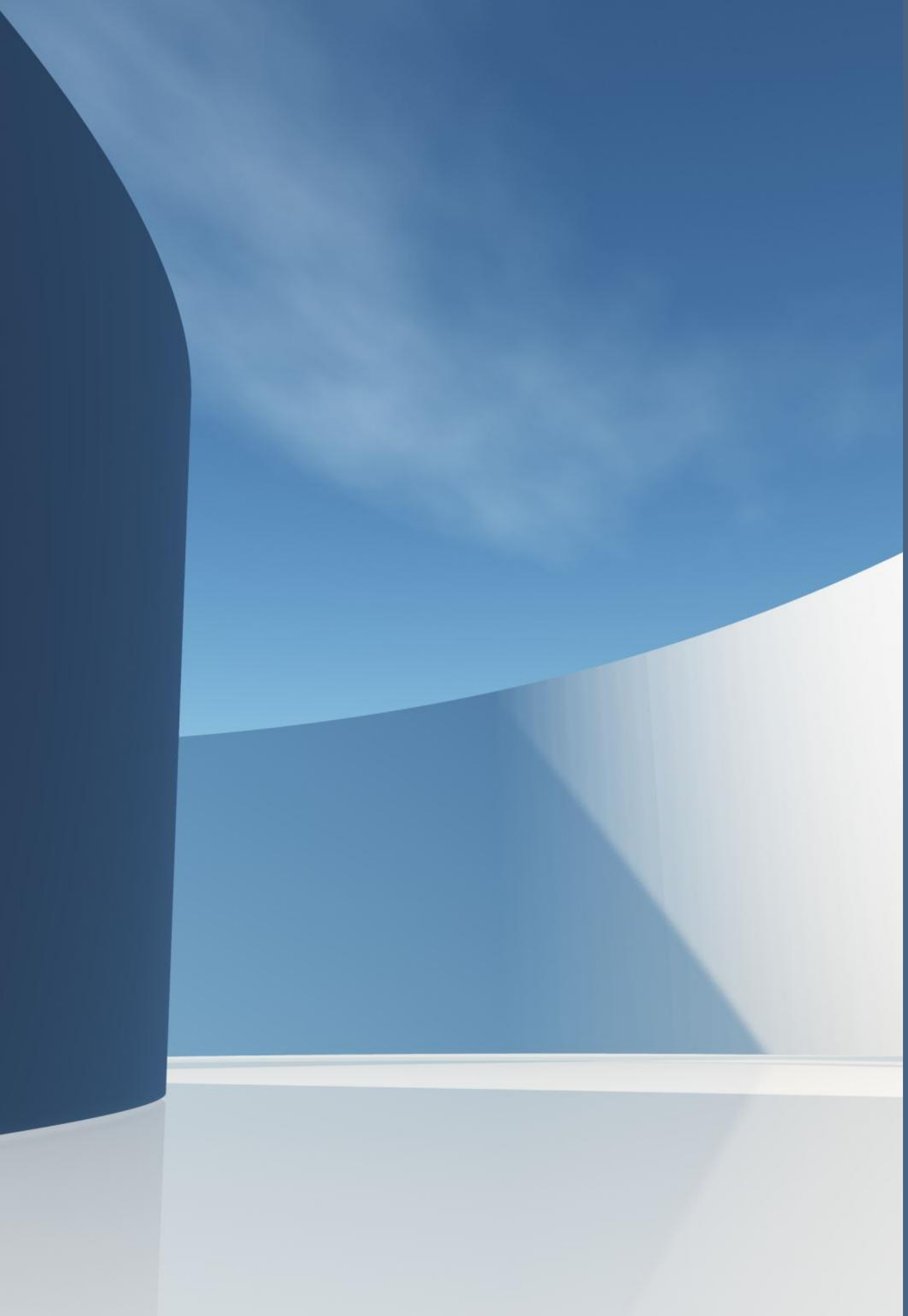

FINANCIAL REPORTING

IAS 38: Intangible Assets

INTANGIBLE ASSETS DEFINED

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

An asset is **identifiable** if;

- It is separable i.e., the asset can be bought, sold, transferred, rented, licensed or exchanged separately from the rest of the business.
- It arises from contractual or other legal rights.

