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LKAS 38 : Intangible Assets

Chartered Accountancy
Corporate Level
Financial Reporting and Governance (FRG)

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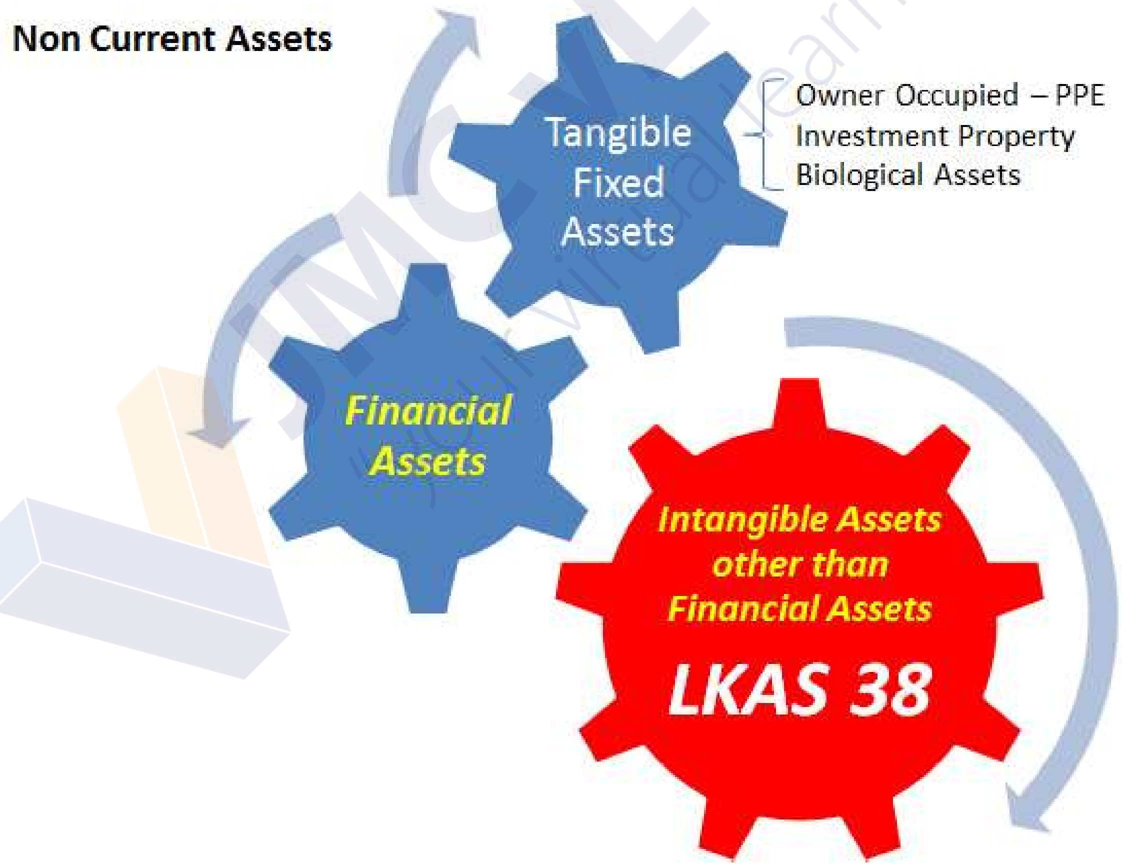
LKAS 38 – INTANGIBLE ASSETS

Learning objectives

- Define intangible assets.
- Analyse the conditions to be satisfied to recognise an intangible asset.
- Explain internally generated intangible assets, the research phase, the development phase and the cost of internally generated intangibles.
- Explain the measurement after recognition.
- Explain amortisation and impairment of intangible assets.
- Compute amortisation and impairment loss of intangible asset.
- Outline the disclosures to be made in respect of intangible assets.

Definitions and recognition



Intangible assets are defined by LKAS 38 as non-monetary assets without physical substance.

LKAS 38 *Intangible assets* defines an intangible asset and provides the recognition criteria and measurement bases to be applied to these assets.

The objectives of the standard

(a) To establish the criteria for when an intangible asset may or should be **recognised**

(b) To specify how intangible assets should be **measured**

(c) To specify the **disclosure requirements** for intangible assets

Definition of an intangible asset

The definition of an intangible asset is a key aspect of the standard; both the definition and the recognition criteria must be met in order to recognise an intangible asset.

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

An **asset** is a resource:

(a) Controlled by the entity as a result of events in the past

(b) Something from which the entity expects future economic benefits to flow **Monetary assets** are money held and assets to be received in fixed or determinable amounts of money.

Examples of items that might be considered as intangible assets include computer software, patents, copyrights, motion picture films, customer lists, franchises and fishing rights.

These items are not capitalised unless they meet the definition of an intangible in full, ie they are:

(1) Identifiable;

(2) Controlled by the entity as a result of past events; and

(3) Expected to result in future economic benefits.

