

AASB 138 'Intangible Assets' Summary

OVERVIEW

The Accounting Standard AASB 138 will replace the existing requirements that apply to intangible assets in AAS 4/AASB 1021 'Depreciation', AAS 10/AASB 1010 'Recoverable Amount of Non-Current Assets', AAS 13/AASB 1011 'Accounting for Research and Development', AAS 18/AASB 1013 'Accounting for Goodwill', AAS 21/AASB 1015 'Acquisition of Assets' and AASB 1041 'Revaluation of Non-Current Assets'.

An intangible asset is defined as an 'identifiable non-monetary asset without physical substance'. There is currently no specific Australian Accounting Standard on accounting for intangibles.

The key differences from the existing requirements are:

- To be recognised, an intangible asset be separable (capable of being separated from the entity and able to be sold, transferred, licensed, rented or exchanged) or arise from contractual or other legal rights.
- All research expenditure must be expensed.
- Specific criteria must be met before development expenditure can be capitalised.
- Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance must not be recognised.
- Revaluation is only permitted where there is an active market to determine fair value
- The useful life of an intangible asset is either finite or indefinite.
- An intangible asset with an indefinite life must not be amortised.
- Computer software that is not integral to the operation of related hardware is an intangible asset.

Although less significant than the impact on the private sector, AASB 138 will impact on public sector agencies with intangible assets. Some intangibles previously recognised, for example capitalised research and development expenditure, may not meet the new recognition criteria. These assets would need to be derecognised at transition. The Standard's definition of active market is restrictive and it is unlikely that intangibles can be revalued. Consequently, at transition date, any existing revaluations will need to be derecognised. Adjustments are made against the asset revaluation reserve. Agencies that currently classify computer software as property, plant and equipment will be required to reclassify software that is not integral to the

operation of related hardware to intangible assets and compliance with AASB 138 recognition and measurement criteria will be required.

INTRODUCTION

Accounting Standard AASB 138 will replace the existing requirements that apply to intangible assets in AAS 4/AASB 1021 'Depreciation', AAS 10/AASB 1010 'Recoverable Amount of Non-Current Assets', AAS 13/AASB 1011 'Accounting for Research and Development', AAS 18/AASB 1013 'Accounting for Goodwill', AAS 21/AASB 1015 'Acquisition of Assets' and AASB 1041 'Revaluation of Non-Current Assets'. AASB 138 adopts the proposals in the IASB Exposure Draft of Proposed Amendments to IAS 38 'Intangible Assets'. There is currently no specific Australian Accounting Standard on accounting for intangibles.

The Standard prescribes the identification, recognition, measurement and disclosure requirements for intangible assets.

An intangible asset is defined as an 'identifiable non-monetary asset without physical substance'. Expenditures on the acquisition, development and enhancement of intangible resources (such as new systems, processes, intellectual property and market knowledge) cannot be recognised as intangible assets unless an asset is separately identifiable and the entity has control over the future economic benefits to be generated by the asset (paragraphs 9 to 23). In addition, the Standard does not permit the recognition of internally generated brands, mastheads, publishing titles, customer lists and items similar in substance.

Computer software, licences, patents, copyrights, customer lists and marketing rights are examples of intangibles.

Scope

The Standard applies to all intangible assets except intangibles that are covered by another Standard, financial assets, and mineral rights and expenditure on the exploration, development and extraction of mineral resources. The key intangibles covered by other Standards are:

- intangibles held for sale in the ordinary course of business (AASB 102 and AASB 111);
- deferred tax assets (AASB 112);
- leases within the scope of (AASB 117);
- goodwill acquired in a business combination (AASB 3); and
- intangibles classified as held for sale (AASB 5).

Identification criteria

To meet the definition of an intangible asset, an asset must be identifiable to distinguish it from goodwill. To be identifiable, the asset be separable or arise from contractual or other legal rights. Separable means that the asset must be capable of being separated from the entity and able to be sold, transferred, licensed, rented or exchanged.

Recognition criteria

An intangible asset shall be recognised if, and only if, it is probable that the future economic benefits attributable to the asset will flow to the entity and its cost can be measured reliably. Probability shall be assessed using reasonable and supportable assumptions that represent management's best estimate of the economic conditions that will exist over the useful life of the asset (paragraph 22).

The probability recognition criteria is always considered to be satisfied for separately acquired intangible assets (paragraph 25) and intangible assets acquired as part of a business combination (paragraph 33).

Specific rules apply in respect of internally generated intangibles (paragraphs 51 to 67). Internally generated goodwill (paragraph 48), internally generated brands, mastheads, publishing titles, customer lists and items similar in substance (paragraph 63) and research expenditure (paragraph 54) must not be recognised. Specific recognition criteria apply to development expenditure (paragraph 57).

