



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item

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DATE: June 2, 2008
MEMO TO: Members of the IPSASB
FROM: Don Geiger
SUBJECT: Intangible Assets (IA)

OBJECTIVE OF THIS SESSION

To **review** and **discuss** the Issues Paper on intangible assets, with a goal towards approving an ED at the October 2008 IPSASB meeting.

AGENDA MATERIAL

- 7.1 Issues Paper – “Intangible Assets: Exploring the Public Sector Issues”
- 7.2 IAS 38, *Intangible Assets*
- 7.3 SIC-32, *Intangible Assets – Web Site Costs*
- 7.4 Project Brief – project initiation document – Intangible Assets
- 7.5 Markup of IAS 38 (to be distributed in Moscow)

ACTION REQUIRED

The IPSASB is asked to:

- **Discuss issues** as outlined in the draft Issues Paper – “Intangible Assets: Exploring the Public Sector Issues”; and
- **Provide** staff with direction on issues and other comments to be incorporated in the development of an ED for the October 2008 IPSASB meeting.

BACKGROUND

At the March 2008 IPSASB meeting, the IPSASB identified intangible assets as a high priority towards convergence with the IASB. Intangible asset reporting has been addressed in only a few public sector jurisdictions internationally.

Guidelines for Modifying IASB Documents

As for all IFRS convergence projects newly initiated, the starting point is an analysis of public sector issues using the IPSASB Guidelines for Modifying IASB Documents (Rules of the Road). These have been applied to IAS 38, “*Intangible Assets*” and interpretation SIC 32, “*Intangible Assets - Web Site Costs*” to determine the approach to the project, i.e. whether Intangible Assets should be an IFRS convergence project or whether a public sector specific project is needed.

Step 1: Are there public sector issues that warrant departure?

In applying the rules in step 1, public sector issues are assessed to determine if they warrant a departure in recognition, measurement, presentation or disclosure.

In addressing Step 1, staff has identified a number of issues in review of IAS 38 for public sector consideration. These issues are related to the definition of an intangible asset as well as to recognition and measurement and are substantive items in relation to the guidelines.

Rule #1: Where applying the international accounting standards/interpretations would mean the objectives of public sector financial reporting would not be met.

Definition and Recognition Issues There are unique factors in the public sector in regards to definition and recognition of intangible assets (see Issues Paper 7.1). The two situations that could lead to public sector financial reporting objectives not being met are:

- **Identifiable Criterion** - In IAS 38, the definition of an intangible asset includes a criterion that the asset is identifiable, meaning that it is separable or arises from contractual or other legal rights. Private sector intangible assets can arise from contractual or legal rights. However, when applied in the public sector context, this could extend recognition to situations such as rights granted by statute or legislation which may not be intended to be included as assets. For example, by statute governments may be given the legal right to levy taxes and to issue and enforce radio frequency spectrum, fishing licenses, casino licenses and cellular telephone operating licenses.
- **Future Service Potential** - When defining assets in the public sector, previous IPSASs have broadened the term “future economic benefit” to “future economic benefits or service potential”.

In both situations, staff believes that the objectives of providing “information useful for decision making” would not be met unless there is some amendment to IAS 38 to reflect these points.

Measurement Issues – Other public sector issues (as identified in the issues paper) relate to measurement of intangible assets in the public sector. Staff believes that these issues would not cause the objectives of public sector financial reporting not be met (with the exception of non-exchange transactions). The basic underlying intangible assets in the public sector are not unique and therefore would not require special measurement standards. Certain terminology changes and placement in a public sector context would be required.

Non-exchange transactions are of obvious importance to the public sector and will play a role in both recognition and measurement of intangible items. IPSAS 23, “*Revenue from Non-Exchange Transactions (Taxes and Transfers)*” provides guidance to the public sector on such transactions. Staff believes that provisions of IPSAS 23 will handle the non-exchange aspects of intangible assets, including the treatment and accounting for emission rights. The treatment of emissions rights and other environmental schemes continue to be a topical issue and will undoubtedly continue to evolve during this project. Staff will continue to monitor these developing areas.

The measurement situation that could lead to public sector financial reporting objectives not being met is:

- Non-exchange transactions involving intangible items are quite prevalent in the public sector and are not covered by IAS 38. Therefore a third departure would exist for non-exchange intangible assets.

Rule #2: Where applying the international accounting standards/interpretations would result in a loss of accountability to stakeholders.

Staff believes that excluding “service potential” would cause a loss of accountability to stakeholders. In the public sector an asset provides a means for the entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying service potential and are common in the public sector. This needs to be included in the public sector because of the unique aspects of governmental operations and for the same reasons already demonstrated in IPSAS 17 and IPSAS 1.

The departure concerning “non-exchange transaction” would also cause a loss of accountability to stakeholders, especially given its importance in the public sector.

Rule #3: Where applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met.

The IPSASB is addressing qualitative characteristics in its conceptual framework project. The existing IPSASB qualitative characteristics are Understandability, Relevance, Reliability and Comparability.

When considering the potential definition issues associated with the expanded public sector reach that “arises from contractual or legal rights,” and in particular “Rights granted by statute or legislation” for powers to levy taxes, issue and enforce radio frequency spectrum, fishing licenses, casino licenses and cellular telephone operating licenses, the qualitative characteristics of Understandability, Relevance, Reliability and Comparability could all be a factor. For example to include the right to tax could create situations that would cause the financial statements to be misunderstood, perhaps introducing irrelevant and unreliable information by including additional items within intangible assets.

Including “rights granted by statute or legislation” and not including a defined treatment for “non-exchange transactions” has the potential to affect all of the qualitative characteristics.

Rule #4: Where the cost of applying the international accounting standards/interpretations exceeds the benefit.

In the preliminary research that has been completed in the area of intangible assets, there has been no indication that cost/benefit factors are a major concern. Staff will continue to monitor the existence of cost/benefit concerns. However, the development of accounting

standards and guidance for intangible assets does not seem to be a major issue or have undue cost concerns. The recent experiences in South Africa and the United States do not indicate any potential issues in this area.

Summary of Step 1 – Analysis:

Areas of consideration	Issue Identified	Comments
1) Cause objectives of financial reporting not to be met?	Identifiable Criterion – Rights Granted by Statute or Legislation	objectives not met
	Future Service Potential	objectives not met
	Treatment for non-exchange transactions	objectives not met
2) Affect the accountability to stakeholders?	Future Service Potential	accountability to shareholders could be compromised without this
	Treatment for non-exchange transactions	accountability to shareholders could be compromised without this
3) Cause qualitative characteristics not to be met?	Identifiable Criterion – Rights Granted by Statute or Legislation	qualitative characteristics not met
	Treatment for non-exchange transactions	qualitative characteristics not met
4) Where Cost of applying exceeds the benefit.	NA	To be monitored but no immediate indications of concern

Conclusion Step 1: Staff concludes that there are three public sector issues that warrant a departure:

- Rights granted by statute or legislation;
- The exclusion of service potential; and
- Treatment of non-exchange transaction

Therefore in applying the guidelines we need to proceed to step 2.

Step 2: Are the departures so significant that a public sector specific project should be initiated?

There are three departures that have been identified in step 1 “rights granted by statute or legislation,” “service potential” and “non-exchange transactions.”

There is an existing model in previous IPSASs for dealing with the “service potential” considerations. Staff believes that this approach should be followed for intangible assets.

There is an existing model in previous IPSASs for dealing with the “non-exchange transactions.” in IPSAS 23. Staff believes that this approach should be followed for intangible assets.

Concerning “rights granted by statute or legislation”, staff believes that an approach similar to that taken by the public sector standard setters in South Africa or the United States could be followed. In South Africa there is scope exclusion for rights granted by statute. In the United States a reference to a concept statement that excludes certain powers from the definition of assets. In either case the end result is that an intangible asset is not recognized for rights granted by statute or legislation.

The South African Accounting Standards Board (SAASB), added excludes “excluding rights granted by statute” from the identifiable criteria because:

Entities may execute a regulatory right over certain activities, for example, fishing, mining or industries such as telecommunications and energy. These regulatory rights and the power to transfer, license, rent or execute such rights, does not meet the definition of an intangible asset when these rights are granted in terms of statute. These rights, once issued, are usually an intangible asset of those individuals or entities that acquired each right, provided that the acquirer can demonstrate that the definition and recognition criteria of an intangible asset are met.

Similarly, a municipality’s right to levy taxes is granted in terms of a statute. The right arising from the statute does not qualify for recognition as an intangible asset in terms of this Standard, because the cost or fair value of the right to levy taxes cannot be reliably measured. Future economic benefits or service potential arise once a past event has occurred, for example income tax will become leviable once a taxable event has occurred. There might be a cost associated with exercising the right granted in terms of the statute, for example the preparation of a valuation roll to levy property rates. The principles in, amongst others, the Framework for the Preparation and Presentation of Financial Statements, and other applicable Standards of GRAP, should be applied to account for costs incurred to exercise the right granted in terms of legislation.

In the United States, the GASB created a category of intangible assets called *intangible assets created through statutes or the inherent nature of the government entity*. The GASB made a distinction between “powers” and “rights” held by a government. Powers give the government the ability or authority to directly compel or control actions of

another party. Powers are generally obtained by a government through its constitution or charter, or through the passage of legislation, either by the government or a higher level of government. Powers are generally not obtained through transactions that create an obligation or duty on the part of another party to grant such powers to the government.

Examples given by the GASB include the power to tax, the power of eminent domain (compulsory purchase or acquisition), the power to require use of government services, the power to require fee-based permits and licenses for certain activities and the power to regulate (for example, award franchises or exclusivity to service providers).

The GASB relied on Concept Statement 4 to determine if “powers” should be considered assets. Concept Statement 4 noted:

A government’s power to tax may be considered one of the government’s most important resources (that is, a means that can be drawn on), but it is not an asset of the government because the power to tax does not have present service capacity. The power to tax produces an asset for accounting and financial reporting purposes only when the power to tax is exercised and an enforceable tax levy or taxable transaction has occurred, as applicable, resulting in a resource with present service capacity – taxes receivable. Similarly, other power inherent in a government, such as regulatory or eminent domain powers are not assets, but they produce assets when exercised.

The GASB concluded that powers held by a government would not be considered assets and would not meet the description of an intangible asset.

In order to address this in a converged standard it would likely be necessary to include specific scope exclusion along with guidance that explains the rationale.

Conclusion Step 2: Staff concludes that public sector issues that warrant departure can be addressed within a converged IASB document with some modification. Step three will consider the parameters for the extent of modification allowed.

Step 3: Modify IASB documents

The Issues Paper and eventual Exposure Draft are intended to identify any public sector issues relating to intangible assets. As noted, staff believes that under the recognition of intangible assets there are two situations unique to the public sector that would call for modification under Step 3 of IAS 38. Those two situations are for “rights granted by statute or legislation” and the term “future economic benefit” to be expanded to encompass service potential.

The first criteria in Step 3 of the guidelines indicates that recognition and measurement requirements may be modified, if doing so will result in the objectives of public sector financial reporting being better met. Staff believes that the two modifications above would both enhance the usefulness of information for decision makers, as indicated in the current IPSAS objectives. The information on how the entity financed its intangible

assets and financial activities to meet its liabilities and commitments would be much clearer with the modification/exclusion for “rights granted by statute or legislation.”

Step 3 also indicates that amendments may be made to the scope to be consistent with existing IPSASs. Staff believes that the modification to “future economic benefit” to be expanded to encompass service potential would fall into this category.

Modification considerations	“rights granted by statute or legislation”	“service potential”
i) Result in objectives of public sector financial reporting being better met	Yes	Yes
ii) An alternative that better achieves the objective	n/a	n/a
iii) eliminate options	n/a	n/a
iv) guidance for public sector context	Yes	Yes
v) modify disclosure	to be determined	n/a
vi) add public sector example	Yes	Yes
vii) amendments to scope to be consistent with existing IPSAS	n/a	Yes, IPSAS 1 & 17

Conclusion Step 3: Staff concludes that the three identified issues can be addressed by modifying IASB documents.

Step 4: Make IPSAS style and terminology changes to IASB documents

The standard IPSAS style and terminology changes would be made in preparing the ED.

**Don Geiger
TECHNICAL MANAGER**

Issues Paper

June 2008

Intangible Assets: Exploring the Public Sector Issues

Based on the IASB standard IAS 38, “*Intangible Assets*”
and
IFRIC SIC 32, “*Intangible Assets -Web Site Costs*”

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INTRODUCTION

1. The objective of this project is to prescribe the accounting treatment for intangible assets of public sector entities so that users of financial statements have useful and relevant information. The principal issues in accounting for intangible assets are the definition and recognition of the assets, and measurement, including related amortization charges and impairment losses.
2. Private sector entities have intangible assets such as patents, copyrights, trademarks, computer software (acquired or internally developed), and web site costs. Many of these are equally prevalent in the public sector. In addition, there are a number of public sector specific intangible assets, including easements, water rights, timber rights, various licenses, databases, acquired broadcasting licenses, goodwill from a government entity combination.
3. The IPSASB has identified intangible assets as a high priority towards convergence with the IASB. The absence of a standard on intangible assets is viewed as a significant gap in the body of IPSASs. As a convergence project, the *starting point for analysis* is IAS 38, “*Intangible Assets*” and the *IASB IFIC interpretation SIC 32*, “*Intangible Assets – Web Site Costs*.”
4. Staff has also considered the work of national standards setters on intangible assets including South Africa, the United Kingdom and the United States. The South African standard, GRAP 102, “*Intangible Assets*” was issued in December 2006 and is based on IAS 38 and modified for public sector use. The UK’s Governmental Financial Reporting Manual “FReM” Chapter 7 deals with intangible assets and is also based on IAS 38 convergence. In the United States, Statement No. 51, “*Accounting and Financial Reporting for Intangible Assets*” issued by the Government Accounting Standards Board (GASB) was also reviewed. While not based on IAS 38, the GASB standard is similar in many respects. It should be noted that few public sector national standard setters have standards on intangible assets.
5. Staff has also received some input from adopters of IPSASs, such as the United Nations, where significant work has been done in the area of intangible assets. As the project develops staff will nurture these and other potential resources in developing the standard, e.g. with examples.
6. The new IPSAS will establish definition and recognition criteria, address measurement and identify specific disclosures for intangible assets. There are some intangible assets that are addressed specifically in other IPSASs (i.e. *intangible assets held for sale in the ordinary course of business* – see IPSAS 11 or 12, *leases* – see IPSAS 13) or other existing projects (i.e. *entity combinations* – see entity combination project).

OVERVIEW OF IAS 38 INTANGIBLE ASSETS

Scope of IAS 38

7. In IAS 38, intangible assets are defined: "An intangible asset is an identifiable non-monetary asset without physical substance." Examples of common intangible assets include trade secrets (e.g., customer lists), copyrights, patents, trademarks, goodwill, as well as intangible related to human capital.
8. Certain items are excluded from the scope of IAS 38 because they are addressed in other IFRS standards. These exclusions include, among others, intangible assets held by an entity for sale in the ordinary course of business, leases, financial assets, goodwill acquired in a business combination, insurer's contractual rights, exploration and evaluation assets, development and extraction of minerals, oil, natural gas and similar non-regenerative resources.
9. IAS 38 and SIC 32 do apply to expenditures on advertising, training, startup, research and development activities, separately acquired intangible assets, web site costs, internally generated intangible assets, and internally generated goodwill.

Definition Criteria (see IAS 38.9-38.17)

10. As noted, an intangible asset is an identifiable non-monetary asset without physical substance. In order to meet the definition of an intangible asset there are three elements that must exist – identifiability, control over a resource and existence of future economic benefits.
 - i) **Identifiability**
11. In order for an asset to be identifiable it must be separable or it must arise from a contractual or legal right. Something is separable when it is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged. When an asset arises from a contractual or legal right, these rights may be transferable or separable from the entity or from others' rights and obligations. An asset that arises from a contractual or legal right will qualify as identifiable.
 - ii) **Control over a resource**
12. An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. This would normally stem from a legal right, enforceable in a court of law. Without legal rights it is more difficult to demonstrate control, but it is possible.
13. An example of this would be control over technical knowledge. An entity may control technical knowledge, for example, when protected by legal rights such as copyrights, restraint of trade agreements, or confidentiality agreements.

Conversely, control would not be demonstrated when an entity has a unique training program that may lead to future economic benefit, but that is not protected by legal rights.

iii) Future Economic Benefits

14. The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity.

Recognition Criteria

15. The recognition of an intangible asset requires an entity to demonstrate that the item meets the definition of an intangible asset (as described above) and meets specified recognition criteria. These are that it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and that the cost of the asset can be reliably measured.

i) Probable expected future economic benefit

16. The probability of expected future economic benefits would be assessed using reasonable and supportable assumptions of management's best estimate of the economic conditions.
17. The probability criterion is always deemed to be met for separately acquired intangibles and for those acquired as part of a business combination. This is because the market price an entity pays for a separately acquired intangible will reflect expectations about the probability of economic benefits flowing to holder, as well as the price reflected as part of a business combination.

ii) Cost Measured Reliably

18. Separately acquired intangible assets can usually be measured reliably, because a market exists. This is obviously true if the purchase consideration is in the form of cash or other monetary assets. Likewise, when acquired as part of a business combination, the cost of an intangible asset will be its fair market value at the acquisition date.

Measurement

19. IAS 38 addresses various aspects of measurement.
20. For initial measurement, intangible assets acquired in an exchange transaction will be measured at cost. Intangibles acquired in a business combination are recorded at fair value at the acquisition date.
21. Expenditure on an intangible item that was initially recognized as an expense would not be recognized as part of the cost of an intangible asset at a later date.

