

IPSAS 31

Intangible assets

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Definition

- Intangible represent high proportion of value
- Identifiable long-term assets of an entity having no physical existence are called intangible assets.
- Intangible assets are either acquired, arise in business combination or developed internally.
- They include goodwill, patents, copyrights, etc.



Pick the intangibles

Wifi networks - Ksh 200 million

Hospital Curtains – Ksh 7 Million

Wheelbarrows - Ksh 109 000 each

Facebook – Ksh 2 million

Launch of 3m borehole – Ksh 12 million

Street beautification project - Ksh 50 million

Contrast with materiality, accrual basis and cash basis



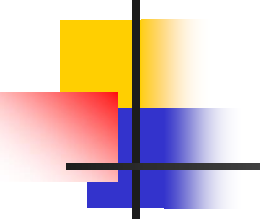
Imagine

- The communication authority
- Broadcasting frequencies
- Do they have a value ?
- Should they be recognised and included in the financial statements ?



Intangible value of a business

- Investment in intangible assets is growing rapidly.
- Matches or exceeds investment in tangible assets such as machinery, equipment and buildings.
- Intensified global competition, ICTs, new business models, and the growing importance of the services sector have all amplified the importance of intangible assets to firms and industries.

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- Intangible Assets: IPSAS 31
 - Purchased intangibles
 - Internally generated intangibles
 - Research and development
 - Initial cost
 - Subsequent expenditures
 - Amortization
 - Revaluation model
 - Impairment of Assets of Cash generating and
 - Impairment of non-cash generating



Other issue

- Powers to grant rights;
- Future economic benefit and service potential of intangible assets;
- Treatment of intangible items not acquired or developed;
- Treatment of internally generated intangible assets and goodwill;
- Non-exchange transactions involving intangible items; and
- Web site costs.



Scope of discussion - exclude

- financial assets as defined in IAS 32 Financial instruments: presentation
- recognition and measurement of exploration and evaluation assets, and
- expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.



Typical cases

- Some intangible assets may be contained in or on a physical substance — for example, computer software residing on a computer hard drive or compact disc, licenses or patents embodied in legal documentation, and audio or film products.
- In cases where an asset incorporates both tangible and intangible elements, judgment is required to assess whether the tangible or intangible element is more significant; the outcome of that assessment determines whether the asset is accounted for under IPSAS 17 Property, Plant and Equipment or as an intangible asset under IPSAS 31.
- Consequently, the operating system of a computer is an integral part of the related hardware and it is treated as PP&E. Application software, which is not an integral part of the related hardware, is treated as an intangible asset.



scope

- Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights are excluded from the scope of IPSAS 12 and are included in IAS 38.
- IAS 17 specifies that after initial recognition, a lessee accounts for any intangible asset held under a finance lease in accordance with IAS 38.



Recognition criteria

- Recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:
 1. the definition of an intangible asset; and
 2. the recognition criteria.

- 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.



Defenation criteria

- To meet the definition of an intangible asset, there must be all of the following elements:
 - Identifiability (i.e. separable from the entity, or arises from contractual or legal rights)
 - control over a resource by the entity
 - existence of future economic benefits.



Control

- An entity controls an asset if the entity has;
 - the power to obtain the future economic benefits flowing from the underlying resource and,
 - Power to restrict the access of others to those benefits.



Future economic benefits

- 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

- An intangible asset shall be recognised 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 entity 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.
- An intangible asset shall be measured initially at cost



Internally generated intangible assets

- there are two phases: research phase and development phase.
 - Research phase includes all activities and costs incurred before the intangible asset is commercially feasible, while
 - the development phase includes all activities and costs incurred after the asset is established to be commercially feasible.
- All costs in research phase are expensed in the period incurred while costs incurred in development phase can be capitalized.



Capitalisation of development cost

- An intangible asset arising from development (or from the development phase of an internal project) can be recognised if all the conditions described below can be demonstrated:
 - the technical feasibility of completing the intangible asset so that it will be available for use or sale;
 - 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; and
 - its ability to measure reliably the expenditure attributable to the intangible asset during its development.



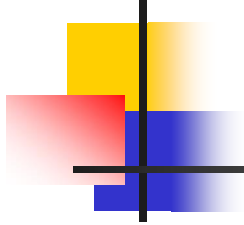
Not recognised

- Internally developed and not specifically identifiable.
- If there is not a specifically identifiable intangible asset, then you should charge its cost to expense in the period incurred



Example of intangible asset not recognised

- IPSAS 31 specifically prohibits the following internally generated intangible assets from being recognised:
- goodwill;
- Internal brands names;
- publishing titles;
- customer lists;
- item similar in substance and
- intangible assets arising from research (or from the research phase of an internal project)



- Other examples of items that are expensed as incurred include expenditures for
 - start-up costs that are not included in PP&E in accordance with IPSAS 17
 - training, advertising, and promotional activities
 - relocating or reorganizing part or all of an entity



Legal contract

- Copyrights
- Copyrights grant a business sole authority to reproduce and sale a software, book, magazine, journal, etc.
- Patents
- Patents grant a manufacturing and research company control over the use and sale of a specific design in manufacturing process, etc.