Where the research phase of an internal project cannot be distinguished from the development phase, the expenditure on the project is classified as research and it must be expensed (paragraph 53).

Measurement

Intangible assets are initially measured at cost. Where a not-for-profit entity acquires an intangible asset for no cost, or for a nominal cost, the cost is the fair value of the asset as at the date of acquisition.

The cost of separately acquired intangible assets includes the purchase price and any directly attributable cost of preparing the asset for use (paragraph 26 to 32).

The cost of intangible assets acquired as part of a business combination is its fair value at acquisition date (paragraphs 35 to 41). Paragraphs 65 to 67 set out the costs that can be capitalised for internally generated intangible assets (direct costs) and those costs that must be expensed (these include training, selling, administrative and general overheads). Note AASB 123 'Borrowing Costs' specify the criteria for the recognition of borrowing costs in internally generated intangible assets.

Past expenses cannot be capitalised at a later date (paragraph 71).

Subsequent expenditures on intangibles will rarely be recognised. Most subsequent expenditures are likely to be only maintaining the existing future economic benefits or are difficult to attribute to a particular intangible (paragraph 20).

Subsequent to initial recognition, assets are measured at cost or fair value (paragraph 72). The fair value option is only permitted where valuation is by reference to an active market (paragraph 75). An active market is defined as a market where the items traded are homogenous, where willing buyers and sellers can be found at any time and prices are available to the public (paragraph 8). The frequency of revaluations and accounting for revaluation increments and decrements is consistent with the existing requirements for property, plant and equipment.

Where an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market, the asset is carried at cost less accumulated amortisation and impairment losses (paragraph 81).

If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the asset is carried at its revalued amount as at the date of the last revaluation determined by reference to an active market less subsequent accumulated amortisation and impairment losses (paragraph 82).

Useful life

Entities must assess whether the useful life of an intangible asset is finite or indefinite (paragraphs 88 to 96).

Intangible assets with a finite useful life are amortised over the useful life of the asset (paragraphs 97 to 106). The depreciable amount is allocated systematically over its useful life in a manner that reflects the expected consumption of the asset's future economic benefits. If the pattern of consumption cannot be reliably determined, the straight-line method shall be used. The residual value of an intangible asset with a finite useful life is assumed to be zero unless there is an active market for the asset or there is a commitment by a third party to purchase the asset. The amortisation period and method must be reviewed at least at the end of each annual reporting period.

An indefinite useful life means there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows. Intangible assets with an indefinite useful life are not to be amortised (paragraphs 107 to 108).

AASB 136 'Impairment of Assets' requires intangible assets to be assessed for an indication of impairment at each reporting date. Irrespective of whether there is any indication of impairment, an entity must estimate the recoverable amount during the reporting period (at the same time each year) for intangible assets with an indefinite useful life and those not yet available for use.

Retirements and disposals

A intangible asset must be derecognised on disposal or when no future economic benefits are expected from its use or disposal (paragraph 112). The gain or loss shall be recognised in the income statement (paragraph 113).

Disclosures

For each class of intangible assets, distinguishing between internally generated and other intangibles, entities must disclose:

- whether useful lives are finite or indefinite;
- amortisation rates and methods;
- the gross carrying amount and any accumulated amortisation aggregated with accumulated impairment losses at the beginning and end of the reporting period;
- line items of income statement in which amortisation is included; and
- a reconciliation of the carrying amount at the beginning and end of the reporting period.

There are specific disclosures required in respect of intangibles with indefinite useful lives, revaluations of intangibles and research and development expenditure recognised as expense.

Paragraphs 118 to 128 specify the disclosure requirements.

APPLICATION DATE

The Standard will be applicable from the first reporting period beginning on or after 1 January 2005.

TRANSITIONAL PROVISIONS

The Transitional Provisions contained in the Standard do not apply as they are to be overridden by AASB 1 'First-time Adoption of Australian Equivalents to International Financial Reporting Standards'. The provisions of AASB 1 must be followed by **all** first-time adopters.

Under AASB 1, agencies with a 30 June year end must produce an opening balance sheet at 1 July 2004 (the date of transition) that is compliant with Australian Equivalents of International Financial Reporting Standards (IFRS). AASB 1 requires IFRS to be applied retrospectively. Any adjustments as a result of applying IFRS to the opening balance sheet are taken directly to equity.

AASB 1 makes some mandatory exemptions and allows some voluntary exemptions to the retrospective application of IFRS. The deemed cost option for property, plant

and equipment under paragraphs 16 and 17 (AASB 1) is available for intangible assets where fair value has been determined by reference to an active market (paragraph 18).

On transition to IFRS agencies with intangible assets will need to ensure that they meet IFRS recognition and measurement criteria.

