IAS 38	Intangible Assets

BASIC CONCEPTS

Intangible asset	An intangible asset is an identifiable non-monetary asset without physical substance. ***Identifiable*** means separable (can be rented or sold separately) or arising from legal rights. ***Monetary assets*** are money held and assets to be received in fixed or determinable amounts of money.
Active market	An ***active market*** is a market in which all the following conditions exist: (a) the items traded in the market are homogeneous; (b) willing buyers and sellers can normally be found at any time; and (c) prices are available to the public. In practice, such markets for intangible assets are rare.
Control	An important element of definition of any asset is 'control'. For an intangible asset, an entity must be able to enjoy the future economic benefits from the asset, and prevent the access of others to those benefits. A legally enforceable right is evidence of such control, but is not always a necessary condition. ▪ Control over **technical knowledge or know-how** only exists if it is protected by a legal right. ▪ The skill of employees, arising out of the benefits of **training costs**, are most likely not to be recognizable as an intangible asset, because an entity does not control the future actions of its staff. ▪ **Market share and customer loyalty** cannot normally be intangible assets, since an entity cannot control the action of its customers.
Examples	The following may be intangible assets of an entity: ▪ Licenses ▪ Quotas ▪ Intellectual property e.g. patents, copyrights, etc. ▪ Customer lists ▪ Trademarks ▪ Brands ▪ Mastheads / Publishing titles ▪ Licensed software
Internally generated items	The following internally generated items can never be recognised under IAS 38 because the cost of developing these items cannot be distinguished from other costs: ▪ Goodwill (purchased goodwill may be recognised) ▪ Brands ▪ Mastheads /publishing titles ▪ Customer lists

INITIAL MEASUREMENT

Type of intangible	Initial recognition: cost	Reason	Example
Separately acquired	Purchase cost + attributable costs	Expected benefits will flow and cost can also be measured.	Patent or brand purchased
Acquired in business combination	Fair value at acquisition date	Expected benefits will flow and cost can also be measured.	License acquired as part of running businesses
Acquired as government grant	Fair value or nominal value + expenses incurred	Expected benefits will flow and cost can also be measured.	Airport landing rights, license to operate TV station.
Exchange of asset	Fair value (or carrying amount of asset given up)	Expected benefits will flow and cost can also be measured.	Software bought in exchange of machine.
Internally generated goodwill, brand etc.	Not recognised as an asset	Costs cannot be measured.	18 years old business has goodwill, but we cannot measure value

RESEARCH AND DEVELOPMENT

RESEARCH	
Definition	is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
Treatment	No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

DEVELOPMENT	
Definition	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.
Treatment	An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following: (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale. (b) its intention to complete the intangible asset and use or sell it. (c) its ability to use or sell the intangible asset. (d) how the intangible asset will generate probable future economic benefits. (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset. (f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.
Amortisation	Development expenditure should be amortised over its useful life as soon as commercial production begins.

EXAMPLE 38A

An entity has incurred the following expenditure during the current year:

(a) $100,000 spent on the design of a new product it is anticipated that this design will be taken forward over the next two year period to be developed and tested with a view to production in three years time.

(b) $500,000 spent on the testing of a new production system which has been designed internally and which will be in operation during the following accounting year. This new system should reduce the costs of production by 20%.

Required:
How should each of these costs be treated in the financial statements of the entity?

EXAMPLE 38B

James has capitalised development expenditure of $600,000 relating to the development of New Miracle Brand X. It is expected that the demand for the product will stay at a high level for the next three years. Annual sales of 400,000, 300,000 and 200,000 units respectively are expected over this period. Brand X sells for $10.

Required:
How should the development expenditure be amortised?

SUBSEQUENT MEASUREMENT

IAS 38 allows choice of accounting treatment:	
Cost model	**Cost less accumulated depreciation** [same as IAS 16]
Revaluation model	**Revalued amount less subsequent accumulated depreciation.** [same as IAS 16 with one exception] The exception is that the revaluation model can only be applied if intangible asset's fair value can be determined using active market value.

AMORTISATION & IMPAIRMENT

The intangible assets are categorized as follows:	
Definite useful life	These are amortised in the same manner as tangible assets are depreciated (usually using straight line method).
Indefinite useful life	These are not amortised. Instead, these intangible assets are tested for impairment annually (see IAS 36).

HOW GOODWILL IS DIFFERENT?

Definition	Goodwill is created by good relationships between a business and its customers.
Internally generated goodwill	This is not recognised as an asset because its cost cannot be distinguished from other costs incurred in business. (IAS 38)
Purchased goodwill	This can be recognised because it has been paid for (and this is its cost). This is shown in SFP as intangible non-current asset. (IFRS 3 applies to purchased goodwill)
Value of purchased goodwill	This is calculated as follows: = Fair value of purchase consideration of business – fair value of net assets acquired
Different from other intangible assets?	The goodwill is different from other intangible assets. The goodwill is not separable. It is always linked with whole business. It cannot be separately sold or rented out.

SOFTWARE / HARDWARE & WEBSITES

Purchased Computer Software	Capitalise if it meets the definition of intangible asset (control)
Operating system for hardware	Include in hardware cost
Internally developed Computer software	Charge as expense unless development criteria is met in which case, these are capitalised.
Internal website	Cost incurred on development of internal website should be charged off because the benefits (if any) cannot be estimated reliably.
External website	Cost incurred on development of external website including the cost of linking it to credit card facilities should be capitalized because it can be established that external revenue is generated directly with the use of such website through external orders. If development of external website cannot generate revenues, this should not be capitalised.

ANSWER 38A

(a) These are research costs as they are only in the early design stage and therefore should be written off as part of profit and loss for the period.

(b) These would appear to be development stage costs as the new production system is due to be in place fairly soon and will produce economic benefits in the shape of reduced costs. Therefore these should be capitalised as development costs.

ANSWER 38B

There are two possibilities for amortisation:

- Amortise the development costs on straight line basis over three years
  i.e. $600,000 / 3 years = $200,000 per annum
- Amortise in relation to total sales expected:
  Year 1: (400,000 / 900,000 units) x $600,000 = $266,667
  Year 2: (300,000 / 900,000 units) x $600,000 = $200,000
  Year 3: (200,000 / 900,000 units) x $600,000 = $133,333

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