Financial Accounting

Intangible Assets

Disclaimer

The online video lectures and related study material (consisting of Powerpoint slides, summary modules, integrated question banks and other academic material) are based on the views and/or opinions of the relevant presenter(s) and preparer(s) thereof and do not necessarily constitute official views and/or opinions of *The WOW Academy (Pty) Ltd* or any of its alliance partners. Neither the WOW Academy (Pty) Ltd, its directors, employees, agents, nor any of its alliance partners, shall be held liable to anyone in respect of any reliance placed on any information so received. Should you require an official opinion or view on a specific matter, please contact *The WOW Academy (Pty) Ltd* directly and we will gladly assist you further, after having obtained a thorough understanding of the specific scope of the engagement and your specific facts and circumstances.

© Copyright notice

CHAPTER 1
Overview of / introduction to IAS 38 and considerations relating to its scope

Intangible assets

- The **most challenging** assets to prove
- Very important link to the **Framework**
- No Standard on “**expenses**”
  - Last “port of call” for capitalisation
  - Other assets easier to identify
- A lot of **valuable guidance** on assets in general
- Detailed **“loose-standing” rules** in IAS 38

Overview of the Standard

- Identification: Definitions (.08) → **IFRS 3 *Business combinations***
- Recognition and **measurement** (.18)
  - **Separate acquisition (easy)**
  - **Acquisition as part of a business combination** — **(NB) probability criterion assumed to be met**
  - **Acquisition by way of a government grant**
  - **Exchanges of assets**
  - **Internally-generated goodwill**
  - **Internally-generated intangible assets (R&D)** — **probability a very important issue to consider**
- Recognition of an expense (.68) – an important rule i.r.o. past expenses!
- Subsequent measurement (.72)
  - Cost model
  - Revaluation model – the need for an active market
- Useful life (.88) – NB: See illustrative examples 1 – 9 in Appendix to IAS
- Intangible assets with finite useful lives (.97)
- Intangible assets with indefinite useful lives (.107)
- Recoverability of the carrying amount – impairment losses (.111)
- Retirements and disposals (.112)
- Disclosure (.118)

Approach i.r.o. intangible assets – what to look out for in questions

- **Identification and recognition**
  1. Decide whether the element is part of the scope exclusions of the Standard
  2. Decide whether the item meets the definition of an asset in terms of the framework
  3. Decide whether the asset can be classified as an intangible asset by applying the definition in terms of IAS 38 (focus on the main components)
  4. Decide whether the intangible asset complies with the recognition criteria of the framework taking into account that probability of FEB and reliable measurement could be assumed to be met for certain intangible assets in terms of IAS 38 (read .25, .26, .33, .35)
  5. Decide how the intangible asset is obtained (one of six ways) and apply rules for that way
  6. Always consider I/A's that may NOT be recognised (read .20, .29, .30 to .32, .48, .63, .67 to .69, .71)

Approach i.r.o. intangible assets – what to look out for in questions

- **Measurement**
  1. Initial measurement: Cost or fair value + SOF issues (hidden/deferred pmt terms (.32))
  2. Subsequent measurement:
     - Determine accounting policy of company (remember consistency in valuation methods!) = cost model or revaluation model with reference to **active market**
     - Consider amortisation by considering useful life very carefully (big issue) (Appendix!)
       - Finite useful life: amortise over useful life, impairment when indicator
       - Indefinite useful life: no amortisation, test annually for impairment <u>and</u> when indicator
     - Impairment loss = carrying amount less recoverable amount (*) (* = as per IAS 36)
     - Carefully split between research and development with internally-generated I/A's
- **Presentation and disclosure**

Intangible assets NOT covered by IAS 38 (scope exclusions)

Intangible asset:	Covered by:
1. Held in ordinary course of business	IAS 2 & 11 (C/C)
2. Deferred tax assets	IAS 12
3. Leases within scope of IAS 17 (*)	IAS 17
4. Employee benefit assets	IAS 19
5. Financial assets and investments	IAS 39/27/28/31
6. Goodwill acquired in a B/Combination	IFRS 3
7. Assets arising from insurance contracts	IFRS 4
8. Non-current intangible assets held-for-sale	IFRS 5