It must as well meet the definition of an asset i.e.

- Controlled by the entity as a result of past events (normally by enforceable legal rights)
- A resource from which future economic benefits are expected to flow (either revenue in nature or cost saving in nature)

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Intangible assets include; Patents and copy rights, licenses and quotas, trademarks, brand names, computer software, customer lists, among others.

OBJECTIVE OF THE STANDARD

To prescribe the accounting treatment for intangible assets that are not dealt with, specifically in another Standard; and to recognize an intangible asset if the specified criteria is met.

SCOPE OF THE STANDARD

The standard does not apply to;

- Intangible assets that are within the scope of another Standard.
- Financial assets, as defined in IAS 32 Financial Instruments.
- The recognition and measurement of exploration and evaluation assets in IFRS 6 Exploration for and Evaluation of Mineral Resources.
- Expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.
- Intangible assets held by an entity for sale in the ordinary course of business (see IAS 2 Inventories).
- Leases of intangible assets accounted for in accordance with IFRS 16 Leases.
- Goodwill acquired in a business combination in IFRS 3 Business Combinations.
- Deferred tax assets in IAS 12 Income Taxes.
- Assets arising from employee benefits in IAS 19 Employee Benefits.

RECOGNITION

To be recognized in financial statements, intangible assets must meet the;

- Definition of an intangible asset.
- Recognition criteria of the conceptual framework I.e.;
    - It is probable that future economic benefits attributable to the asset will flow to the entity.
    - The cost of the asset can be measured reliably.

INNITIAL MEASUREMENT

An intangible asset shall be measured initially at cost.

It comprises;

- purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- Directly attributable cost of preparing the asset for its intended use such as professional fees arising directly from bringing the asset to its working condition, costs of testing whether the asset is functioning properly, costs of employee benefits arising directly from bringing the asset to its working condition.

SUBSEQUENT MEASUREMENT

Choice must be made subsequently between;

- **Cost model (commonly used)**

The intangible asset should be carried at cost less accumulated amortization and any accumulated impairment losses after initial recognition. Amortization is like depreciation for tangible assets.

If an intangible asset has a definite useful life, it is amortized over its useful life with an expense (amortization) recognized in the statement of profit or loss.

If an intangible asset has an indefinite useful life, it should not be amortized but rather tested for impairment annually or more often if there is an indicator of impairment.

- **Revaluation model**

An intangible asset is carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization and any subsequent accumulated impairment losses. Fair value must be measured by reference to an **active market.**

REVALUATION MODEL

- If an asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.
- Revaluations should be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.
- If a revaluation results into a gain, the gain is recognized in **other comprehensive income** and accumulated in equity under the heading of revaluation surplus. However, the gain can be recognized to profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.
- If a revaluation results into a loss, the loss is recognized as an expense in **profit or loss**. However, the loss can be recognized in other comprehensive income to the extent that it reverses a revaluation increase of the same asset previously recognized in other comprehensive income. In that case, the decrease reduces the amount accumulated in equity under the heading of revaluation surplus.

An active market is a market in which transactions for the asset take place with sufficient frequency and volume to provide pricing information on an ongoing basis. However, active markets for intangible assets are rare to find and as such the standard prohibits the revaluation of assets such as brand names, patents/trademarks, newspaper mastheads, publishing rights because of their individual uniqueness.

INTERNALLY GENERATED INTANGIBLE ASSETS

Generally, internally-generated intangible assets cannot be capitalized, as it hard to;

- Identify whether and when there is an identifiable asset capable of generating future economic benefits.
- Determine the cost of the asset reliably. Sometimes the costs associated with these cannot be identified separately from the costs associated with running the business.

Subject to the above, internally generated brands, mastheads, publishing titles, customer lists, internally generated good will and items similar in substance can not be recognized as intangible assets. Therefore, expenditure on these items should be written off as incurred (expensed in SOPL).

