



IFRS Training

IAS 38 – Intangible Assets

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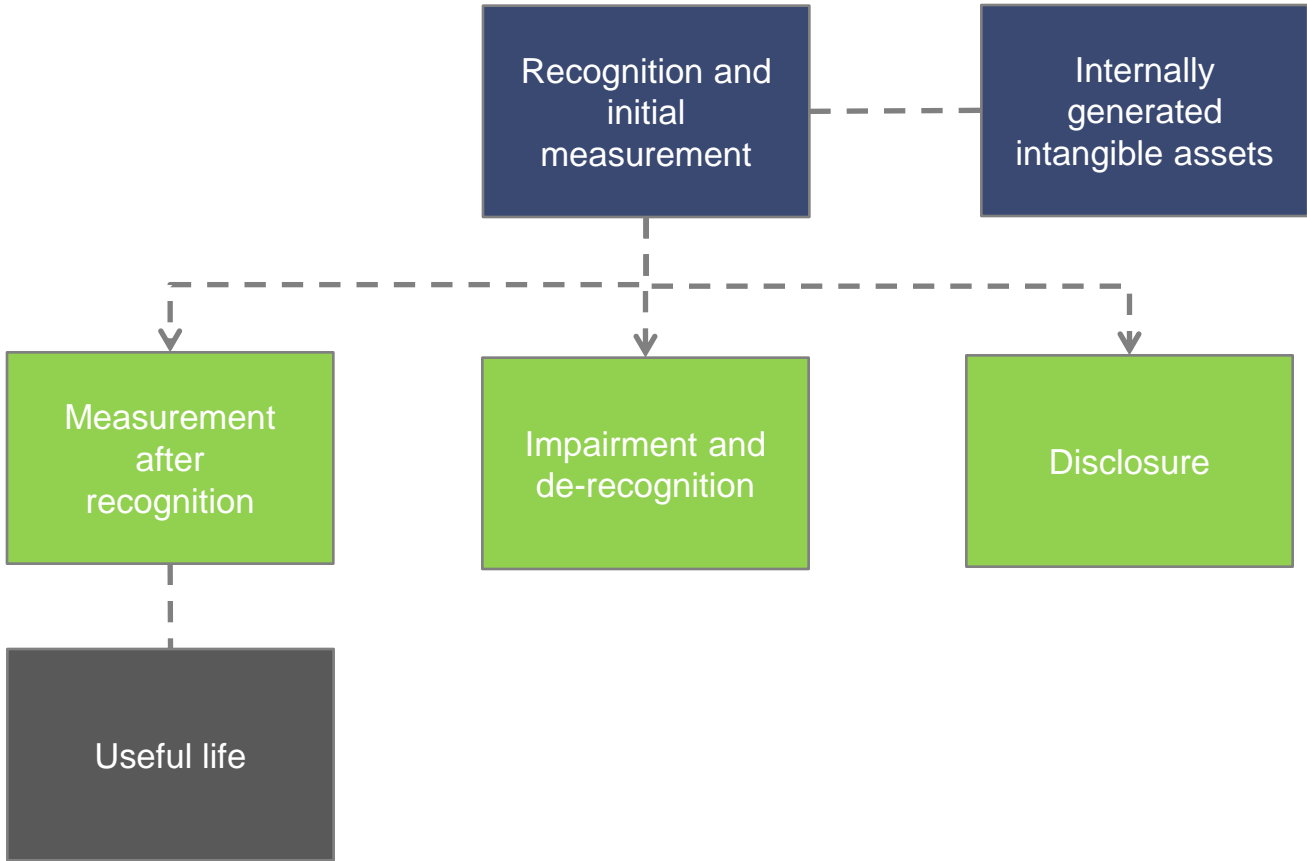
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Section 1

Overview







Section 2

Introduction to Intangible Assets



- ✓ Intangible assets applies to all intangible except:
 - ❑ Those covered specifically by other standards (IAS 2, IAS 11, IAS 12, IAS 19, IAS 32, IAS 39, IFRS 3, IFRS 4, IFRS 5 and IFRS 6)
 - ❑ Expenditure on the development and extraction of minerals, etc

- ✓ Intangible assets are identifiable non-monetary assets without physical substance
- ✓ Some intangibles may be contained in or on a physical medium (such as software on a floppy disk or embedded within the hardware). Judgment has to be used to determine which element is more significant, i.e. the intangible or the tangible asset