- (*) Underlying **intangible assets** in finance leases are treated in terms of IAS 38 (.06)

Scope considerations (.04 - .06)

- **.04: Intangible assets contained in or on a physical substance**
  - CDs (computer software); legal documentation (patents; licenses); films

Assess which element is more material (i.e. <u>integral part</u> of hardware or not? → classify accordingly

- **.05: R&D aims to develop knowledge**
  - Could result in physical substance (e.g. prototype of new machine/product)
  - Physical element of asset = secondary to <u>knowledge</u> embodied in it

- **.06: Finance lease: leased asset could be intangible, then IAS 38**
  - Lease of rights, e.g. license for films, video recordings, plays, manuscripts, patents and copyrights

CHAPTER 2
Recognition of an intangible asset

Important definitions (.08) - important for all asset standards

- **Active market**
- Agreement date (very NB for business combinations IFRS 3)
- Cost
- Depreciable amount
- **Development**
- Entity-specific value
- **Intangible asset**
- **Monetary assets**
- **Research**
- Residual value
- Useful life

The link to the conceptual framework

- **Intangible 'asset'**

resource | controlled | past event | FEB inflow

Probable future economic benefits

automatic compliance for intangible assets separately acquired or acquired in a business combination

Remember this vital principle!

Cost or value can be reliably measured

‘Intangible asset’ (.09 - .11)

Identifiable — **Non-monetary** — **Without physical substance**

Identifiable

Separability
or
arises from legal/
contractual rights
(.11 - .12) = NB!

Non-monetary

‘Monetary’ = money
or
assets held to be
received in fixed
determinable amounts
of money (financial assets)

Without physical substance

Take into account
.04 to .06
“the physical
substance test”

When is an intangible asset **controlled**? (.13 - .16)

- .13 "… if the entity has the **power *(right)* to obtain** the future economic benefits flowing from the underlying resource AND to **restrict the access of others** to those benefits" **= LINK TO LECTURE ON FRAMEWORK!!**

- Legal/contractual rights
  - easiest to prove (enforceable in court)
- Market & technical knowledge (FEB arise from future transactions)
  - Legal rights such as copyright, restraint of trade agreements, confidentiality agreements with employees = intangible assets
- Staff skills (FEB arise from training)
  - Team of skilled staff, specific management, technical talent = unlikely I/Assets unless protected by legal rights (very difficult though)
- Portfolio of customers or a market share (FEB from loyalty/relationships)
  - If protected by legal rights = intangible assets
  - If no legal rights = exchange transactions of such non-contractual relationships provide evidence of the ability to gain benefit (i.e. control) and separability = intangible assets

Which FEB can be expected from intangible assets? (.17)

- Future revenue from sale of goods or services
- Think wider than just future sales/services

Cost savings!
Improved products!
Improved production processes!

- E.g. intellectual property (research & development) = reduction of future production costs iso increasing revenue

Recognition of intangible assets (.18 ...)

- Consider the **framework** to justify the existence of an **asset**
- **Classify** the justified asset in terms of IAS 38 (definition)
- Item must meet the **definition** of an intangible asset AND both the **recognition criteria**
- The entity must **DEMONSTRATE** the above (.18)
- **Recognition criteria**
  - Probable that FEB will flow to the entity and
  - Cost of the asset can be reliably measured

CHAPTER 3
Measurement of an intangible asset

Initial measurement of intangible assets - **extensive** guidance (.25 - .67)

- **Measured initially at cost (.24)** = basic principle

- What is cost?

