IAS 38 - Intangible Assets

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Handout

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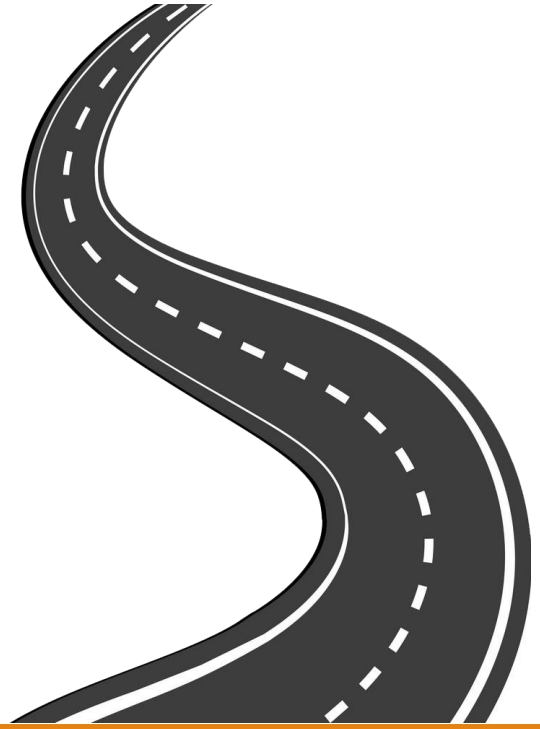

KEYWORDS

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English	العربية
Intangible asset	أصل غير ملموس
Goodwill	الشهرة
Identifiable	محدد
Control	تحكم
Know how	معرفه الكيفيه
Legal right	حق قانونى
Measured reliably	قياس بموثوقيه
Internally generated	متولد داخليا
Research	بحث
Development	تطوير
Technical feasibility	جدوى فنيه
Commercial feasibility	جدوى تجاريه
Intention	نية
Ability	قدرة

English	العربية
Active market	سوق نشط
Useful life	العمر الانتاجى
A finite	محدد
indefinite	غير محدد
Amortization	استهلاك
Impairment	اضمحلال
Disposal	استبعاد
Brand name	علامه تجارية
Copy right	حقوق النشر – التأليف
Pattern	نمط
Revaluation surplus	فائض اعاده تقيم
Class	فئه
design	تصميم
Without physical substance	ليس لها وجود مادى

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IAS 23 | IAS 37 | IAS 20 | IAS 36 | IFRS 13

Asset

Usage

Assets held for sale & Discontinued operation

IFRS 5

Non Current assets held for sale

Usage

Tangible assets held for use in the production or supply goods or services or for administrative purpose

IAS 16

Property, Plant & Equipment

Usage

Biological assets
Cows
Sheep
Fruit Trees

IAS 41

Biological Assets

Usage

Intangible assets
Brand name
Patent
licenses

IAS 38

Intangible Assets

Usage

Land or Building or both are using as an investment or to earn rent

IAS 40

Investment Property

Usage

To resale in the normal course of business

IAS 2

Inventories

Objective & Definition

Objective

- Establish Criteria when an intangible asset may or should be recognized.
- To specify how intangible assets should be measured.
- To specify the disclosures requirements for intangible assets.

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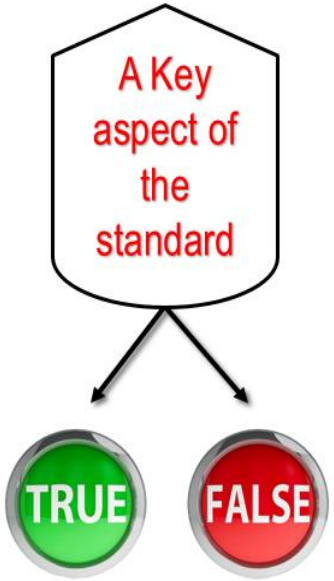
Definition

Is an **Identifiable** non-monetary asset without physical substance , the asset must be :

1- **Controlled** By the entity as a result of events in the past.
- Purchased
- Research & Development

2- Something from which the entity **Expects future economic** benefits to flow.