22. After initial recognition, an entity will choose either the cost model or the revaluation model to measure intangibles. Under the cost model an intangible asset is carried at its cost less any accumulated amortization and any accumulated impairment losses. Under the 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.
23. An intangible asset would be amortized when it has a *finite* useful life. In this case, the depreciable amount of an intangible asset with a finite useful life would be allocated on a systematic basis over its useful life. When the life of an intangible asset is *indefinite* it would not be amortized. The assessment that the useful life is indefinite would be reviewed regularly.

Internally Generated Intangible Assets

24. Many internally-generated intangibles will fail to be recognized because it is difficult to demonstrate that expected future economic benefit will be generated and because of problems in determining the cost of the asset reliably. To determine if an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into either a research phase or a development phase. No intangible assets arising from research will be recognized. Rather, such expenditures will be expensed as incurred.
25. Intangible assets arising from development would be recognized if, and only if all of the following can be demonstrated:
 - 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.
26. If an entity cannot distinguish the research phase from the development phase of an internal project, the entity will treat the expenditure on that project as if it was incurred in the research phase only and therefore it will be expensed.

ISSUES TO BE CONSIDERED BY THE IPSASB

a) Rights granted by statute or legislation

27. When applying the IAS 38 Identifiable Criterion in the public sector, issues relating to legal rights take on an expanded meaning. Private sector intangible assets can arise from contractual or legal rights. However, when applied in a public sector context this may extend recognition to situations not intended to be

- included as assets. For example, by statute governments may be given the legal right to levy taxes. Examples of other situations where rights are granted by statute include: radio frequency spectrum, granting of fishing licenses, casino licenses, and cellular telephone operating licenses.
28. Public sector standard-setters (South Africa and United States) that have addressed the recognition of intangible assets in the public sector acknowledge that some intangible assets, for example the right to levy taxes, are granted in legislation. There is no cost to acquire or construct the intangible asset. A municipality cannot sell the right to levy rates. There is a cost associated with the exercise of this right, such as the preparation of a valuation roll. This cost should be expensed as incurred.
 29. In the private sector this situation does not exist, and creates an issue for the public sector because of the inherent role that governments have.
 30. Expenditures are incurred in allocating rights or licenses, and ensuring license conditions are enforced. Rights granted by statute or legislation are not identifiable because they cannot be separable by sale or transfer. Additionally, in contrast to intangible assets that are separately acquired or internally generated, the cost (of exercising) rights granted by statute or legislation usually have no market and cannot be measured easily and reliably.
 31. Staff proposes that the identifiable criterion be modified to state that rights established by legislation do not give rise to intangible assets and should be expensed. This would follow the same approach as the South Africa Standard on intangible assets.

<p>Staff Recommendation: That the identifiable criterion should be modified to exclude rights established by legislation.</p>
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b) Future economic benefits or service potential

32. In IPSAS 01, *Presentation of Financial Statements* the IPSASB outlines an overarching principle that has been applied to the definition of assets within the existing IPSASs. Assets that are used to generate net cash inflows are described as embodying “future economic benefits.” Within the public sector, assets used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential.”
33. In IAS 38, as within other IASs/IFRSs standards dealing with assets the term “future economic benefit” is used. In other IPSASs that are converged with IFRSs this term has been consistently modified to be “future economic benefits or service potential.” As described in IPSAS 1, paragraph 11 “to encompass all the purposes to which assets may be put, this Standard uses the term ‘future economic benefits or service potential’ to describe the essential characteristics of assets.”

34. This modification will be necessary to describe the essential characteristics of intangible assets.

Staff Recommendation: That the “service potential” modification be made to this definition requirement

c) Assets Not Acquired or Developed

35. IAS 38 establishes that only intangible assets acquired or developed should be recognized. Intangible items that are not acquired or developed lack identifiable and separable characteristics inherent in the definition and recognition criteria. In the public sector some assets are naturally occurring, for example, non-cultivated biological resources and water resources. Only those resources that have been acquired, transferred or donated and are not included in the value of the associated land would be recognized as an asset under IAS 38.
36. Mineral rights, rivers and other groundwater resources are also administered by government. Only those mineral rights and water resources that have been purchased and which are not included in the value of the associated land would be recognized as an intangible asset under IAS 38.
37. Naturally occurring assets, water resources, air space rights that are not acquired will not meet the recognition requirement that the cost or fair value of the asset can be measured reliably. These powers are generally not obtained by a government through a purchase (or transfer or donation) transaction. Therefore the recognition requirement for reliable cost measurement will not be possible.
38. Based on the fact that these types of assets cannot be reliably measured, they would not meet the recognition criteria and therefore would not be recognized under IAS 38. This is consistent with the principle of IAS 38 which if applied to the public sector, intangibles that resulted from government exercising control over certain rights and costs incurred to manage and regulate the use of an asset should not be recognized as an intangible asset.
39. Acquisition would include transfer or donations as defined in IPSAS 23, “*Revenue from Non-Exchange Transactions (Taxes and Transfers)*.”

Staff Recommendation: Recognizing only those intangible assets acquired or developed is an appropriate principle to be applied in a public sector environment.

d) Internally Generated Goodwill and Intangible Assets

40. Internally generated goodwill will not meet the definition of an intangible asset under IAS 38 and will not be recognized because it is not an identifiable resource (i.e. it is not separable nor does it arise from contractual rights or other legal rights) controlled by the entity that can be measured reliably at cost. This is unlikely to be a major issue in the public sector.

41. As far as internally generated intangible assets, these will be classified into either a research phase or a development phase as noted previously.
42. In the research phase, no intangible asset arising from research will be recognized; expenditures will be expensed when incurred.
43. In the development phase, an intangible asset arising from development will be recognized if and only if, an entity can demonstrate all of the development criteria outline in paragraph 24 (technically feasible, intention to complete, ability to use or sell, probable future economic benefit, availability of resources, measure reliably). (IAS 38.57)
44. Staff has evaluated the conditions surrounding internally generated intangible assets and is not aware of any situations that are unique in this area in the public sector. Staff has reviewed what other public sector standards setters have proposed for the criteria when these assets are generated internally, South Africa and the United States are both in close proximity to the wording as prescribed in IAS 38.
45. Staff proposes that the IAS 38 position on internally generated intangible assets regarding research and development is appropriate to the public sector.

Staff Recommendation: The principles established in IAS 38 concerning internally generated intangible assets are appropriate for the public sector.

e) SIC 32, Web Site Costs

46. SIC 32 outlines stages of development as a basis for recognition as either expense or asset. These states include Planning (expense), Application and Infrastructure (recognize as intangible asset), Content Development (expense), and Operating (expense).
47. Staff have not identified any unique public sector aspects of the treatment (expense or capitalize as intangible asset) of web site costs identified in SIC 32. Staff also relies on the work of South Africa, United States and the United Kingdom all whom have similar treatment.

Staff Recommendation: The provisions concerning recognition of expense or intangible asset for web site costs as defined in SIC 32 are appropriate in the public sector context.

f) Changing recognition from expense to Intangible Asset

48. IAS 38 paragraph 71 states that an expenditure on an intangible item that was initially recognized as an expense should not be recognized as part of the cost of an intangible asset at a later date. The IAS 38 Basis for Conclusions (BCZ43-BCX46) supports this.

49. Staff has not identified any public sector reasons to deviate from the IAS 38 rule.

Staff Recommendation: The provisions of IAS 38 that preclude reclassification of an expense as an intangible asset should also apply in a public sector standard on intangible assets

g) Emissions Trading – Cap and Trade- Allowances

50. Emissions trading and other environmental schemes will continue to be a current topic for the IPSASB as evidenced by the 182 bodies that have signed the Kyoto Protocol as of June 2008.¹
51. **Emissions trading** is an administrative approach used to control pollution by providing economic incentives for achieving reductions in the emissions of pollutants. It is sometimes called **cap and trade**.
52. A central authority (usually a government or international body) sets a limit or *cap* on the amount of a pollutant that can be emitted. Companies or other groups are issued emission permits and are required to hold an equivalent number of *allowances* (or credits) which represent the right to emit a specific amount. The total amount of allowances and credits cannot exceed the cap, limiting total emissions to that level. Companies that need to increase their emissions must buy credits from those who pollute less. The transfer of allowances is referred to as a trade. In effect, the buyer is paying a charge for polluting, while the seller is being rewarded for having reduced emissions by more than was needed. Thus, in theory, those that can easily reduce emissions most cheaply will do so, achieving the pollution reduction at the lowest possible cost to society.²
53. IAS 38 currently does not provide for the accounting treatment of emissions trading. The IASB and IFRIC have considered the issue since 2002 and published IFRIC 3 on the topic of Emissions rights in December 2004.
54. At its meeting in June 2005, the International Accounting Standards Board (IASB) decided to withdraw IFRIC 3 *Emission Rights* with immediate effect.
55. IFRIC 3 attempted to establish accounting treatment for schemes that are based on a ‘cap and trade model’ whereby participating are allocated emissions rights equal to a ‘cap’ (a target level of emissions) and are permitted to trade those emission rights. The IASB had difficulty agreeing on the treatment of the receipt of these rights. There is both an asset and liability component. An asset for holding the right to emit a certain amount and a liability in the amount of the minimum obligation assumed by accepting the asset. The IASB considered various

¹ Wikipedia contributors, "Kyoto Protocol," *Wikipedia, The Free Encyclopedia*, http://en.wikipedia.org/w/index.php?title=Kyoto_Protocol&oldid=216588283 (accessed June 2, 2008).

² Wikipedia contributors, "Emissions trading," *Wikipedia, The Free Encyclopedia*, http://en.wikipedia.org/w/index.php?title=Emissions_trading&oldid=216624864 (accessed June 2, 2008).

- alternatives to measuring the asset at cost or fair market value. In the private sector IAS 20, *Accounting for Government Grants and disclosure of Government Assistance* was also a factor to record a deferred income. The IASB and the IFRIC did not reach consensus on defining when and if the receipt of emission rights met the definition of income under IAS 20, and how such income should be measured.
56. Respondents to the IASB exposure draft were concerned about the accounting treatment of three elements (the allowances, the liability for emissions to date, and the government grant).
 57. From a public sector perspective we are concerned about the treatment in respect to holding the allowance and not the right to grant the allowance.
 58. Staff believes that a public sector entity, that would hold an emissions rights allowance, would apply the provisions of IPSAS 23 "*Revenue from Non-Exchange Transactions (Taxes and Transfers)*." for treatment. IPSAS 23 uses fair market value at the date of receipt as the basis for measurement.
 59. Staff believes this approach is consistent with the provisions of the FReM manual, Chapter 5 page 19 and with the worked example of transactions provided in the FReM. Staff recommends that the IPSASB consider this same example for the IPSAS standard.
 60. Staff will continue to monitor the IASB/IFRIC concerning emissions rights, and will liaise with the UK Financial Reporting Advisory Board on the FReM treatment of emission rights and with the New Zealand Treasury on new work on the Kyoto Protocol.

<p>Staff Recommendation: The provisions of IPSAS 23, Non-exchange revenue should apply to the treatment of emission allowances. Continue to monitor developments with other standard-setters.</p>
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h) Non-exchange transactions

61. Non-exchange transactions are very prevalent in the public sector. Therefore it will be important for this standard to contemplate the major types on non-exchange transactions giving rise to intangible assets as well as the interaction with other IPSAS standards since these have not been addressed in IAS 38.
62. In the private sector intangible assets would normally be acquired in an exchange transaction. Intangibles acquired in an exchange transaction, will be measured initially at cost.
63. Intangible assets acquired in a non-exchange transaction will be accounted for in accordance with IPSAS 23 "*Revenue from Non-Exchange Transactions (Taxes and Transfers)*." Paragraph 31 of IPSAS 23 requires that an asset that is recognized be measured at fair value on initial recognition.

64. An asset acquired through a non-exchange transaction will initially be measured at its fair value as at the date of acquisition. Consistent with IPSAS 12, “Inventories,” IPSAS 16, “Investment Property” and IPSAS 17, “Property, Plant and Equipment” assets acquired through non-exchange transaction are measured at their fair value as at the date of acquisition.

Staff Recommendation: The principles established in IAS 38 do not cover non-exchange transactions. Staff believes that IPSAS 23 covers non-exchange transaction concerning intangible assets. However, staff seeks IPSASB agreement in this area and believes this should be highlighted in the exposure draft.

i) Proposed IPSAS Scope

65. Staff proposes that the scope of IAS 38 be used as a basis for the development of an IPSAS Standard on Intangible Assets; if an IPSAS has not been issued we will refer to the relevant international or national accounting standard dealing with the topic. In accordance with the hierarchy established in IPSAS 3 paragraphs 15 and 26, where there is not a published IPSAS refer to IFRS pronouncements.
66. Comparison of IAS 38 Exclusion with IPSAS existing Standards or Projects

Exclusion	IFRS Standard	IPSAS Standard
intangible assets held by an entity for sale in the ordinary course of business	IAS 2, “ <i>Inventories</i> ” IAS 11, “ <i>Construction Contracts</i> ”	IPSAS 11, “ <i>Construction Contracts</i> ” IPSAS 12, “ <i>Inventories</i> ”
deferred tax assets	IAS 12, “ <i>Income Taxes</i> ”	No IPSAS standard or project (apply hierarchy)
leases	IAS 17, “ <i>Leases</i> ”	IPSAS 13, “ <i>Leases</i> ”
assets arising from employee benefits	IAS 19, “ <i>Employee Benefits</i> ”	IPSAS 25, “ <i>Employee Benefits</i> ”
financial assets	IAS 32, “ <i>Financial Instruments</i> ”	IPSAS 15, “ <i>Financial Instruments; Disclosure and presentation</i> ” <i>Current Project</i> ”
goodwill acquired in a business combination	IFRS 3, “ <i>Business combinations</i> ”	Current Project
insurer's contractual rights	IFRS 4, “ <i>Insurance Contracts</i> ”	No IPSAS standard or project (apply hierarchy)
the recognition and measurement of exploration and evaluation assets	IFRS 6, “ <i>Exploration for and Evaluation of Mineral Resources</i> ”	No IPSAS standard or project (apply hierarchy)

expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources; and non-current intangible assets classified as held for sale	IFRS 5, “ <i>Non-current Assets Held for Sale and Discontinued Operations.</i> ”	No IPSAS standard or project (apply hierarchy)
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Staff Recommendation: The scope of the IPSAS standard will be based on IAS 38 and modified as indicated above for existing IPSAS standards and hierarchy.

j) Transitional Provisions

67. As this project advances we will have to consider transitional provisions that take into account adopting entities to shift to the new accounting policy for intangible assets. For example, a longer implementation period for the proposed IPSAS standard on Intangible Assets may be needed to allow entities to evaluate current arrangements to determine whether an intangible asset should be recognized, and how such a recognized intangible asset should be valued.
68. Provision for an entity that adopts accrual accounting for the first time in accordance with International Public Sector Accounting Standards should be considered.

Staff Recommendation: Consider transitional provisions as the project evolves and input is received from constituents.

IMPORTANT SOURCES OF INFORMATION (CLICK TO FOLLOW LINK)

1. [IASB Intangible Assets Project Page](#)
2. [South Africa – Accounting Standards Board – GRAP 102, Intangible Assets](#)
3. [United States – Government Accounting Standards Board – Statement No. 51, Accounting and Financial Reporting for Intangible Assets](#)
4. [United Kingdom – FReM Government Financial Reporting Manual](#)

APPENDIX A – IAS 38, IASB STANDARD ON INTANGIBLE ASSETS
**APPENDIX B – SIC 32, INTERPRETATION – INTANGIBLE ASSETS – WEB
SITE COSTS**
APPENDIX C – IFAC PROJECT BRIEF

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International Accounting Standard 38

Intangible Assets

This version includes amendments resulting from IFRSs issued up to 17 January 2008.

IAS 38 *Intangible Assets* was issued by the International Accounting Standards Committee in September 1998. It replaced IAS 9 *Research and Development Costs* (issued 1993, replacing an earlier version issued in July 1978). Limited amendments were made in 1998.

In April 2001 the International Accounting Standards Board (IASB) resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

IAS 38 was subsequently amended by the following IFRSs:

- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (issued December 2003)
- IAS 16 *Property, Plant and Equipment* (as revised in December 2003)
- IAS 21 *The Effects of Changes in Foreign Exchange Rates* (as revised in December 2003)
- IFRS 2 *Share-based Payment* (issued February 2004)
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (issued March 2004).

In March 2004 the IASB issued a revised IAS 38, which was also amended by IFRS 5 and has subsequently been amended by the following IFRSs:

- IFRS 6 *Exploration for and Evaluation of Mineral Resources* (issued December 2004)
- IAS 23 *Borrowing Costs* (as revised in March 2007)
- IAS 1 *Presentation of Financial Assets* (as revised in September 2007)
- IFRS 3 *Business Combinations* (as revised in January 2008).

The following Interpretations refer to IAS 38, as revised in 2004:

- SIC-29 *Service Concession Arrangements: Disclosures* (issued December 2001)
- SIC-32 *Intangible Assets—Web Site Costs* (issued March 2002, amended December 2003 and March 2004)
- IFRIC 4 *Determining whether an Arrangement contains a Lease* (issued December 2004)
- IFRIC 12 *Service Concession Arrangements* (issued November 2006 and subsequently amended).

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International Accounting Standard 38 *Intangible Assets* (IAS 38) is set out in paragraphs 1–133. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. IAS 38 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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Introduction

IN1 International Accounting Standard 38 *Intangible Assets* (IAS 38) replaces IAS 38 *Intangible Assets* (issued in 1998), and should be applied:

- (a) on acquisition to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004.
- (b) to all other intangible assets, for annual periods beginning on or after 31 March 2004.

Earlier application is encouraged.

Reasons for revising IAS 38

IN2 The International Accounting Standards Board developed this revised IAS 38 as part of its project on business combinations. The project's objective is to improve the quality of, and seek international convergence on, the accounting for business combinations and the subsequent accounting for goodwill and intangible assets acquired in business combinations.