The following intangible assets will need to be derecognised:

- internally generated brands, mastheads, publishing titles, customer lists and items similar in substance must not be recognised;
- capitalised research expenditure;
- capitalised development expenditure that does not meet the criteria specified in AASB 138 (paragraph 57); and
- any other capitalised expenditure that AASB 138 does not allow to be included in the cost of an internally generated intangible asset (paragraphs 65 to 67).

Any revaluations of intangible assets not made by reference to an active market (defined in paragraph 8) will need to be derecognised.

All computer software that is not integral to the operation of hardware, must be classified as intangible assets. It is likely that some agencies will need to reclassify some software from property, plant and equipment as intangible assets. Assets reclassified will need to comply with the measurement and recognition requirements under AAS 138.

Agencies must also ensure that all intangibles that meet the AASB 138 recognition criteria at the date of transition are included in the opening balance sheet. AASB 1 provides an exception to this in respect of certain intangibles acquired in a business combination (refer to Appendix B of AASB 1).

Note that if an internally generated intangible asset qualifies for recognition at the date of transition, agencies must recognise the intangible asset in the opening balance sheet even if the expenditure was previously expensed.

KEY DIFFERENCES FROM THE EXISTING AUSTRALIAN STANDARDS

Classification of computer software

AASB 138 prescribes that computer software that is an integral part of the related hardware is treated as property, plant and equipment (paragraph 4). Other software is treated as an intangible asset. The current standards provide no such guidance and as a consequence, varying practices have developed. For some agencies, there may be an initial reclassification of some computer software from property, plant

and equipment to intangible assets on transition and ongoing change on how software is classified, recognised and measured.

All research expenditure must be expensed.

Under existing requirements basic research is expensed and applied research would normally be expensed. AAS 13 permits applied research expenditure to be capitalised where it can be linked to future benefits that are beyond any reasonable doubt. Circumstances where applied research expenditure could be capitalised under the existing requirements are considered rare, therefore the requirement to expense all research expenditure under AASB 138 will have very limited impact generally.

Specific criteria must be met before development expenditure can be capitalised.

Under AAS 13 requirements, development expenditure may be capitalised where it can be linked to future benefits that are beyond any reasonable doubt. It is more likely to be capitalised than applied research. AASB 138 requires the following to be demonstrated before development expenditure is capitalised as an intangible asset:

- it is technically feasible to complete the asset for use or sale;
- the entity intends to complete the asset;
- the entity is able to sell or use the asset;
- the intangible asset will generate probable future economic benefits;
- adequate technical, financial and other resources available to complete the development and to use or sell the asset; and
- the expenditure attributable to the intangible asset during the development phase can be measured reliably.

As AASB 138 HAS more specific recognition criteria, there may be circumstances where expenditure that would be capitalised under AAS 13, will be expensed under the AASB 138.

Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance must not be recognised.

These changes are not expected to have a material impact on public sector agencies.

Revaluation only permitted where there is an active market to determine fair value.

This represents a significant difference from the existing requirements under AASB 1041 and will effectively prevent revaluation of intangible assets in the public sector.

Inconsistent measurement within an asset class.

The application of the revaluation requirements in AASB 138 may result in a class of assets being carried at a mix of cost and fair value. This is not expected to be an issue for the public sector as all intangibles are likely to be carried at cost.

The useful life of an intangible asset is finite or indefinite.

Unlikely to have an effect on public sector agencies.

An intangible asset with an indefinite life must not be amortised.

Unlikely to have an effect on public sector agencies.

IMPACT OF DIFFERENCES

Effect on general reporting in the public sector

Where an agency has intangible assets, impacts will result from the requirement to account for computer software as intangibles, the restrictions on revaluation and the potential impact from the application of the specific recognition rules for development expenditure.

FREQUENTLY ASKED QUESTIONS

Question: What is an intangible asset?

Answer: An intangible asset is an identifiable asset without physical substance. Common examples are software, technology, patents, copyright, customer lists, franchises and marketing rights.

Question: Is goodwill an intangible asset?

Answer: Goodwill is not classed as an intangible asset as it is not identifiable. Acquired goodwill represents a payment by the acquirer in expectation of future economic benefits from assets that are not capable of being separately identified and recognised. Internally generated goodwill cannot be recognised. Purchased goodwill is recognised under AASB 3 'Business Combinations'.

Question: When should I recognise an internally generated intangible asset?

Answer: Any intangible asset can be recognised only when it meets the identification and recognition criteria. However, AASB 138 imposes additional recognition requirements in respect of internally generated intangible assets. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance and research expenditure must not be recognised. Development expenditure is recognised when the entity can demonstrate that six specified criteria have been met.