

LKAS 38 – Intangible Assets

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1. Objective

- To establish the criteria for when an intangible asset may or should be recognized
- To specify how intangible assets should be measured
- To specify the disclosure requirements for intangible assets

2. Scope

- IAS 38 applies to all intangible assets other than:
 - Financial assets
 - Deferred tax assets
 - Assets arising from employee benefits
 - Goodwill (SLFRS 3 Business Combinations).

3. Key definitions

- Intangible asset: an identifiable non-monetary asset without physical substance, such assets should be controlled by the entity as a result of past events and from which future economic benefits are expected.
- Thus, the three critical attributes of an intangible asset are:
 1. Identifiability
 2. Control (power to obtain benefits from the asset)
 3. Future economic benefits (such as revenues or reduced future costs)
- Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Examples of intangible assets

- Patented technology
- Computer software
- Databases and trade secrets trademarks,
- Internet domains video and audiovisual material
- Customer lists mortgage servicing rights licensing,
- Royalty

3.1 Identifiability

An intangible asset must be identifiable in order to distinguish it from goodwill. With non-physical items,

there may be a problem with 'identifiability'.

- (a) If an intangible asset is acquired separately through purchase, there may be a transfer of a legal right that would help to make an asset identifiable.
- (b) An intangible asset may be identifiable if it is separable, ie if it could be rented or sold separately. However, 'separability' is not an essential feature of an intangible asset.

3.2 Control

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. A legally enforceable right is evidence of such control, but is not always a necessary condition.

expected future economic benefits

3.3 Expected future economic benefits

An item can only be recognized 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).

An intangible asset, when recognized initially, must be measured at cost. It should be recognized if, and only if both the following occur.

- (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.

Test your understanding 01

Over the year Apple Inc has developed considerable amount of intangible assets, according to LKAS 38, identify the intangible assets.

No	Description	Intangible Asset (Yes / No)	Reason
1.	Registered Brand Name		
2.	Patent Technology		
3.	Customer Product awareness		
4.	Committed Staff		
5.	Experience Management		
6.	Licenses		
7.	Goodwill on business combinations		
8.	Software – Utilities or Applications		

4. Recognition and measurement

- In addition of meeting the definition requirements, an intangible asset shall be recognized if, and only if:
 - it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
 - the cost of the asset can be measured reliably.
- An intangible asset shall be measured initially at cost.

- 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.
 - If an intangible asset is acquired separately, its 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).
 - When an intangible asset is acquired as part of a business combination, the cost of the intangible asset is its fair value at the date of the acquisition.
- Internally generated goodwill shall not be recognized as an asset.
- It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:
 - identifying whether and when there is an identifiable asset that will generate expected future economic benefits; and
 - 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.
- To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:
 - a research phase; and
 - a development phases.

5. Accounting for Research and Development Cost

5.1 Accounting for Research Cost

- Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
- 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
- Examples of research activities are:
 - activities aimed at obtaining new knowledge;
 - the search for, evaluation and final selection of, applications of research findings or other knowledge;
 - the search for alternatives for materials, devices, products, processes, systems or services; and
 - the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

5.2 Accounting for Development Cost

- 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.
- 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:
 - the technical feasibility of completing the intangible asset
 - its intention to complete the intangible asset and use or sell it.
 - its ability to use or sell the intangible asset.
 - how the intangible asset will generate probable future economic benefits.
 - the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
 - its ability to measure reliably the expenditure attributable to the intangible asset during its development
- 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.

Test your understanding 02

Which one of the following internally-generated items may be eligible for capitalisation as intangible assets in accordance with LKAS 38 Intangible Assets? (Ignore business combinations.)

- A customer list
- A pre-production prototype
- Goodwill
- The cost of researching new material

Test your understanding 03

G PLC is developing a new product and expects to be able to capitalize the costs. Which one of the following would preclude capitalization of the costs?

- Development of the product is not yet complete.
- No patent has yet been registered in respect of the product.

- No sales contracts have yet been signed in relation to the product.
- It has not been possible to reliably allocate costs to development of the product.

Select the most appropriate answer?

Test your understanding 03

A company had LKR 20 million of capitalised development expenditure at cost brought forward at 1 October 20X7 in respect of products currently in production and a new project began on the same date.

