

Hong Kong Accounting Standard 38

Intangible Assets



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Hong Kong Accounting Standard 38 *Intangible Assets* (HKAS 38) is set out in paragraphs 1-133. All the paragraphs have equal authority. HKAS 38 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 38 *Intangible Assets* (HKAS 38) replaces SSAP 29 *Intangible Assets* (issued in 2001), and should be applied:

- (a) on acquisition to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 1 January 2005.
- (b) to all other intangible assets, for annual periods beginning on or after 1 January 2005.

Earlier application is encouraged.

Reasons for issuing HKAS 38

IN2 Pursuant to its convergence policy, the Hong Kong Institute of Certified Public Accountants (“HKICPA”) issues HKAS 38 as part of its project on business combinations to converge with the International Accounting Standards Board (“the Board”)’s project on business combinations. The project’s objective is to improve the quality of the accounting for business combinations and the subsequent accounting for goodwill and intangible assets acquired in business combinations.

IN3 The project has two phases. The first phase resulted in the HKICPA issuing simultaneously HKFRS 3 *Business Combinations* and HKAS 38 and HKAS 36 *Impairment of Assets* to converge with IFRS 3 and the revised versions of IAS 38 and IAS 36 issued by the Board. The first phase of the project focused primarily on:

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

IN4 Therefore, the HKICPA’s intention while issuing HKAS 38 was to reflect only those changes resulting from the Business Combinations project, and *not* to reconsider all of the previous requirements in SSAP 29. The changes are primarily concerned with clarifying the notion of ‘identifiability’ as it relates to intangible assets, the useful life and amortisation of intangible assets, and the accounting for in-process research and development projects acquired in business combinations.

Summary of main changes

Definition of an intangible asset

- IN5 SSAP 29 defined an intangible asset as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. The requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative purposes has been removed from the definition of an intangible asset.
- IN6 SSAP 29 did not define 'identifiability', but stated that an intangible asset could be distinguished clearly from goodwill if the asset was separable, but that separability was not a necessary condition for identifiability. The Standard states that an asset meets the identifiability criterion in the definition of an intangible asset when it:
- (a) is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
 - (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Criteria for initial recognition

- IN7 SSAP 29 required an intangible asset to be recognised if, and only if, it was probable that the expected future economic benefits attributable to the asset would flow to the entity, and its cost could be measured reliably. These recognition criteria have been included in the Standard. However, additional guidance has been included to clarify that:
- (a) the probability recognition criterion is always considered to be satisfied for intangible assets that are acquired separately or in a business combination.
 - (b) the fair value of an intangible asset acquired in a business combination can be measured with sufficient reliability to be recognised separately from goodwill.

Subsequent expenditure

- IN8 Under SSAP 29, the treatment of subsequent expenditure on an in-process research and development project acquired in a business combination and recognised as an asset separately from goodwill was unclear. The Standard requires such expenditure to be:
- (a) recognised as an expense when incurred if it is research expenditure;
 - (b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria in HKAS 38 for recognising such expenditure as an intangible asset; and
 - (c) recognised as an intangible asset if it is development expenditure that satisfies the criteria in HKAS 38 for recognising such expenditure as an intangible asset.

Useful life

- IN9 SSAP 29 was based on the assumption that the useful life of an intangible asset is always finite, and included a rebuttable presumption that the useful life cannot exceed twenty years from the date the asset is available for use. That rebuttable presumption has been removed. The Standard requires an intangible asset to be regarded as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is

no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

IN10 SSAP 29 required that if control over the future economic benefits from an intangible asset was achieved through legal rights granted for a finite period, the useful life of the intangible asset could not exceed the period of those rights, unless the rights were renewable and renewal was virtually certain. The Standard requires that:

- (a) the useful life of an intangible asset arising from contractual or other legal rights should not exceed the period of those rights, but may be shorter depending on the period over which the asset is expected to be used by the entity; and
- (b) if the rights are conveyed for a limited term that can be renewed, the useful life should include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

Intangible assets with indefinite useful lives

IN11 The Standard requires that:

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

Impairment testing intangible assets with finite useful lives

IN12 SSAP 29 required the recoverable amount of an intangible asset that was amortised over a period exceeding twenty years from the date it was available for use to be estimated at least at each financial year-end, even if there was no indication that the asset was impaired. This requirement has been removed. Therefore, an entity needs to determine the recoverable amount of an intangible asset with a finite useful life that is amortised over a period exceeding twenty years from the date it is available for use only when, in accordance with HKAS 36, there is an indication that the asset may be impaired.