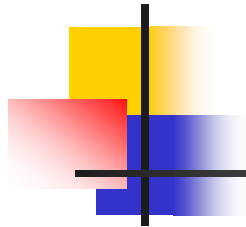
Subsequent measurement

- After initial recognition, either the cost model or revaluation model can be applied, however, the revaluation model can only be selected if fair values can be determined in an active market.
- IPSAS 31 notes that it is uncommon for an active market to exist for intangible assets.
- However, some jurisdictions may have an active market for freely transferable licences, which may provide a fair value for some intangible assets.



Cost model

- An intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses.



- Amortization of Intangible Assets
- Amortization is the process of expensing out intangible assets over their useful life. It is in effect the depreciation of intangible assets.
- Some intangible assets have indefinite or unlimited useful life, such as goodwill. Such assets are not amortized. Others have a definite useful life and are amortized over their useful life. Most of intangible assets are amortized using straight line method. Useful life is the shorter of legal life and economic life.



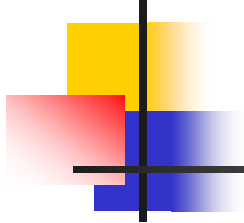
Finite life

- An intangible asset with a finite useful life is systematically amortised over its useful life from the time that it is available for use until it is either derecognised or classified as held for sale in accordance with IFRS 5 Non-current assets held for sale and discontinued operations
- The useful life of an intangible asset that arises from contractual or other legal rights does not exceed the period of the contractual or legal rights, but may be shorter depending on the period over which the entity expects to use the asset.
- The amortisation period and method must be reviewed at least at the end of each reporting period



Example – amortisation

- Innovative Gadgets Ltd. patented one of their products at a cost of Ksh100 million. The patent is enforceable for 10 years, so the legal life is 10 years. However, the company expects to produce the patented product for only 5 years and expects to replace it with an advanced version at the end of 5 years. The company uses straight line method of amortization. The company is required to amortize the patent over 5 years which is the shorter of legal life and economic life and hence per year amortization would be ksh 20 million ($100/5$).

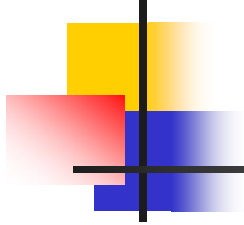


- If an intangible asset has a finite useful life, you should amortize it over that useful life.
- The amount to be amortized is its recorded cost, less any residual value.
- However, intangible assets are usually not considered to have any residual value.
- If there is any pattern of economic benefits to be gained from the intangible asset, then you should adopt an amortization method that approximates that pattern.
- If not, the customary approach is to amortize it using the straight-line method



Software developed for internal use - IFMIS

- This is the cost of software developed for internal use, with no plan to market it externally.
- You amortize these costs over the useful life of the asset.

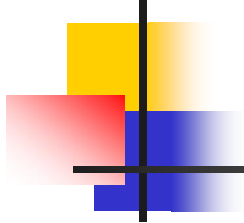


- Leasehold improvements.
- These are improvements to a lease hold, where the landlord takes ownership of the improvements at end of lease term.
- amortize these improvements over the shorter of their useful lives or the lease term



Impairment Testing for Intangible Assets

- Test for an impairment loss whenever circumstances indicate that an intangible asset's carrying amount may not be recoverable, or at least once a year.
- Examples of such instances are:
 - Significant decrease in the asset's market price
 - Significant adverse change in the asset's manner of use
 - Significant adverse change in legal factors or the business climate that could affect the asset's value
 - Excessive costs incurred to acquire or construct the asset
 - Historical and projected operating or cash flow losses associated with the asset
 - The asset is more than 50% likely to be sold or otherwise disposed of significantly before the end of its previously estimated useful life



- If an intangible asset is subsequently impaired adjust the amortization level to take into account the reduced carrying amount of the asset, and possibly a reduced useful life
- recognize an impairment loss. This will be a debit to an impairment loss account and a credit to the intangible assets account.
- The new carrying amount of the intangible asset is its former carrying amount, less the impairment loss.
- This means that you should alter the amortization of that asset to factor in its now-reduced carrying amount.
- It may also be necessary to adjust the remaining useful life of the asset, based on the information obtained during the testing process.