Intangible asset: must be identifiable

An asset is identifiable if either of the following applies.

(a) It is separable, ie it is capable of being sold or transferred either as a single item or together with a related contract or identifiable asset or liability

(b) It arises from contractual or other legal rights Purchased intangible assets are usually identifiable; internally generated intangibles, such as customer lists, are also normally identifiable (although they may not meet other elements of the definition of intangibles).

Goodwill, whether purchased or internally generated, is not identifiable and is not an intangible asset within the scope of LKAS 38. It is, however, an intangible asset within the scope of SLFRS 3 *Business combinations* and is dealt with in detail in Consolidation.

Intangible asset: must be controlled by the entity

Another element of the definition of an intangible asset is that it must be under the control of the entity as a result of a past event. The entity must therefore be able to enjoy the future economic benefits from the asset, and prevent the access of others to those benefits. A legally enforceable right is evidence of such control, but is not always a **necessary** condition.

(a) Control over technical knowledge or know-how only exists if it is protected by a legal right such as a patent.

(b) The skill of employees, arising out of the benefits of training costs, are most unlikely to be recognisable as an intangible asset, because an entity does not control the future actions of its staff.

(c) Similarly, market share and customer loyalty cannot normally be intangible assets, since an entity cannot control the actions of its customers.

Intangible asset: must result in expected future economic benefits

An item can only be recognised as an intangible asset if economic benefits are expected to flow in the future from ownership of the asset. Economic benefits may come from the sale of products or services, or from a reduction in expenditures (cost savings).

Recognition criteria

An intangible asset is recognised if, and only if, both of the following criteria are met:

(a) It is probable that the future economic benefits that are attributable to the asset will flow to the entity

(b) The cost can be measured reliably Management has to exercise its judgement in assessing the degree of certainty attached to the flow of economic benefits to the entity. External evidence is best.

The recognition criteria can be applied as follows:

(a) If an intangible asset is **acquired separately**, it is normally because there is an expectation of future economic benefits. In addition, cost can usually be measured reliably as its purchase price (including incidental costs of purchase such as legal fees, and any costs incurred in getting the asset ready for use). Therefore, separately acquired intangibles are normally recognized in the financial statements.

(b) When an intangible asset is acquired as part of a **business combination** (ie an acquisition or takeover), the cost of the intangible asset is its fair value at the date of the acquisition. Therefore, the intangible is recognised in the acquirer's financial statements. This is even the case where the acquiree did not previously recognise the asset.

(c) **Internally generated** intangible assets may meet the recognition criteria; however, due to the judgement involved in this assessment, LKAS 38 required that all internally generated intangible assets are separately assessed as research and development (see Section 3).

(d) **The standard specifically prohibits the recognition of any of the following as an intangible asset: internally generated brands, mastheads, publishing titles, customer lists and items similar in substance.**

Measurement

An intangible asset is initially measured at cost and then under the cost or, in limited cases, the revaluation model.

Initial measurement

An intangible asset is initially measured at cost.

(a) The cost of **separately acquired** intangible assets includes:

• Purchase price

• Directly attributable costs of preparing the asset for its intended use (including professional fees and testing costs)

(b) Intangible assets acquired as part of a **business combination** are initially measured at fair value at the date of the acquisition.

(c) An **internally generated intangible asset** that meets the criteria to be recognised is measured at cost. This is discussed in more detail in Section 3.

Exchanges of assets

If one intangible asset is exchanged for another, the cost of the intangible asset is measured at fair value unless either of the following applies.

(a) The exchange transaction lacks commercial substance

(b) The fair value of neither the asset received nor the asset given up can be measured reliably Otherwise, its cost is measured at the carrying amount of the asset given up.

Intangibles acquired by way of government grant

LKAS 38 requires that intangible assets acquired by way of government grant are measured either at cost (which may be zero) or fair value.

Subsequent measurement

The standard allows two methods of valuation for intangible assets after they have been first recognised:

(a) The **cost model** requires that an intangible asset is carried at its cost, less any accumulated amortisation and less any accumulated impairment losses.
(b) The **revaluation model** allows an intangible asset to be carried at a revalued amount, which is its fair value at the date of revaluation, less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

The cost model

Where the cost model is applied, the useful life of an intangible asset must be assessed and the asset amortised over this period. The useful life may be indefinite or finite.

Indefinite useful life

Where there is no foreseeable limit to the period over which the asset is expected to generate cash inflows, the life is indefinite. In this case:

- The asset is not amortised
- The useful life is reviewed annually to assess whether it remains indefinite
- The asset is tested for impairment annually in accordance with LKAS 36

Finite useful life

In determining useful life, the following factors should be considered: typical product life cycles; technical, technological, commercial or other types of obsolescence; the stability of the industry; expected actions by competitors; the level of maintenance expenditure required; and legal or similar limits on the use of the asset, such as the expiry dates of related leases.