Disclosure

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

Hong Kong Accounting Standard 38

Intangible Assets

Objective

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

Scope

- 2 **This Standard shall be applied in accounting for intangible assets, except:**
- (a) **intangible assets that are within the scope of another Standard;**
 - (b) **financial assets, as defined in HKAS 32 *Financial Instruments: Presentation*;**
 - (c) **the recognition and measurement of exploration and evaluation assets (see HKFRS 6 *Exploration for and Evaluation of Mineral Resources*); and**
 - (d) **expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.**
- 3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:
- (a) intangible assets held by an entity for sale in the ordinary course of business (see HKAS 2 *Inventories*).
 - (b) deferred tax assets (see HKAS 12 *Income Taxes*).
 - (c) leases of intangible assets accounted for in accordance with HKFRS 16 *Leases*.
 - (d) assets arising from employee benefits (see HKAS 19 *Employee Benefits*).
 - (e) financial assets as defined in HKAS 32. The recognition and measurement of some financial assets are covered by HKFRS 10 *Consolidated Financial Statements*, HKAS 27 *Separate Financial Statements* and HKAS 28 *Investments in Associates and Joint Ventures*.
 - (f) goodwill acquired in a business combination (see HKFRS 3 *Business Combinations*).
 - (g) contracts within the scope of HKFRS 17 *Insurance Contracts* and any assets for insurance acquisition cash flows as defined in HKFRS 17.
 - (h) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
 - (i) assets arising from contracts with customers that are recognised in accordance with HKFRS 15 *Revenue from Contracts with Customers*.

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

Definitions

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

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

An *asset* is a resource:

- (a) controlled by an entity as a result of past events; and**
- (b) from which future economic benefits are expected to flow to the entity.¹**

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

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

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

¹ The definition of an asset in this Standard was not revised following the revision of the definition of an asset in the *Conceptual Framework for Financial Reporting* issued in 2018.

***Development* is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.**

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

***Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13 *Fair Value Measurement*.)**

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

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

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

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

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

***Useful life* is:**

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

Intangible assets

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

Identifiability

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

Control

- 13 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.
- 14 Market and technical knowledge may give rise to future economic benefits. An entity controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.
- 15 An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.
- 16 An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (eg portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

Future economic benefits

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

Recognition and measurement

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

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

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

24 An intangible asset shall be measured initially at cost.

Separate acquisition

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

26 In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

27 The cost of a separately acquired intangible asset comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
- (b) any directly attributable cost of preparing the asset for its intended use.

28 Examples of directly attributable costs are:

- (a) costs of employee benefits (as defined in HKAS 19) arising directly from bringing the asset to its working condition;
- (b) professional fees arising directly from bringing the asset to its working condition; and
- (c) costs of testing whether the asset is functioning properly.

29 Examples of expenditures that are not part of the cost of an intangible asset are:

- (a) costs of introducing a new product or service (including costs of advertising and promotional activities);
- (b) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- (c) administration and other general overhead costs.

30 Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:

- (a) costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use; and
- (b) initial operating losses, such as those incurred while demand for the asset's output builds up.

31 Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental

operations are recognised immediately in profit or loss, and included in their respective classifications of income and expense.

- 32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with HKAS 23 *Borrowing Costs*.

Acquisition as part of a business combination

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

Intangible asset acquired in a business combination

- 35 If an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the asset's fair value.
- 36 An intangible asset acquired in a business combination might be separable, but only together with a related contract, identifiable asset or liability. In such cases, the acquirer recognises the intangible asset separately from goodwill, but together with the related item.
- 37 The acquirer may recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. For example, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

38-41 [Deleted]

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

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

Acquisition by way of a government grant

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

Exchanges of assets

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

or

- (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
- (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

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

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

Internally generated goodwill

48 Internally generated goodwill shall not be recognised as an asset.

- 49 In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (ie it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

- 50 Differences between the fair value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the fair value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

Internally generated intangible assets

- 51 It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

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

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

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

- (a) a research phase; and

- (b) a development phase.