An asset is a resource

Controlled by an entity as a result of past events

From which future economic benefits are expected to flow to the entity

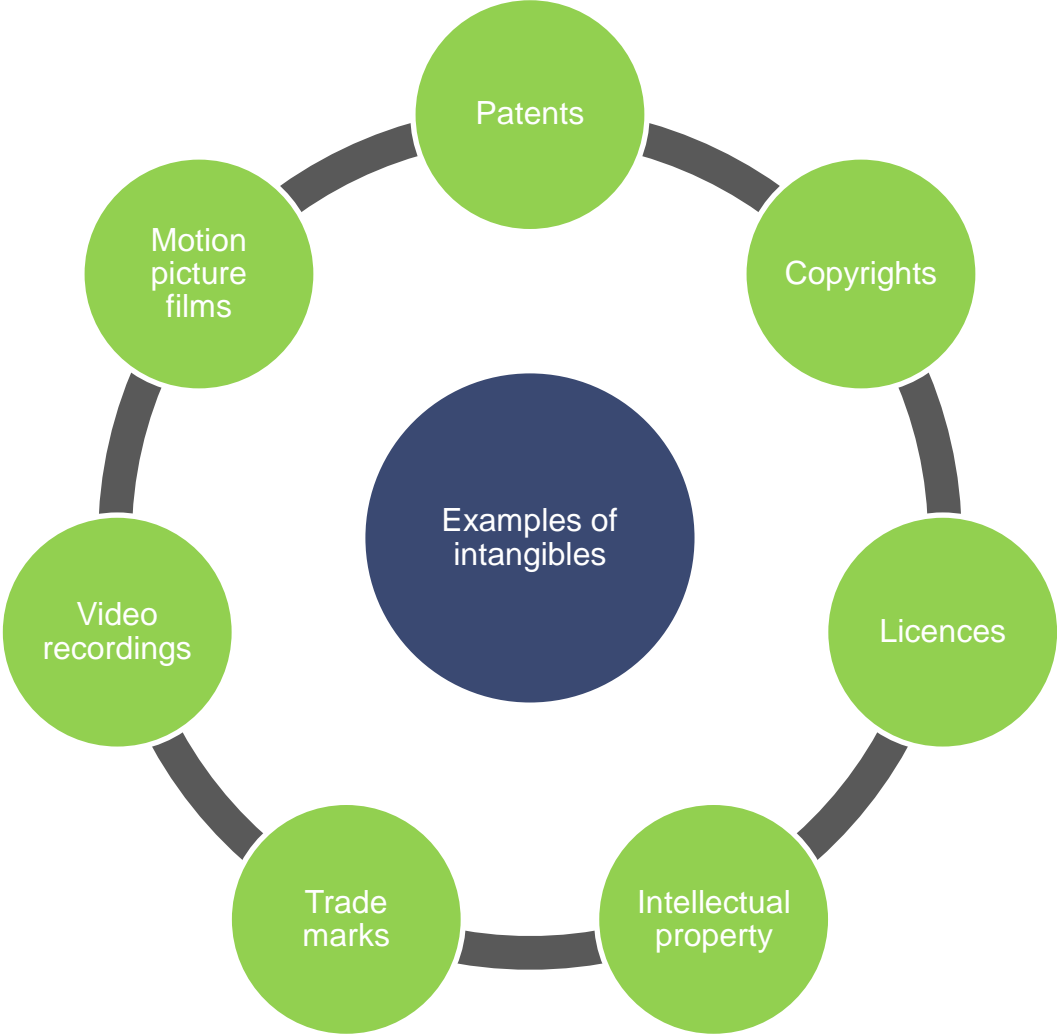


Illustration 1

Classify each of the following assets as either tangible or intangible:

- (1) Operating system of a personal computer
- (2) Off-the-shelf integrated publishing software package
- (3) Specialized software embedded in computer controlled machine tools
- (4) A firewall controlling access to restricted sections of an Internet website

Illustration 1 (Continued)

- (1) Tangible: the operating system (ex. DOS or Windows) of a personal computer is an integral part of the related hardware and should be accounted for under IAS 16
- (2) Intangible: such computer software (ex. QuarkXpress) is not an integral part of the hardware on which it is used
- (3) Tangible: specialized software integrated into production line "robots" is similar in nature to (1)
- (4) Intangible: companies developing "firewall" software to protect their own websites may also sell the technology to other companies

Definition Criteria – Identifiability

An intangible asset, whether generated internally or acquired in a business combination, is identifiable when it:

1. Is separable

So it is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability

or

2. Arises from contractual or other legal rights

These rights are regardless of whether they are transferable or separate from the entity or from other rights and obligations
Intangible assets v/s goodwill acquired in a business combination

| Control means | |
|---------------------------------------------------------------------------|----------------------------------------------------------------|
| The power to obtain future economic benefits from the underlying resource | The ability to restrict the access of others to those benefits |

- ✓ Control normally stems from a legal right that is enforceable in a court of law. However, legal enforceability is not a prerequisite for control as future economic benefits can be controlled in some other way
- ✓ Expenditure incurred in obtaining market and technical knowledge, increasing staff skills and building customer loyalty may be expected to generate future economic benefits. However, control over the actions of employees and customers is unlikely to be sufficient to meet the definition criterion especially where there are non-contractual rights
- ✓ Non-compete or restraint of trade clause with employees for protection

Definition Criteria – Future Economic



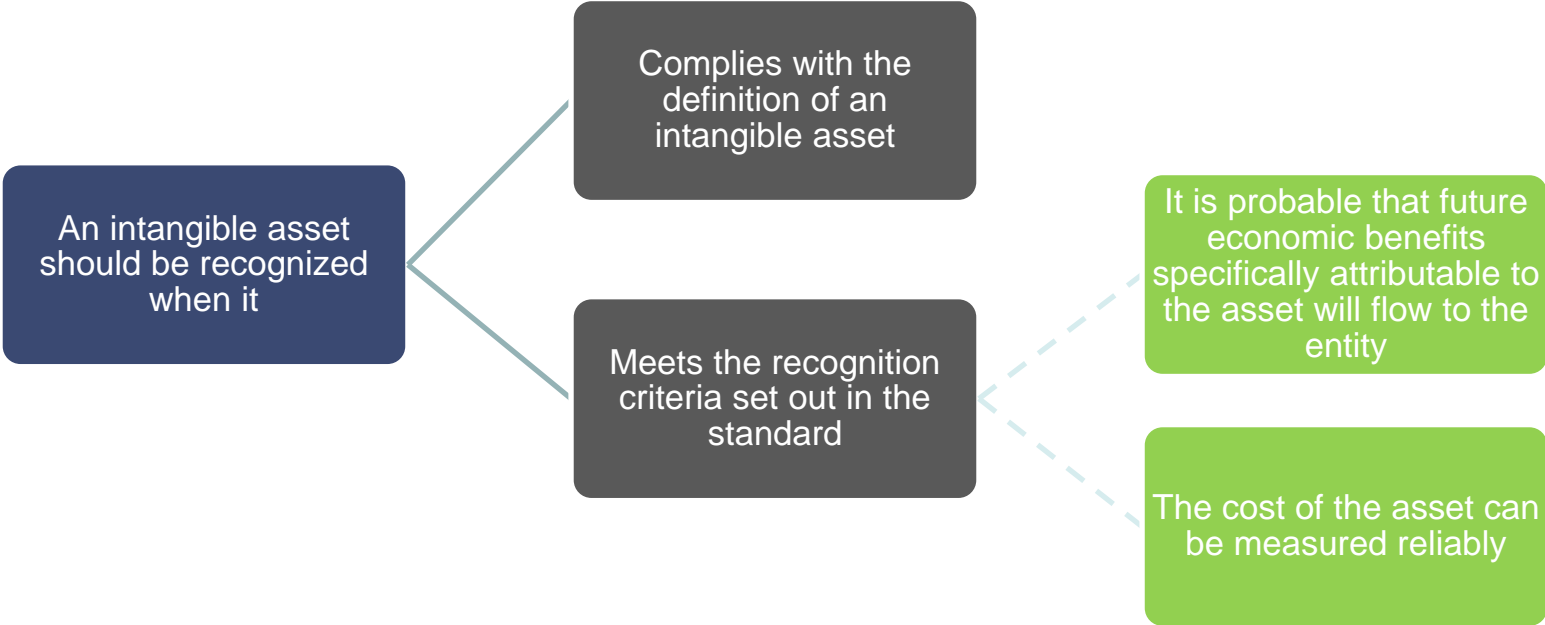
- ✓ These are net cash inflows and may include increased revenues and/or cost savings
- The use of intellectual property in a production process may reduce future production costs rather than increase future revenues