Objective & Definition

Identifiable — قابله للتحديد

Must be identifiable in order to distinguish it from goodwill

- Non-current Assets
- Property, plant, and equipment
- Goodwill
- Intangible Assets

It could be rented or sold or transfer separately (i.e. separable)

Acquired separately through purchase , there is may be a transfer of legal right that would help to make an asset identifiable

Controlled

The entity able to enjoy the future economic benefits from the assets

Prevent the access of others to those benefits

Legal Right

Expects future economic

May be come from the sale of the products or services

May be come from a reduction expenditures - Cost saving

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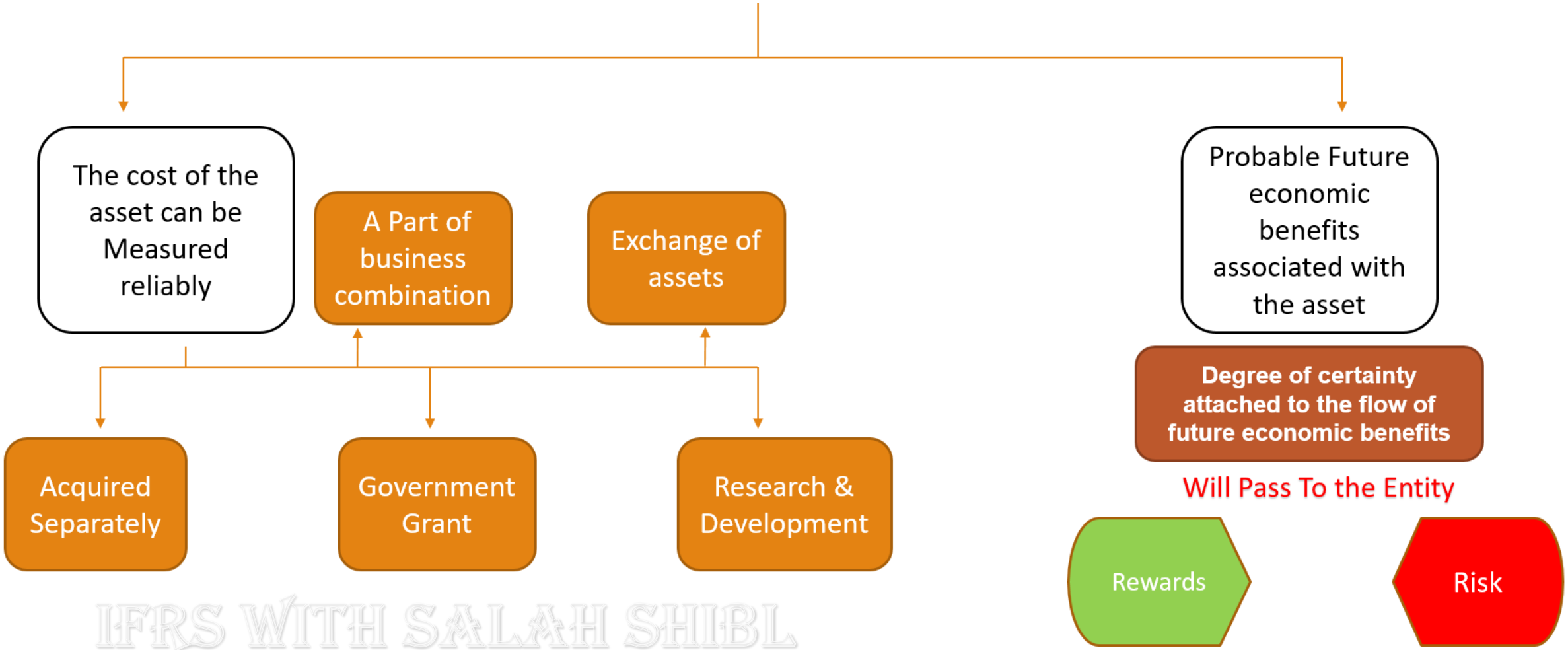
Recognition