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

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

Research phase

- 54 **No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.**

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

- 56 Examples of research activities are:

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

Development phase

- 57 **An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:**

- (a) **the technical feasibility of completing the intangible asset so that it will be available for use or sale.**
- (b) **its intention to complete the intangible asset and use or sell it.**
- (c) **its ability to use or sell the intangible asset.**
- (d) **how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.**
- (e) **the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.**
- (f) **its ability to measure reliably the expenditure attributable to the intangible asset during its development.**

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

advanced than the research phase.

- 59 Examples of development activities are:
- (a) the design, construction and testing of pre-production or pre-use prototypes and models;
 - (b) the design of tools, jigs, moulds and dies involving new technology;
 - (c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
 - (d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.
- 60 To demonstrate how an intangible asset will generate probable future economic benefits, an entity assesses the future economic benefits to be received from the asset using the principles in HKAS 36 *Impairment of Assets*. If the asset will generate economic benefits only in combination with other assets, the entity applies the concept of cash-generating units in HKAS 36.
- 61 Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the entity's ability to secure those resources. In some cases, an entity demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.
- 62 An entity's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.
- 63 Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.**
- 64 Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an internally generated intangible asset

- 65 The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.
- 66 The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:
- (a) costs of materials and services used or consumed in generating the intangible asset;
 - (b) costs of employee benefits (as defined in HKAS 19) arising from the generation of the intangible asset;
 - (c) fees to register a legal right; and
 - (d) amortisation of patents and licences that are used to generate the intangible asset.

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

- 67 The following are not components of the cost of an internally generated intangible asset:
- (a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;
 - (b) identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and
 - (c) expenditure on training staff to operate the asset.

Example illustrating paragraph 65

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

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

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

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

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

Recognition of an expense

68 Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:

- (a) it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 18-67); or**
- (b) the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, it forms part of the amount recognised as goodwill at the acquisition date (see HKFRS 3).**

69 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In

the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognises the expenditure as an expense when it receives the services. For example, expenditure on research is recognised as an expense when it is incurred (see paragraph 54), except when it is acquired as part of a business combination. Other examples of expenditure that is recognised as an expense when it is incurred include:

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

69A An entity has a right to access goods when it owns them. Similarly, it has a right to access goods when they have been constructed by a supplier in accordance with the terms of a supply contract and the entity could demand delivery of them in return for payment. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver an advertisement to customers.

70 Paragraph 68 does not preclude an entity from recognising a prepayment as an asset when payment for goods has been made in advance of the entity obtaining a right to access those goods. Similarly, paragraph 68 does not preclude an entity from recognising a prepayment as an asset when payment for services has been made in advance of the entity receiving those services.

Past expenses not to be recognised as an asset

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

Measurement after recognition

72 An entity shall choose either the cost model in paragraph 74 or the revaluation model in paragraph 75 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.

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

Cost model

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

Revaluation model

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

The amount of the adjustment of accumulated amortisation forms part of the increase or decrease in the carrying amount that is accounted for in accordance with paragraphs 85 and 86.

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

Useful life

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

- managed efficiently by another management team;
- (b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;
 - (c) technical, technological, commercial or other types of obsolescence;
 - (d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
 - (e) expected actions by competitors or potential competitors;
 - (f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;
 - (g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
 - (h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.
- 91 The term 'indefinite' does not mean 'infinite'. The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.
- 92 Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it will often be the case that their useful life is short. Expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.
- 93 The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.
- 94 The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.**
- 95 There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.
- 96 Existence of the following factors, among others, indicates that an entity would be able to renew the contractual or other legal rights without significant cost:
- (a) there is evidence, possibly based on experience, that the contractual or other

legal rights will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;

- (b) there is evidence that any conditions necessary to obtain renewal will be satisfied; and
- (c) the cost to the entity of renewal is not significant when compared with the future economic benefits expected to flow to the entity from renewal.

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

Intangible assets with finite useful lives

Amortisation period and amortisation method

- 97 The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.**
- 98 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.
- 98A There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:
- (a) in which the intangible asset is expressed as a measure of revenue, as described in paragraph 98C; or
 - (b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.
- 98B In choosing an appropriate amortisation method in accordance with paragraph 98, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an

intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (ie time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortisation, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits.