Section 3

Recognition and Initial Measurement





- ✓ Further, the probability of future economic benefits must be assessed using reasonable and supportable assumptions, with greater weight being given to external evidence

Goodwill Versus Other Intangible Assets



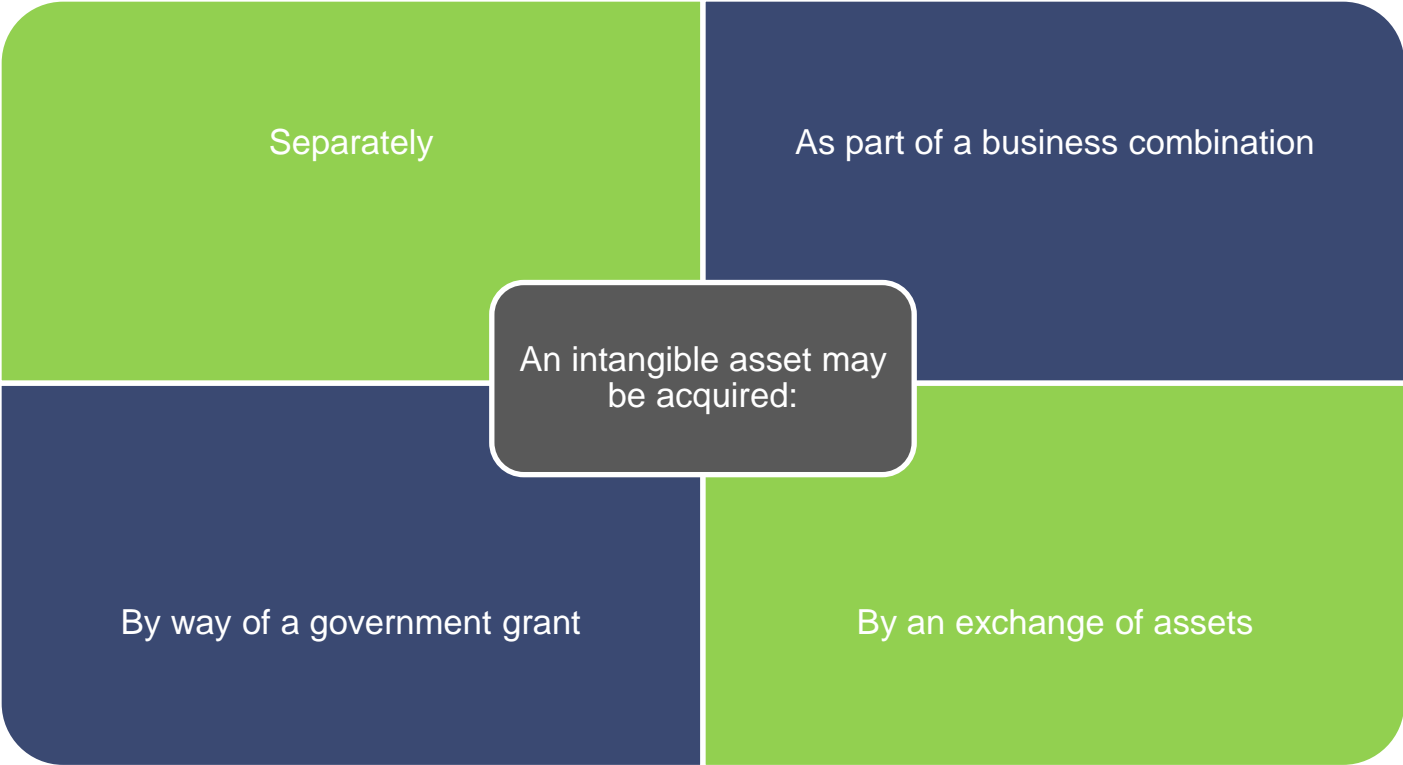
- ✓ Goodwill, as a general term, describes such things as brand name, reputation, competitive advantage and high employee morale which bring value to a business. It contributes to the generation of revenue
- ✓ It is generated over many years with expenditure on promotion, the creation and maintenance of good customer and supplier relations, the provision of high quality goods and services, skilled workforce and experienced management
- ✓ It includes the worth of a corporate identity and is enhanced by such things as corporate image and location. In well established businesses this worth may be well in excess of that of its physical assets
- ✓ When acquiring a business goodwill is commonly valued using and earnings multiple