The useful life of an intangible asset that arises from contractual or other legal rights should not exceed the period of the rights, but may be shorter depending on the period over which the entity expects to use the asset.

Amortisation

The following points are relevant with regard to amortisation.

(a) Amortisation should start when the asset is available for use.

(b) Amortisation should cease at the earlier of the date that the asset is classified as held for sale in accordance with SLFRS 5 *Non-current assets held for sale and discontinued operations* and the date that the asset is derecognised.

(c) The amortisation method used should reflect the pattern in which the asset's future economic benefits are consumed. If such a pattern cannot be predicted reliably, the straight line method should be used.

(d) The amortisation charge for each period should normally be recognised in profit or loss.

(e) The residual value of an intangible asset with a finite useful life is assumed to be zero unless a third party is committed to buying the intangible asset at the end of its useful life or unless there is an active market for that type of asset (so that its expected residual value can be measured) and it is probable that there will be a market for the asset at the end of its useful life.

(f) The amortisation period and the amortisation method used for an intangible asset with a finite useful life should be reviewed at each financial year end.

Example -Useful life

It may be difficult to establish the useful life of an intangible asset, and judgment will be needed.

Required

Discuss how to determine the useful life of a **purchased** brand name.

Factors to consider would include the following.

(a) Legal protection of the brand name and the control of the entity over the (illegal) use by others of the brand name (ie control over pirating)

(b) Age of the brand name

(c) Status or position of the brand in its particular market

(d) Ability of the management of the entity to manage the brand name and to measure activities that support the brand name (eg advertising and PR activities)

(e) Stability and geographical spread of the market in which the branded products are sold

(f) Pattern of benefits that the brand name is expected to generate over time

(g) Intention of the entity to use and promote the brand name over time (as evidenced perhaps by a business plan in which there will be substantial expenditure to promote the brand name)

The revaluation model

The revaluation model can only be applied to assets for which fair value can be measured reliably by reference to an active market in that type of asset. An **active market** is a market in which transactions for the asset take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

There will not usually be an active market in an intangible asset; therefore the revaluation model will usually not be available. For example, although copyrights, publishing rights and film rights can be sold, each has a unique sale value. In such cases, revaluation to fair value would be inappropriate. A fair value might be obtainable, however, for assets of which there is a large population of similar items, such as fishing rights or quotas or taxi-cab licences.

Where the revaluation model is applied:

(a) The entire class of intangible assets of that type must be revalued at the same time (to prevent selective revaluations).

(b) 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 should be carried at its cost less any accumulated amortisation and impairment losses.

(c) Revaluations should be made with such regularity that the carrying amount does not differ from that which would be determined using fair value at the end of the reporting period.

(d) Where an intangible asset is revalued upwards to a fair value, the amount of the revaluation should be credited directly to equity under the heading of a revaluation surplus (unless it is a reversal of a revaluation decrease that was previously charged against income, in which case the increase can be recognised as income).

(e) The amortisation charge per annum will increase after an upwards revaluation, and the excess over historical cost amortisation can be transferred annually from the revaluation surplus to retained earnings.

(f) Where the carrying amount of an intangible asset is revalued downwards, the amount of the downward revaluation should be charged as an expense against income (unless the asset has previously been revalued upwards, in which case the decrease is first charged against any previous revaluation surplus in respect of that asset).

<u>Example - Downward revaluation</u>

An intangible asset is measured by a company at fair value. The asset was revalued by Rs. 40,000 in 20X3, and there is a revaluation surplus of Rs. 40,000 in the statement of financial position. At the end of 20X4, the asset is valued again, and a downward valuation of Rs. 50,000 is required.

Required

State the accounting treatment for the downward revaluation.

In this example, the downward revaluation of Rs. 50,000 is first set against the revaluation surplus of Rs. 40,000. The revaluation surplus will be reduced to Rs. nil and a charge of Rs. 100 made as an expense in 20X4.

Disposals/retirements of intangible assets

An intangible asset is derecognised from the statement of financial position when it is disposed of or when there is no further expected economic benefit from its future use.

On disposal, the gain or loss arising from the difference between the net disposal proceeds and the carrying amount of the asset should be taken to profit or loss as a gain or loss on disposal (ie treated as income or expense).

Research and development

Research costs are recognised in profit or loss; development costs are recognised as an asset if they meet certain criteria.

LKAS 38 assesses all internally generated intangible assets by classifying them aseither research or development.

Definitions

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

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.