- 98C In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortisation. For example, an entity could acquire a concession to explore and extract gold from a gold mine. The expiry of the contract might be based on a fixed amount of total revenue to be generated from the extraction (for example, a contract may allow the extraction of gold from the mine until total cumulative revenue from the sale of gold reaches CU2 billion) and not be based on time or on the amount of gold extracted. In another example, the right to operate a toll road could be based on a fixed total amount of revenue to be generated from cumulative tolls charged (for example, a contract could allow operation of the toll road until the cumulative amount of tolls generated from operating the road reaches CU100 million). In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortising the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortisation is to be determined.
- 99 Amortisation is usually recognised in profit or loss. However, sometimes the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the amortisation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see HKAS 2 *Inventories*).

Residual value

- 100 **The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:**
- (a) **there is a commitment by a third party to purchase the asset at the end of its useful life; or**
 - (b) **there is an active market (as defined in HKFRS 13) for the asset and:**
 - (i) **residual value can be determined by reference to that market; and**
 - (ii) **it is probable that such a market will exist at the end of the asset's useful life.**
- 101 The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.
- 102 An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 103 The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortisation charge is zero

unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

Review of amortisation period and amortisation method

- 104 The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with HKAS 8.**
- 105 During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.
- 106 Over time, the pattern of future economic benefits expected to flow to an entity from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Intangible assets with indefinite useful lives

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

Review of useful life assessment

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

Recoverability of the carrying amount - impairment losses

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

Retirements and disposals

- 112 An intangible asset shall be derecognised:**
- (a) on disposal; or**
 - (b) when no future economic benefits are expected from its use or disposal.**
- 113 The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised (unless HKFRS 16 requires otherwise on a sale and leaseback.) Gains shall not be classified as revenue.**
- 114** The disposal of an intangible asset may occur in a variety of ways (eg by sale, by entering into a finance lease, or by donation). The date of disposal of an intangible asset is the date that the recipient obtains control of that asset in accordance with the requirements for determining when a performance obligation is satisfied in HKFRS 15. HKFRS 16 applies to disposal by a sale and leaseback.
- 115** If in accordance with the recognition principle in paragraph 21 an entity recognises in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognises the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.
- 115A** In the case of a reacquired right in a business combination, if the right is subsequently reissued (sold) to a third party, the related carrying amount, if any, shall be used in determining the gain or loss on reissue.
- 116** The amount of consideration to be included in the gain or loss arising from the derecognition of an intangible asset is determined in accordance with the requirements for determining the transaction price in paragraphs 47–72 of HKFRS 15. Subsequent changes to the estimated amount of the consideration included in the gain or loss shall be accounted for in accordance with the requirements for changes in the transaction price in HKFRS 15.
- 117** Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5.

Disclosure

General

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

period;

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

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

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

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

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

121 HKAS 8 requires an entity to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods. Such disclosure may arise from changes in:

- (a) the assessment of an intangible asset's useful life;
- (b) the amortisation method; or
- (c) residual values.

122 An entity shall also disclose:

- (a) for an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.**
- (b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements.**
- (c) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 44):**
 - (i) the fair value initially recognised for these assets;**
 - (ii) their carrying amount; and**
 - (iii) whether they are measured after recognition under the cost model or the revaluation model.**
- (d) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.**
- (e) the amount of contractual commitments for the acquisition of intangible assets.**

123 When an entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset is indefinite, the entity considers the list of factors in paragraph 90.

Intangible assets measured after recognition using the revaluation model

124 If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:

- (a) by class of intangible assets:**
 - (i) the effective date of the revaluation;**
 - (ii) the carrying amount of revalued intangible assets; and**
 - (iii) the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 74; and**

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

(c) [deleted]

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

Research and development expenditure

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

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

Other information

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

- (a) a description of any fully amortised intangible asset that is still in use; and
- (b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before the version of SSAP 29 *Intangible Assets* issued in 2001 was effective.

Transitional provisions and effective date

129 [Deleted]

130 An entity shall apply this Standard:

- (a) to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 1 January 2005; and**
- (b) to the accounting for all other intangible assets prospectively from the beginning of the first annual period beginning on or after 1 January 2005. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of such intangible assets. If, as a result of that reassessment, the entity changes its assessment of the useful life of an asset, that change shall be accounted for as a change in an accounting estimate in accordance with HKAS 8.**

130A An entity shall apply the amendments in paragraph 2 for annual periods beginning on or after 1 January 2006. If an entity applies HKFRS 6 for an earlier period, those amendments shall be applied for that earlier period.

