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IAS-38

INTANGIBLE ASSETS

DEFINITION - INTANGIBLE ASSETS

An intangible asset is an identifiable, non-monetary asset without physical substance.

Identifiable

An asset is identifiable if it is either:

- is separable (can be exchanged, rented, sold or transferred separately); or
- arises from contractual or other legal rights, either from contract, legislation etc. In this case, the asset does not need to be separable.

Non-monetary asset

- An intangible asset must meet the definition of "Asset" i.e. control over a resource and existence of future economic benefits.
- An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

Without physical substance

Some intangible assets may be contained in or on a physical substance such as a

- ompact disc (in case of computer software),
- legal documentation (in case of a licence or patent) or
- film.

Intangible assets may have secondary physical element. But, the physical element of the asset is secondary to its intangible component, i.e. the knowledge embodied in it.

Examples of intangibles

- Computer software.
- Patent.
- Copyright.
- Customer list.
- License.
- Franchise.
- Marketing right.
- Customer/supplier relationship.

RECOGNITION CRITERIA

An intangible should be recognized if:

- It is probable that future economic benefits attributable to the asset will flow to the entity; and
- The cost of the asset can be measured reliably.

INITIAL MEASUREMENT OF INTANGIBLE ASSETS

The initial measurement of an intangible asset depends on how you acquired the asset. An intangible asset may be acquired in following ways:

- Acquired or Purchased Separately
- Acquired in Exchange of Another Asset
- Acquired by way of Government Grant
- Internally Generated Intangibles (Other than Goodwill)
- Internally Generated Goodwill
- Acquired in Business Combination

(1) INTANGIBLE ASSET ACQUIRED OR PURCHASED SEPARATELY

COST = Purchase Price + Directly Attributable Costs

Purchase Price

Purchase price

- plus import duties & non-refundable taxes,
- after deducting trade discounts & rebates

Deferred Payment

- If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent.
- The difference between the cash price equivalent and the total payment is recognized as interest over the period of credit

Directly Attributable Costs

Examples of directly attributable costs:

- Costs of employee benefits arising directly from bringing the asset to its working condition;
- Professional fees (e.g. legal or consulting fees) arising directly from bringing the asset to its working condition;
- Posts of testing whether the asset is functioning properly.

Examples of costs that are NOT directly attributable costs:

- Costs of introducing a new product/service (including advertising/promotional activities);
- Costs of conducting business in a new location or with a new class of customer (including costs of staff training);
- Administration and other general overhead costs.

Finit Solutions

IAS-38

INTANGIBLE ASSETS

INITIAL MEASUREMENT OF INTANGIBLE ASSETS

(2) INTERNALLY GENERATED INTANGIBLES (OTHER THAN GOODWILL)

In case of internally generated intangible, assess the generation of the asset into:

Research Phase

- Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
- Examples of research activities are:
  - activities aimed at obtaining new knowledge;
  - the search for, evaluation and final selection of, applications of research findings or other knowledge;
  - the search for alternatives for materials, devices, products, processes, systems or services; and
  - the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.
- In the research phase, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, expenditure on research phase is expense out.

Development Phase

- Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.
- Examples of development activities are:
  - Design, construction & testing of pre-production or pre-use prototypes & models;
  - Design of tools, jigs, moulds & dies involving new technology;
  - Design, construction & operation of a pilot plant that is not of a scale economically feasible for commercial production; and
  - Design, construction & testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.
- In development phase, an entity can identify an intangible asset & demonstrate that the asset will generate future economic benefits.
- Therefore, expenditure on development phase is capitalised if it meets the capitalization criteria.
- Otherwise, this expenditure is expensed out.

Past expenses not to be recognised as an asset

Expenditure incurred prior to the criteria being met can not be capitalized retrospectively.

Capitalization Criteria for Expenditure in Development Phase

An intangible asset arising from development shall be recognised if all criteria are met:

a. Technical feasibility of completing the intangible asset

b. Intention to complete the intangible asset and use/sell it.

c. Ability to use/sell the intangible asset.

d. Intangible asset will generate probable future economic benefits.

e. Availability of adequate technical, financial and other resources to complete and to use/sell the intangible asset.

f. Ability to reliably measure the expenditure during the development phase.

Acquired R&D project

- Acquired research and development project (in-process) would be recognized as intangible if the project meets the definition of an intangible asset.

Subsequent Expenditure on acquired R&D

- Research or development expenditure incurred after the acquisition of in-process R&D project acquired separately, shall be accounted for in accordance with IAS 38 rules on research and development expenditure as explained earlier.

INITIAL MEASUREMENT OF INTANGIBLE ASSETS

(3) INTANGIBLE ASSET ACQUIRED IN EXCHANGE OF ANOTHER ASSET

Intangible asset may be acquired in exchange for another asset. The cost of the intangible asset acquired will be:

- Fair value of the asset given up ± Cash paid (received);
- Fair value of the acquired asset, if it is more clearly evident;
- Carrying amount of the asset given up ± Cash paid (received), if:
  - Exchange transaction lacks commercial substance or
  - Fair value of neither the asset received nor the asset given up is reliably measurable.