Examples of research costs

(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

(d) The formulation, design evaluation and final selection of possible alternatives for new or improved materials, devices, products, systems or services

Examples of development costs

(a) The design, construction and testing of pre-production or pre-use prototypes and models

(b) The design of tools, jigs, moulds and dyes involving new technology

(c) The design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production

(d) The design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services

Accounting treatment - R&D

Research activities by definition do not meet the criteria for recognition under LKAS 38. This is because, at the research stage of a project, it cannot be certain that future economic benefits will probably flow to the entity from the project. There is too much uncertainty about the likely success or otherwise of the project.

Research costs should therefore be written off as an expense as they are incurred.

Development costs may qualify for recognition as intangible assets provided that the following strict criteria can be demonstrated.

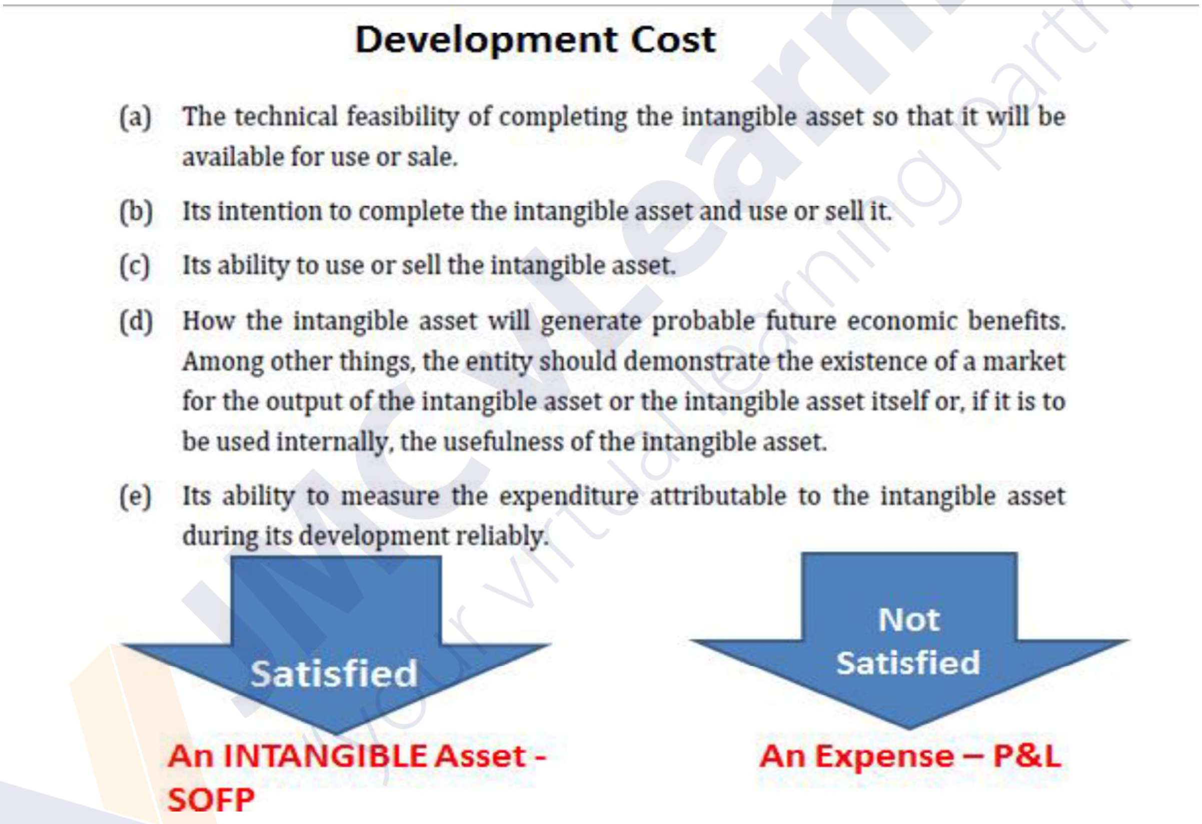
(a) The technical feasibility of completing the intangible asset so that it will be available for use or sale.

(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. Among other things, the entity should 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.

(e) Its ability to measure the expenditure attributable to the intangible asset during its development reliably.



Initial measurement of an internally generated intangible asset

The costs allocated to an internally generated intangible asset should be only costs that can be directly attributed or allocated on a reasonable and consistent basis to creating, producing or preparing the asset for its intended use. The principles underlying the costs that may or may not be included are similar to those for other non-current assets and inventory.

The cost of an internally generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria. If, as often happens, considerable costs have already been recognised as expenses before management could demonstrate that the criteria have been met, this earlier expenditure should not be retrospectively recognised at a later date as part of the cost of an intangible asset.

Subsequent measurement of an internally generated intangible asset

Subsequent to initial recognition, either the cost model or, where available, the revaluation model is applied as described in Section 2.