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Initial recognition

1 Acquired Separately

At Cost

Purchase Price

+

All attributable Cost

- Legal Fees
- Testing
- Cost to get asset ready for use

Cost doesn't apply

- Interest expenses due to deferred payment
- Marketing & advertising campaign cost
- Training Cost
- Any cost after asset become ready for use
- Initial losses

2 A Part of business combination

At Fair Value

Consideration = $120M

- Goodwill: $20M
- Intangible Assets: FV of Asset

Net Assets = $100M

-

FV of Liability

3 Government Grant

At Fair Value / Cost

IAS 20

- Cost = 0
- FV

4 Exchange of assets

At Fair Value / assets given up

Alpha receives landing rights to airport Y in an arm's length transaction

500,000 Litre @$1

- FV of Intangible assets ✓
- ✗

	DR	CR
Land Right	$500,000	
Fuel		$500,000

Research & Development

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What if Intangible asset internally generated ?

IAS 38 Prohibits recognition intangible assets internally generated

Future economic benefits

Measure reliably

Identifiable

Is subjective and cannot be measured reliably

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Research & Development

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If an entity cannot distinguish the research phase of an internal project to create an intangible asset from the development phase, the entity treats the expenditure for that project as if it were incurred in the research phase only.

1-1-2020 Project

Research

1-8-2020

Development

Production

Time Line

Technical feasibility & Commercial viability

Cost of activities aimed at obtaining new knowledge

Cost of search of material

Cost of search of devices

Cost of search of systems

It cannot be certain that future economic benefits will probably flow to the entity from this project

Research Costs should therefore be written off as an expense (P/L) as they are incurred

The technical feasibility of completion

The entity's intention to complete

The entity's ability to use or sell the intangible assets

Adequate technical & financial resources

Entity's ability to measure the expenditure

Probable future economic benefits through sale or internal use

It's probably that future economic benefits will flow to the entity from this project

Once these strict criteria are met , IAS 38 Requires development expenditure to be capitalized

Subsequent Measurement

Notes

Cost Model

No Active Market

Initial Measurement

-

Accum-Amortisation

-

Accum-Impairment Loss

=

Net Carrying amount

Revaluation Model

Active Market

Fair Value

-

Accum Amortisation

-

Accum-Impairment Loss

=

Net Carrying amount

The entire class of intangible assets of that type must be revalued at the same time

To prevent selective

Revaluation should be made with such regularity that the carrying amount doesn't differ from that which would be determined using fair value at the end of the reporting date

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Useful life

- Expected usage
- The stability of the industry
- The level of maintenance expenditure required
- Legal or similar limits on the use of assets

Finite

ذات عمر محدد

Legal right

benefits within specific time

⇨ The useful life of an intangible asset that arise from contractual or other legal rights shouldn't exceed the period of the rights, but may be shorter depending on the period over which the entity expects to use the asset.

Should be amortized over its expected useful life

- Start when the assets is available for use
- Stop when derecognize or become held for sale
- Should reflect the pattern in which the asset's future economic benefits are consumed
- Amortization charge be recognized in P/L

Indefinite

ليس لها عمر محدد

No foreseeable limit to the period over which the asset is expected to generate net cash inflows to the entity

Should not be amortized

IAS 36

Require tested for impairment each year

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Bye

Retirements and disposal

When an assets is **disposed from use** or **sold** or **no future economic benefits** are expected from its use, it should be eliminated from the statement of financial position

Cost Model

Gains or losses are the difference between the net disposal proceeds and the carrying amount of the asset . **They should be recognized as income or expense in profit or loss.**

	DR	CR
Cash	XXX	
RS	XXX	
RE		XXX
Intangible asset		XXX
Gain on disposal		XXX

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Revaluation Model

- Leave the amount in the equity (revaluation surplus)
- Transferred directly to retained earnings

The transfer to retained earnings should not be made through profit or loss for the year , in other words it must not be made as a reclassification a djustment

Derecognition

Derecognition asset criteria is the same as IFRS 15 revenue from contract criteria (Transfer of control)

But a gain its (gain or loss) not revenue

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Question

Query Two

When I looked at the note detailing the intangible assets we include in our consolidated statement of financial position, I noticed that several brand names associated with subsidiaries we acquired recently were included in this figure. Therefore I also expected to see a figure for the Omega brand name included within intangible assets. There doesn't appear to be any amount for the Omega brand name included within intangible assets and I don't understand why. The Omega brand name has been developed within Omega for a number of years and is well regarded by our customers. Surely it's a mistake not to include it as well? (6 marks)

Answer

Query two

The accounting treatment of intangible assets is regulated by IAS 38 – *Intangible Assets*.