Definition Criteria – Identifiability

- ✓ An intangible asset, whether generated internally or acquired in a business combination, is identifiable when it:
 - ❑ Is separable
 - ❑ Arises from contractual or other legal rights
- ✓ Separable so it is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability
- ✓ These rights are regardless of whether they are transferable or separable from the entity or from other rights and obligations
- ✓ These criteria distinguish intangible assets from goodwill acquired in a business combination

Definition Criteria – Identifiability

✓ Intangible assets should be measured initially at cost:



- ✓ The cost of an intangible asset can usually be measured reliably when it has been separately acquired
- ✓ Cost is determined according to the same principles applied in accounting for other assets:
 - ❑ Purchase price + import duties + non-refundable purchase tax
 - ❑ Deferred payments are included at the cash price equivalent and the difference between this amount and the payments made are treated as interest
- ✓ However, expenditure that would not be classified as cost include those associated with:



Illustration 2

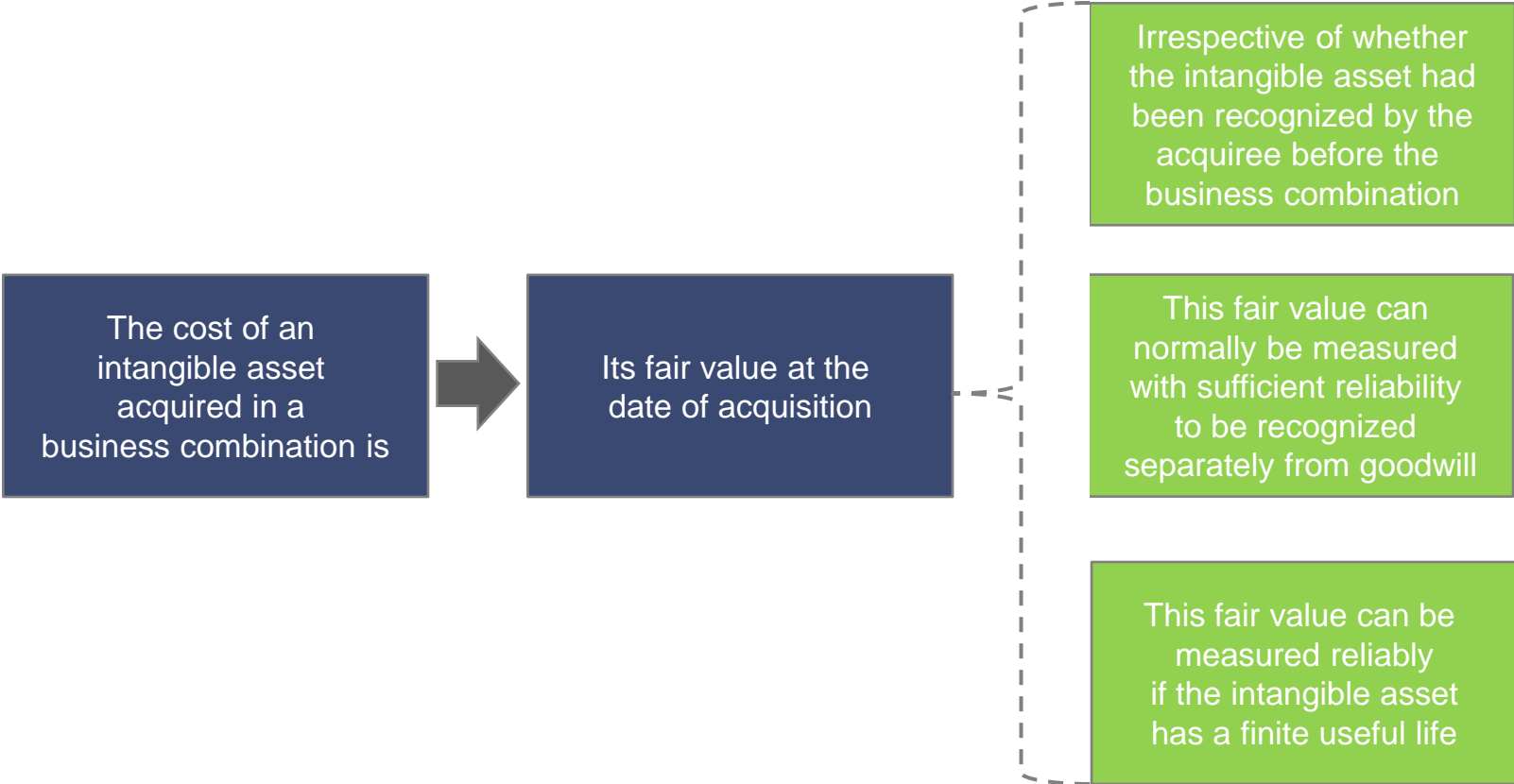
On 31 December ABC was successful in a bid to acquire the exclusive rights to a patent developed by another entity. The amount payable for the rights was US\$600,000 immediately and US\$400,000 in one year's time. ABC incurred US\$87,000 legal fees in respect of the bid. Kirk operates in a country where the government levies a flat rate fee (a stamp duty) of US\$1,000 for the registration of patent rights. Kirk's cost of capital is 10%

Required

Calculate the cost of the patent rights on initial recognition

Illustration 2 (Continued)

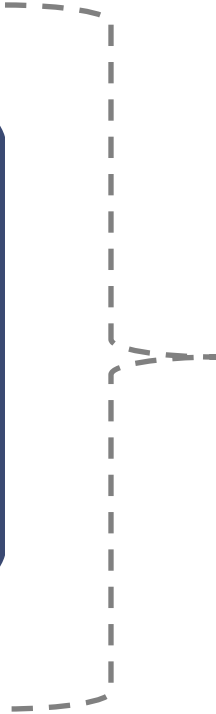
| | US\$ |
|-----------------------------------------------------|------------------|
| Cash paid | 600,000 |
| Deferred consideration ($\$400,000 \times 1/1.1$) | 363,636 |
| Legal fees | 87,000 |
| Stamp duty | 1,000 |
| Cost on initial recognition | 1,051,636 |