Example -Measurement

Colombo Manufacturing PLC is developing a new production process. During 20X3, expenditure incurred was Rs. 1,000,000, of which Rs. 900,000 was incurred before 1 December 20X3 and Rs. 100,000 between 1 December 20X3 and 31 December 20X3. Colombo Manufacturing can demonstrate that, at 1 December 20X3, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process is estimated to be Rs. 500,000.

Required

Explain how the expenditure should be treated.

At the end of 20X3, the production process is recognised as an intangible asset at a cost of Rs. 100,000. This is the expenditure incurred since the date when the recognition criteria were met, that is 1 December 20X3. The Rs. 900,000 expenditure incurred before 1 December 20X3 is expensed, because the recognition criteria were not met. It will never form part of the cost of the production process recognised in the statement of financial position.

Example - Internally generated intangible assets

Liyanage Textiles PLC has incurred the following costs in the year ended 31 December 20X5.

(1) Rs. 500,000 was spent on investigating properties of certain substances with the aim of developing a fire-resistant coating for fabrics. The company expects to develop and test this coating over the next three years with a view to commercial sales thereafter.

(2) Rs. 750,000 was spent on testing a computerised design programme developed by the company's IT department for internal use. This programme will be used by the company from 20X6 and is expected to reduce costs by 30%.

Required

State how these costs are treated in the financial statements of Liyanage Textiles PLC.

(1) The project is at the research phase: investigations have been performed into the properties of substances, however as yet there is no product being developed for use or commercial sale. Therefore, the Rs. 500,000 is recognised as an expense.

(2) The Rs. 750,000 should be classified as development costs: the programme is at an advanced stage and is due to be in place within a year. It will result in economic benefits in the form of cost savings. The Rs. 750,000 shouldtherefore be capitalised as an intangible asset.

Disclosure

LKAS 38 requires a number of general disclosures together with additional disclosures about research and development expenditure and intangible assets measured using the revaluation model.

General disclosures

An entity must disclose the following for each class of intangible assets, distinguishing between those that are internally generated and those that are not.

(a) Whether useful lives are indefinite, and where this is not the case, the amortisation rates and methods used

(b) The gross carrying amount and accumulated amortisation at the start and end of the period

(c) The line item in the statement of profit or loss in which amortisation is included

(d) A reconciliation of the carrying amount at the start and end of the period showing additions, assets classified as held for sale, revaluation increases and decreases, impairment losses recognised and reversed, amortisation, exchange differences and other changes In addition, the following must be disclosed.

(a) The carrying amount of any intangible asset with an indefinite useful life and the reasons supporting the assessment of an indefinite life

(b) A description, the carrying amount and remaining amortisation period of any material intangible asset

(c) For intangible assets acquired by way of government grant and recognized initially at fair value:

- The fair value initially recognised
- Their carrying amount
- Whether the cost or revaluation model is applied

(d) The existence and carrying amounts of intangible assets with restricted title/pledged as security for liabilities

(e) The amount of contractual commitments for the acquisition of intangible assets

Research and development expenditure

An entity should disclose the aggregate amount of research and development expenditure recognised as an expense in the period.

Revaluation model disclosures

If intangible assets are accounted for at revalued amounts, the following must be disclosed:

(a) By class of intangible assets:

- The effective date of the revaluation
- The carrying amount of revalued intangible assets
- The carrying amount that would have been recognised if the cost model were applied

(b) The amount of the revaluation surplus that relates to intangible assets at the start and end of the period indicating changes in the period and restrictions on the distribution of the balance to shareholders.

Related interpretations

SIC 32 deals with accounting for the costs of setting up a website.

When a company sets up a website (which may be for internal or external use), it may incur internal expenditure at the following stages of development.

1. Planning stage: planning the website
2. Application and infrastructure development stage: obtaining a domain name and developing hardware and operating software
3. Graphical design stage: designing the web pages
4. Content development stage: developing content
5. When the website has been set up, further expenditure will be incurred on maintaining and updating the site (the operating stage).

SIC 32 *Intangible assets – website costs* addresses the issue of how to account for the internal costs of developing and operating a website and in particular whether the website is an intangible asset.

Note that certain associated costs are outside the scope of the Interpretation:

- Hardware such as web servers are property, plant and equipment within the scope of LKAS 16.
- Hosting costs are an expense accounted for as service is received.

Accounting treatment

SIC 32 states that a website is recognised as an intangible asset if:

(a) It is probable that future economic benefits will flow to the entity

(b) The cost of the asset can be measured reliably

(c) The recognition criteria associated with development costs are met, ie:

- Completion of the intangible asset is technically feasible
- The entity intends to complete the website and use it
- The entity can use the website
- The entity can demonstrate how the website will generate economic benefits
- There are adequate resources to complete the website
- Expenditure attributable to the website during development can be measured reliably

In respect of the requirement to demonstrate how the website will generate economic benefits, SIC 32 states:

(a) The requirement is met when a website is capable of generating revenue by allowing online orders to be placed

(b) The requirement is not met when a website is developed solely as an advertising or promotional tool

Therefore, the costs of developing a website that is not capable of taking orders and is simply an advertising tool are recognised as an expense.