Under IAS 38, the accounting treatment of intangible assets depends on how they arose.

The intangible assets of acquired subsidiaries were acquired as a result of a business combination and the initial recognition requirements are contained in IFRS® 3 – *Business Combinations*.

When a new subsidiary is acquired, the purchase consideration needs to be allocated to the identifiable assets and liabilities of the acquired subsidiary.

A brand name (or any other intangible asset for that matter) is regarded as identifiable if it is **separable** (can be sold without selling the whole business) or arises from **contractual or other legal rights** (such as legally protecting its use).

Identifiable intangible assets associated with an acquired subsidiary **can be recognised separately in the consolidated financial statements provided their fair value can be reliably estimated**.

The Omega brand is an internally developed brand.

IAS 38 does **not allow** the recognition of internally developed brands because of the **inherent difficulties** involved in identifying and measuring them.

This explains why the Omega brand is treated differently compared to the brands of acquired subsidiaries.

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Question

Query Three

When I read the disclosure note relating to intangible non-current assets in the consolidated financial statements, I notice that this figure includes brand names associated with subsidiaries which we've acquired in recent years. However, the brand names which are associated directly with products sold by Omega (the parent entity) are not included within the non-current assets figure. This is another inconsistency that I don't understand. Please explain how this practice can be in line with IFRS requirements. One final question: would I be right in thinking that, as with property, plant and equipment, we can use the fair value model to measure intangible assets? (8 marks)

Answer

Query Three

Under the provisions of IAS 38 – *Intangible Assets* – the ability to recognise an intangible asset depends on how the potential asset arose. From the perspective of the Omega group, brand names generated by Omega are internally generated. The recognition criteria for such potential assets are very stringent and only costs associated with the development phase of an identifiable research and development project would satisfy them. This explains why the Omega brand names are not recognised.

In contrast, intangible items which relate to an acquired subsidiary which exist at the date of acquisition are acquired as part of a business combination and for such assets the recognition criteria are different. Provided the fair value of such an intangible can be reliably measured at the date of acquisition, it is recognised in the consolidated statement of financial position based on its fair value at the date of acquisition.

The use of the fair value model for intangible non-current assets is restricted to those assets which are traded in an active market. This is relatively uncommon in the case of intangibles. It is most unlikely that brand names would be traded in such a market, so the fair value model is unlikely to be available here.

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Question

(ii) On 1 April 2016, Epsilon purchased a brand from a competitor for an agreed price of $80 million. The directors of Epsilon believe that the useful life of the brand is indefinite. On 31 March 2017, no reliable estimate of its selling price was available but the directors of Epsilon estimated that the value in use of the brand was $85 million. The directors of Epsilon wish to use the fair value model for measuring intangible assets whenever permitted by International Financial Reporting Standards. (5 marks)

Required:

Explain and state how the two events should be reported in the financial statements of Epsilon for the year ended 31 March 2017.

Note: The mark allocation is shown against each of the two events above.

Answer

(ii) Since the brand has been separately purchased, IAS 38 *Intangible Assets* requires that it is initially recognised at its cost of $80 million.

Epsilon is unable to use the revaluation model to measure the brand because IAS 38 requires the existence of an active market in the asset before this can occur – this is clearly not present in this situation as the brand name is unique.

Under the cost model, intangible assets are amortised over their useful lives. If the useful life is assessed as indefinite, then no amortisation is charged but the asset must be reviewed annually for impairment.