IN3 The project has two phases. The first phase resulted in the Board issuing simultaneously IFRS 3 *Business Combinations* and revised versions of IAS 38 and IAS 36 *Impairment of Assets*. The Board's deliberations during the first phase of the project focused primarily on:

- (a) the method of accounting for business combinations;
- (b) the initial measurement of the identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination;
- (c) the recognition of provisions for terminating or reducing the activities of an acquiree;
- (d) the treatment of any excess of the acquirer's interest in the fair values of identifiable net assets acquired in a business combination over the cost of the combination; and
- (e) the accounting for goodwill and intangible assets acquired in a business combination.

IN4 Therefore, the Board's intention while revising IAS 38 was to reflect only those changes related to its decisions in the Business Combinations project, and *not* to reconsider all of the requirements in IAS 38. The changes that have been made in the Standard are primarily concerned with clarifying the notion of 'identifiability' as it relates to intangible assets, the useful life and amortisation of intangible assets, and the accounting for in-process research and development projects acquired in business combinations.

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Summary of main changes

Definition of an intangible asset

- IN5 The previous version of IAS 38 defined an intangible asset as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. The requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative purposes has been removed from the definition of an intangible asset.
- IN6 The previous version of IAS 38 did not define 'identifiability', but stated that an intangible asset could be distinguished clearly from goodwill if the asset was separable, but that separability was not a necessary condition for identifiability. The Standard states that an asset meets the identifiability criterion in the definition of an intangible asset when it:
- (a) is separable, ie 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
 - (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Criteria for initial recognition

- IN7 The previous version of IAS 38 required an intangible asset to be recognised if, and only if, it was probable that the expected future economic benefits attributable to the asset would flow to the entity, and its cost could be measured reliably. These recognition criteria have been included in the Standard. However, additional guidance has been included to clarify that:
- (a) the probability recognition criterion is always considered to be satisfied for intangible assets that are acquired separately or in a business combination.
 - (b) the fair value of an intangible asset acquired in a business combination can be measured with sufficient reliability to be recognised separately from goodwill.

Subsequent expenditure

- IN8 Under the previous version of IAS 38, the treatment of subsequent expenditure on an in-process research and development project acquired in a business combination and recognised as an asset separately from goodwill was unclear. The Standard requires such expenditure to be:
- (a) recognised as an expense when incurred if it is research expenditure;
 - (b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria in IAS 38 for recognising such expenditure as an intangible asset; and

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- (c) recognised as an intangible asset if it is development expenditure that satisfies the criteria in IAS 38 for recognising such expenditure as an intangible asset.

Useful life

- IN9 The previous version of IAS 38 was based on the assumption that the useful life of an intangible asset is always finite, and included a rebuttable presumption that the useful life cannot exceed twenty years from the date the asset is available for use. That rebuttable presumption has been removed. The Standard requires an intangible asset to be regarded as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
- IN10 The previous version of IAS 38 required that if control over the future economic benefits from an intangible asset was achieved through legal rights granted for a finite period, the useful life of the intangible asset could not exceed the period of those rights, unless the rights were renewable and renewal was virtually certain. The Standard requires that:
 - (a) the useful life of an intangible asset arising from contractual or other legal rights should not exceed the period of those rights, but may be shorter depending on the period over which the asset is expected to be used by the entity; and
 - (b) if the rights are conveyed for a limited term that can be renewed, the useful life should include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

Intangible assets with indefinite useful lives

- IN11 The Standard requires that:
 - (a) an intangible asset with an indefinite useful life should not be amortised.
 - (b) the useful life of such an asset should be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate.

Impairment testing intangible assets with finite useful lives

- IN12 The previous version of IAS 38 required the recoverable amount of an intangible asset that was amortised over a period exceeding twenty years from the date it was available for use to be estimated at least at each financial year-end, even if there was no indication that the asset was impaired. This requirement has been removed. Therefore, an entity needs to determine the recoverable amount of an intangible asset with a finite useful life that is amortised over a period exceeding twenty years from the date it is available for use only when, in accordance with IAS 36, there is an indication that the asset may be impaired.

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Disclosure

IN13 If an intangible asset is assessed as having an indefinite useful life, the Standard requires an entity to disclose the carrying amount of that asset and the reasons supporting the indefinite useful life assessment.

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International Accounting Standard 38

Intangible Assets

Objective

- 1 The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

Scope

- 2 **This Standard shall be applied in accounting for intangible assets, except:**
- (a) **intangible assets that are within the scope of another Standard;**
 - (b) **financial assets, as defined in IAS 32 *Financial Instruments: Presentation*;**
 - (c) **the recognition and measurement of exploration and evaluation assets (see IFRS 6 *Exploration for and Evaluation of Mineral Resources*); and**
 - (d) **expenditure on the development and extraction of, minerals, oil, natural gas and similar non-regenerative resources.**
- 3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:
- (a) intangible assets held by an entity for sale in the ordinary course of business (see IAS 2 *Inventories* and IAS 11 *Construction Contracts*).
 - (b) deferred tax assets (see IAS 12 *Income Taxes*).
 - (c) leases that are within the scope of IAS 17 *Leases*.
 - (d) assets arising from employee benefits (see IAS 19 *Employee Benefits*).
 - (e) financial assets as defined in IAS 32. The recognition and measurement of some financial assets are covered by IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.
 - (f) goodwill acquired in a business combination (see IFRS 3 *Business Combinations*).
 - (g) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4 *Insurance Contracts*. IFRS 4 sets out specific disclosure requirements for those deferred acquisition costs but not for those intangible assets. Therefore, the disclosure requirements in this Standard apply to those intangible assets.

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- (h) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- 4 Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated under IAS 16 *Property, Plant and Equipment* or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant. For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.
- 5 This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (eg a prototype), the physical element of the asset is secondary to its intangible component, ie the knowledge embodied in it.
- 6 In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of IAS 17 and are within the scope of this Standard.
- 7 Exclusions from the scope of a Standard may occur if activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the accounting for expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of insurance contracts. Therefore, this Standard does not apply to expenditure on such activities and contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries or by insurers.

Definitions

- 8 **The following terms are used in this Standard with the meanings specified:**

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.**

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

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An asset is a resource:

- (a) controlled by an entity as a result of past events; and
- (b) from which future economic benefits are expected to flow to the entity.

Carrying amount is the amount at which an asset is recognised in the statement of financial position after deducting any accumulated amortisation and accumulated impairment losses thereon.

Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 *Share-based Payment*.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Development 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.

Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

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

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

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

The *residual value* of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

- (a) the period over which an asset is expected to be available for use by an entity; or
- (b) the number of production or similar units expected to be obtained from the asset by an entity.

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Intangible assets

- 9 Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.
- 10 Not all the items described in paragraph 9 meet the definition of an intangible asset, ie identifiability, control over a resource and existence of future economic benefits. If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date (see paragraph 68).

Identifiability

- 11 The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognised in a business combination is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.
- 12 **An asset is identifiable if it either:**
- (a) **is separable, ie 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, identifiable asset or liability, regardless of whether the entity intends to do so; or**
 - (b) **arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.**

Control

- 13 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.

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- 14 Market and technical knowledge may give rise to future economic benefits. An entity controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.
- 15 An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.
- 16 An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (eg portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

Future economic benefits

- 17 The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and measurement

- 18 The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:
- (a) the definition of an intangible asset (see paragraphs 8–17); and
 - (b) the recognition criteria (see paragraphs 21–23).

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it.

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- 19 Paragraphs 25–32 deal with the application of the recognition criteria to separately acquired intangible assets, and paragraphs 33–43 deal with their application to intangible assets acquired in a business combination. Paragraph 44 deals with the initial measurement of intangible assets acquired by way of a government grant, paragraphs 45–47 with exchanges of intangible assets, and paragraphs 48–50 with the treatment of internally generated goodwill. Paragraphs 51–67 deal with the initial recognition and measurement of internally generated intangible assets.
- 20 The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognised in the carrying amount of an asset. Consistently with paragraph 63, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally acquired or internally generated) is always recognised in profit or loss as incurred. This is because such expenditure cannot be distinguished from expenditure to develop the business as a whole.
- 21 **An intangible asset shall be recognised if, and only if:**
- (a) **it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and**
 - (b) **the cost of the asset can be measured reliably.**
- 22 **An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management’s best estimate of the set of economic conditions that will exist over the useful life of the asset.**
- 23 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.
- 24 **An intangible asset shall be measured initially at cost.**

Separate acquisition

- 25 Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets.

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- 26 In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.
- 27 The cost of a separately acquired intangible asset comprises:
- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
 - (b) any directly attributable cost of preparing the asset for its intended use.
- 28 Examples of directly attributable costs are:
- (a) costs of employee benefits (as defined in IAS 19) arising directly from bringing the asset to its working condition;
 - (b) professional fees arising directly from bringing the asset to its working condition; and
 - (c) costs of testing whether the asset is functioning properly.
- 29 Examples of expenditures that are not part of the cost of an intangible asset are:
- (a) costs of introducing a new product or service (including costs of advertising and promotional activities);
 - (b) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
 - (c) administration and other general overhead costs.
- 30 Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:
- (a) costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use; and
 - (b) initial operating losses, such as those incurred while demand for the asset's output builds up.
- 31 Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised immediately in profit or loss, and included in their respective classifications of income and expense.
- 32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with IAS 23 *Borrowing Costs*.

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Acquisition as part of a business combination

- 33 In accordance with IFRS 3 *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. Thus, the reliable measurement criterion in paragraph 21(b) is always considered to be satisfied for intangible assets acquired in business combinations.
- 34 In accordance with this Standard and IFRS 3 (as revised in 2008), an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset. An acquiree's in-process research and development project meets the definition of an intangible asset when it:
- (a) meets the definition of an asset; and
 - (b) is identifiable, ie is separable or arises from contractual or other legal rights.

Measuring the fair value of an intangible asset acquired in a business combination

- 35 If an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the asset's fair value.
- 36 An intangible asset acquired in a business combination might be separable, but only together with a related tangible or intangible asset. For example, a magazine's publishing title might not be able to be sold separately from a related subscriber database, or a trademark for natural spring water might relate to a particular spring and could not be sold separately from the spring. In such cases, the acquirer recognises the group of assets as a single asset separately from goodwill if the individual fair values of the assets in the group are not reliably measurable.
- 37 Similarly, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and

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technological expertise. The acquirer recognises as a single asset a group of complementary intangible assets comprising a brand if the individual fair values of the complementary assets are not reliably measurable. If the individual fair values of the complementary assets are reliably measurable, an acquirer may recognise them as a single asset provided the individual assets have similar useful lives.

38 [Deleted]

39 Quoted market prices in an active market provide the most reliable estimate of the fair value of an intangible asset (see also paragraph 78). The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

40 If no active market exists for an intangible asset, its fair value is the amount that the entity would have paid for the asset, at the acquisition date, in an arm's length transaction between knowledgeable and willing parties, on the basis of the best information available. In determining this amount, an entity considers the outcome of recent transactions for similar assets.

41 Entities that are regularly involved in the purchase and sale of unique intangible assets may have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in a business combination if their objective is to estimate fair value and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, when appropriate:

- (a) applying multiples reflecting current market transactions to indicators that drive the profitability of the asset (such as revenue, market shares and operating profit) or to the royalty stream that could be obtained from licensing the intangible asset to another party in an arm's length transaction (as in the 'relief from royalty' approach); or
- (b) discounting estimated future net cash flows from the asset.

Subsequent expenditure on an acquired in-process research and development project

42 **Research or development expenditure that:**

- (a) relates to an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset; and**
- (b) is incurred after the acquisition of that project**

shall be accounted for in accordance with paragraphs 54-62.

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- 43 Applying the requirements in paragraphs 54–62 means that subsequent expenditure on an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset is:
- (a) recognised as an expense when incurred if it is research expenditure;
 - (b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 57; and
 - (c) added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 57.

Acquisition by way of a government grant

- 44 In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may happen when a government transfers or allocates to an entity intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. In accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, an entity may choose to recognise both the intangible asset and the grant initially at fair value. If an entity chooses not to recognise the asset initially at fair value, the entity recognises the asset initially at a nominal amount (the other treatment permitted by IAS 20) plus any expenditure that is directly attributable to preparing the asset for its intended use.

Exchanges of assets

- 45 One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.
- 46 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
- (a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
 - (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

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- (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

- 47 Paragraph 21(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset for which comparable market transactions do not exist is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Internally generated goodwill

- 48 **Internally generated goodwill shall not be recognised as an asset.**
- 49 In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (ie it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.
- 50 Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

Internally generated intangible assets

- 51 It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:
 - (a) identifying whether and when there is an identifiable asset that will generate expected future economic benefits; and
 - (b) determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies the requirements and guidance in paragraphs 52–67 to all internally generated intangible assets.

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52 To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

- (a) a research phase; and
- (b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this Standard.

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

Research phase

54 **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.**

55 In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred.

56 Examples of research activities are:

- (a) activities aimed at obtaining new knowledge;
- (b) the search for, evaluation and final selection of, applications of research findings or other knowledge;
- (c) the search for alternatives for materials, devices, products, processes, systems or services; and
- (d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development phase

57 **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. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.**

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- (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.**

58 In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits. This is because the development phase of a project is further advanced than the research phase.

59 Examples of development activities are:

- (a) the design, construction and testing of pre-production or pre-use prototypes and models;
- (b) the design of tools, jigs, moulds and dies involving new technology;
- (c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- (d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

60 To demonstrate how an intangible asset will generate probable future economic benefits, an entity assesses the future economic benefits to be received from the asset using the principles in IAS 36 *Impairment of Assets*. If the asset will generate economic benefits only in combination with other assets, the entity applies the concept of cash-generating units in IAS 36.

61 Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the entity's ability to secure those resources. In some cases, an entity demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.

62 An entity's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.

63 **Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.**

64 Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an internally generated intangible asset

65 The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.

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66 The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:

- (a) costs of materials and services used or consumed in generating the intangible asset;
- (b) costs of employee benefits (as defined in IAS 19) arising from the generation of the intangible asset;
- (c) fees to register a legal right; and
- (d) amortisation of patents and licences that are used to generate the intangible asset.

IAS 23 specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

67 The following are not components of the cost of an internally generated intangible asset:

- (a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;
- (b) identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and
- (c) expenditure on training staff to operate the asset.

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Example illustrating paragraph 65

An entity is developing a new production process. During 20X5, expenditure incurred was CU1,000^(a), of which CU900 was incurred before 1 December 20X5 and CU100 was incurred between 1 December 20X5 and 31 December 20X5. The entity is able to demonstrate that, at 1 December 20X5, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be CU500.

At the end of 20X5, the production process is recognised as an intangible asset at a cost of CU100 (expenditure incurred since the date when the recognition criteria were met, ie 1 December 20X5). The CU900 expenditure incurred before 1 December 20X5 is recognised as an expense because the recognition criteria were not met until 1 December 20X5. This expenditure does not form part of the cost of the production process recognised in the statement of financial position.

During 20X6, expenditure incurred is CU2,000. At the end of 20X6, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be CU1,900.

At the end of 20X6, the cost of the production process is CU2,100 (CU100 expenditure recognised at the end of 20X5 plus CU2,000 expenditure recognised in 20X6). The entity recognises an impairment loss of CU200 to adjust the carrying amount of the process before impairment loss (CU2,100) to its recoverable amount (CU1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in IAS 36 are met.

(a) In this Standard, monetary amounts are denominated in 'currency units' (CU).

Recognition of an expense

- 68 **Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:**
- (a) **it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 18–67); or**
 - (b) **the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, it forms part of the amount recognised as goodwill at the acquisition date (see IFRS 3).**
- 69 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is recognised as an expense when

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it is incurred (see paragraph 54), except when it forms part of a business combination. Other examples of expenditure that is recognised as an expense when it is incurred include:

- (a) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with IAS 16. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) or expenditures for starting new operations or launching new products or processes (ie pre-operating costs).
- (b) expenditure on training activities.
- (c) expenditure on advertising and promotional activities.
- (d) expenditure on relocating or reorganising part or all of an entity.

70 Paragraph 68 does not preclude recognising a prepayment as an asset when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services.

Past expenses not to be recognised as an asset

71 **Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.**

Measurement after recognition

72 **An entity shall choose either the cost model in paragraph 74 or the revaluation model in paragraph 75 as its accounting policy. If an intangible 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.**

73 A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. The items within a class of intangible assets are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

Cost model

74 **After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortisation and any accumulated impairment losses.**

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Revaluation model

- 75 **After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market. Revaluations shall 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.**
- 76 The revaluation model does not allow:
- (a) the revaluation of intangible assets that have not previously been recognised as assets; or
 - (b) the initial recognition of intangible assets at amounts other than cost.
- 77 The revaluation model is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 65), the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received by way of a government grant and recognised at a nominal amount (see paragraph 44).
- 78 It is uncommon for an active market with the characteristics described in paragraph 8 to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable taxi licences, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public.
- 79 The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.
- 80 If an intangible asset is revalued, any accumulated amortisation at the date of the revaluation is either:
- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount; or
 - (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.

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- 81 **If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortisation and impairment losses.**
- 82 **If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.**
- 83 The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with IAS 36.
- 84 If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.
- 85 **If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.**
- 86 **If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.**
- 87 The cumulative revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the entity; in such a case, the amount of the surplus realised is the difference between amortisation based on the revalued carrying amount of the asset and amortisation that would have been recognised based on the asset's historical cost. The transfer from revaluation surplus to retained earnings is not made through profit or loss.

Useful life

- 88 **An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.**
- 89 The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised (see paragraphs 97–106), and an intangible asset with an indefinite useful life is not (see paragraphs 107–110). The Illustrative Examples accompanying this Standard illustrate the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.