The application of the SIC 32 recognition criteria to the stages of development and operation of a website can be summarised as follows.

<table>
<tr><td>Planning stage</td><td>Expenditure recognised as an expense when incurred.</td></tr>
<tr><td>Application and infrastructure development stage</td><td rowspan="3">Where content is developed for purposes other than to advertise products or services, expenditure is recognised as an intangible when the expenditure can be attributed to preparing the website for its intended use.</td></tr>
<tr><td>Graphical design stage</td></tr>
<tr><td rowspan="2">Content development stage</td></tr>
<tr><td>To the extent that content is developed to advertise products or services (eg photographing products), associated costs are expensed when services are received.</td></tr>
<tr><td>Operating stage</td><td>Expenditure recognised as an expense unless it meets the LKAS 38 definition and recognition criteria for an intangible asset.</td></tr>
</table>

December 2017 – Question 07 (ii)

During the year, Win developed a website that will be used for online sales. The development activities have already been completed. Customers can place orders online instead of visiting the shops in the particular area. Management estimates have shown that this website is capable of increasing revenue through online sales. Costs incurred for the development of the website are as follows.

- Planning the website: Rs. 10,000
- Obtaining the domain name: Rs. 50,000
- Developing an operating software: Rs. 4,050,000
- Designing the web pages and developing content: Rs. 1,750,000 (This includes a cost of Rs. 150,000 incurred in developing a content page that is used to advertise the products sold by the company).

Advise how the costs incurred in developing the website should be accounted for using the information given in (ii) above. (7 marks)

As per SIC 32 web site cost, entity requires to recognize expenses incurred for planning and for domain name in the P/L during the year it incurred.

However, expenses incurred to develop the software, designing and content development can be capitalized as an intangible asset since the website facilitating online sales. But Rs. 150,000 incurred to develop a website which facilitate only advertisements cannot be capitalized.

Question 01

(c) Klancet is collaborating with Retto Laboratories (Retto), a third party, to develop two existing drugs owned by Klancet.

In the case of the first drug, Retto is simply developing the drug for Klancet without taking any risks during the development phase and will have no further involvement if regulatory approval is given. Regulatory approval has been refused for this drug in the past. Klancet will retain ownership of patent rights attached to the drug. Retto is not involved in the marketing and production of the drug. Klancet has agreed to make two non-refundable payments to Retto of $4 million on the signing of the agreement and $6 million on successful completion of the development.

Klancet and Retto have entered into a second collaboration agreement in which Klancet will pay Retto for developing and manufacturing an existing drug. The existing drug already has regulatory approval. The new drug being developed by Retto for Klancet will not differ substantially from the existing drug. Klancet will have exclusive marketing rights to the drug if the regulatory authorities approve it. Historically, in this jurisdiction, new drugs receive approval if they do not differ substantially from an existing approved drug.

The contract terms require Klancet to pay an upfront payment on signing of the contract, a payment on securing final regulatory approval, and a unit payment of $10 per unit, which equals the estimated cost plus a profit margin, once commercial production begins. The cost-plus profit margin is consistent with Klancet's other recently negotiated supply arrangements for similar drugs.

Klancet would like to know how to deal with the above contracts with Retto. (8 marks)

Required:

Advise Klancet on how the above transactions should be dealt with in its financial statements with reference to relevant International Financial Reporting Standards.

Answer:

First Agreement

This is an agreement to develop a drug since entity only outsourced development activities and nor the getting approval, marketing or production.

Development expenditure will charge into the P/L unless capitalization criteria are met.

In the given case, entity not yet obtained the regulatory approval for the product and it is not clear whether they will be receiving the approval. Therefore, $4mn paid at the singing the agreement shall be transferred to the P/L at the time it paid. The balance $6mn shall be capitalized at the end of the development if its satisfied capitalization criteria. Otherwise it also charges into p/l.

Second Agreement

This is an agreement to develop and manufacture an existing drug since entity outsourced both development activities and production. Further expenses in this agreement will cover the production cost per drug as $ 10 per drug.

Therefore, this expenditure not come under the scope of LKAS 38.

Entity shall account for the payments will be paid to Retto as production expenditure when it actually incurred.