130B HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 85, 86 and 118(e)(iii). An entity shall apply those amendments for annual periods beginning on or

after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

- 130C HKFRS 3 (as revised in 2008) amended paragraphs 12, 33-35, 68, 69, 94 and 130, deleted paragraphs 38 and 129 and added paragraph 115A. *Improvements to HKFRSs* issued in May 2009 amended paragraphs 36 and 37. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. Therefore, amounts recognised for intangible assets and goodwill in prior business combinations shall not be adjusted. If an entity applies HKFRS 3 (revised 2008) for an earlier period, it shall apply the amendments for that earlier period and disclose the fact.
- 130D Paragraphs 69, 70 and 98 were amended and paragraph 69A was added by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.
- 130E [Deleted]
- 130F HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 3(e). An entity shall apply that amendment when it applies HKFRS 10 and HKFRS 11.
- 130G HKFRS 13, issued in June 2011, amended paragraphs 8, 33, 47, 50, 75, 78, 82, 84, 100 and 124 and deleted paragraphs 39-41 and 130E. An entity shall apply those amendments when it applies HKFRS 13.
- 130H *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraph 80. An entity shall apply that amendment for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.
- 130I An entity shall apply the amendment made by *Annual Improvements to HKFRSs 2010–2012 Cycle* to all revaluations recognised in annual periods beginning on or after the date of initial application of that amendment and in the immediately preceding annual period. An entity may also present adjusted comparative information for any earlier periods presented, but it is not required to do so. If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been presented on a different basis and explain that basis.
- 130J *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to HKAS 16 and HKAS 38), issued in June 2014, amended paragraphs 92 and 98 and added paragraphs 98A–98C. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.
- 130K HKFRS 15 *Revenue from Contracts with Customers*, issued in July 2014, amended paragraphs 3, 114 and 116. An entity shall apply those amendments when it applies HKFRS 15.
- 130L HKFRS 16, issued in May 2016, amended paragraphs 3, 6, 113 and 114. An entity shall apply those amendments when it applies HKFRS 16.
- 130M HKFRS 17, issued in January 2018, amended paragraph 3, *Amendments to HKFRS 17*, issued in October 2020, further amended paragraph 3. An entity shall apply that amendment when it applies HKFRS 17.

Exchanges of similar assets

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

Early application

- 132 **Entities to which paragraph 130 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 130. However, if an entity applies this Standard before those effective dates, it also shall apply HKFRS 3 and HKAS 36 at the same time.**

Withdrawal of SSAP 29

- 133 This Standard supersedes SSAP 29 *Intangible Assets* (issued in 2001).

*Basis for Conclusions on
Hong Kong Accounting Standard 38*

Intangible Assets



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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HKAS 38 is based on IAS 38 *Intangible Assets*. In approving HKAS 38, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 38. Accordingly, there are no significant differences between HKAS 38 and IAS 38. The IASB's Basis for Conclusions is reproduced below for reference. The paragraph numbers of IAS 38 referred to below generally correspond with those in HKAS 38.

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Basis for Conclusions on IAS 38 *Intangible Assets*

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

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

Introduction

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

Definition of an intangible asset (paragraph 8)

- BC4 An intangible asset was defined in the previous version of IAS 38 as ‘an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative services’. The definition in the revised Standard eliminates the requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative services.
- BC5 The Board observed that the essential characteristics of intangible assets are that they:
- (a) are resources controlled by the entity from which future economic benefits are expected to flow to the entity;
 - (b) lack physical substance; and
 - (c) are identifiable.

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

Identifiability (paragraph 12)

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

Background to the Board’s deliberations

- BC7 The Board was prompted to consider the issue of ‘identifiability’ as part of the first phase of its Business Combinations project as a result of changes during 2001 to the requirements in Canadian and United States standards on the separate recognition of intangible assets acquired in business combinations. The Board observed that intangible assets comprise an increasing proportion of the assets of many entities, and that intangible assets acquired in a business combination are often included in the amount recognised as goodwill, despite the requirements in IAS 22 *Business Combinations* and IAS 38 for them to be recognised separately from goodwill. The Board agreed with the conclusion reached by the Canadian and US standard-setters that the usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill. Therefore, the Board concluded that the IFRS arising from the first phase of the Business Combinations project should provide a definitive basis for identifying and recognising intangible assets acquired in a business combination separately from goodwill.
- BC8 In revising IAS 38 and developing IFRS 3, the Board affirmed the view in the previous version of IAS 38 that identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill. The Board concluded that to provide a definitive basis for identifying and recognising intangible assets separately from goodwill, the concept of identifiability needed to be articulated more clearly.