In this case no impairment is evident as the value in use is $85 million, so the brand will be shown as a non-current intangible asset at its original cost of $80 million.

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Question

Query Three

As you know, in the year to September 2016 we spent considerable sums of money designing a new product. We spent the six months from October 2015 to March 2016 researching into the feasibility of the product. We charged these research costs to profit or loss. From April 2016, we were confident that the product would be commercially successful and we fully committed ourselves to financing its future development. We spent most of the rest of the year developing the product, which we will begin to sell in the next few months. These development costs have been recognised as intangible assets in our statement of financial position. How can this be right when all these research and development costs are design costs? Please justify this with reference to relevant reporting standards.

Answer

Query Three

Accounting for product design costs is governed by IAS 38 – *Intangible Assets*.

Under IAS 38, the treatment of expenditure on intangible items depends on how it arose.

Generally internal expenditure on intangible items cannot be recognised as assets.

The exception to the above rule is that once it can be demonstrated that a development project is likely to be **technically feasible, commercially viable, overall profitable** and can be **adequately resourced**, then **future** expenditure on the project can be recognised as an **intangible** asset. This explains the differing treatment of expenditure up to 31 March 2016 and expenditure after that date.

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Question

Doug Co is developing a new production process. During 20X3, expenditure incurred was $100,000, of which $90,000 was incurred before 1 December 20X3 and $10,000 between 1 December 20X3 and 31 December 20X3. Doug Co can demonstrate that, at 1 December 20X3, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process is estimated to be $50,000.

Required

How should the expenditure be treated?

Answer

At the end of 20X3, the production process is recognised as an intangible asset at a cost of $10,000. This is the expenditure incurred since the date when the recognition criteria were met, that is 1 December 20X3. The $90,000 expenditure incurred before 1 December 20X3 is expensed, because the recognition criteria were not met. It will never form part of the cost of the production process recognised in the statement of financial position.

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Question

An intangible asset is measured by a company at fair value. The asset was revalued by $400 in 20X3, and there is a revaluation surplus of $400 in the statement of financial position. At the end of 20X4, the asset is valued again, and a downward valuation of $500 is required.

Required

State the accounting treatment for the downward revaluation.

Answer

In this example, the downward valuation of $500 can first be set against the revaluation surplus of $400. The revaluation surplus will be reduced to $nil and a charge of $100 made as an expense in 20X4.

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Question

Dexterity is a public listed pharmaceutical company. It has been considering the accounting treatment of its intangible assets and has asked for your opinion on how the matters contained in the exhibits should be treated in its financial statements for the year to 31 March 20X5.

Exhibit 1 – Acquisition of subsidiary

On 1 October 20X4 Dexterity acquired Temerity, a small company that specialises in pharmaceutical drug research and development. The purchase consideration was by way of a share exchange and valued at $35m. The fair value of Temerity's net assets was $15m (excluding any items referred to below). Temerity owns a patent for an established successful drug that has a remaining life of eight years. A firm of specialist advisors, Leadbrand, has estimated the current value of this patent to be $10m, however the company is awaiting the outcome of clinical trials where the drug has been tested to treat a different illness. If the trials are successful, the value of the drug is then estimated to be $15m. Also included in the company's statement of financial position is $2m for medical research that has been conducted on behalf of a client.

Exhibit 2 – Patent

Dexterity has developed and patented a new drug which has been approved for clinical use. The costs of developing the drug were $12m. Based on early assessments of its sales success, Leadbrand have estimated its market value at $20m.

Exhibit 3 – Production process

On 1 October 20X3 Dexterity began a project to investigate a more efficient production process. Expenses relating to the project of $2m were charged in the statement of profit or loss and other comprehensive income in the year ended 31 March 20X4. Further costs of $1.5m were incurred in the three-month period to 30 June 20X4. On that date it became apparent that the project was technically feasible and commercially viable. Further expenditure of $3m was incurred in the six-month period from 1 July 20X4 to 31 December 20X4. The new process, which began on 1 January 20X5, was expected to generate cost savings of at least $600,000 per annum over the ten-year period commencing 1 January 20X5.