The research stage of the new project lasted until 31 December 20X7 and incurred LKR 1.4 million of costs. From that date the project incurred development costs of LKR 800,000 per month. On 1 April 20X8 the directors became confident that the project would be successful and yield a profit well in excess of costs. The project was still in development at 30 September 20X8. Capitalised development expenditure is amortised at 20% per annum using the straight line method.

What amount will be charged to profit or loss for the year ended 30 September 20X8 in respect of research and development costs?

- LKR 8,280,000
- LKR 6,880,000
- LKR 7,800,000
- LKR 3,800,000

5.3 Cost of an internally generated intangible asset

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

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

- (a) selling, administrative and other general overhead expenditure
- (b) identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and
- (c) expenditure on training staff to operate the asset.

Test your understanding 04

A PLC purchased an intangible asset for 150 Mn, further they incurred other attributable cost as follows,

1. Direct taxes 22 Mn (non-refundable)
2. Cost of testing 13 Mn
3. Admin overhead 10 Mn

4. Directly related staff cost 5 Mn
5. Advertising cost 3 Mn

Calculate the cost of intangible assets to be capitalized in A PLC's books?

Test Your Understanding 05 Initial recognition: computer software

A PLC has purchased fleet of computers for 100 Mn to support the operation of the computers they have purchases operating system which is pre-loaded with the computer, the cost of operating software was 20 Mn. These new computers were installed with high-end graphic designing software at a price of 50 Mn and these licenses are for a period of 5 years.

Discuss how this will be accounted under LKAS 38.

Test Your Understanding 06 PP 2019 June Q3

- (a) State a criteria to be met to recognize an asset as an intangible asset. (02 marks)
- (b) EPL Ltd. has developed a new product during the year ended 31st March 2019 and started commercial operation in May 2019. Cost incurred for the new product during the year 2018/19 were as follows:
 - 1) A research was done for the new product and incurred Rs.1 million during the year.
 - 2) The company registered the patent right for the new product during the year and fee on registration for patent right was Rs.100,000/-.
 - 3) Costs of Rs.300,000/- for advertising and promotional activities were spend on the new product.

You are required to:

Explain whether each of the above costs could be recognized as intangible assets as per LKAS 38-Intangible Assets. (03 marks)

(Total 05 marks)

Test Your Understanding 07 PP 2018 Jan Q5

- (a) Chemichem PLC, a manufacturing company has developed a new product during the year ended 31st March 2017. A research was done for the new product and the company has incurred Rs.3 million for the research during the year. The company registered the patent right for the new product in March 2017 and started commercial production in April 2017. Other costs incurred for the new product during the year 2016/17 were as follows:

	Rs.
Registration fee to register the new product (patent right)	25,000
Cost incurred to train the staff	300,000
Cost of sales promotions	50,000
Professional fees incurred to generate the new product	250,000

You are required to:

Assess the amount to be charged as expenditure for the year ended 31st March 2017 and the amount to be capitalized as an intangible asset in the Financial Statements of Chemichem PLC.

(06 marks)

6. Measurement subsequent to acquisition:

- An entity must choose either the cost model or the revaluation model for each class of intangible asset.
- Cost model. After initial recognition intangible assets should be carried at cost less accumulated amortisation and impairment losses.
- Revaluation model. Intangible assets may be carried at a revalued amount (based on fair value) less any subsequent amortisation and impairment losses only if fair value can be determined by reference to an active market. Such active markets are expected to be uncommon for intangible assets.

7. Classification of intangible assets based on useful life

- Intangible assets are classified as:
 - Indefinite life: no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
 - Finite life: a limited period of benefit to the entity.

Measurement subsequent to acquisition: intangible assets with finite lives

- The cost less residual value of an intangible asset with a finite useful life should be amortised on a systematic basis over that life:
- The amortisation method should reflect the pattern of benefits. If the pattern cannot be determined reliably, amortise by the straight-line method. The amortisation charge is recognised in profit or loss unless another SLFRS requires that it be included in the cost of another asset. The amortisation period should be reviewed at least annually.

Measurement subsequent to acquisition: intangible assets with indefinite useful lives

- An intangible asset with an indefinite useful life should not be amortised.
- Its useful life 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.
- The asset should also be assessed for impairment in accordance with IAS 36.

8. Subsequent expenditure

Due to the nature of intangible assets, subsequent expenditure will only rarely meet the criteria for being recognised in the carrying amount of an asset. Subsequent expenditure on brands, mastheads, publishing titles, customer lists and similar items must always be recognised in profit or loss as incurred.

9. Disclosure

- (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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