- **Separate acquisition** → FV of cons (.25)
  - **IFRS 3** → FV (.33)
  - **Government grants** → FV/nominal (.44)
  - **Exchanges of I/A's** → FV/CA (.45)
  - **Internally-generated**
    - **goodwill** → N/A (.48)
    - **I/A's** → R&D (.65)

Expenditure on intangible assets - certain costs not to be capitalised

- General costs and expenditures on intangible items (.68)
- Recognise as expenses, unless
  - **Forms part of the cost of intangible asset and meets the recognition criteria;   or**
  - **The item is acquired in a business combination and cannot be recognised as an intangible asset (then absorbed in goodwill)**
- Guidance on what should be expensed (.69)
- Past **expenses** not to be recognised as asset (.71)

Subsequent measurement of intangible assets

- Accounting policy determines the valuation model
- Consistency in valuation model, unless exception

Cost model (.74)	**Revaluation model (.75)**
@ Cost	@ Revalued amount
less: Accum. amort.	= Fair value at revaluation
less: Accum. impairment	less: Accum. amort.
	less: Accum. impairment

Revaluation model (.75 - .87)

	PP&E (IAS 16)	**Intangible assets (IAS 38)**
• Frequency:	3 – 5 years (avoid material diff)	Depends on volatility of FV (avoid material diff)
• Based on:	Market value (1st) or net replacement value (2nd)	*Fair value, w.r.t.* ***'active market'***
• Take to:	Revaluation surplus	Revaluation surplus
• Consistency:	Whole class (no exception)	Whole class (unless no 'active market')
• Depreciation:	Write-off /Restatement	Write-off / Restatement
• Trf to R/E?	Yes, based on additional depreciation	Yes, based on additional amortisation

What is an active market?

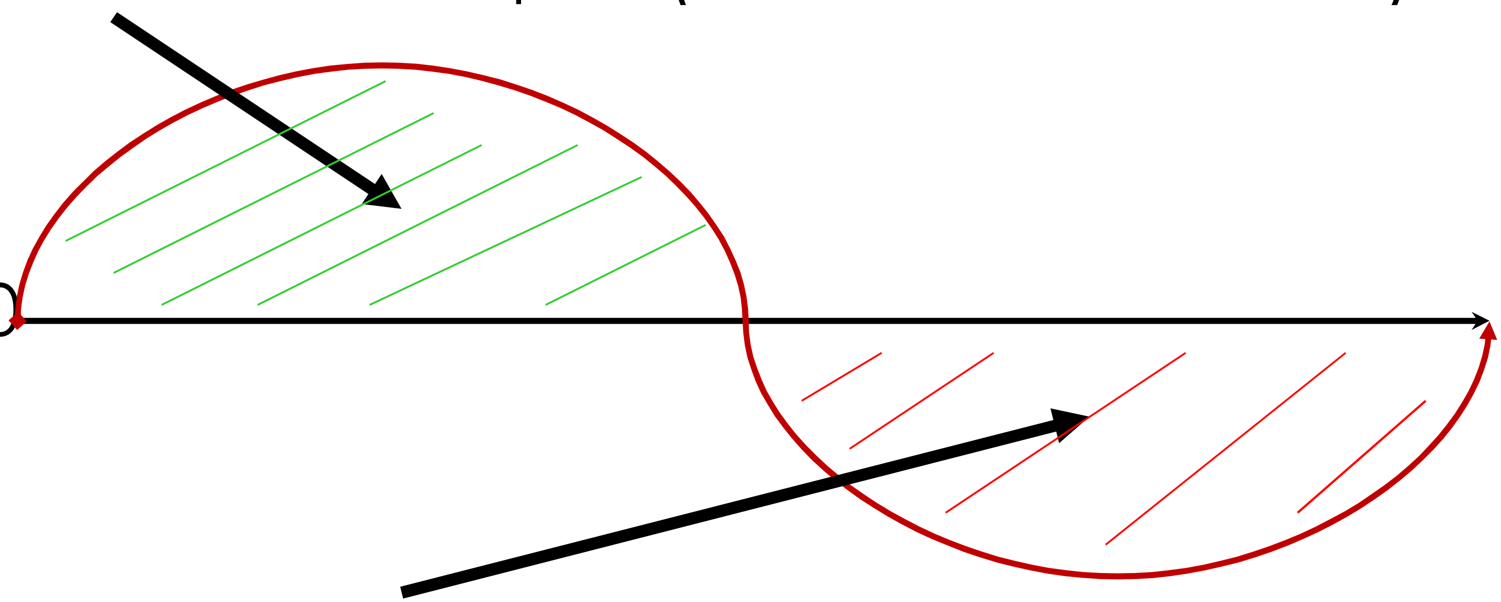
- A market in which ALL of the following conditions exist (.08):
  - **Items traded in the market are homogenous (similar/comparable)**
    - *Can my intangible asset identify with the I/A trading in the market?*
  - **Willing buyers and sellers can normally be found at any time**
    - *Will I be able to sell my I/A easily in the market at the market price?*
  - **Prices are *(freely)* available to the public**
    - *Is information available to the company? How many values are available? Only one/more?*