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Exhibit 3 – Production process

On 1 October 20X3 Dexterity began a project to investigate a more efficient production process. Expenses relating to the project of $2m were charged in the statement of profit or loss and other comprehensive income in the year ended 31 March 20X4. Further costs of $1.5m were incurred in the three-month period to 30 June 20X4. On that date it became apparent that the project was technically feasible and commercially viable. Further expenditure of $3m was incurred in the six-month period from 1 July 20X4 to 31 December 20X4. The new process, which began on 1 January 20X5, was expected to generate cost savings of at least $600,000 per annum over the ten-year period commencing 1 January 20X5.

Exhibit 4 – Advertising

In December 20X4, Dexterity paid $5m for a television advertising campaign for its products that will run for six months from 1 January 20X5 to 30 June 20X5. The directors believe that increased sales as a result of the publicity will continue for two years from the start of the advertisements.

Requirements

(a) In accordance with IAS 38 *Intangible Assets*, discuss whether intangible assets should be recognised, and, if so, how they should be initially and subsequently recognised in the following circumstances:

(i) When they are purchased separately from other assets
(ii) When they are obtained as part of acquiring a whole a business
(iii) When they are developed internally **(10 marks)**

Note. Your answer should consider goodwill separately from other intangibles.

(b) Explain how the transactions described in Exhibit 1 to Exhibit 4 would be accounted for in the financial statements of Dexterity for the year ended 31 March 20X5 in accordance with IAS 38.

The marks allocated are as follows:

Exhibit 1 – Acquisition of subsidiary	**(4 marks)**
Exhibit 2 – Patent	**(3 marks)**
Exhibit 3 – Production process	**(5 marks)**
Exhibit 4 – Advertising	**(3 marks)**

Note. The values given by Leadbrand can be taken as being reliable measurements. You are not required to consider depreciation aspects.

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(b) **Note 1 – Acquisition of subsidiary**

The following assets will be recognised on acquisition:

	$m
Fair value of sundry net assets	15
Patent at fair value	10
Research carried out for customer	2
Goodwill (balancing figure)	8
Total consideration	35

The patent is recognised at its fair value at the date of acquisition, even if it hadn't previously been recognised by Temerity. It will be amortised over the remaining eight years of its useful life with an assumed nil residual value

The higher value of $15m can't be used because it depends on the successful outcome of the clinical trials. The extra $5m is a contingent asset, and contingent assets are not recognised in a business combination. (Only assets, liabilities and contingent liabilities are recognised.)

Although research is not capitalised, this research has been carried out for a customer and should be recognised as work-in-progress in current assets. It will be valued at the lower of cost and net realisable value.

The goodwill is capitalised at cost. It is not amortised but it will be tested for impairment annually.

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Answer

Note 2 - Patent

Under IAS 38 the $12m costs of **developing** this new drug are capitalised and then amortised over its commercial life. (The costs of **researching** a new drug are never capitalised.)

Although IAS 38 permits some intangibles traded in an active market to be held at valuation it **specifically forbids revaluing patents**, therefore the $20m valuation is irrelevant.

Note 3 – Production Process

Costs are capitalised from 30 June 20X4 onwards (when **commercial feasibility and technical viability** were demonstrated). Hence the $3.5m incurred before this point is **expensed.**

The $3m incurred from 1 July to 31 December 20X4 is capitalised. **Amortisation** is charged over the ten-year useful life, giving an annual charge of $300,000.

Amortisation is charged from when the process begins to be exploited commercially; here this is **1 January 20X5**. Amortisation charged in the year ended 20X9 is $300,000 × 3/12 = **$75,000.**

The carrying amount is thus:

Cost	3,000,000
Amortisation	(75,000)
Carrying amount	2,925,000

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Note 4 – Advertising

IAS 38 Paragraph 69 states that advertising and promotional costs should be **recognised as an expense when incurred.** This is because the expected future economic benefits are uncertain and they are **beyond the control** of the entity.

However, because the year end is half way through the campaign there is a **$2.5m prepayment** to be recognised as a current asset.

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