridges, and other traditional capital assets.

In the past decade the landscape shifted yet again, this time to the cloud. And of course, by definition, the cloud

means no physical infrastructure. States and localities now subscribe to cloud-based IT services to, in effect, pay to use someone else’s servers and software. That’s a massive conceptual shift. If there’s no physical asset, is there still a capital asset?

With Statement No. 96, GASB’s answer was “basically, yes.” Today, most states and localities procure their enterprise resource planning (ERP) systems and other essential cloud-based IT capacity through contracts broadly known as subscription-based information technology arrangements (SBITAs). Statement No. 96 calls for governments to account for SBITAs just like they would account for a long-term lease for a building, a fleet vehicle, or any other physical asset. The rationale is simple: paying for access to someone else’s IT infrastructure—often called “right to use” arrangements—is still paying for infrastructure. The hard

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part is putting that concept into practice. In a typical lease, the unpaid portion is a liability, and the portion of the asset the government controls is an asset. With SBITAs, it's tough to know who owns what, and when.

This is not GASB's first foray into the world of substance-less assets. Previous pronouncements like Statements No. 51, Accounting and Financial Reporting for Intangible Assets, and, to a degree, Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, called for more careful attention to intangible assets like IT systems. But Statement No. 96 has struck a different nerve. More than a few finance officers bemoaned that complying with Statement No. 96 meant they had to subscribe to new software to account for IT leases. In other words, they had to get a SBITA to account for their SBITAs. That's a fair concern, and it speaks to some of the often-voiced criticisms about the imbalance between the costs and benefits of new GASB standards.

But in the GASB's defense, it's important to get the accounting for SBITAs right because they're a major spending item for most states and localities. But more important, they're a clear and visible example of the ongoing shift from "hard" public infrastructure to "soft" public infrastructure. The sooner we adapt financial reporting to reflect that shift, the better.

To put that shift in context, consider the following. Spending on "digital" public assets first appeared in the National Income and Product Accounts (NIPA) data—the data used to compute gross domestic product, among other statistics—in about 1988. Since then, it's

hovered around 1.5 percent of the total stock of state and local fixed assets. That's far less than the 60 percent devoted to "basic" infrastructure like highways and water and sewer systems, and the 29 percent for "social" infrastructure like schools and hospitals. That 1.5 percent, however, remained constant at the same time spending has decreased on equipment, conservation, and other types of assets. That suggests digital infrastructure is slowly replacing other types of infrastructure.

That slow shift is about to accelerate. According to the NIPA data, the amounts that states and local governments spent on fixed assets decreased from 2017 through 2022 by about four percent. That seems odd, given the big run up in inflation we experienced during and immediately after the pandemic. But it also makes sense, given how much states and localities now spend on office space, school buildings, and other fixed assets that became much cheaper during the pandemic. But buried deep in that four percent overall decrease is a nugget of a detail: during that time, the prices governments paid for information technology increased by a whopping 70 percent. Of course, much of that spending happens through SBITAs.

If we zoom out a bit, it's also important to consider that data is now vital to most state and local government operations. Transit systems collect and translate enormous amounts of data to transit riders, public safety officials, traffic planners, and others. Smart solid waste management systems use the "Internet of things" (IoT) to track waste containers and verify deliveries. Modern stormwater management systems use tiny remote sensors to monitor the flow

of stormwater through rain gardens, retention ponds, and other "green" infrastructure that preserves capacity in traditional underground storm sewers. County assessors have built sophisticated data analytic models that produce striking improvements in their estimated market values of commercial and residential properties. This mirrors a trend in the broader economy toward intangible capital, and the macroeconomists tell us that roughly 40 percent of the recent gains in labor productivity are due to that shift. As these and other innovations progress, clear thinking about the value of "soft" assets like government data and data analytics will be paramount.

So SBITAs are just the start. In fact, at the top of the GASB's current technical agenda is a proposed standard that would call for more detailed disclosures of intangible assets as a special type of capital asset. That seems a reasonable ask, given that "soft assets" are now a hard truth in public infrastructure. ■



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