Business Combination (Continued)

Fair value at date of acquisition

- Current bid price in an active market (where one exists)
- Price of the most recent or similar transaction for similar assets
- Multiples applied to relevant indicators such as earnings
- Discounted future net cash flows



Using a weighted probability where there is a range of possible outcomes demonstrates uncertainty rather than inability to measure fair value reliably

Business Combination (Continued)



- ✓ An intangible asset acquired in a business combination may meet the recognition criteria only if it is considered to be part of a related tangible or intangible asset
- ✓ Such a group of assets is recognized as a single asset separately from goodwill if the individual fair values of the assets within the group are not reliably measured

Illustration 3

On 31 December Picard paid US\$10,000,000 for a 100% interest in Borg. At that date Borg's net assets had a fair value of US\$6,000,000. In addition Borg also held the following rights:

Brand name – Assimilation – valued at US\$300,000 by Brand International, a reputable firm of valuation specialists, using a discounted cash flow technique

Sole distribution rights to a product – Lacutus. Future cash flows from which are estimated to be US\$250,000 per annum for the next 6 years. 10% is considered an appropriate discount rate

The 6 year, 10% annuity factor is 4.36

Required

Calculate goodwill arising on acquisition

Illustration 3 (Continued)

| | US\$'000 |
|--------------------------------------|--------------|
| Cost | 10,000 |
| Net assets | (6,000) |
| Brand acquired | (300) |
| Distribution rights (250,000 x 4.36) | (1,090) |
| Goodwill on acquisition | 2,610 |

Some intangible assets may be acquired free of charge, or for nominal consideration, by way of a government grant

- Airport handling rights
- License to operate radio or television stations
- Import quotas
- Rights to emit pollution

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, both

- Intangible asset (debit)
- Grant (credit)
- May be recorded at either fair value or cost (which may be zero)

The cost of an intangible asset acquired in exchange for a non-monetary asset is measured at fair value unless:

The fair value of neither the asset received nor the asset given up is reliably measured

The exchange transaction lacks commercial substance

Intangible assets

In most cases, there are no additions to an intangible asset, nor the replacement of parts of such assets

Most subsequent expenditures maintain the expected future economic benefits embodied in an existing intangible asset and do not meet the definition of an intangible asset and the accounting standards recognition criteria

It is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to a business as a whole

Subsequent Expenditure (Continued)

Acquired in-process research and development

Research expenditure

- Expense when incurred

Development expenditure that does not satisfy the recognition criteria

- Expense when incurred

Development expenditure that satisfies the recognition criteria

- Add to carrying amount of
the acquired in-process
research or development
project



Section 4

Internally Generated Intangible Assets



Internally generated goodwill:

Generally should not be recognized as asset

Is not an identifiable resource controlled by the entity

Cannot be measured reliably at cost

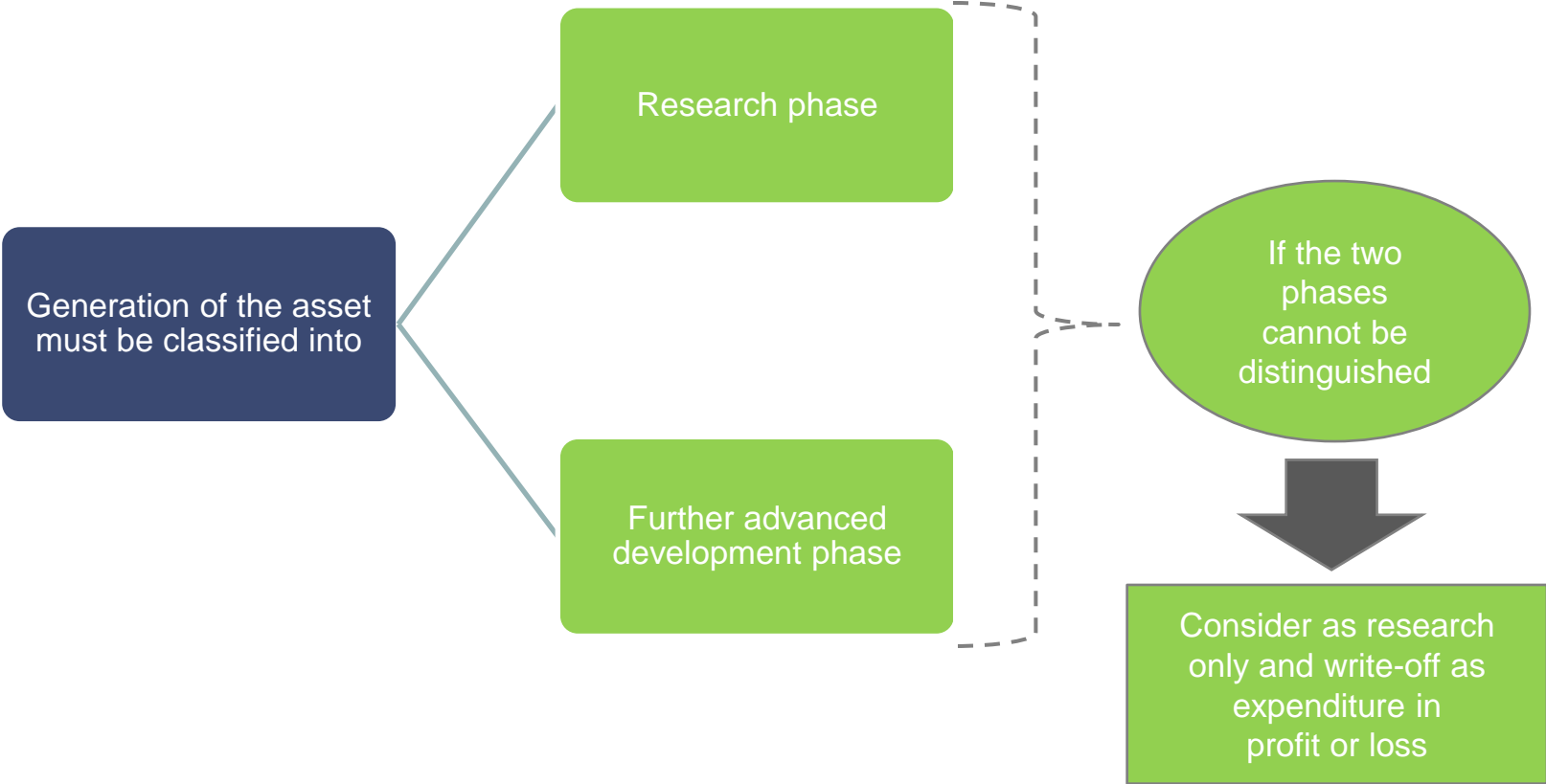
Other internally generated assets:

Often difficult to identify whether there is an identifiable asset that will generate probable future economic benefits

Often difficult to determine the cost of the asset reliably

Internally generated brands, publishing titles, customer lists and items similar in substance are not recognized as intangible assets as they cannot be distinguished from the cost of developing the business as a whole

Specific Recognition Criteria



An entity cannot demonstrate that an intangible exists that will generate probable future economic benefits

Expenditure on research should be recognized as an expense when it is incurred

Examples of research activities:

Activities aimed at obtaining new knowledge

Search for, evaluation and final selection of, applications of research findings or other knowledge

Search for alternatives for materials, devices, products, processes, systems or services

Formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or devices

An intangible asset should be recognized **if, and only if**, an entity can demonstrate **all** of the following

Technical feasibility of completing the intangible asset

The intention to complete, use or sell the intangible asset

The ability to use or sell the intangible asset

How the intangible asset will generate probable future economic benefits

The availability of resources to complete, use or sell the intangible asset

The ability to measure the expenditure attributable to the intangible asset reliably

Accounting in the Development Phase (Continued)

Examples of development activities:

Design, construction and testing of pre-production or pre-use prototypes and models

Design of tools, jigs, moulds, and dies involving new technology

Design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production

Design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services

Expenditure on an intangible item that was recognized as an expense (research) should not be recognized as part of the cost of an intangible asset at a later date (after the development phase has commenced)

Research and Development Acquired as Part of a Business Combination

An in-process R&D project acquired as part of a business combination should be recognized separately from goodwill if

The project meets the definition of an intangible asset

It is identifiable (i.e. is separate or arises from contractual or other legal rights)



Expenditures recognized as expense when incurred unless:

- It forms part of the cost that meets the recognition criteria
- The item is acquired in a business combination and cannot be recognized as an intangible asset

The cost of internally generated intangible asset comprises all directly attributable costs necessary to

- Create
- Produce
- Prepare the asset to be operational as intended

Recognition of Expenses and Costs (Continued)

Examples:

- Costs of materials and services used
- Salaries, wages and other employment related costs
- Fees to register a legal right

Costs that are not components of the cost of an internally generated intangible asset

- Selling, administration and other general overhead costs
- Identified inefficiencies and initial operating losses incurred before the asset achieves planned performance
- Costs that have previously been expensed (during research phase) must not be reinstated
- Training expenditure

Recognition of Expenses and Costs (Continued)

Expenditures incurred

No intangible asset can
be recognized

Expense when incurred

Examples

- Research costs
- Pre-opening costs for a new facility
- Plant start-up costs incurred prior to full scale production (unless capitalized under IAS 16)
- Legal and secretarial costs incurred in setting up a legal entity
- Training costs involved in running a business or a product line
- Advertising and related costs

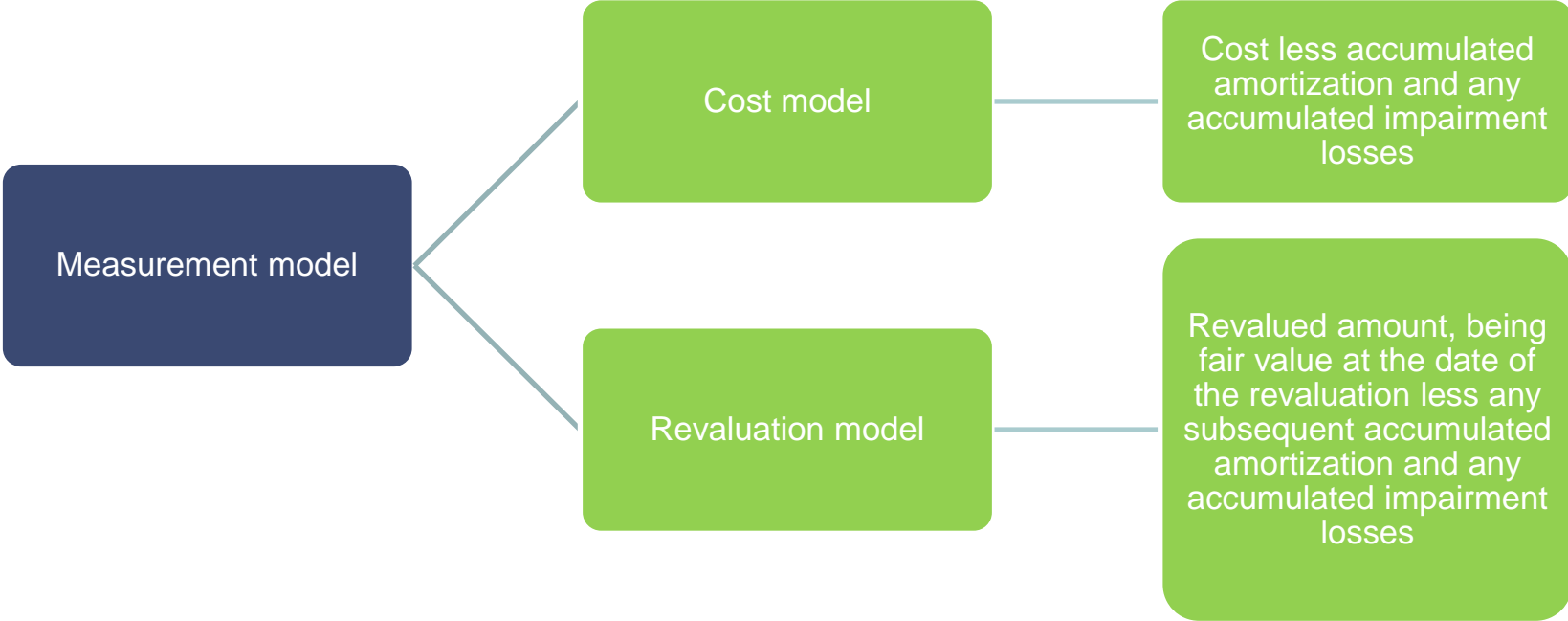
Except when they form
part of the cost of a
business combination