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- 90 Many factors are considered in determining the useful life of an intangible asset, including:
- (a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;
 - (b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;
 - (c) technical, technological, commercial or other types of obsolescence;
 - (d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
 - (e) expected actions by competitors or potential competitors;
 - (f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;
 - (g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
 - (h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.
- 91 The term 'indefinite' does not mean 'infinite'. The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.
- 92 Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life is short.
- 93 The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.
- 94 **The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.**

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- 95 There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.
- 96 Existence of the following factors, among others, indicates that an entity would be able to renew the contractual or other legal rights without significant cost:
- (a) there is evidence, possibly based on experience, that the contractual or other legal rights will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;
 - (b) there is evidence that any conditions necessary to obtain renewal will be satisfied; and
 - (c) the cost to the entity of renewal is not significant when compared with the future economic benefits expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits expected to flow to the entity from renewal, the 'renewal' cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

Intangible assets with finite useful lives

Amortisation period and amortisation method

- 97 **The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.**
- 98 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits. There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method.

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- 99 Amortisation is usually recognised in profit or loss. However, sometimes the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the amortisation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see IAS 2 *Inventories*).

Residual value

- 100 **The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:**

- (a) **there is a commitment by a third party to purchase the asset at the end of its useful life; or**
- (b) **there is an active market for the asset and:**
 - (i) **residual value can be determined by reference to that market; and**
 - (ii) **it is probable that such a market will exist at the end of the asset's useful life.**

- 101 The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.

- 102 An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

- 103 The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortisation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

Review of amortisation period and amortisation method

- 104 **The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with IAS 8.**

- 105 During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

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- 106 Over time, the pattern of future economic benefits expected to flow to an entity from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Intangible assets with indefinite useful lives

- 107 An intangible asset with an indefinite useful life shall not be amortised.**
- 108 In accordance with IAS 36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount
- (a) annually, and
 - (b) whenever there is an indication that the intangible asset may be impaired.

Review of useful life assessment

- 109 The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with IAS 8.**
- 110 In accordance with IAS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.

Recoverability of the carrying amount—impairment losses

- 111 To determine whether an intangible asset is impaired, an entity applies IAS 36. That Standard explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.

Retirements and disposals

- 112 An intangible asset shall be derecognised:**
- (a) on disposal; or
 - (b) when no future economic benefits are expected from its use or disposal.

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- 113 **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised (unless IAS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.**
- 114 The disposal of an intangible asset may occur in a variety of ways (eg by sale, by entering into a finance lease, or by donation). In determining the date of disposal of such an asset, an entity applies the criteria in IAS 18 *Revenue* for recognising revenue from the sale of goods. IAS 17 applies to disposal by a sale and leaseback.
- 115 If in accordance with the recognition principle in paragraph 21 an entity recognises in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognises the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.
- 115A In the case of a reacquired right in a business combination, if the right is subsequently reissued (sold) to a third party, the related carrying amount, if any, shall be used in determining the gain or loss on reissue.
- 116 The consideration receivable on disposal of an intangible asset is recognised initially at its fair value. If payment for the intangible asset is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with IAS 18 reflecting the effective yield on the receivable.
- 117 Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5.

Disclosure

General

- 118 **An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:**
- (a) **whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used;**
 - (b) **the amortisation methods used for intangible assets with finite useful lives;**
 - (c) **the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;**
 - (d) **the line item(s) of the statement of comprehensive income in which any amortisation of intangible assets is included;**

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- (e) **a reconciliation of the carrying amount at the beginning and end of the period showing:**
 - (i) **additions, indicating separately those from internal development, those acquired separately, and those acquired through business combinations;**
 - (ii) **assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;**
 - (iii) **increases or decreases during the period resulting from revaluations under paragraphs 75, 85 and 86 and from impairment losses recognised or reversed in other comprehensive income in accordance with IAS 36 (if any);**
 - (iv) **impairment losses recognised in profit or loss during the period in accordance with IAS 36 (if any);**
 - (v) **impairment losses reversed in profit or loss during the period in accordance with IAS 36 (if any);**
 - (vi) **any amortisation recognised during the period;**
 - (vii) **net exchange differences arising on the translation of the financial statements into the presentation currency, and on the translation of a foreign operation into the presentation currency of the entity; and**
 - (viii) **other changes in the carrying amount during the period.**

119 A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. Examples of separate classes may include:

- (a) brand names;
- (b) mastheads and publishing titles;
- (c) computer software;
- (d) licences and franchises;
- (e) copyrights, patents and other industrial property rights, service and operating rights;
- (f) recipes, formulae, models, designs and prototypes; and
- (g) intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

120 An entity discloses information on impaired intangible assets in accordance with IAS 36 in addition to the information required by paragraph 118(e)(iii)–(v).

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- 121 IAS 8 requires an entity to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods. Such disclosure may arise from changes in:
- (a) the assessment of an intangible asset's useful life;
 - (b) the amortisation method; or
 - (c) residual values.
- 122 **An entity shall also disclose:**
- (a) **for an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.**
 - (b) **a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements.**
 - (c) **for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 44):**
 - (i) **the fair value initially recognised for these assets;**
 - (ii) **their carrying amount; and**
 - (iii) **whether they are measured after recognition under the cost model or the revaluation model.**
 - (d) **the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.**
 - (e) **the amount of contractual commitments for the acquisition of intangible assets.**
- 123 When an entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset is indefinite, the entity considers the list of factors in paragraph 90.

Intangible assets measured after recognition using the revaluation model

- 124 **If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:**
- (a) **by class of intangible assets:**
 - (i) **the effective date of the revaluation;**
 - (ii) **the carrying amount of revalued intangible assets; and**

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(iii) **the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 74;**

(b) **the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders; and**

(c) **the methods and significant assumptions applied in estimating the assets' fair values.**

125 It may be necessary to aggregate the classes of revalued assets into larger classes for disclosure purposes. However, classes are not aggregated if this would result in the combination of a class of intangible assets that includes amounts measured under both the cost and revaluation models.

Research and development expenditure

126 **An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.**

127 Research and development expenditure comprises all expenditure that is directly attributable to research or development activities (see paragraphs 66 and 67 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 126).

Other information

128 An entity is encouraged, but not required, to disclose the following information:

- (a) a description of any fully amortised intangible asset that is still in use; and
- (b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before the version of IAS 38 *Intangible Assets* issued in 1998 was effective.

Transitional provisions and effective date

129 [Deleted]

130 An entity shall apply this Standard:

- (a) to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004; and
- (b) to the accounting for all other intangible assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of such intangible assets. If, as a result of that reassessment, the entity changes its assessment of the useful life of an asset, that change shall be accounted for as a change in an accounting estimate in accordance with IAS 8.

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- 130A An entity shall apply the amendments in paragraph 2 for annual periods beginning on or after 1 January 2006. If an entity applies IFRS 6 for an earlier period, those amendments shall be applied for that earlier period.
- 130B IAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraphs 85, 86 and 118(e)(iii). An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.
- 130C IFRS 3 (as revised in 2008) amended paragraphs 12, 33–35, 68, 69, 94 and 130, deleted paragraphs 38 and 129 and added paragraph 115A. An entity shall apply prospectively those amendments for annual periods beginning on or after 1 July 2009. Therefore, amounts recognised for intangible assets and goodwill in prior business combinations shall not be adjusted. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.

Exchanges of similar assets

- 131 The requirement in paragraphs 129 and 130(b) to apply this Standard prospectively means that if an exchange of assets was measured before the effective date of this Standard on the basis of the carrying amount of the asset given up, the entity does not restate the carrying amount of the asset acquired to reflect its fair value at the acquisition date.

Early application

- 132 Entities to which paragraph 130 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 130. However, if an entity applies this Standard before those effective dates, it also shall apply IFRS 3 and IAS 36 (as revised in 2004) at the same time.

Withdrawal of IAS 38 (issued 1998)

- 133 This Standard supersedes IAS 38 *Intangible Assets* (issued in 1998).

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Approval of IAS 38 by the Board

International Accounting Standard 38 *Intangible Assets* was approved for issue by thirteen of the fourteen members of the International Accounting Standards Board. Professor Whittington dissented. His dissenting opinion is set out after the Basis for Conclusions on IAS 38.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
Harry K Schmid	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

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Basis for Conclusions on IAS 38 *Intangible Assets*

The International Accounting Standards Board revised IAS 38 as part of its project on business combinations. It was not the Board's intention to reconsider as part of that project all of the requirements in IAS 38.

The previous version of IAS 38 was accompanied by a Basis for Conclusions summarising the former International Accounting Standards Committee's considerations in reaching some of its conclusions in that Standard. For convenience the Board has incorporated into its own Basis for Conclusions material from the previous Basis for Conclusions that discusses (a) matters the Board did not reconsider and (b) the history of the development of a standard on intangible assets. That material is contained in paragraphs denoted by numbers with the prefix BCZ. Paragraphs describing the Board's considerations in reaching its own conclusions are numbered with the prefix BC.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IAS 38 *Intangible Assets*. Individual Board members gave greater weight to some factors than to others.
- BC2 The International Accounting Standards Committee (IASC) issued the previous version of IAS 38 in 1998. It has been revised by the Board as part of its project on business combinations. That project has two phases. The first has resulted in the Board issuing simultaneously IFRS 3 *Business Combinations* and revised versions of IAS 38 and IAS 36 *Impairment of Assets*. Therefore, the Board's intention in revising IAS 38 as part of the first phase of the project was not to reconsider all of the requirements in IAS 38. The changes to IAS 38 are primarily concerned with:
- (a) the notion of 'identifiability' as it relates to intangible assets;
 - (b) the useful life and amortisation of intangible assets; and
 - (c) the accounting for in-process research and development projects acquired in business combinations.
- BC3 With the exception of research and development projects acquired in business combinations, the Board did not reconsider the requirements in the previous version of IAS 38 on the recognition of internally generated intangible assets. The previous version of IAS 38 was accompanied by a Basis for Conclusions summarising IASC's considerations in reaching some of its conclusions in that Standard. For convenience, the Board has incorporated into this Basis for Conclusions material from the previous Basis for Conclusions that discusses the recognition of internally generated intangible assets (see paragraphs BCZ29–BCZ46) and the history of the development of a standard on intangible assets (see paragraphs BCZ104–BCZ110). The views expressed in paragraphs BCZ29–BCZ46 and BCZ104–BCZ110 are those of IASC.

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Definition of an intangible asset (paragraph 8)

BC4 An intangible asset was defined in the previous version of IAS 38 as ‘an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative services’. The definition in the revised Standard eliminates the requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative services.

BC5 The Board observed that the essential characteristics of intangible assets are that they:

- (a) are resources controlled by the entity from which future economic benefits are expected to flow to the entity;
- (b) lack physical substance; and
- (c) are identifiable.

The Board concluded that the purpose for which an entity holds an item with these characteristics is not relevant to its classification as an intangible asset, and that all such items should be within the scope of the Standard.

Identifiability (paragraph 12)

BC6 Under the Standard, as under the previous version of IAS 38, a non-monetary asset without physical substance must be identifiable to meet the definition of an intangible asset. The previous version of IAS 38 did not define ‘identifiability’, but stated that an intangible asset could be distinguished from goodwill if the asset was separable, but that separability was not a necessary condition for identifiability. The revised Standard requires an asset to be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable, or when it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Background to the Board’s deliberations

BC7 The Board was prompted to consider the issue of ‘identifiability’ as part of the first phase of its Business Combinations project as a result of changes during 2001 to the requirements in Canadian and United States standards on the separate recognition of intangible assets acquired in business combinations. The Board observed that intangible assets comprise an increasing proportion of the assets of many entities, and that intangible assets acquired in a business combination are often included in the amount recognised as goodwill, despite the requirements in IAS 22 *Business Combinations* and IAS 38 for them to be recognised separately from goodwill. The Board agreed with the conclusion reached by the Canadian and US standard-setters that the usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were

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distinguished from goodwill. Therefore, the Board concluded that the IFRS arising from the first phase of the Business Combinations project should provide a definitive basis for identifying and recognising intangible assets acquired in a business combination separately from goodwill.

- BC8 In revising IAS 38 and developing IFRS 3, the Board affirmed the view in the previous version of IAS 38 that identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill. The Board concluded that to provide a definitive basis for identifying and recognising intangible assets separately from goodwill, the concept of identifiability needed to be articulated more clearly.

Clarifying identifiability (paragraph 12)

- BC9 Consistently with the guidance in the previous version of IAS 38, the Board concluded that an intangible asset can be distinguished from goodwill if it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged. Therefore, in the context of intangible assets, separability signifies identifiability, and intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.

- BC10 However, again consistently with the guidance in the previous version of IAS 38, the Board concluded that separability is not the only indication of identifiability. The Board observed that, in contrast to goodwill, the values of many intangible assets arise from rights conveyed legally by contract or statute. In the case of acquired goodwill, its value arises from the collection of assembled assets that make up an acquired entity or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining entities or businesses. The Board also observed that, although many intangible assets are both separable and arise from contractual-legal rights, some contractual-legal rights establish property interests that are not readily separable from the entity as a whole. For example, under the laws of some jurisdictions some licences granted to an entity are not transferable except by sale of the entity as a whole. The Board concluded that the fact that an intangible asset arises from contractual or other legal rights is a characteristic that distinguishes it from goodwill. Therefore, intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.

Non-contractual customer relationships (paragraph 16)

- BC11 The previous version of IAS 38 and the Exposure Draft of Proposed Amendments to IAS 38 stated that 'An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits.' The documents then expanded on this by stating that 'in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the economic benefits from customer relationships and loyalty to consider that such items meet the definition of intangible assets.'

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- BC12 However, the Draft Illustrative Examples accompanying ED 3 *Business Combinations* stated that 'If a customer relationship acquired in a business combination does not arise from a contract, the relationship is recognised as an intangible asset separately from goodwill if it meets the separability criterion. Exchange transactions for the same asset or a similar asset provide evidence of separability of a non-contractual customer relationship and might also provide information about exchange prices that should be considered when estimating fair value.' Whilst respondents to the Exposure Draft generally agreed with the Board's conclusions on the definition of identifiability, some were uncertain about the relationship between the separability criterion for establishing whether a non-contractual customer relationship is identifiable, and the control concept for establishing whether the relationship meets the definition of an asset. Additionally, some respondents suggested that non-contractual customer relationships would, under the proposal in the Exposure Draft, be separately recognised if acquired in a business combination, but not if acquired in a separate transaction.
- BC13 The Board observed that exchange transactions for the same or similar non-contractual customer relationships provide evidence not only that the item is separable, but also that the entity is able to control the expected future economic benefits flowing from that relationship. Similarly, if an entity separately acquires a non-contractual customer relationship, the existence of an exchange transaction for that relationship provides evidence both that the item is separable, and that the entity is able to control the expected future economic benefits flowing from the relationship. Therefore, the relationship would meet the intangible asset definition and be recognised as such. However, in the absence of exchange transactions for the same or similar non-contractual customer relationships, such relationships acquired in a business combination would not normally meet the definition of an 'intangible asset'—they would not be separable, nor would the entity be able to demonstrate that it controls the expected future economic benefits flowing from that relationship.
- BC14 Therefore, the Board decided to clarify in paragraph 16 of IAS 38 that in the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

Criteria for initial recognition

- BC15 In accordance with the Standard, as with the previous version of IAS 38, an intangible asset is recognised if, and only if:
- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
 - (b) the cost of the asset can be measured reliably.

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In revising IAS 38 the Board considered the application of these recognition criteria to intangible assets acquired in business combinations. The Board's deliberations on this issue are set out in paragraphs BC16–BC25.

**Acquisition as part of a business combination
(paragraphs 33–38)**

BC16 [Deleted]

BC16A The Board observed that in a business combination both criteria, the probability criterion and the reliability of measurement criterion, will always be met.

Probability recognition criterion

BC17 In revising IAS 38, the Board observed that the fair value of an intangible asset reflects market expectations about the probability that the future economic benefits associated with the intangible asset will flow to the acquirer. In other words, the effect of probability is reflected in the fair value measurement of an intangible asset. Therefore, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations.

BC18 The Board observed that this highlights a general inconsistency between the recognition criteria for assets and liabilities in the *Framework* (which states that an item meeting the definition of an element should be recognised only if it is probable that any future economic benefits associated with the item will flow to or from the entity, and the item can be measured reliably) and the fair value measurements required in, for example, a business combination. However, the Board concluded that the role of probability as a criterion for recognition in the *Framework* should be considered more generally as part of a forthcoming Concepts project.

Reliability of measurement recognition criterion

BC19 [Deleted]

BC19A In developing IFRS 3, the IASB noted that the fair values of identifiable intangible assets acquired in a business combination are normally measurable with sufficient reliability to be recognised separately from goodwill. The effects of uncertainty because of a range of possible outcomes with different probabilities are reflected in measuring the asset's fair value; the existence of such a range does not demonstrate an inability to measure fair value reliably. IAS 38 (as revised in 2004) included a rebuttable presumption that the fair value of an intangible asset with a finite useful life acquired in a business combination can be measured reliably. The Board had concluded that it might not always be possible to measure reliably the fair value of an asset that has an underlying contractual or legal basis. However, IAS 38 (revised 2004) provided that the only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination that arises from legal or other contractual rights were if it either:

- (a) is not separable; or
- (b) is separable, but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would depend on immeasurable variables.

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BC19B In developing the 2005 Business Combinations exposure draft, the Board concluded that separate recognition of intangible assets, on the basis of an estimate of fair value, rather than subsuming them in goodwill, provides better information to the users of financial statements even if a significant degree of judgement is required to estimate fair value. For this reason, the Board decided to propose consequential amendments to IAS 38 to remove the reliability of measurement criterion for intangible assets acquired in a business combination. In redeliberating the proposals in the 2005 Business Combinations exposure draft, the Board affirmed those amendments to IAS 38.

BC20– [Deleted]
BC25

Separate acquisition (paragraphs 25 and 26)

BC26 Having decided to include paragraphs 33–38 in IAS 38, the Board also decided that it needed to consider the role of the probability and reliability of measurement recognition criteria for separately acquired intangible assets.