BUT: Where a brand name, publishing titles etc. are separately acquired and can be measured reliably, then it should be separately recognized as an intangible asset and accounted for in accordance with the general rules of IAS 38.

HOWEVER, to assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into; the **research** phase and the **development** phase.

EXPENDITURES IN RESEARCH AND DEVELOPMENT PHASES

Research defined: Original and planned investigation undertaken with the prospect of gaining new scientific knowledge and understanding.

Development defined: 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.

Research expenditure (expenditure incurred during the research phase of an internal project): No expenditure incurred during the research phase shall be capitalized as an intangible asset. We write off such expenditure as incurred in the SOPL (this is because at the research phase, the entity cannot demonstrate that an intangible asset exists that is capable of generating future economic benefits).

DEVELOPMENT PHASE CONT'D

Development expenditure: (expenditure incurred during the development phase of an internal project): Expenditures incurred during the development phase shall be capitalized as an intangible asset only if the entity can demonstrate **all** the following; (this is because at dev't stage, the entity can somehow identify an intangible asset and its ability to generate future economic benefits).

- **P**robable flow of economic benefit from the intangible asset, whether through sale or internal cost savings.
- **I**ntention to complete the intangible asset and use or sell it.
- **R**eliable measure of development cost (dev't costs can be measured reliably).
- **A**dequate resources to complete the project (availability of technical, financial and other resources).
- **T**echnical feasibility of completing the intangible asset so that it will be available for use or sale.
- **E**xpected to be profitable, i.e. the costs of the project will be exceeded by the benefits generated.

Only development expenditure incurred after the recognition criteria have been met should be recognized as an intangible asset otherwise, expensed in the SOPL.

Note: Capitalized development expenditure should subsequently be amortized over its useful life.

EXAMPLES OF RESEARCH & DEVELOPMENT ACTIVITIES

Research:

- activities aimed at obtaining new knowledge.
- search for research findings or other knowledge, evaluation and selection of such findings and their application, among others.
- the search for alternatives for materials, devices, products, processes, systems or services
- the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development:

- design, construction and testing of pre-production prototypes and models.
- design, construction and operation of a pilot plant that is not of a scale that is economically feasible for commercial production among other.
- the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

ACCOUNTING FOR INTERNALLY GENERATED INTANGIBLE ASSETS

- Where an internally generated intangible asset meets the recognition criteria, the intangible asset is recognized **at cost**.
- The cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria.
- Cost includes all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management such as;
  - costs of materials and services used or consumed in generating the intangible asset.
  - costs of employee benefits arising from the generation of the intangible asset.
  - fees to register a legal right.
  - Amortization of patents and licenses that are used to generate the intangible asset.
  - Borrowing costs.

GOODWILL

It can be defined as the difference between the value of a business as a whole and the aggregate of the fair values of its **separable net assets**. It can exist because of the following;

- Technical expertise
- Good management and staff
- Possession of favorable contracts
- Reputation (quality of service) among others

Separable net assets are those assets and liabilities which can be identified and sold off separately without necessarily disposing of the business as a whole.

Goodwill may be **purchased** or **non purchased (inherent/internally generated)**

It is purchased if it arises when one business acquires another as a going concern. Such goodwill is recognized in the financial statements.

On the other hand, inherent goodwill has no identifiable value and therefore not recognized in the financial statements since its not capable of being measured reliably.

DERECOGNITION

An intangible asset is derecognized:

- on disposal
- when no future economic benefits are expected from its use or disposal.

Upon derecognition, a gain or loss on disposal is calculated by comparing the carrying amount of the asset and the net disposal proceeds obtained from the disposal of the intangible asset. Gains or losses shall be recognized in **profit or loss** but not under revenue.

DISCLOSURES

- Whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortization rates used.
- The amortization methods used for intangible assets with finite useful lives.
- The gross carrying amount and any accumulated amortization at the beginning and end of the period.
- An entity shall disclose the aggregate amount of research and development expenditure recognized as an expense during the period.

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