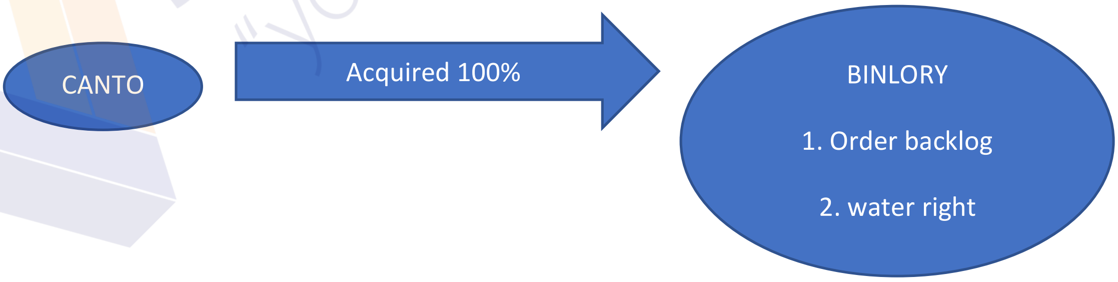
Question 02

On 28 February 2017, Canto acquired all of the share capital of Binlory, a company which manufactures and supplies industrial vehicles. At the acquisition date, Binlory has an order backlog, which relates to a contract between itself and a customer for 10 industrial vehicles to be delivered in the next two years.

In addition, Binlory requires the extensive use of water in the manufacturing process and can take a pre-determined quantity of water from a water source for industrial use. Binlory cannot manufacture vehicles without the use of the water rights. Binlory was the first entity to use water from this source and acquired this legal right at no cost several years ago. Binlory has the right to continue to use the quantity of water for manufacturing purposes but any unused water cannot be sold separately. These rights can be lost over time if non-use of the water source is demonstrated or if the water has not been used for a certain number of years. Binlory feels that the valuation of these rights is quite subjective and difficult to achieve.

Required:

The directors of Canto wish to know how to account for the above intangible assets on the acquisition of Binlory. (7 marks)



As per LKAS 38 an intangible asset can be recognized in the FS, if following conditions are met,

1. control by the entity
2. it generates future economic benefits
3. identifiable.

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.

According to given scenario canto can treat mentioned intangible assets as follows.

1. Order Backlog

This can be separable from the entity and transferred to another party if canto not going to manufacture the agreed vehicles. Therefore, this can be recognized as an intangible asset in the books of accounts.

2. Water Right

This right cannot be used to transfer or sell to another party according to the legal agreement. Further unused water cannot be sold as well. Because of these matters' canto cannot separate the right from the entity and they don't have control over the right as well.

Therefore, canto cannot recognize this as an intangible asset.

Question 03

On 1 December 2012, Suntory acquired a trademark, Golfo, for a line of golf clothing for $3 million. Initially, Suntory expected to continue marketing and receiving cash flows from the Golfo product-line indefinitely.

However, because of the difficulty in determining its useful life, Suntory decided to amortise the trademark overa 10-year life, using the straight-line method. In December 2015, a competitor unexpectedly revealed a technological breakthrough which is expected to result in a product which, when launched, will significantly reduce the demand for the Golfo product-line. The demand for the Golfo product-line is expected to remain high until May 2018, when the competitor is expected to launch its new product.

At 30 November 2016, the end of the financial year, Suntory assessed the recoverable amount of the trademark at $500,000 and intends to continue manufacturing Golfo products until 31 May 2018.

Required:

The directors of Suntory require advice as to how to deal with the trademark in the financial statements for the year ended 30 November 2016. (7 marks)

Answer:

As per LKAS 38 entity shall measure the trade mark at cost less accumulate amortization and impairment as follows,

	$000
Cost at acquisition 1.12.2012	3 000
Acc. Amortization up to 30.11.2016 (3000/10)x 4	1 200
CV at 30.11.2016	1 800
Recoverable value at 30.11.2016	500
Impairment in P/L for the year 2015/2016	1 300
Amortization for the remaining years (per annum)	500/1.5
	333

Question 04

Emcee purchases and sells players' registrations on a regular basis. Emcee must purchase registrations for that player to play for the club. Player registrations are contractual obligations between the player and Emcee. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club. Often players' former clubs are paid amounts which are contingent upon the performance of the player whilst they play for Emcee. For example, if a contracted basketball player scores an average of more than 20 points per game in a season, then an additional $5 million may become payable to his former club.

Also, players' contracts can be extended and this incurs additional costs for Emcee. At the end of every season, which also is the financial year end of Emcee, the club reviews its playing staff and makes decisions as to whether they wish to sell any players' registrations. These registrations are actively marketed by circulating other clubs with a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. Occasionally, it becomes clear that a player will not play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for another reason.

The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of $25 million. These registrations had a net book value of $7 million.

Required:

Emcee would like to know the financial reporting treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above. (10 marks)

Answer

Acquisition Player Registrations:

As per LKAS 38, this player registrations can be identified as an intangible asset since club can transferred registrations to another party (identifiable).

Directly purchase intangible assets shall recognized initially at its purchase cost plus any directly attributable cost. Therefore, Transfer fees, League levy and agent fees shall capitalize as the initial cost of the asset. However, the contingent fee payable on the performance of the player cannot be capitalized since it is an uncertain amount which will depend on the player performance in future. It shall charge into the p/l when it actually incurred.