BC27 Consistently with its conclusion about the role of probability in the recognition of intangible assets acquired in business combinations, the Board concluded that the probability recognition criterion is always considered to be satisfied for separately acquired intangible assets. This is because the price an entity pays to acquire separately an intangible asset normally reflects expectations about the probability that the expected future economic benefits associated with the intangible asset will flow to the entity. In other words, the effect of probability is reflected in the cost of the intangible asset.

BC28 The Board also concluded that when an intangible asset is separately acquired in exchange for cash or other monetary assets, sufficient information should exist to measure the cost of that asset reliably. However, this might not be the case when the purchase consideration comprises non-monetary assets. Therefore, the Board decided to carry forward from the previous version of IAS 38 guidance clarifying that the cost of a separately acquired intangible asset can usually be measured reliably, particularly when the purchase consideration is cash or other monetary assets.

Internally generated intangible assets (paragraphs 51–67)

BCZ29 The controversy relating to internally generated intangible assets surrounds whether there should be:

- (a) a requirement to recognise internally generated intangible assets in the balance sheet whenever certain criteria are met;
- (b) a requirement to recognise expenditure on all internally generated intangible assets as an expense;
- (c) a requirement to recognise expenditure on all internally generated intangible assets as an expense, with certain specified exceptions; or
- (d) an option to choose between the treatments described in (a) and (b) above.

IAS 38 BC

Background on the requirements for internally generated intangible assets

BCZ30 Before IAS 38 was issued in 1998, some internally generated intangible assets (those that arose from development expenditure) were dealt with under IAS 9 *Research and Development Costs*. The development of, and revisions to, IAS 9 had always been controversial.

BCZ31 Proposed and approved requirements for the recognition of an asset arising from development expenditure and other internally generated intangible assets had been the following:

- (a) in 1978, IASC approved IAS 9 *Accounting for Research and Development Activities*. It required expenditure on research and development to be recognised as an expense when incurred, except that an enterprise had the option to recognise an asset arising from development expenditure whenever certain criteria were met.
- (b) in 1989, Exposure Draft E32 *Comparability of Financial Statements* proposed retaining IAS 9's option to recognise an asset arising from development expenditure if certain criteria were met and identifying:
 - (i) as a preferred treatment, recognising all expenditure on research and development as an expense when incurred; and
 - (ii) as an allowed alternative treatment, recognising an asset arising from development expenditure whenever certain criteria were met.

The majority of commentators on E32 did not support maintaining an option or the proposed preferred treatment.

- (c) in 1991, Exposure Draft E37 *Research and Development Costs* proposed requiring the recognition of an asset arising from development expenditure whenever certain criteria were met. In 1993, IASC approved IAS 9 *Research and Development Costs* based on E37.
- (d) in 1995, consistently with IAS 9, Exposure Draft E50 *Intangible Assets* proposed requiring internally generated intangible assets—other than those arising from development expenditure, which would still have been covered by IAS 9—to be recognised as assets whenever certain criteria were met.
- (e) in 1997, Exposure Draft E60 *Intangible Assets* proposed:
 - (i) retaining E50's proposals for the recognition of internally generated intangible assets; but
 - (ii) extending the scope of the Standard on intangible assets to deal with all internally generated intangible assets—including those arising from development expenditure.
- (f) in 1998, IASC approved:
 - (i) IAS 38 *Intangible Assets* based on E60, with a few minor changes; and
 - (ii) the withdrawal of IAS 9.

IAS 38 BC

BCZ32 From 1989, the majority view at IASC and from commentators was that there should be only one treatment that would require an internally generated intangible asset—whether arising from development expenditure or other expenditure—to be recognised as an asset whenever certain recognition criteria are met. Several minority views were strongly opposed to this treatment but there was no clear consensus on any other single treatment.

Combination of IAS 9 with the Standard on intangible assets

BCZ33 The reasons for not retaining IAS 9 as a separate Standard were that:

- (a) IASC believed that an identifiable asset that results from research and development activities is an intangible asset because knowledge is the primary outcome of these activities. Therefore, IASC supported treating expenditure on research and development activities similarly to expenditure on activities intended to create any other internally generated intangible assets.
- (b) some commentators on E50, which proposed to exclude research and development expenditures from its scope,
 - (i) argued that it was sometimes difficult to identify whether IAS 9 or the proposed Standard on intangible assets should apply, and
 - (ii) perceived differences in accounting treatments between IAS 9 and E50's proposals, whereas this was not IASC's intent.

BCZ34 A large majority of commentators on E60 supported including certain aspects of IAS 9 with the proposed Standard on intangible assets and the withdrawal of IAS 9. A minority of commentators on E60 supported maintaining two separate Standards. This minority supported the view that internally generated intangible assets should be dealt with on a case-by-case basis with separate requirements for different types of internally generated intangible assets. These commentators argued that E60's proposed recognition criteria were too general to be effective in practice for all internally generated intangible assets.

BCZ35 IASC rejected a proposal to develop separate standards (or detailed requirements within one standard) for specific types of internally generated intangible assets because, as explained above, IASC believed that the same recognition criteria should apply to all types of internally generated intangible assets.

Consequences of combining IAS 9 with IAS 38

BCZ36 The requirements in IAS 38 and IAS 9 differ in the following main respects:

- (a) IAS 9 limited the amount of expenditure that could initially be recognised for an asset arising from development expenditure (ie the amount that formed the cost of such an asset) to the amount that was probable of being recovered from the asset. Instead, IAS 38 requires that:
 - (i) all expenditure incurred from when the recognition criteria are met until the asset is available for use should be accumulated to form the cost of the asset; and

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- (ii) an enterprise should test for impairment, at least annually, an intangible asset that is not yet available for use. If the cost recognised for the asset exceeds its recoverable amount, an enterprise recognises an impairment loss accordingly. This impairment loss should be reversed if the conditions for reversals of impairment losses under IAS 36 *Impairment of Assets* are met.
 - (b) IAS 38 permits an intangible asset to be measured after recognition at a revalued amount less subsequent amortisation and subsequent impairment losses. IAS 9 did not permit this treatment. However, it is highly unlikely that an active market (the condition required to revalue intangible assets) will exist for an asset that arises from development expenditure.
 - (c) IAS 38 requires consideration of residual values in determining the depreciable amount of an intangible asset. IAS 9 prohibited the consideration of residual values. However, IAS 38 sets criteria that make it highly unlikely that an asset that arises from development expenditure would have a residual value above zero.
- BCZ37 IASC believed that, in practice, it would be unlikely that the application of IAS 38 would result in differences from the application of IAS 9.

Recognition of expenditure on all internally generated intangible assets as an expense

- BCZ38 Those who favour the recognition of expenditure on all internally generated intangible assets (including development expenditure) as an expense argue that:
- (a) internally generated intangible assets do not meet the *Framework's* requirements for recognition as an asset because:
 - (i) the future economic benefits that arise from internally generated intangible assets cannot be distinguished from future economic benefits that arise from internally generated goodwill; and/or
 - (ii) it is impossible to distinguish reliably the expenditure associated with internally generated intangible assets from the expenditure associated with enhancing internally generated goodwill.
 - (b) comparability of financial statements will not be achieved. This is because the judgement involved in determining whether it is probable that future economic benefits will flow from internally generated intangible assets is too subjective to result in similar accounting under similar circumstances.
 - (c) it is not possible to assess reliably the amount that can be recovered from an internally generated intangible asset, unless its fair value can be determined by reference to an active market. Therefore, recognising an internally generated intangible asset for which no active market exists at an amount other than zero may mislead investors.

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- (d) a requirement to recognise internally generated intangible assets at cost if certain criteria are met results in little, if any, decision-useful or predictive information because:
 - (i) demonstration of technological feasibility or commercial success in order to meet the recognition criteria will generally not be achieved until substantial expenditure has been recognised as an expense. Therefore, the cost recognised for an internally generated intangible asset will not reflect the total expenditure on that asset.
 - (ii) the cost of an internally generated intangible asset may not have any relationship to the value of the asset.
- (e) in some countries, users are suspicious about an enterprise that recognises internally generated intangible assets.
- (f) the added costs of maintaining the records necessary to justify and support the recognition of internally generated intangible assets do not justify the benefits.

Recognition of internally generated intangible assets

BCZ39 Those who support the mandatory recognition of internally generated intangible assets (including those resulting from development expenditure) whenever certain criteria are met argue that:

- (a) recognition of an internally generated intangible asset if it meets the definition of an asset and the recognition criteria is consistent with the *Framework*. An enterprise can, in some instances:
 - (i) determine the probability of receiving future economic benefits from an internally generated intangible asset; and
 - (ii) distinguish the expenditure on this asset from expenditure on internally generated goodwill.
- (b) there has been massive investment in intangible assets in the last two decades. There have been complaints that:
 - (i) the non-recognition of investments in intangible assets in the financial statements distorts the measurement of an enterprise's performance and does not allow an accurate assessment of returns on investment in intangible assets; and
 - (ii) if enterprises do not track the returns on investment in intangible assets better, there is a risk of over- or under-investing in important assets. An accounting system that encourages such behaviour will become an increasingly inadequate signal, both for internal control purposes and for external purposes.
- (c) certain research studies, particularly in the United States, have established a cost-value association for research and development expenditures. The studies establish that capitalisation of research and development expenditure yields value-relevant information to investors.

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- (d) the fact that some uncertainties exist about the value of an asset does not justify a requirement that no cost should be recognised for the asset.
- (e) it should not matter for recognition purposes whether an asset is purchased externally or developed internally. Particularly, there should be no opportunity for accounting arbitrage depending on whether an enterprise decides to outsource the development of an intangible asset or develop it internally.

IASC's view in approving IAS 38

BCZ40 IASC's view—consistently reflected in previous proposals for intangible assets—was that there should be no difference between the requirements for:

- (a) intangible assets that are acquired externally; and
- (b) internally generated intangible assets, whether they arise from development activities or other types of activities.

Therefore, an internally generated intangible asset should be recognised whenever the definition of, and recognition criteria for, an intangible asset are met. This view was also supported by a majority of commentators on E60.

BCZ41 IASC rejected a proposal for an allowed alternative to recognise expenditure on internally generated intangible assets (including development expenditure) as an expense immediately, even if the expenditure results in an asset that meets the recognition criteria. IASC believed that a free choice would undermine the comparability of financial statements and the efforts of IASC to reduce the number of alternative treatments in International Accounting Standards.

Differences in recognition criteria for internally generated intangible assets and purchased intangible assets

BCZ42 IAS 38 includes specific recognition criteria for internally generated intangible assets that expand on the general recognition criteria for intangible assets. It is assumed that these criteria are met implicitly whenever an enterprise acquires an intangible asset. Therefore, IAS 38 requires an enterprise to demonstrate that these criteria are met for internally generated intangible assets only.

Initial recognition at cost

BCZ43 Some commentators on E50 and E60 argued that the proposed recognition criteria in E50 and E60 were too restrictive and that they would prevent the recognition of many intangible assets, particularly internally generated intangible assets. Specifically, they disagreed with the proposals (retained in IAS 38) that:

- (a) an intangible asset should not be recognised at an amount other than its cost, even if its fair value can be determined reliably; and
- (b) expenditure on an intangible asset that has been recognised as an expense in prior periods should not be reinstated.

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They argued that these principles contradict the *Framework* and quoted paragraph 83 of the *Framework*, which specifies that an item that meets the definition of an asset should be recognised if, among other things, its 'cost or value can be measured with reliability'. These commentators supported recognising an intangible asset—an internally generated intangible asset—at its fair value, if, among other things, its fair value can be measured reliably.

BCZ44 IASC rejected a proposal to allow the initial recognition of an intangible asset at fair value (except if the asset is acquired in a business combination, in exchange for a dissimilar asset* or by way of a government grant) because:

- (a) this is consistent with IAS 16 *Property, Plant and Equipment*. IAS 16 prohibits the initial recognition of an item of property, plant or equipment at fair value (except in the specific limited cases as those in IAS 38).
- (b) it is difficult to determine the fair value of an intangible asset reliably if no active market exists for the asset. Since active markets with the characteristics set out in IAS 38 are highly unlikely to exist for internally generated intangible assets, IASC did not believe that it was necessary to make an exception to the principles generally applied for the initial recognition and measurement of non-financial assets.
- (c) the large majority of commentators on E50 supported the initial recognition of intangible assets at cost and the prohibition of the reinstatement of expenditure on an intangible item that was initially recognised as an expense.

Application of the recognition criteria for internally generated intangible assets

BCZ45 IAS 38 specifically prohibits the recognition as intangible assets of brands, mastheads, publishing titles, customer lists and items similar in substance that are internally generated. IASC believed that internally generated intangible items of this kind would rarely, and perhaps never, meet the recognition criteria in IAS 38. However, to avoid any misunderstanding, IASC decided to set out this conclusion in the form of an explicit prohibition.

BCZ46 IAS 38 also clarifies that expenditure on research, training, advertising and start-up activities will not result in the creation of an intangible asset that can be recognised in the financial statements. Whilst some view these requirements and guidance as being too restrictive and arbitrary, they are based on IASC's interpretation of the application of the recognition criteria in IAS 38. They also reflect the fact that it is sometimes difficult to determine whether there is an internally generated intangible asset distinguishable from internally generated goodwill.

* IAS 16 *Property, Plant and Equipment* (as revised in 2003) requires an entity to measure an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless the exchange transaction lacks commercial substance. Previously, an entity measured such an acquired asset at fair value unless the exchanged assets were similar. The IASB concluded that the same measurement criteria should apply to intangible assets acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets.

IAS 38 BC

Subsequent accounting for intangible assets

- BC47 The Board initially decided that the scope of the first phase of its Business Combinations project should include a consideration of the subsequent accounting for intangible assets acquired in business combinations. To that end, the Board initially focused its attention on the following three issues:
- (a) whether an intangible asset with a finite useful life and acquired in a business combination should continue to be accounted for after initial recognition in accordance with IAS 38.
 - (b) whether, and under what circumstances, an intangible asset acquired in a business combination could be regarded as having an indefinite useful life.
 - (c) how an intangible asset with an indefinite useful life (assuming such an asset exists) acquired in a business combination should be accounted for after initial recognition.
- BC48 However, during its deliberations of the issues in (b) and (c) of paragraph BC47, the Board decided that any conclusions it reached on those issues would equally apply to recognised intangible assets obtained other than in a business combination. The Board observed that amending the requirements in the previous version of IAS 38 only for intangible assets acquired in business combinations would create inconsistencies in the accounting for intangible assets depending on how they are obtained. Thus, similar items would be accounted for in dissimilar ways. The Board concluded that creating such inconsistencies would impair the usefulness of the information provided to users about an entity's intangible assets, because both comparability and reliability (which rests on the notion of representational faithfulness, ie that similar transactions are accounted for in the same way) would be diminished. Therefore, the Board decided that any amendments to the requirements in the previous version of IAS 38 to address the issues in (b) and (c) of paragraph BC47 should apply to all recognised intangible assets, whether generated internally or acquired separately or as part of a business combination.
- BC49 Before beginning its deliberations of the issues identified in paragraph BC47, the Board noted the concern expressed by some that, because of the subjectivity involved in distinguishing goodwill from other intangible assets as at the acquisition date, differences between the subsequent treatment of goodwill and other intangible assets increases the potential for intangible assets to be misclassified at the acquisition date. The Board concluded, however, that adopting the separability and contractual or other legal rights criteria provides a reasonably definitive basis for separately identifying and recognising intangible assets acquired in a business combination. Therefore, the Board decided that its analysis of the accounting for intangible assets after initial recognition should have regard only to the nature of those assets and not to the subsequent treatment of goodwill.

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**Accounting for intangible assets with finite useful lives
acquired in business combinations**

BC50 The Board observed that the previous version of IAS 38 required an intangible asset to be measured after initial recognition:

- (a) at cost less any accumulated amortisation and any accumulated impairment losses; or
- (b) at a revalued amount, being the asset's fair value, determined by reference to an active market, at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. Under this approach, revaluations must be made with such regularity that at the balance sheet date the carrying amount of the asset does not differ materially from its fair value.

Whichever of the above methods was used, the previous version of IAS 38 required the depreciable amount of the asset to be amortised on a systematic basis over the best estimate of its useful life.

BC51 The Board observed that underpinning the requirement for all intangible assets to be amortised is the notion that they all have determinable and finite useful lives. Setting aside the question of whether, and under what circumstances, an intangible asset could be regarded as having an indefinite useful life, an important issue for the Board to consider was whether a departure from the above requirements would be warranted for intangible assets acquired in a business combination that have finite useful lives.

BC52 The Board observed that any departure from the above requirements for intangible assets with finite lives acquired in business combinations would create inconsistencies between the accounting for recognised intangible assets based wholly on the means by which they are obtained. In other words, similar items would be accounted for in dissimilar ways. The Board concluded that creating such inconsistencies would impair the usefulness of the information provided to users about an entity's intangible assets, because both comparability and reliability would be diminished.

BC53 Therefore, the Board decided that intangible assets with finite useful lives acquired in business combinations should continue to be accounted for in accordance with the above requirements after initial recognition.

**Impairment testing intangible assets with finite useful lives
(paragraph 111)**

BC54 The previous version of IAS 38 required the recoverable amount of an intangible asset with a finite useful life that is being amortised over a period of more than 20 years, whether or not acquired in a business combination, to be measured at least at each financial year-end.

BC55 The Board observed that the recoverable amount of a long-lived tangible asset needs to be measured only when, in accordance with IAS 36 *Impairment of Assets*, there is an indication that the asset may be impaired. The Board could see no conceptual reason for requiring the recoverable amounts of some identifiable assets being amortised over very long periods to be determined more regularly

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than for other identifiable assets being amortised or depreciated over similar periods. Therefore, the Board concluded that the recoverable amount of an intangible asset with a finite useful life that is amortised over a period of more than 20 years should be determined only when, in accordance with IAS 36, there is an indication that the asset may be impaired. Consequently, the Board decided to remove the requirement in the previous version of IAS 38 for the recoverable amount of such an intangible asset to be measured at least at each financial year-end.