Clarifying identifiability (paragraph 12)

- BC9 Consistently with the guidance in the previous version of IAS 38, the Board concluded that an intangible asset can be distinguished from goodwill if it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged. Therefore, in the context of intangible assets, separability signifies identifiability, and intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.
- BC10 However, again consistently with the guidance in the previous version of IAS 38, the Board concluded that separability is not the only indication of identifiability. The Board observed that, in contrast to goodwill, the values of many intangible assets arise from rights conveyed legally by contract or statute. In the case of acquired goodwill, its value arises from the collection of assembled assets that make up an acquired entity or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining entities or businesses. The Board also observed that, although many intangible assets are both separable and arise from contractual-legal rights, some contractual-legal rights establish property interests that are not readily separable from the entity as a whole. For example, under the laws of some jurisdictions some licences granted to an entity are not transferable except by sale of the entity as a whole. The Board concluded that the fact that an intangible asset arises from contractual or other legal rights is a characteristic that distinguishes it from goodwill. Therefore, intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.

Non-contractual customer relationships (paragraph 16)

- BC11 The previous version of IAS 38 and the Exposure Draft of Proposed Amendments to IAS 38 stated that 'An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits'. The documents then expanded on this by stating that 'in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the economic benefits from customer relationships and loyalty to consider that such items meet the definition of intangible assets'.
- BC12 However, the Draft Illustrative Examples accompanying ED 3 *Business Combinations* stated that 'If a customer relationship acquired in a business combination does not arise from a contract, the relationship is recognised as an intangible asset separately from goodwill if it meets the separability criterion. Exchange transactions for the same asset or a similar asset provide evidence of separability of a non-contractual customer relationship and might also provide information about exchange prices that should be considered when estimating fair value.' Whilst respondents to the Exposure Draft generally agreed with the Board's conclusions on the definition of identifiability, some were uncertain about the relationship between the separability criterion for establishing whether a non-contractual customer relationship is identifiable, and the control concept for establishing whether the relationship meets the definition of an asset. Additionally, some respondents suggested that non-contractual customer relationships would, under the proposal in the Exposure Draft, be separately recognised if acquired in a business combination, but not if acquired in a separate transaction.
- BC13 The Board observed that exchange transactions for the same or similar non-contractual customer relationships provide evidence not only that the item is separable, but also that the entity is able to control the expected future economic benefits flowing from that relationship. Similarly, if an entity separately acquires a non-contractual customer relationship, the existence of an exchange transaction for that relationship provides evidence both that the item is separable, and that the entity is able to control the expected future economic benefits flowing from the relationship. Therefore, the relationship would meet the intangible asset definition and be recognised as such.

However, in the absence of exchange transactions for the same or similar non-contractual customer relationships, such relationships acquired in a business combination would not normally meet the definition of an ‘intangible asset’—they would not be separable, nor would the entity be able to demonstrate that it controls the expected future economic benefits flowing from that relationship.

BC14 Therefore, the Board decided to clarify in paragraph 16 of IAS 38 that in the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

Criteria for initial recognition

BC15 In accordance with the Standard, as with the previous version of IAS 38, an intangible asset is recognised if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- (b) the cost of the asset can be measured reliably.

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

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

BC16 [Deleted]

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

Probability recognition criterion

BC17 In revising IAS 38, the Board observed that the fair value of an intangible asset reflects market expectations about the probability that the future economic benefits associated with the intangible asset will flow to the acquirer. In other words, the effect of probability is reflected in the fair value measurement of an intangible asset.¹ Therefore, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations.

BC18 The Board observed that this highlights a general inconsistency between the recognition criteria for assets and liabilities in the *Framework*² (which states that an item meeting the definition of an element should be recognised only if it is probable that any future economic benefits associated with the item will flow to or from the entity, and the item can be measured reliably) and the fair value measurements required in, for example, a business combination. However, the Board concluded that the role of probability as a criterion for recognition in the *Framework* should be considered more generally as part of a forthcoming Concepts project.