Extensions:

This cost will be capitalized as part of the CV. Then the value shall amortize over the remaining life time (extended period) of the player registration.

Review:

At the end of each financial year Player registration shall amortise base on its contracted period. However, if player become non playable condition, club shall impair the remaining value of the player registration immediately to p/l.

Disposals:

Club shall derecognize the player registration once its sold. The difference between sales proceed and Remaining value of the player registration shall recognize as disposal gain or loss in p/l

Question 05

Chemclean trades in the chemical industry. The entity has development and production operations in various countries. It has entered into an agreement with Jomaster under which Chemclean will licence Jomaster's knowhow and technology to manufacture a chemical compound, Volut. The know-how and technology has a fair value of $4 million. Chemclean cannot use the know-how and technology for manufacturing any other compound than Volut. Chemclean has not concluded that economic benefits are likely to flow from this compound but will use Jomaster's technology for a period of three years. Chemclean will have to keep updating the technology in accordance with Jomaster's requirements. The agreement stipulates that Chemclean will make a non-refundable payment of $4 million to Jomaster for access to the technology. Additionally, Jomaster will also receive a 10% royalty from sales of the chemical compound.

Additionally, Chemclean is interested in another compound, Yacton, which is being developed by Jomaster. The compound is in the second phase of development. The intellectual property of compound Yacton has been put into a newly formed shell company, Conew, which has no employees. The compound is the only asset of Conew. Chemclean is intending to acquire a 65% interest in Conew, which will give it control over the entity and the compound. Chemclean will provide the necessary resources to develop the compound.

Required:

Discuss how the above items should be dealt with in the financial statements of Chemclean under International Financial Reporting Standards. (8 marks)

Answer

As per LKAS 38, an intangible asset shall recognize when all of the following conditions are met.

1. Its generate future economic benefits to the entity

2. Entity can control the assets

3. identifiable – separable from the entity as sales or transfer

In the case of volut, chemclean cannot identify an intangible asset since, it cannot control the volut, that is chemclean shall update the compound according to the owner's requirement and they cannot produce any product other than the agreed product.

In addition to that chemclean cannot sell the license or transfer the license to another party.

Therefore, the non-refundable payment made shall charge into p/l at the time it paid.

The royalty on the production shall be charged into p/l when the actual production occurred.

Question 06

Dexterity is a public listed company. It has been considering the accounting treatment of its intangible assets and has asked for your opinion on how the matters below should be treated in its financial statements for the year to 31 March 20X4.

(i) On 1 October 20X3 Dexterity acquired Temerity, a small company that specialises in pharmaceutical drug research and development. The purchase consideration was by way of a share exchange and valued at Rs. 35 million.

The fair value of Temerity's net assets was Rs. 15 million (excluding any items referred to below). Temerity owns a patent for an established successful drug that has a remaining life of eight years. A firm of specialist advisors, Leadbrand, has estimated the current value of this patent to be Rs. 10 million, however the company is awaiting the outcome of clinical trials where the drug has been tested to treat a different illness. If the trials are successful, the value of the drug is then estimated to be Rs. 15 million. Also included in the company's statement of financial position is Rs. 2 million for medical research that has been conducted on behalf of a client. (7 marks)

(ii) Dexterity has developed and patented a new drug which has been approved for clinical use. The costs of developing the drug were Rs. 12 million. Based on early assessments of its sales success, Leadbrand have estimated its market value at Rs. 20 million. (5 marks)

(iii) Dexterity's manufacturing facilities have recently received a favourable inspection by government medical scientists. As a result of this the company has been granted an exclusive five-year licence to manufacture anddistribute a new vaccine. Although the licence had no direct cost to Dexterity, its directors feel its granting is a reflection of the company's standing and have asked Leadbrand to value the licence. Accordingly they have placed a value of Rs. 10 million on it. (5 marks)

(iv) In the current accounting period, Dexterity has spent Rs. 3 million sending its staff on specialist training courses. Whilst these courses have been expensive, they have led to a marked improvement in production quality and staff now need less supervision. This in turn has led to an increase in revenue and cost reductions. The directors of Dexterity believe these benefits will continue for at least three years and wish to treat the training costs as an asset. (4 marks)

(v) In December 20X3, Dexterity paid Rs. 5 million for a television advertising campaign for its products that will run for 6 months from 1 January 20X4 to 30

June 20X4. The directors believe that increased sales as a result of the publicity will continue for two years from the start of the advertisements. (4 marks)

Required

Advise the directors of Dexterity how they should treat the above items in the financial statements for the year to 31 March 20X4. (Note. The values given by Leadbrand can be taken as being reliable measurements. You are not required to consider amortisation aspects.) (Total = 25 marks)