Section 5

Measurement after Recognition





Revaluation model

Revalued amount, being fair value at the date of the revaluation less any subsequent accumulated amortization and any accumulated impairment losses

Fair value must be determined by reference to an active market

Revaluations must be sufficiently regular that carrying amount is not materially different from fair value

The revaluation model does not allow:

- The revaluation of intangible assets that have not previously been recognized as assets
- The initial recognition of intangible assets at amounts other than their costs

The revaluation is carried out according to the same principles applied in accounting for other assets. For example, any surplus is recognized in other comprehensive income and accumulated in equity and all intangible assets in the class must be revalued

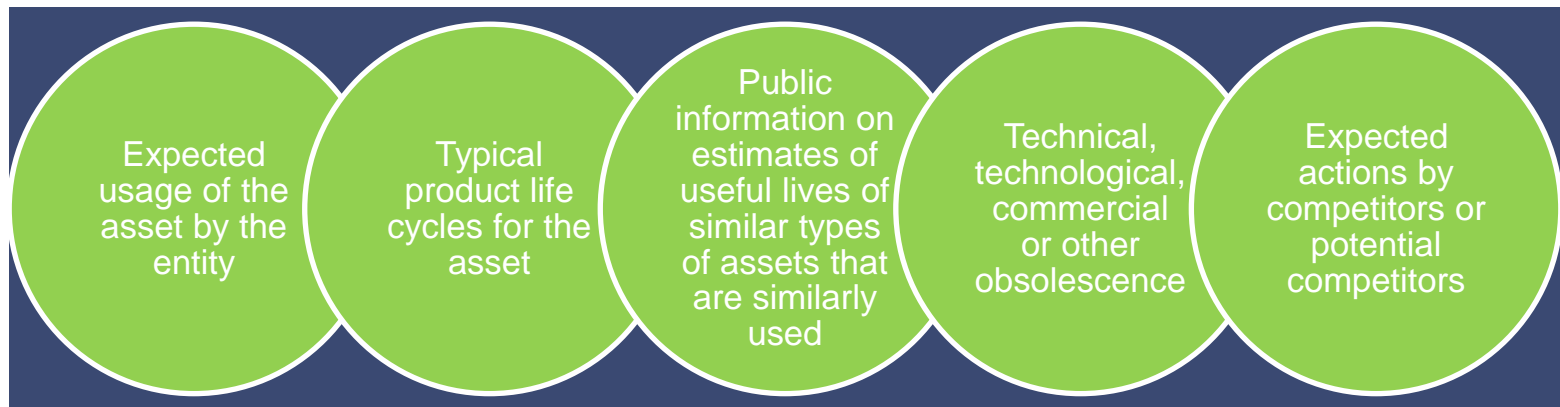


Section 6

Useful Life



- ✓ The useful life of an intangible asset should be assessed as finite or indefinite (indefinite does not mean infinite)
- ✓ Useful life is regarded as indefinite when there is no foreseeable limit to the period over which an asset is expected to generate net cash inflows
- ✓ An intangible asset with an indefinite life is not amortized
- ✓ Factors to be considered in determining useful life include:



- ✓ Contractual or other legal rights
 - ❑ The useful life of an intangible asset arising from contractual or other legal rights should not exceed the period of such rights, but may be shorter

- ✓ Amortization
 - ❑ The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life
 - ❑ Amortization begins when the asset is available for use
 - ❑ Amortization ceases at the earlier of the date that the asset is classified as held for sale or derecognized
 - ❑ The amortization method should reflect the pattern in which an asset's economic benefits are consumed by the entity (ex. unit of production method). If that pattern cannot be determined reliably, the straight-line method should be adopted