- BC56 The Board also decided that all of the requirements relating to impairment testing intangible assets should be included in IAS 36 rather than in IAS 38. Therefore, the Board relocated to IAS 36 the requirement in the previous version of IAS 38 that an entity should estimate at the end of each annual reporting period the recoverable amount of an intangible asset not yet available for use, irrespective of whether there is any indication that it may be impaired.

**Residual value of an intangible asset with a finite useful life
(paragraph 100)**

- BC57 In revising IAS 38, the Board considered whether to retain for intangible assets with finite useful lives the requirement in the previous version of IAS 38 for the residual value of an intangible asset to be assumed to be zero unless:
- (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
 - (b) there is an active market for the asset and:
 - (i) the asset's residual value can be determined by reference to that market; and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.
- BC58 The Board observed that the definition in the previous version of IAS 38 (as amended by IAS 16 when revised in 2003) of residual value required it to be estimated as if the asset were already of the age and in the condition expected at the end of the asset's useful life. Therefore, if the useful life of an intangible asset was shorter than its economic life because the entity expected to sell the asset before the end of that economic life, the asset's residual value would not be zero, irrespective of whether the conditions in paragraph BC57(a) or (b) are met.
- BC59 Nevertheless, the Board observed that the requirement for the residual value of an intangible asset to be assumed to be zero unless the specified criteria are met was included in the previous version of IAS 38 as a means of preventing entities from circumventing the requirement in that Standard to amortise all intangible assets. Excluding this requirement from the revised Standard for finite-lived intangible assets would similarly provide a means of circumventing the requirement to amortise such intangible assets—by claiming that the residual value of such an asset was equal to or greater than its carrying amount, an entity could avoid amortising the asset, even though its useful life is finite. The Board

IAS 38 BC

concluded that it should not, as part of the Business Combinations project, modify the criteria for permitting a finite-lived intangible asset's residual value to be other than zero. However, the Board decided that this issue should be addressed as part of a forthcoming project on intangible assets.

Useful lives of intangible assets (paragraphs 88–96)

- BC60 Consistently with the proposals in the Exposure Draft of Proposed Amendments to IAS 38, the Standard requires an intangible asset to be regarded by an entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
- BC61 In developing the Exposure Draft and the revised Standard, the Board observed that the useful life of an intangible asset is related to the expected cash inflows that are associated with that asset. The Board observed that, to be representationally faithful, the amortisation period for an intangible asset generally should reflect that useful life and, by extension, the cash flow streams associated with the asset. The Board concluded that it is possible for management to have the intention and the ability to maintain an intangible asset in such a way that there is no foreseeable limit on the period over which that particular asset is expected to generate net cash inflows for the entity. In other words, it is conceivable that an analysis of all the relevant factors (ie legal, regulatory, contractual, competitive, economic and other) could lead to a conclusion that there is no foreseeable limit to the period over which a particular intangible asset is expected to generate net cash inflows for the entity.
- BC62 For example, the Board observed that some intangible assets are based on legal rights that are conveyed in perpetuity rather than for finite terms. As such, those assets may have cash flows associated with them that may be expected to continue for many years or even indefinitely. The Board concluded that if the cash flows are expected to continue for a finite period, the useful life of the asset is limited to that finite period. However, if the cash flows are expected to continue indefinitely, the useful life is indefinite.
- BC63 The previous version of IAS 38 prescribed a presumptive maximum useful life for intangible assets of 20 years. In developing the Exposure Draft and the revised Standard, the Board concluded that such a presumption is inconsistent with the view that the amortisation period for an intangible asset should, to be representationally faithful, reflect its useful life and, by extension, the cash flow streams associated with the asset. Therefore, the Board decided not to include in the revised Standard a presumptive maximum useful life for intangible assets, even if they have finite useful lives.
- BC64 Respondents to the Exposure Draft generally supported the Board's proposal to remove from IAS 38 the presumptive maximum useful life and instead to require useful life to be regarded as indefinite when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period of time over which the intangible asset is expected to generate net cash inflows for the entity. However, some respondents suggested that an inability to determine clearly the useful life of an asset applies equally to many items of property, plant and equipment.

IAS 38 BC

Nonetheless, entities are required to determine the useful lives of those items of property, plant and equipment, and allocate their depreciable amounts on a systematic basis over those useful lives. Those respondents suggested that there is no conceptual reason for treating intangible assets differently.

BC65 In considering these comments, the Board noted the following:

- (a) an intangible asset's useful life would be regarded as indefinite in accordance with IAS 38 only when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period of time over which the asset is expected to generate net cash inflows for the entity. Difficulties in accurately determining an intangible asset's useful life do not provide a basis for regarding that useful life as indefinite.
- (b) although the useful lives of both intangible and tangible assets are directly related to the period during which they are expected to generate net cash inflows for the entity, the expected physical utility to the entity of a tangible asset places an upper limit on the asset's useful life. In other words, the useful life of a tangible asset could never extend beyond the asset's expected physical utility to the entity.

The Board concluded that tangible assets (other than land) could not be regarded as having indefinite useful lives because there is always a foreseeable limit to the expected physical utility of the asset to the entity.

**Useful life constrained by contractual or other legal rights
(paragraphs 94–96)**

BC66 The Board noted that the useful life of an intangible asset that arises from contractual or other legal rights is constrained by the duration of those rights. The useful life of such an asset cannot extend beyond the duration of those rights, and may be shorter. Accordingly, the Board concluded that in determining the useful life of an intangible asset, consideration should be given to the period that the entity expects to use the intangible asset, which is subject to the expiration of the contractual or other legal rights.

BC67 However, the Board also observed that such rights are often conveyed for limited terms that may be renewed. It therefore considered whether renewals should be assumed in determining the useful life of such an intangible asset. The Board noted that some types of licences are initially issued for finite periods but renewals are routinely granted at little cost, provided that licensees have complied with the applicable rules and regulations. Such licences are traded at prices that reflect more than the remaining term, thereby indicating that renewal at minimal cost is the general expectation. However, renewals are not assured for other types of licences and, even if they are renewed, substantial costs may be incurred to secure their renewal.

BC68 The Board concluded that because the useful lives of some intangible assets depend, in economic terms, on renewal and on the associated costs of renewal, the useful lives assigned to those assets should reflect renewal when there is evidence to support renewal without significant cost.

IAS 38 BC

BC69 Respondents to the Exposure Draft generally supported this conclusion. Those that disagreed suggested that:

- (a) when the renewal period depends on the decision of a third party and not merely on the fulfilment of specified conditions by the entity, it gives rise to a contingent asset because the third-party decision affects not only the cost of renewal but also the probability of obtaining it. Therefore, useful life should reflect renewal only when renewal is not subject to third-party approval.
- (b) such a requirement would be inconsistent with the basis used to measure intangible assets at the date of a business combination, particularly contractual customer relationships. For example, it is not clear whether the fair value of a contractual customer relationship includes an amount that reflects the probability that the contract will be renewed. The possibility of renewal would have a fair value regardless of the costs required to renew. This means the useful life of a contractual customer relationship could be inconsistent with the basis used to determine the fair value of the relationship.

BC70 In relation to (a) above, the Board observed that if renewal by the entity is subject to third-party (eg government) approval, the requirement that there be evidence to support the entity's ability to renew would compel the entity to make an assessment of the likely effect of the third-party approval process on the entity's ability to renew. The Board could see no conceptual basis for narrowing the requirement to situations in which the contractual or legal rights are not subject to the approval of third parties.

BC71 In relation to (b) above, the Board observed the following:

- (a) the requirements relating to renewal periods address circumstances in which *the entity* is able to renew the contractual or other legal rights, notwithstanding that such renewal may, for example, be conditional on the entity satisfying specified conditions, or subject to third-party approval. Paragraph 94 of the Standard states that '... the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal *by the entity* [emphasis added] without significant cost.' The ability to renew a customer contract normally rests with the customer and not with the entity.
- (b) the respondents seem to regard as a single intangible asset what is, in substance, two intangible assets—one being the customer contract and the other being the related customer relationship. Expected renewals by the customer would affect the fair value of the customer relationship intangible asset, rather than the fair value of the customer contract. Therefore, the useful life of the customer contract would not, under the Standard, extend beyond the term of the contract, nor would the fair value of that customer contract reflect expectations of renewal by the customer. In other words, the useful life of the customer contract would not be inconsistent with the basis used to determine its fair value.

IAS 38 BC

- BC72 However, in response to respondents' suggestions, the Board included paragraph 96 in the Standard to provide additional guidance on the circumstances in which an entity should be regarded as being able to renew the contractual or other legal rights without significant cost.

**Accounting for intangible assets with indefinite useful lives
(paragraphs 107–110)**

- BC73 Consistently with the proposals in the Exposure Draft, the Standard prohibits the amortisation of intangible assets with indefinite useful lives. Therefore, such assets are measured after initial recognition at:
- (a) cost less any accumulated impairment losses; or
 - (b) a revalued amount, being fair value determined by reference to an active market less any accumulated impairment losses.

Non-amortisation

- BC74 In developing the Exposure Draft and the revised Standard, the Board observed that many assets yield benefits to an entity over several periods. Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not be representationally faithful. Respondents to the Exposure Draft generally supported this conclusion.
- BC75 Consequently, the Board decided that intangible assets with indefinite useful lives should not be amortised, but should be subject to regular impairment testing. The Board's deliberations on the form of the impairment test, including the frequency of impairment testing, are included in the Basis for Conclusions on IAS 36. The Board further decided that regular re-examinations should be required of the useful life of an intangible asset that is not being amortised to determine whether circumstances continue to support the assessment that the useful life is indefinite.

Revaluations

- BC76 Having decided that intangible assets with indefinite useful lives should not be amortised, the Board considered whether an entity should be permitted to carry such assets at revalued amounts. The Board could see no conceptual justification for precluding some intangible assets from being carried at revalued amounts solely on the basis that there is no foreseeable limit to the period over which an entity expects to consume the future economic benefits embodied in those assets.
- BC77 As a result, the Board decided that the Standard should permit intangible assets with indefinite useful lives to be carried at revalued amounts.

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Research and development projects acquired in business combinations

BC78 The Board considered the following issues in relation to in-process research and development (IPR&D) projects acquired in a business combination:

- (a) whether the proposed criteria for recognising intangible assets acquired in a business combination separately from goodwill should also be applied to IPR&D projects;
- (b) the subsequent accounting for IPR&D projects recognised as assets separately from goodwill; and
- (c) the treatment of subsequent expenditure on IPR&D projects recognised as assets separately from goodwill.

The Board's deliberations on issue (a), although included in the Basis for Conclusions on IFRS 3, are also, for the sake of completeness, outlined below.

BC79 The Board did not reconsider as part of the first phase of its Business Combinations project the requirements in the previous version of IAS 38 for internally generated intangibles and expenditure on the research or development phase of an internal project. The Board decided that a reconsideration of those requirements is outside the scope of this project.

Initial recognition separately from goodwill

BC80 The Board observed that the criteria in IAS 22 *Business Combinations* and the previous version of IAS 38 for recognising an intangible asset acquired in a business combination separately from goodwill applied to all intangible assets, including IPR&D projects. Therefore, in accordance with those Standards, any intangible item acquired in a business combination was recognised as an asset separately from goodwill when it was identifiable and could be measured reliably, and it was probable that any associated future economic benefits would flow to the acquirer. If these criteria were not satisfied, the expenditure on the cost or value of that item, which was included in the cost of the combination, was part of the amount attributed to goodwill.

BC81 The Board could see no conceptual justification for changing the approach in IAS 22 and the previous version of IAS 38 of using the same criteria for all intangible assets acquired in a business combination when assessing whether those assets should be recognised separately from goodwill. The Board concluded that adopting different criteria would impair the usefulness of the information provided to users about the assets acquired in a combination because both comparability and reliability would be diminished. Therefore, IAS 38 and IFRS 3 require an acquirer to recognise as an asset separately from goodwill any of the acquiree's IPR&D projects that meet the definition of an intangible asset. This will be the case when the IPR&D project meets the definition of an asset and is identifiable, ie is separable or arises from contractual or other legal rights.

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- BC82 Some respondents to the Exposure Draft of Proposed Amendments to IAS 38 expressed concern that applying the same criteria to all intangible assets acquired in a business combination to assess whether they should be recognised separately from goodwill results in treating some IPR&D projects acquired in business combinations differently from similar projects started internally. The Board acknowledged this point, but concluded that this does not provide a basis for subsuming those acquired intangible assets within goodwill. Rather, it highlights a need to reconsider the conclusion in the Standard that an intangible asset can never exist in respect of an in-process research project and can exist in respect of an in-process development project only once all of the Standard's criteria for deferral have been satisfied. The Board decided that such a reconsideration is outside the scope of its Business Combinations project.

Subsequent accounting for IPR&D projects acquired in a business combination and recognised as intangible assets

- BC83 The Board observed that the previous version of IAS 38 required all recognised intangible assets to be accounted for after initial recognition at:
- (a) cost less any accumulated amortisation and any accumulated impairment losses; or
 - (b) revalued amount, being the asset's fair value, determined by reference to an active market, at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

Such assets included: IPR&D projects acquired in a business combination that satisfied the criteria for recognition separately from goodwill; separately acquired IPR&D projects that satisfied the criteria for recognition as an intangible asset; and recognised internally developed intangible assets arising from development or the development phase of an internal project.

- BC84 The Board could see no conceptual justification for changing the approach in the previous version of IAS 38 of applying the same requirements to the subsequent accounting for all recognised intangible assets. Therefore, the Board decided that IPR&D projects acquired in a business combination that satisfy the criteria for recognition as an asset separately from goodwill should be accounted for after initial recognition in accordance with the requirements applying to the subsequent accounting for other recognised intangible assets.

Subsequent expenditure on IPR&D projects acquired in a business combination and recognised as intangible assets (paragraphs 42 and 43)

- BC85 The Standard requires subsequent expenditure on an IPR&D project acquired separately or in a business combination and recognised as an intangible asset to be:
- (a) recognised as an expense when incurred if it is research expenditure;
 - (b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 57; and

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- (c) added to the carrying amount of the acquired IPR&D project if it is development expenditure that satisfies the recognition criteria in paragraph 57.

BC86 In developing this requirement the Board observed that the treatment required under the previous version of IAS 38 of subsequent expenditure on an IPR&D project acquired in a business combination and recognised as an asset separately from goodwill was unclear. Some suggested that the requirements in the previous version of IAS 38 relating to expenditure on research, development, or the research or development phase of an internal project should be applied. However, others argued that those requirements were ostensibly concerned with the initial recognition and measurement of internally generated intangible assets. Instead, the requirements in the previous version of IAS 38 dealing with subsequent expenditure should be applied. Under those requirements, subsequent expenditure on an intangible asset after its purchase or completion would have been recognised as an expense when incurred unless:

- (a) it was probable that the expenditure would enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and
- (b) the expenditure could be measured and attributed to the asset reliably.

If these conditions were satisfied, the subsequent expenditure would be added to the carrying amount of the intangible asset.

BC87 The Board observed that this uncertainty also existed for separately acquired IPR&D projects that satisfied the criteria in the previous version of IAS 38 for recognition as intangible assets.

BC88 The Board noted that applying the requirements in the Standard for expenditure on research, development, or the research or development phase of an internal project to subsequent expenditure on IPR&D projects acquired in a business combination and recognised as assets separately from goodwill would result in such subsequent expenditure being treated inconsistently with subsequent expenditure on other recognised intangible assets. However, applying the subsequent expenditure requirements in the previous version of IAS 38 to subsequent expenditure on IPR&D projects acquired in a business combination and recognised as assets separately from goodwill would result in research and development expenditure being accounted for differently depending on whether a project is acquired or started internally.

BC89 The Board concluded that until it has had the opportunity to review the requirements in IAS 38 for expenditure on research, development, or the research or development phase of an internal project, more useful information will be provided to users of an entity's financial statements if all such expenditure is accounted for consistently. This includes subsequent expenditure on a separately acquired IPR&D project that satisfies the Standard's criteria for recognition as an intangible asset.

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Transitional provisions (paragraphs 129–132)

- BC90 If an entity elects to apply IFRS 3 from any date before the effective dates outlined in IFRS 3, it is also required to apply IAS 38 prospectively from that same date. Otherwise, IAS 38 applies to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004, and to the accounting for all other intangible assets prospectively from the beginning of the first annual reporting period beginning on or after 31 March 2004. IAS 38 also requires an entity, on initial application, to reassess the useful lives of intangible assets. If, as a result of that reassessment, the entity changes its useful life assessment for an asset, that change is accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- BC91 The Board's deliberations on the transitional issues relating to the initial recognition of intangible assets acquired in business combinations and the impairment testing of intangible assets are addressed in the Basis for Conclusions on IFRS 3 and the Basis for Conclusions on IAS 36, respectively.
- BC92 In developing the requirements outlined in paragraph BC90, the Board considered the following three questions:
- (a) should the useful lives of, and the accounting for, intangible assets already recognised at the effective date of the Standard continue to be determined in accordance with the requirements in the previous version of IAS 38 (ie by amortising over a presumptive maximum period of twenty years), or in accordance with the requirements in the revised Standard?
 - (b) if the revised Standard is applied to intangible assets already recognised at its effective date, should the effect of a reassessment of an intangible asset's useful life as a result of the initial application of the Standard be recognised retrospectively or prospectively?
 - (c) should entities be required to apply the requirements in the Standard for subsequent expenditure on an acquired IPR&D project recognised as an intangible asset retrospectively to expenditure incurred before the effective date of the revised Standard?
- BC93 In relation to the first question above, the Board noted its previous conclusion that the most representationally faithful method of accounting for intangible assets is to amortise those with finite useful lives over their useful lives with no limit on the amortisation period, and not to amortise those with indefinite useful lives. Thus, the Board concluded that the reliability and comparability of financial statements would be diminished if the Standard was not applied to intangible assets recognised before its effective date.
- BC94 On the second question, the Board observed that a reassessment of an asset's useful life is regarded throughout IFRSs as a change in an accounting estimate, rather than a change in an accounting policy. For example, in accordance with the Standard, as with the previous version of IAS 38, if a new estimate of the expected useful life of an intangible asset is significantly different from previous

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estimates, the change must be accounted for as a change in accounting estimate in accordance with IAS 8. IAS 8 requires a change in an accounting estimate to be accounted for prospectively by including the effect of the change in profit or loss in:

- (a) the period of the change, if the change in estimate affects that period only;
or
- (b) the period of the change and future periods, if the change in estimate affects both.