¹ IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

² References to the *Framework* in this Basis for Conclusions are to the IASC’s *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was developed and revised.

Reliability of measurement recognition criterion

BC19 [Deleted]

BC19A In developing IFRS 3, the IASB noted that the fair values of identifiable intangible assets acquired in a business combination are normally measurable with sufficient reliability to be recognised separately from goodwill. The effects of uncertainty because of a range of possible outcomes with different probabilities are reflected in measuring the asset's fair value³; the existence of such a range does not demonstrate an inability to measure fair value reliably. IAS 38 (as revised in 2004) included a rebuttable presumption that the fair value of an intangible asset with a finite useful life acquired in a business combination can be measured reliably. The Board had concluded that it might not always be possible to measure reliably the fair value of an asset that has an underlying contractual or legal basis. However, IAS 38 (revised 2004) provided that the only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination that arises from legal or other contractual rights were if it either:

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

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

BC19C When the Board developed IFRS 3 (as revised in 2008), it decided that if an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure the fair value of the asset reliably. The Board made related amendments to IAS 38 to reflect that decision. However, the Board identified additional amendments that were needed to reflect clearly its decisions on the accounting for intangible assets acquired in a business combination. Consequently, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraphs 36 and 37 of IAS 38 to clarify the Board's intentions.

BC19D Additionally, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraphs 40 and 41 of IAS 38 to clarify the description of valuation techniques commonly used to measure intangible assets at fair value⁴ when assets are not traded in an active market. The Board also decided that the amendments should be applied prospectively because retrospective application might require some entities to remeasure fair values associated with previous transactions. The Board does not think this is appropriate because the remeasurement might involve the use of hindsight in those circumstances.

BC20-
BC25 [Deleted]

³ IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

⁴ IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs 40 and 41 of IAS 38 have been deleted.

Separate acquisition (paragraphs 25 and 26)

- BC26 Having decided to include paragraphs 33-38 in IAS 38, the Board also decided that it needed to consider the role of the probability and reliability of measurement recognition criteria for separately acquired intangible assets.
- BC27 Consistently with its conclusion about the role of probability in the recognition of intangible assets acquired in business combinations, the Board concluded that the probability recognition criterion is always considered to be satisfied for separately acquired intangible assets. This is because the price an entity pays to acquire separately an intangible asset normally reflects expectations about the probability that the expected future economic benefits associated with the intangible asset will flow to the entity. In other words, the effect of probability is reflected in the cost of the intangible asset.
- BC28 The Board also concluded that when an intangible asset is separately acquired in exchange for cash or other monetary assets, sufficient information should exist to measure the cost of that asset reliably. However, this might not be the case when the purchase consideration comprises non-monetary assets. Therefore, the Board decided to carry forward from the previous version of IAS 38 guidance clarifying that the cost of a separately acquired intangible asset can usually be measured reliably, particularly when the purchase consideration is cash or other monetary assets.

Internally generated intangible assets (paragraphs 51-67)

- BCZ29 The controversy relating to internally generated intangible assets surrounds whether there should be:
- (a) a requirement to recognise internally generated intangible assets in the balance sheet whenever certain criteria are met;
 - (b) a requirement to recognise expenditure on all internally generated intangible assets as an expense;
 - (c) a requirement to recognise expenditure on all internally generated intangible assets as an expense, with certain specified exceptions; or
 - (d) an option to choose between the treatments described in (a) and (b) above.

Background on the requirements for internally generated intangible assets

- BCZ30 Before IAS 38 was issued in 1998, some internally generated intangible assets (those that arose from development expenditure) were dealt with under IAS 9 *Research and Development Costs*. The development of, and revisions to, IAS 9 had always been controversial.
- BCZ31 Proposed and approved requirements for the recognition of an asset arising from development expenditure and other internally generated intangible assets had been the following:
- (a) in 1978, IASC approved IAS 9 *Accounting for Research and Development Activities*. It required expenditure on research and development to be recognised as an expense when incurred, except that an enterprise had the option to recognise an asset arising from development expenditure whenever certain criteria were met.
 - (b) in 1989, Exposure Draft E32 *Comparability of Financial Statements* proposed retaining IAS 9's option to recognise an asset arising from development

expenditure if certain criteria were met and identifying:

- (i) as a preferred treatment, recognising all expenditure on research and development as an expense when incurred; and
- (ii) as an allowed alternative treatment, recognising an asset arising from development expenditure whenever certain criteria were met.