What is an active market?

- **Guidance (.78) = very important when determining acc. policy!**
  - Active markets are <u>unlikely to exist</u> for intangible assets (.78)
  - Depends on jurisdiction; trade legislation; trade conditions; practices etc.
  - Freely transferable taxi licenses; fishing licenses; production quotas = active market – why? *Homogenous, buyers and sellers, prices available*
  - Brands, newspaper mastheads, music and film publishing rights, patents or trademark = no active market – why? *Assets are UNIQUE*
  - Intangible assets can be bought/sold, but transactions are infrequent = no active market – why? *Prices not freely available*

Revaluation model and impairment or reversal of impairment (.85 - .86)

- Revaluation surplus (revaluation/reversal)
- 0



- Profit or loss (impairment loss/reversal of loss)

CHAPTER 4
Principles relating to the amortisation and impairment of intangible assets

The useful life of an asset
- extensive guidance (.88 - .96)

- **Finite** versus **Indefinite** → is not infinite!!!
  → new option in IAS 38

- (.90): Factors to consider when determining useful life (8)
- (.91): Indefinite versus infinite (very NB principle!)
- (.92): Assets subject to technological obsolescence = short useful life (e.g. computer software/hardware)
- (.94): Renewal options for 'contractual/legal rights'
  – Useful life cannot > the term of legal/contractual rights, but may be <

APPENDIX: 9 VALUABLE EXAMPLES TO ASSIST IN DETERMINING USEFUL LIFE OF INTANGIBLE ASSETS!

Finite useful lives (.97)

1. Amortisation period

- Systematic basis over useful life
- Commence when asset is available for use
- Amortisation ceases earlier of held-for-sale (IFRS 5) or derecognition
- Amortisation method must reflect the pattern of expected FEB
- If not determinable, straight-line method (default)
- Amortisation to be expensed, unless other standard permits capitalisation to cost price of that asset (e.g. IAS 2, IAS 16, IAS 40)

2. Residual value

- Assumed to be zero, unless:
  - Commitment by 3rd party to purchase I/A at end of useful life;
  - Or active market exists for the I/A and:
    - Residual value can be determined w.r.t. that market and
    - Active market will exist at the END of the useful life

3. Review of amortisation period and amortisation method

- At least annually
- Any change will constitute change in accounting estimate (IAS 8) = prospectively

Indefinite useful lives

- Shall **not be amortised**
- Tested for impairment in terms of IAS 36
  - Annually and
  - When indicator exists
- Useful life reviewed annually to confirm that it is still indefinite
  - If not, change in accounting estimate

Impairment, retirements and disposals (.111 – .117)

- Impairment done in terms of IAS 36
  - **Lower** of:
    - Carrying amount or
    - Recoverable amount
      - **Higher** of:
        - » Value in use
        - » Fair value less cost to sell

IAS 36 *Impairment of Assets*

- Derecognition upon disposal or when no further FEB expected from use/disposal.
- **GAINS = NOT revenue (but 'other income')**