BC95 Similarly, in accordance with IAS 16 *Property, Plant and Equipment*, if a new estimate of the expected useful life of an item of property, plant and equipment is significantly different from previous estimates, the change must be accounted for prospectively by adjusting the depreciation expense for the current and future periods.

BC96 Therefore, the Board decided that a reassessment of useful life resulting from the initial application of IAS 38, including a reassessment from a finite to an indefinite useful life, should be accounted for as a change in an accounting estimate. Consequently, the effect of such a change should be recognised prospectively.

BC97 The Board considered the view that because the previous version of IAS 38 required intangible assets to be treated as having a finite useful life, a change to an assessment of indefinite useful life for an intangible asset represents a change in an accounting policy, rather than a change in an accounting estimate. The Board concluded that, even if this were the case, the useful life reassessment should nonetheless be accounted for prospectively. This is because retrospective application would require an entity to determine whether, at the end of each reporting period before the effective date of the Standard, the useful life of an intangible asset was indefinite. Such an assessment requires an entity to make estimates that would have been made at a prior date, and therefore raises problems in relation to the role of hindsight, in particular, whether the benefit of hindsight should be included or excluded from those estimates and, if excluded, how the effect of hindsight can be separated from the other factors existing at the date for which the estimates are required.

BC98 On the third question, and as noted in paragraph BC86, it was not clear whether the previous version of IAS 38 required subsequent expenditure on acquired IPR&D projects recognised as intangible assets to be accounted for:

- (a) in accordance with its requirements for expenditure on research, development, or the research or development phase of an internal project;
or
- (b) in accordance with its requirements for subsequent expenditure on an intangible asset after its purchase or completion.

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The Board concluded that subsequent expenditure on an acquired IPR&D project that was capitalised under (b) above before the effective date of the Standard might not have been capitalised had the Standard applied when the subsequent expenditure was incurred. This is because the Standard requires such expenditure to be capitalised as an intangible asset only when it is development expenditure and all of the criteria for deferral are satisfied. In the Board's view, those criteria represent a higher recognition threshold than (b) above.

- BC99 Thus, retrospective application of the revised Standard to subsequent expenditure on acquired IPR&D projects incurred before its effective date could result in previously capitalised expenditure being reversed. Such reversal would be required if the expenditure was research expenditure, or it was development expenditure and one or more of the criteria for deferral were not satisfied at the time the expenditure was incurred. The Board concluded that determining whether, at the time the subsequent expenditure was incurred, the criteria for deferral were satisfied raises the same hindsight issues discussed in paragraph BC97: it would require assessments to be made as of a prior date, and therefore raises problems in relation to how the effect of hindsight can be separated from factors existing at the date of the assessment. In addition, such assessments could, in many cases, be impossible: the information needed may not exist or no longer be obtainable.
- BC100 Therefore, the Board decided that the Standard's requirements for subsequent expenditure on acquired IPR&D projects recognised as intangible assets should not be applied retrospectively to expenditure incurred before the revised Standard's effective date. The Board noted that any amounts previously included in the carrying amount of such an asset would, in any event, be subject to the requirements for impairment testing in IAS 36.

Early application (paragraph 132)

- BC101 The Board noted that the issue of any Standard reflects its opinion that application of the Standard will result in more useful information being provided to users about an entity's financial position, performance or cash flows. On that basis, a case exists for permitting, and indeed encouraging, entities to apply the revised Standard before its effective date. However, the Board also considered the assertion that permitting a revised Standard to be applied before its effective date potentially diminishes comparability between entities in the period(s) leading up to that effective date, and has the effect of providing entities with an option.
- BC102 The Board concluded that the benefit of providing users with more useful information about an entity's financial position and performance by permitting early application of the Standard outweighs the disadvantages of potentially diminished comparability. Therefore, entities are encouraged to apply the requirements of the revised Standard before its effective date, provided they also apply IFRS 3 and IAS 36 (as revised in 2004) at the same time.

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Summary of main changes from the Exposure Draft

BC103 The following are the main changes from the Exposure Draft of Proposed Amendments to IAS 38:

- (a) The Standard includes additional guidance clarifying the relationship between the separability criterion for establishing whether a non-contractual customer relationship is identifiable, and the control concept for establishing whether the relationship meets the definition of an asset. In particular, the Standard clarifies that in the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset (see paragraphs BC11–BC14).
- (b) The Exposure Draft proposed that, except for an assembled workforce, an intangible asset acquired in a business combination should always be recognised separately from goodwill; there was a presumption that sufficient information would always exist to measure reliably its fair value. The Standard states that the fair value of an intangible asset acquired in a business combination can *normally* be measured with sufficient reliability to qualify for recognition separately from goodwill. If an intangible asset acquired in a business combination has a finite useful life, there is a rebuttable presumption that its fair value can be measured reliably (see paragraphs BC16–BC25).
- (c) The Exposure Draft proposed, and the Standard requires, that the useful life of an intangible asset arising from contractual or other legal rights should not exceed the period of those rights. However, if the rights are conveyed for a limited term that can be renewed, the useful life should include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. Additional guidance has been included in the Standard to clarify the circumstances in which an entity should be regarded as being able to renew the contractual or other legal rights without significant cost (see paragraphs BC66–BC72).

History of the development of a standard on intangible assets

BCZ104 IASC published a Draft Statement of Principles on Intangible Assets in January 1994 and an Exposure Draft E50 *Intangible Assets* in June 1995. Principles in both documents were consistent as far as possible with those in IAS 16 *Property, Plant and Equipment*. The principles were also greatly influenced by the decisions reached in 1993 during the revisions to the treatment of research and development costs and goodwill.

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BCZ105 IASC received about 100 comment letters on E50 from over 20 countries. Comment letters on E50 showed that the proposal for the amortisation period for intangible assets—a 20-year ceiling for almost all intangible assets, as required for goodwill in IAS 22 (revised 1993)—raised significant controversy and created serious concerns about the overall acceptability of the proposed standard on intangible assets. IASC considered alternative solutions and concluded in March 1996 that, if an impairment test that is sufficiently robust and reliable could be developed, IASC would propose deleting the 20-year ceiling on the amortisation period for both intangible assets and goodwill.

BCZ106 In August 1997, IASC published proposals for revised treatments for intangible assets and goodwill in Exposure Drafts E60 *Intangible Assets* and E61 *Business Combinations*. This followed the publication of Exposure Draft E55 *Impairment of Assets* in May 1997, which set out detailed proposals for impairment testing.

BCZ107 E60 proposed two major changes to the proposals in E50:

- (a) as explained above, revised proposals for the amortisation of intangible assets; and
- (b) combining the requirements relating to all internally generated intangible assets in one standard. This meant including certain aspects of IAS 9 *Research and Development Costs* in the proposed standard on intangible assets and withdrawing IAS 9.

BCZ108 Among other proposed changes, E61 proposed revisions to IAS 22 to make the requirements for the amortisation of goodwill consistent with those proposed for intangible assets.

BCZ109 IASC received about 100 comment letters on E60 and E61 from over 20 countries. The majority of the commentators supported most of the proposals in E60 and E61, although some proposals still raised significant controversy. The proposals for impairment tests were also supported by most commentators on E55.

BCZ110 After considering the comments received on E55, E60 and E61, IASC approved:

- (a) IAS 36 *Impairment of Assets* (April 1998);
- (b) IAS 38 *Intangible Assets* (July 1998);
- (c) a revised IAS 22 *Business Combinations* (July 1998); and
- (d) withdrawal of IAS 9 *Research and Development Costs* (July 1998).

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Dissenting Opinion

Dissent of Geoffrey Whittington

- DO1 Professor Whittington dissents from the issue of this Standard because it does not explicitly require the probability recognition criterion in paragraph 21(a) to be applied to intangible assets acquired in a business combination, notwithstanding that it applies to all other intangible assets.
- DO2 The reason given for this (paragraphs 33 and BC17) is that fair value is the required measurement on acquisition of an intangible asset as part of a business combination, and fair value incorporates probability assessments. Professor Whittington does not believe that the *Framework* precludes having a prior recognition test based on probability, even when subsequent recognition is at fair value. Moreover, the application of probability may be different for recognition purposes: for example, it may be the ‘more likely than not’ criterion used in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, rather than the ‘expected value’ approach used in the measurement of fair value.
- DO3 This inconsistency between the recognition criteria in the *Framework* and fair values is acknowledged in paragraph BC18. In Professor Whittington’s view, the inconsistency should be resolved before changing the recognition criteria for intangible assets acquired in a business combination.

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IAS 38 Intangible Assets

Illustrative examples

These examples accompany, but are not part of, IAS 38.

Assessing the useful lives of intangible assets

The following guidance provides examples on determining the useful life of an intangible asset in accordance with IAS 38.

Each of the following examples describes an acquired intangible asset, the facts and circumstances surrounding the determination of its useful life, and the subsequent accounting based on that determination.

Example 1 An acquired customer list

A direct-mail marketing company acquires a customer list and expects that it will be able to derive benefit from the information on the list for at least one year, but no more than three years.

The customer list would be amortised over management's best estimate of its useful life, say 18 months. Although the direct-mail marketing company may intend to add customer names and other information to the list in the future, the expected benefits of the acquired customer list relate only to the customers on that list at the date it was acquired. The customer list also would be reviewed for impairment in accordance with IAS 36 *Impairment of Assets* by assessing at the end of each reporting period whether there is any indication that the customer list may be impaired.

Example 2 An acquired patent that expires in 15 years

The product protected by the patented technology is expected to be a source of net cash inflows for at least 15 years. The entity has a commitment from a third party to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in five years.

The patent would be amortised over its five-year useful life to the entity, with a residual value equal to the present value of 60 per cent of the patent's fair value at the date it was acquired. The patent would also be reviewed for impairment in accordance with IAS 36 by assessing at the end of each reporting period whether there is any indication that it may be impaired.

Example 3 An acquired copyright that has a remaining legal life of 50 years

An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.

The copyright would be amortised over its 30-year estimated useful life. The copyright also would be reviewed for impairment in accordance with IAS 36 by assessing at the end of each reporting period whether there is any indication that it may be impaired.

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Example 4 An acquired broadcasting licence that expires in five years

The broadcasting licence is renewable every 10 years if the entity provides at least an average level of service to its customers and complies with the relevant legislative requirements. The licence may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition. The acquiring entity intends to renew the licence indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the licence renewal. The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future. Therefore, the licence is expected to contribute to the entity's net cash inflows indefinitely.

The broadcasting licence would be treated as having an indefinite useful life because it is expected to contribute to the entity's net cash inflows indefinitely. Therefore, the licence would not be amortised until its useful life is determined to be finite. The licence would be tested for impairment in accordance with IAS 36 annually and whenever there is an indication that it may be impaired.

Example 5 The broadcasting licence in Example 4

The licensing authority subsequently decides that it will no longer renew broadcasting licences, but rather will auction the licences. At the time the licensing authority's decision is made, the entity's broadcasting licence has three years until it expires. The entity expects that the licence will continue to contribute to net cash inflows until the licence expires.

Because the broadcasting licence can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired licence would be amortised over its remaining three-year useful life and immediately tested for impairment in accordance with IAS 36.

Example 6 An acquired airline route authority between two European cities that expires in three years

The route authority may be renewed every five years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal. Route authority renewals are routinely granted at a minimal cost and historically have been renewed when the airline has complied with the applicable rules and regulations. The acquiring entity expects to provide service indefinitely between the two cities from its hub airports and expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority. An analysis of demand and cash flows supports those assumptions.

Because the facts and circumstances support the acquiring entity's ability to continue providing air service indefinitely between the two cities, the intangible asset related to the route authority is treated as having an indefinite useful life. Therefore, the route authority would not be amortised until its useful life is determined to be finite. It would be tested for impairment in accordance with IAS 36 annually and whenever there is an indication that it may be impaired.

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Example 7 An acquired trademark used to identify and distinguish a leading consumer product that has been a market-share leader for the past eight years

The trademark has a remaining legal life of five years but is renewable every 10 years at little cost. The acquiring entity intends to renew the trademark continuously and evidence supports its ability to do so. An analysis of (1) product life cycle studies, (2) market, competitive and environmental trends, and (3) brand extension opportunities provides evidence that the trademarked product will generate net cash inflows for the acquiring entity for an indefinite period.

The trademark would be treated as having an indefinite useful life because it is expected to contribute to net cash inflows indefinitely. Therefore, the trademark would not be amortised until its useful life is determined to be finite. It would be tested for impairment in accordance with IAS 36 annually and whenever there is an indication that it may be impaired.

Example 8 A trademark acquired 10 years ago that distinguishes a leading consumer product

The trademark was regarded as having an indefinite useful life when it was acquired because the trademarked product was expected to generate net cash inflows indefinitely. However, unexpected competition has recently entered the market and will reduce future sales of the product. Management estimates that net cash inflows generated by the product will be 20 per cent less for the foreseeable future. However, management expects that the product will continue to generate net cash inflows indefinitely at those reduced amounts.

As a result of the projected decrease in future net cash inflows, the entity determines that the estimated recoverable amount of the trademark is less than its carrying amount, and an impairment loss is recognised. Because it is still regarded as having an indefinite useful life, the trademark would continue not to be amortised but would be tested for impairment in accordance with IAS 36 annually and whenever there is an indication that it may be impaired.

Example 9 A trademark for a line of products that was acquired several years ago in a business combination

At the time of the business combination the acquiree had been producing the line of products for 35 years with many new models developed under the trademark. At the acquisition date the acquirer expected to continue producing the line, and an analysis of various economic factors indicated there was no limit to the period the trademark would contribute to net cash inflows. Consequently, the trademark was not amortised by the acquirer. However, management has recently decided that production of the product line will be discontinued over the next four years.

Because the useful life of the acquired trademark is no longer regarded as indefinite, the carrying amount of the trademark would be tested for impairment in accordance with IAS 36 and amortised over its remaining four-year useful life.

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SIC Interpretation 32

Intangible Assets—Web Site Costs

This version includes amendments resulting from IFRSs issued up to 17 January 2008.

SIC-32 *Intangible Assets—Web Site Costs* was developed by the Standing Interpretations Committee and issued in March 2002.

Since then, SIC-32 has been amended by the following IFRSs:

- IAS 16 *Property, Plant and Equipment* (as revised in December 2003)
- IFRS 3 *Business Combinations* (issued March 2004)
- IAS 1 *Presentation of Financial Statements* (as revised in September 2007).

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SIC Interpretation 32 *Intangible Assets—Web Site Costs* (SIC-32) is set out in paragraphs 7–10. SIC-32 is accompanied by a Basis for Conclusions and an appendix illustrating the application of the Interpretation. The scope and authority of Interpretations are set out in paragraphs 2 and 7–17 of the *Preface to International Financial Reporting Standards*.

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SIC Interpretation 32

Intangible Assets – Web Site Costs

References

- IAS 1 *Presentation of Financial Statements* (as revised in 2007)
- IAS 2 *Inventories* (as revised in 2003)
- IAS 11 *Construction Contracts*
- IAS 16 *Property, Plant and Equipment* (as revised in 2003)
- IAS 17 *Leases* (as revised in 2003)
- IAS 36 *Impairment of Assets* (as revised in 2004)
- IAS 38 *Intangible Assets* (as revised in 2004)
- IFRS 3 *Business Combinations*

Issue

- 1 An entity may incur internal expenditure on the development and operation of its own web site for internal or external access. A web site designed for external access may be used for various purposes such as to promote and advertise an entity's own products and services, provide electronic services, and sell products and services. A web site designed for internal access may be used to store company policies and customer details, and search relevant information.
- 2 The stages of a web site's development can be described as follows:
 - (a) Planning – includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences.
 - (b) Application and Infrastructure Development – includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing.
 - (c) Graphical Design Development – includes designing the appearance of web pages.
 - (d) Content Development – includes creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.
- 3 Once development of a web site has been completed, the Operating stage begins. During this stage, an entity maintains and enhances the applications, infrastructure, graphical design and content of the web site.
- 4 When accounting for internal expenditure on the development and operation of an entity's own web site for internal or external access, the issues are:

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- (a) whether the web site is an internally generated intangible asset that is subject to the requirements of IAS 38; and
 - (b) the appropriate accounting treatment of such expenditure.
- 5 This Interpretation does not apply to expenditure on purchasing, developing, and operating hardware (eg web servers, staging servers, production servers and Internet connections) of a web site. Such expenditure is accounted for under IAS 16. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's web site, the expenditure is recognised as an expense under IAS 1.88 and the *Framework* when the services are received.
- 6 IAS 38 does not apply to intangible assets held by an entity for sale in the ordinary course of business (see IAS 2 and IAS 11) or leases that fall within the scope of IAS 17. Accordingly, this Interpretation does not apply to expenditure on the development or operation of a web site (or web site software) for sale to another entity. When a web site is leased under an operating lease, the lessor applies this Interpretation. When a web site is leased under a finance lease, the lessee applies this Interpretation after initial recognition of the leased asset.