(4) INTANGIBLE ASSET ACQUIRED BY WAY OF GOVERNMENT GRANT

- An intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. For example, a government may grant;
  - airport landing rights,
  - licences to operate radio or television stations,
  - import licences or quotas or
  - rights to access other restricted resources.
- Both the intangible asset and the grant may be initially recognized at fair value.
- Alternatively, intangible asset may be initially recognized at a nominal amount plus any expenditure that is directly attributable to preparing the asset for its intended use.

(5) INTANGIBLE ASSET ACQUIRED IN BUSINESS COMBINATION

- An intangible asset acquired in a business combination is recognized at its fair value at the acquisition date.
- Such intangible is recognizedseparately from goodwill (even if acquiree had not recognized it).

(6) INTERNALLY GENERATED GOODWILL

- Internally generated brands, mastheads, publishing titles, customer lists and similar items shall not be recognised as intangible assets.
- Expenditure on above items cannot be distinguished from the cost of developing the business as a whole.
- Therefore, such items are not recognised as intangible assets.
- Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (i.e. it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

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IAS-38

INTANGIBLE ASSETS

USEFUL LIFE OF INTANGIBLE ASSETS

Finite Life

- An intangible asset with a finite useful life shall be amortized on a systematic basis over its useful life.
- Residual value of an intangible asset shall be assumed to be zero unless:
  - **a.** there is a commitment by a 3rd party to purchase the asset at the end of useful life; or
  - **b.** there is an active market for the asset and residual value can be determined by reference to that market and it is probable that such a market will exist at the end of the asset's useful life.

Indefinite Life

- Intangible asset with an indefinite useful life is not amortised (rather tested for impairment annually or when there is indication for impairment).
- There must also be annual review of whether the indefinite life assessment is still appropriate, and if no longer indefinite change to finite useful life.
- Intangible assets with indefinite useful life shall be reviewed annually to determine whether useful life continues to be indefinite.
- Change in the useful life from indefinite to finite shall be accounted for as a change in an accounting estimate (IAS 8).
- Change in useful life from indefinite to finite is an indicator of impairment.

Assessment of useful life of intangible assets

- The contractual period and/or renewal options may also impact the assessment of useful life of intangible assets.
- If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.
- In short, amortization should be worked out at lower of:
  - Useful life for which entity expects to use the intangible asset; or
  - Contractual or legal life (plus renewal period if renewal cost is not significant).

Amortization of Intangible Assets (with Finite Life)

- An intangible asset with a finite useful life shall be amortized on a systematic basis over its useful life.
- Amortisation shall begin when the asset is available for use.
- Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (IFRS 5) and the date that the asset is derecognised.
- The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate.
- A variety of amortisation methods can be used;
  - Straight line method,
  - Diminishing balance method;
  - The units of production method.
- Amortisation charge for each period shall be recognised in P/L unless IAS 38 or another Standard permits or requires it to be included in the carrying amount of another asset.
- The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end.

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IAS-38

INTANGIBLE ASSETS

SUBSEQUENT MEASUREMENT OF INTANGIBLE ASSETS

An entity shall choose either the cost model or the revaluation model as its accounting policy:

REVALUATION MODEL

Fair value	xxxx
Less. Accumulated Amortization	(xxxx)
Less. Accumulated Impairment	(xxxx)
Carrying Amount	**xxxx**

Revaluation of Intangible Asset

Historical Cost

- **Revaluation Surplus – OCI**
- **Revaluation Gain / (Loss) – P/L**

COST MODEL

Fair value	xxxx
Less. Accumulated Amortization	(xxxx)
Less. Accumulated Impairment	(xxxx)
Carrying Amount	**xxxx**

Lower of:
- Historical Cost; or
- Recoverable Amount

Historical Cost

Carrying Amount of an asset (After amortization) as if it had never been revalued / impaired.

Recoverable Amount

Higher of : (i) Value in Use; or
(ii) Fair Value less Cost to sell

Revaluation Model for Intangible Assets

- For revaluation under IAS 38, fair value shall be measured by reference to an active market.
- If an intangible is carried under revaluation model, all other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.
- An active market is a market in which transactions for the asset or liability take place with sufficient frequency & volume to provide pricing information on an ongoing basis.
- If an intangible in a class of revalued intangibles, cannot be revalued because there is no active market for this asset, the asset shall be carried at cost model.
- Revaluations shall be made with such regularity that the carrying amount of the asset does not differ materially from its FV.
- Frequency of revaluations depends on the volatility of the FV of the intangible assets.

Measurement under Revaluation Model

- The revaluation model does not allow revaluation of intangible that have not previously been recognised as assets e.g. internally generated brand.
- The revaluation model is applied after an asset has been initially recognised at cost.
- Also, revaluation model may be applied to an asset that was received by way of a government grant and recognised at a nominal amount.

Active market valuation

- It is uncommon for an active market to exist for an intangible, but this may happen.
- An active market may exist for freely transferable taxi licences, fishing licences or production quotas.
- However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because such asset is unique.
- If FV of a revalued intangible can no longer be measured by reference to an active market, the CA of the asset shall be its revalued amount at the date of the last revaluation less any subsequent acc. amortisation & impairment losses.
- If an active market no longer exists for an intangible, it is an indicator of impairment.
- If FV of intangible is measured by reference to an active market at a subsequent date, the revaluation model is applied from that date.