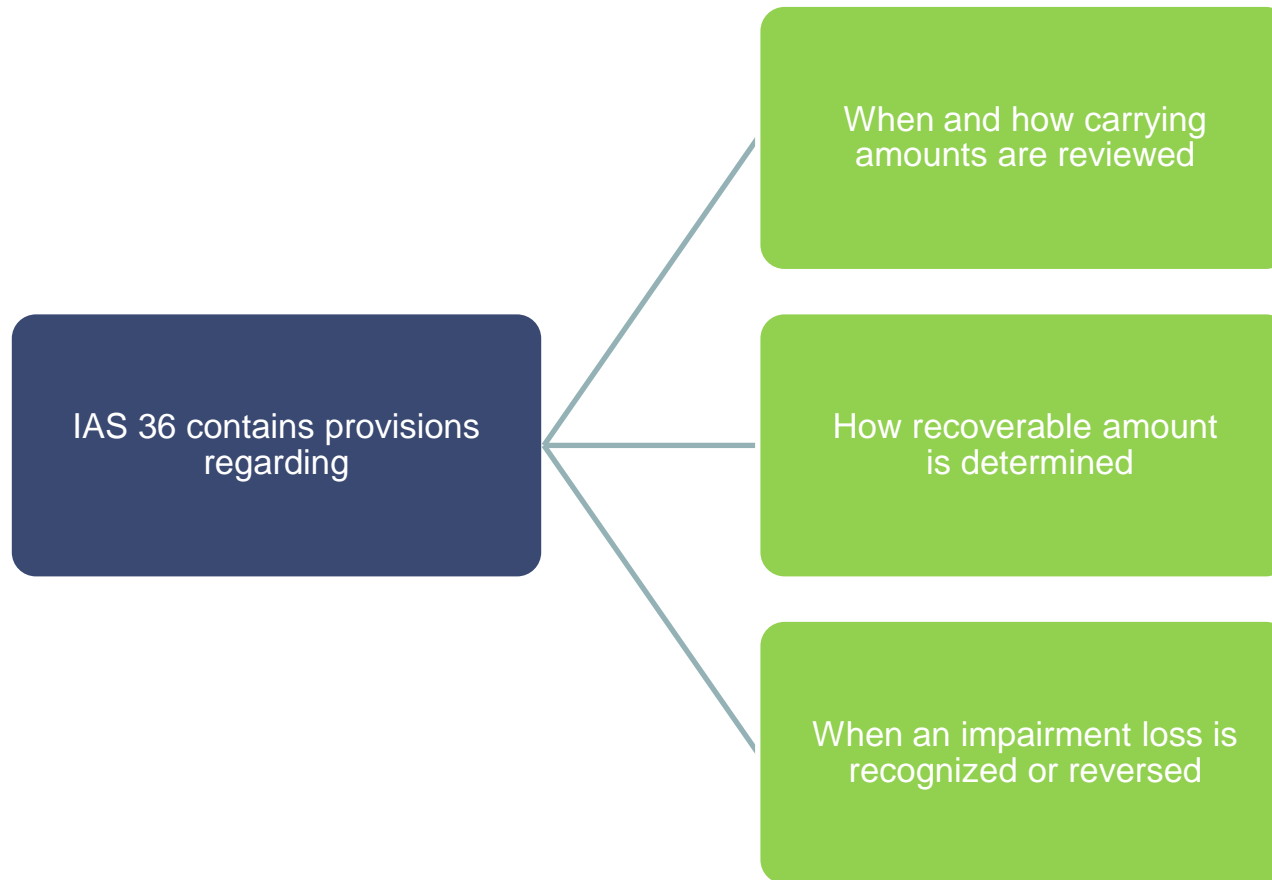
- ✓ Residual value
 - ❑ The residual value of an intangible asset is assumed to be zero unless there is a commitment to purchase by a third party and there is an active market for that particular asset
- ✓ An intangible asset with an indefinite useful life is:
 - ❑ Not amortized
 - ❑ Tested for impairment annually and whenever there is an indication of impairment
- ✓ Reassessing a useful life as finite rather than indefinite is an indicator that the asset may be impaired
- ✓ The useful life is reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment
- ✓ If not, the change in accounting estimate is accounted for in accordance with related accounting standards



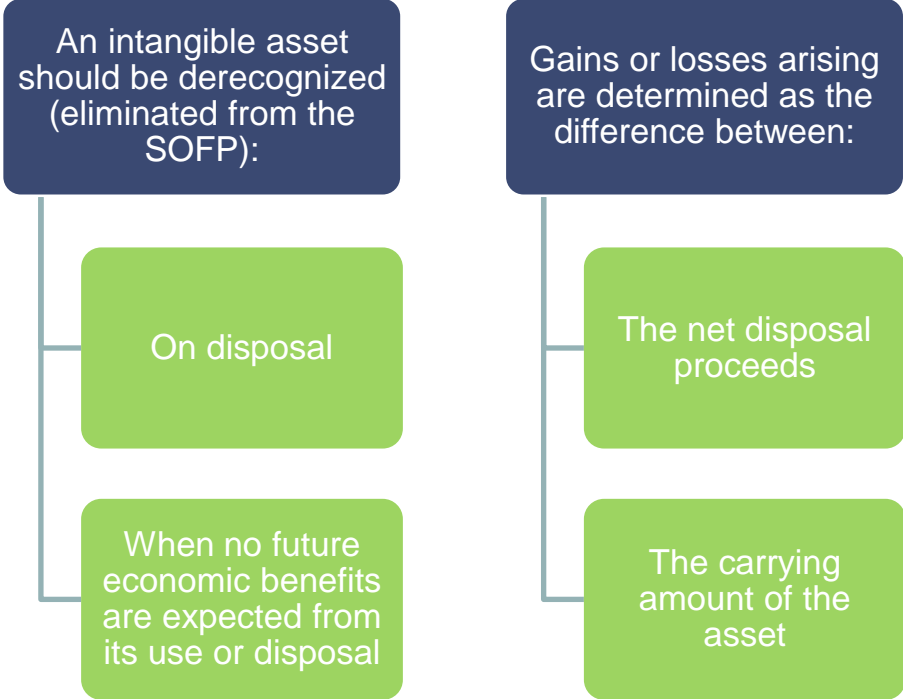
Section 7

Impairment and De-recognition





Retirements and Disposals



Gains or losses are recognized as income or expense in the period in which the retirement or disposal occurs. Gains are not classified as revenue