Consensus

- 7 An entity's own web site that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of IAS 38.
- 8 A web site arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in IAS 38.21 for recognition and initial measurement, an entity can satisfy the requirements in IAS 38.57. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with IAS 38.57(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site shall be recognised as an expense when incurred.
- 9 Any internal expenditure on the development and operation of an entity's own web site shall be accounted for in accordance with IAS 38. The nature of each activity for which expenditure is incurred (eg training employees and maintaining the web site) and the web site's stage of development or post-development shall be evaluated to determine the appropriate accounting treatment (additional guidance is provided in the Appendix to this Interpretation). For example:
- (a) the Planning stage is similar in nature to the research phase in IAS 38.54-.56. Expenditure incurred in this stage shall be recognised as an expense when it is incurred.
 - (b) the Application and Infrastructure Development stage, the Graphical Design stage and the Content Development stage, to the extent that

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content is developed for purposes other than to advertise and promote an entity's own products and services, are similar in nature to the development phase in IAS 38.57–.64. Expenditure incurred in these stages shall be included in the cost of a web site recognised as an intangible asset in accordance with paragraph 8 of this Interpretation when the expenditure can be directly attributed and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own products and services) specifically for a web site, or expenditure to enable use of the content (eg a fee for acquiring a licence to reproduce) on the web site, shall be included in the cost of development when this condition is met. However, in accordance with IAS 38.71, expenditure on an intangible item that was initially recognised as an expense in previous financial statements shall not be recognised as part of the cost of an intangible asset at a later date (eg if the costs of a copyright have been fully amortised, and the content is subsequently provided on a web site).

- (c) expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products), shall be recognised as an expense when incurred in accordance with IAS 38.69(c). For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure shall be recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.
 - (d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage shall be recognised as an expense when it is incurred unless it meets the recognition criteria in IAS 38.18.
- 10 A web site that is recognised as an intangible asset under paragraph 8 of this Interpretation shall be measured after initial recognition by applying the requirements of IAS 38.72–.87. The best estimate of a web site's useful life should be short.

Basis for Conclusions

[The original text has been marked up to reflect the revision of IAS 16 in 2003 and the subsequent issue of IFRS 3: new text is underlined and deleted text is struck through]

- 11 An intangible asset is defined in IAS 38.87 as an identifiable non-monetary asset without physical substance ~~held for use in the production or supply of goods or services, for rental to others, or for administrative purposes~~. IAS 38.98 provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset.

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- 12 IAS 38.~~6856~~ requires expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in IAS 38.18-~~6755~~. IAS 38.~~6957~~ requires expenditure on start-up activities to be recognised as an expense when incurred. An entity developing its own web site for internal or external access is not undertaking a start-up activity to the extent that an internally generated intangible asset is created. The requirements and guidance in IAS 38.~~52-6740-55~~, in addition to the general requirements described in IAS 38.~~2149~~ for recognition and initial measurement of an intangible asset, apply to expenditure incurred on the development of an entity's own web site. As described in IAS 38.~~65-6753-55~~, the cost of a web site recognised as an internally generated intangible asset comprises all expenditure that can be directly attributed, ~~or allocated on a reasonable and consistent basis~~, and is necessary to creating, producing and preparing the asset for it to be capable of operating in the manner intended by management ~~its intended use~~.
- 13 IAS 38.~~5442~~ requires expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in IAS 38.~~5644~~ are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditure incurred in the Planning stage of a web site's development is recognised as an expense when incurred.
- 14 IAS 38.~~5745~~ requires an intangible asset arising from the development phase of an internal project to be recognised only if an entity can demonstrate fulfilment of the six criteria specified. One of the criteria is to demonstrate how a web site will generate probable future economic benefits (IAS 38.~~5745~~(d)). IAS 38.~~6048~~ indicates that this criterion is met by assessing the economic benefits to be received from the web site and using the principles in IAS 36 *Impairment of Assets*, which considers the present value of estimated future cash flows from continuing use of the web site. Future economic benefits flowing from an intangible asset, as stated in IAS 38.17, may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. Therefore, future economic benefits from a web site may be assessed when the web site is capable of generating revenues. A web site developed solely or primarily for advertising and promoting an entity's own products and services is not recognised as an intangible asset, because the entity cannot demonstrate the future economic benefits that will flow. Consequently, all expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred.
- 15 Under IAS 38.~~2149~~, an intangible asset is recognised if, and only if, it meets specified criteria. IAS 38.~~6553~~ indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the specified recognition criteria. When an entity acquires or creates content for purposes other than to advertise and promote an entity's own products and services, it may be possible to identify an intangible asset (eg a licence or a copyright) separate from a web site. However, a separate asset is not recognised when expenditure is directly attributed, ~~or allocated on a reasonable and consistent basis~~, to creating, producing, and preparing the web site for it to be capable of operating in the manner intended by management ~~its intended use~~ –the expenditure is included in the cost of developing the web site.

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- 16 IAS 38.69~~57~~(c) requires expenditure on advertising and promotional activities to be recognised as an expense when incurred. Expenditure incurred on developing content that advertises and promotes an entity's own products and services (eg digital photographs of products) is an advertising and promotional activity, and consequently recognised as an expense when incurred ~~in accordance with IAS 38.57(e).~~
- 17 ~~Once development of a web site is complete, an enterprise begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an enterprise's own web site is recognised as an expense when incurred unless it meets the recognition criteria in IAS 38.60. IAS 38.61 explains that if the expenditure is required to maintain the asset at its originally assessed standard of performance, then the expenditure is recognised as an expense when incurred.*~~ Once development of a web site is complete, an entity begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an entity's own web site is recognised as an expense when incurred unless it meets the recognition criteria in IAS 38.18. IAS 38.20 explains that most subsequent expenditures are likely to maintain the future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria set out in IAS 38. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset—be recognised in the carrying amount of an asset.†
- 18 An intangible asset is measured after initial recognition by applying the requirements of IAS 38.72~~–.8763–.78~~. The revaluation model ~~Allowed Alternative Treatment~~ in IAS 38.75~~64~~ is applied only when the fair value of an intangible asset can be determined by reference to an active market. However, as an active market is unlikely to exist for web sites, the cost model ~~Benchmark Treatment~~ applies. Additionally, ~~since IAS 38.84 states that an intangible asset always has a finite useful life, a web site that is recognised as an asset is amortised over the best estimate of its useful life under IAS 38.79. As~~ as indicated in IAS 38.92~~84~~, many intangible assets are susceptible to technological obsolescence, and given the history of rapid changes in technology, the useful life of web sites will be short.

Date of consensus

May 2001

* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 requires all subsequent costs to be covered by its general recognition principle and eliminated the requirement to reference the originally assessed standard of performance. IAS 38 was amended as a consequence of the change to IAS 16 and the paragraphs specifically referred to were eliminated. This paragraph has been struck through to avoid any confusion.

† The new text was added by IFRS 3 *Business Combinations* in 2004.

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Effective date

This Interpretation becomes effective on 25 March 2002. The effects of adopting this Interpretation shall be accounted for using the transition requirements in the version of IAS 38 that was issued in 1998. Therefore, when a web site does not meet the criteria for recognition as an intangible asset, but was previously recognised as an asset, the item shall be derecognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, but was not previously recognised as an asset, the intangible asset shall not be recognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, was previously recognised as an asset and initially measured at cost, the amount initially recognised is deemed to have been properly determined.

IAS 1 (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraph 5. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

SIC-32

Appendix to SIC-32

This appendix accompanies, but is not part of, SIC-32. The purpose of the appendix is to illustrate examples of expenditure that occur during each of the stages described in paragraphs 2 and 3 of SIC-32 and illustrate application of SIC-32 to assist in clarifying its meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

Example application of SIC-32

Stage/nature of expenditure	Accounting treatment
Planning <ul style="list-style-type: none"> • undertaking feasibility studies • defining hardware and software specifications • evaluating alternative products and suppliers • selecting preferences 	Recognise as an expense when incurred in accordance with IAS 38.54
Application and infrastructure development <ul style="list-style-type: none"> • purchasing or developing hardware 	Apply the requirements of IAS 16
<ul style="list-style-type: none"> • obtaining a domain name • developing operating software (eg operating system and server software) • developing code for the application • installing developed applications on the web server • stress testing 	Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57 ^(a)
Graphical design development <ul style="list-style-type: none"> • designing the appearance (eg layout and colour) of web pages 	Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57 ^(a)

continued...

SIC-32

...continued Stage/nature of expenditure	Accounting treatment
<p>Content development</p> <ul style="list-style-type: none"> • creating, purchasing, preparing (eg creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. Examples of content include information about an entity, products or services offered for sale, and topics that subscribers access 	<p>Recognise as an expense when incurred in accordance with IAS 38.69(c) to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products). Otherwise, recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57^(a)</p>
<p>Operating</p> <ul style="list-style-type: none"> • updating graphics and revising content • adding new functions, features and content • registering the web site with search engines • backing up data • reviewing security access • analysing usage of the web site 	<p>Assess whether it meets the definition of an intangible asset and the recognition criteria set out in IAS 38.18, in which case the expenditure is recognised in the carrying amount of the web site asset</p>
<p>Other</p> <ul style="list-style-type: none"> • selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management • clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance [eg false start testing] • training employees to operate the web site 	<p>Recognise as an expense when incurred in accordance with IAS 38.65–.70</p>
<p>^(a) All expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred in accordance with IAS 38.68.</p>	



INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

PROJECT BRIEF AND OUTLINE

1. Subject – Intangible Assets (IA)

The IPSASB has identified intangible assets as a high priority towards convergence with the IASB. The absence of a standard on intangible assets is viewed as a significant gap in the body of IPSASs.

a) Issues Identification

The principal issues in accounting for intangible assets are the definition, recognition and measurement of the assets, and the amortization charges and impairment losses to be recognized in relation to them. It is anticipated that this will be a convergence project with IAS 38 AND SIC 32, therefore the issues identified will focus primarily on public sector issues.

b) Objectives to be achieved

The objective of this project is to prescribe the accounting treatment for intangible assets of public sector entities so that users of financial statements have useful and relevant information about an entity's investment in intangible assets.

National Standard Setters (NSSs) that have issued standards on intangible assets have done so with the objective of improving financial reporting by reducing inconsistencies that have developed in accounting and financial reporting for intangible assets, and foster enhanced comparability among governmental financial statements.

c) Link to IFAC/IPSASB Strategic Plans

i. *Link to IPSASB Strategy*

In the IPSASB Strategy and Operating Plan intangible assets is listed as a high priority project. The intangible asset project is linked to the IPSASB Strategic Theme "IFRS Convergence" (pending the outcome of the Rules of the Road Analysis). High quality reporting on intangible assets will enhance the quality, transparency and comparability of public sector financial reporting by providing better information for public sector financial management and decision making.

ii. *Link to IFAC Strategic Plan*

The alignment of the IPSASB strategic theme concerning the intangible assets project results in a direct impact on the IFAC strategic theme of "Recognition as the International Standard Setter" as well as a direct impact on the "enhancement of collaborative efforts."

2. Outline of the Project

a) Project Scope

The project applies to all public sector entities (except Government Business Enterprises (GBEs)), in accounting for all intangible assets, under the accrual basis of accounting. GBEs are required to apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB).

The project will include an analysis of IAS 38, Intangible Assets and SIC 32, Web Site Costs to determine whether these are appropriate standards to be applied to the public sector. Current indications are that while there are some public sector differences, it may be possible to develop an IPSAS on intangible assets that is substantially converged with the IASB standards.

The items listed below are excluded from the scope because the accounting treatment is specified in another IPSASB standard.

- intangible assets held by an entity for sale in the ordinary course of business;
- leases;
- assets arising from employee benefits;
- financial assets;
- goodwill acquired in a business combination;
- insurer's contractual rights;
- exploration and evaluation assets, development and extraction of minerals, oil, natural gas and similar non-regenerative resources; and
- non-current intangible assets classified as held for sale.

b) Major Problems and Key Issues that Should be Addressed

I Rights granted by statute or legislation

The recognition of intangible assets in the public sector acknowledges that some intangible assets, for example the right to levy taxes, are granted in legislation. There is no cost to acquire or construct the intangible asset. This is a difference from the private sector and will need to be considered and addressed within the project.

II Future Economic Benefit or Service Potential

In IAS 38, as within other IASs/IFRSs standards dealing with assets the term “future economic benefit” is used. In other IPSASs that are converged with IFRSs this term has been consistently modified to be “future economic benefits or service potential.” As described in IPSAS 1, paragraph 11 “to encompass all the

purposes to which assets may be put, this Standard uses the term ‘future economic benefits or service potential’ to describe the essential characteristics of assets.”

III Treatment of Items Not Acquired or Developed

IAS 38 establishes that only intangible assets acquired or developed should be recognized. Intangible items that are not acquired or developed lack identifiable and separable characteristics inherent in the definition and recognition criteria. In the public sector some assets are naturally occurring, for example, non-cultivated biological resources and water resources. Only those resources that have been acquired, transferred or donated and are not included in the value of the associated land would be recognized as an asset under IAS 38.

IV Treatment of Internally Generated Goodwill and Intangible Assets

Under IAS 38 internally generated goodwill will not meet the definition of an intangible asset and will not be recognized because it is not an identifiable resource (i.e. it is not separable nor does it arise from contractual rights or other legal rights) controlled by the entity that can be measured reliably at cost.

As far as internally generated intangible assets, these will be classified into either a research phase or a development phase with a specified treatment for recognition. Example in the public sector may include the design, construction and testing of pre-production or pre-use prototypes and models or the design, construction and operation of a pilot plant that is not of a scale for production.

V Emissions Trading – Cap and Trade- Allowances

Emissions trading is an administrative approach used to control pollution by providing economic incentives for achieving reductions in the emissions of pollutants. It is sometimes called cap and trade. The IPSASB will explore the public sector issues in regards to the intangible asset.

IPSAS 23, “*Revenue from Non-Exchange Transactions (Taxes and Transfers)*” provides guidance to the public sector on such transactions. This project will explore the provisions of IPSAS 23 and their treatment of non-exchange aspects of intangible assets, including the treatment and accounting for emission rights.

VI Non-Exchange Transactions

Non-exchange transactions are very prevalent in the public sector. Therefore it will be important for this standard to contemplate the major types on non-exchange transactions giving rise to intangible assets as well as the interaction with other IPSAS standards since these have not been addressed in IAS 38.

3. Describe the Implications for any Specific Persons or Groups

a) Relationship to IASB

The IASB has existing standard IAS 38, “Intangible Assets” and an IFRIC interpretation SIC 32, “Intangible Assets – Web Site Costs.” In December 2007 the IASB Board decided not to add a project on intangible assets to its active agenda.

The IASB currently has a project on Fair Value Measurement with a project team and an informal valuation advisory group to provide practical input about measuring fair value and about valuation issues generally. The advisory group will be comprised of valuation experts from around the world with up-to-date knowledge about the latest valuation techniques and methodologies as well as finance theory. Input from the advisory group will inform the staff as the Board develops an IFRS for fair value measurement guidance.

It is anticipated that this guidance will affect intangible assets, along with all other asset types. The IPSASB will continue to monitor the developments in Fair Value Measurement.

b) Relationship to other projects in process or planned

There are close linkages with the Entity Combinations project along with the overarching concepts being developed in the Conceptual Framework project.

There is also a close linkage to IPSAS 17, “*Property Plant and Equipment*” and IPSAS 23, “*Revenue from Non-Exchange Transactions.*”

c) Other

This project has implications for the following:

- Assurance and verifiability (IAASB/INTOSAI); and
- Budget and statistical groups involved with public sector financial statements.

4. Development Process, Project Timetable and Project Output

a) Development process

The development of outputs will be subject to the IPSASB’s formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

The initial output will be an Issues Paper and Rules of the Road Analysis. The next step an Exposure Draft of an IPSAS standard based on a marked-up version of IAS 38, with a consultation period of at least four months. Following analysis

of submissions on the Exposure Draft, timing on the issuance of a standard would be developed.

b) Project timetable

The project timetable should identify the major project milestones and the expected timeline for achieving the objectives.

Major Project Milestones	Expected Completion
Issues Paper & Project Brief	June 2008
Approve Exposure Draft	October 2008 Response date March 31, 2009
Review of responses	May 2009
Approve Final IPSAS	October 2009

c) Project output

The expected output will be an IPSAS converged with IAS 38 and SIC 32.

5. Resources Required

a) Task Force

A Task Force is unlikely to be required; however, members may need to assist the Technical Staff with intangible assets standards that have been set in the public sector as well as any a broad understanding of current practices in both English and non-English speaking countries.

b) Staff

One staff member will be required on this project for the period of the review (May 2008 – October 2009). It is anticipated that approximately one-third of an FTE would be needed.

c) Factors that might add to complexity or length

- Nature of Product (converged or public sector specific);
- Decisions with the IASB Intangible Assets project;

6. Important Sources of Information that Address the Matter being Proposed

[IASB Intangible Assets Project Page](#)

[South Africa – Accounting Standards Board – GRAP 102, Intangible Assets](#)

[United States – Government Accounting Standards Board – Statement No. 51,
Accounting and Financial Reporting for Intangible Assets](#)

[United Kingdom – FReM Government Financial Reporting Manual](#)

Prepared by _____ Date _____

(Technical Manager IPSASB)

The following should be completed after board or committee approval and after revising the project proposal form to reflect any changes by the board or committee.

Approved by _____ Date _____

(Chair IPSASB)

COMMENTS BY TECHNICAL MANAGERS

The comments of Technical Manager from each technical area are required before this Project Proposal is considered by the board or committee proposing to undertake the project.

Technical Manager to the Compliance Advisory Panel

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____

Technical Manager to the DNC

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____

Technical Manager to the SMPC

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____

Technical Manager to the IESBA

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____

Technical Manager to the IAASB

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____

Technical Manager to the PAIB Committee

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____

Technical Manager to the IAESB

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____

Technical Manager to the Transnational Auditors Committee

[Insert comments (prompts – views on importance of project, other matters wished to be communicated)]

Signed _____

Date _____