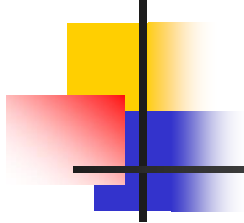
Example

- A media company owns a brand name TRUE LOVE it purchased several years ago but now has the following characteristics:
- Carrying amount is Ksh1.0 million
- Value In Use (the discounted cash flows) is Ksh 0.9 million
- Fair Value Less Cost Sell is Ksh 0.7 million
- An indicator of impairment exists



Impairment of goodwill

- Facts:
- Carrying amount of network/CGU is Ksh 1,400
- Additionally, there is Ksh 500 of goodwill associated with the network/CGU
- FVLCS of the network/CGU is Ksh1,600
- VIU of the network/CGU is Ksh1,550
- Analysis:
- The recoverable amount of the network/CGU is therefore Ksh1,600 (FVLCS), which is the greater of FVLCS and VIU. The difference in the recoverable amount of the network/CGU (Ksh1,600) and the carrying amount of Ksh 1,900 (the sum of Ksh 1,400 and Ksh 500 of goodwill) is Ksh300.
- This amount is attributed to goodwill impairment

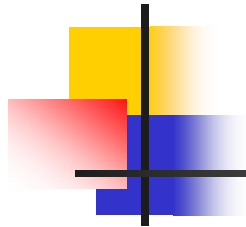


- Where an external event caused the recognition of an impairment loss in previous periods, and subsequent external events clearly and demonstrably reverse the effects of that event in a way that was not foreseen in the original impairment calculations, any resulting reversal of the impairment loss that increases the recoverable amount of the goodwill or intangible asset above its current carrying value should be recognised in the current period.

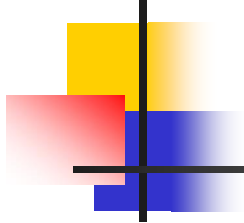


Example

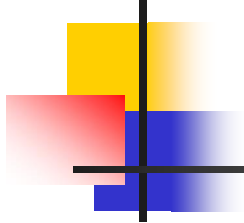
- Reversing an impairment charge
- An entertainment company manufactured an interactive video game. After initial release, unit sales were lower than projected. This resulted in the carrying value of the software being higher than the recoverable amount, and the company recognized an impairment loss.
- The following year, a new gaming platform was released that was better suited to the game's graphic abilities. As a result, sales outperformed the revised estimates. Because the advancement in technological hardware favourably affected the economic performance of the software, management determines the new recoverable amount for the software and reverses the impairment loss if the new recordable amount exceeds the carrying amount.



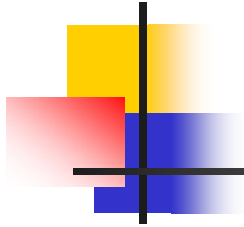
- Indefinite life
- An asset is regarded as having an indefinite useful life when, based on an analysis of all the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
- An intangible asset with an indefinite useful life shall not be amortised. Instead, such intangible assets are tested for impairment annually and whenever there is an indication that the intangible asset may be impaired in accordance with IAS 36 Impairment of assets
- The useful life shall be reviewed annually to determine whether circumstances continue to support an indefinite useful life assessment.



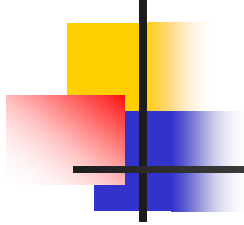
- Revaluation model
- An intangible asset is carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.
- Fair value is determined by reference to an active market and revaluations are obtained to ensure the carrying amount of the intangible asset is not materially different from its carrying amount.



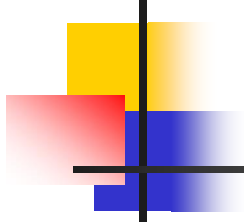
- An asset has a 'readily ascertainable market value' only if:
 - the asset belongs to a homogenous population of assets that are equivalent in all material respects, and
 - an active market, evidenced by frequent transactions, exists for that population of assets.



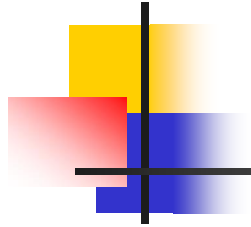
- If one intangible asset is revalued, all other capitalised intangible assets of the same class should be revalued.
- Once an intangible asset has been revalued, further revaluations should be performed sufficiently often to ensure that the carrying value does not differ materially from the market value at the balance sheet date



- if an asset's carrying value is increased as a result of revaluation, the increase is recorded as a component of other comprehensive income, and is accumulated in equity as an item of other comprehensive income under the heading "Revaluation surplus."



- De-recognition of intangible assets
- An intangible asset is derecognised on disposal or when no future benefits are expected from its use or disposal.
- The gain or loss on de-recognition is the difference between any net disposal proceeds and carrying amount of the asset.
- It is recognised in profit or loss when de-recognition occurs.
- Gains shall not be classified as revenue



Thanks

Interactive session