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

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

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

Combination of IAS 9 with the Standard on intangible assets

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

- (a) IASC believed that an identifiable asset that results from research and development activities is an intangible asset because knowledge is the primary outcome of these activities. Therefore, IASC supported treating expenditure on research and development activities similarly to expenditure on activities intended to create any other internally generated intangible assets.
- (b) some commentators on E50, which proposed to exclude research and development expenditures from its scope,
 - (i) argued that it was sometimes difficult to identify whether IAS 9 or the proposed Standard on intangible assets should apply, and

- (ii) perceived differences in accounting treatments between IAS 9 and E50's proposals, whereas this was not IASC's intent.

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

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

Consequences of combining IAS 9 with IAS 38

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

- (a) IAS 9 limited the amount of expenditure that could initially be recognised for an asset arising from development expenditure (ie the amount that formed the cost of such an asset) to the amount that was probable of being recovered from the asset. Instead, IAS 38 requires that:
 - (i) all expenditure incurred from when the recognition criteria are met until the asset is available for use should be accumulated to form the cost of the asset; and
 - (ii) an enterprise should test for impairment, at least annually, an intangible asset that is not yet available for use. If the cost recognised for the asset exceeds its recoverable amount, an enterprise recognises an impairment loss accordingly. This impairment loss should be reversed if the conditions for reversals of impairment losses under IAS 36 *Impairment of Assets* are met.
- (b) IAS 38 permits an intangible asset to be measured after recognition at a revalued amount less subsequent amortisation and subsequent impairment losses. IAS 9 did not permit this treatment. However, it is highly unlikely that an active market (the condition required to revalue intangible assets) will exist for an asset that arises from development expenditure.
- (c) IAS 38 requires consideration of residual values in determining the depreciable amount of an intangible asset. IAS 9 prohibited the consideration of residual values. However, IAS 38 sets criteria that make it highly unlikely that an asset that arises from development expenditure would have a residual value above zero.

BCZ37 IASC believed that, in practice, it would be unlikely that the application of IAS 38 would result in differences from the application of IAS 9.

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

BCZ38 Those who favour the recognition of expenditure on all internally generated intangible assets (including development expenditure) as an expense argue that:

- (a) internally generated intangible assets do not meet the *Framework's* requirements for recognition as an asset because:
 - (i) the future economic benefits that arise from internally generated intangible assets cannot be distinguished from future economic benefits that arise from internally generated goodwill; and/or
 - (ii) it is impossible to distinguish reliably the expenditure associated with internally generated intangible assets from the expenditure associated with enhancing internally generated goodwill.
- (b) comparability of financial statements will not be achieved. This is because the judgement involved in determining whether it is probable that future economic benefits will flow from internally generated intangible assets is too subjective to result in similar accounting under similar circumstances.
- (c) it is not possible to assess reliably the amount that can be recovered from an internally generated intangible asset, unless its fair value can be determined by reference to an active market.⁵ Therefore, recognising an internally generated intangible asset for which no active market exists at an amount other than zero may mislead investors.
- (d) a requirement to recognise internally generated intangible assets at cost if certain criteria are met results in little, if any, decision useful or predictive information because:
 - (i) demonstration of technological feasibility or commercial success in order to meet the recognition criteria will generally not be achieved until substantial expenditure has been recognised as an expense. Therefore, the cost recognised for an internally generated intangible asset will not reflect the total expenditure on that asset.
 - (ii) the cost of an internally generated intangible asset may not have any relationship to the value of the asset.
- (e) in some countries, users are suspicious about an enterprise that recognises internally generated intangible assets.
- (f) the added costs of maintaining the records necessary to justify and support the recognition of internally generated intangible assets do not justify the benefits.

Recognition of internally generated intangible assets

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

- (a) recognition of an internally generated intangible asset if it meets the definition

⁵ IFRS 13, issued in May 2011, defines an active market.

of an asset and the recognition criteria is consistent with the *Framework*. An enterprise can, in some instances:

- (i) determine the probability of receiving future economic benefits from an internally generated intangible asset; and
 - (ii) distinguish the expenditure on this asset from expenditure on internally generated goodwill.
- (b) there has been massive investment in intangible assets in the last two decades. There have been complaints that:
- (i) the non-recognition of investments in intangible assets in the financial statements distorts the measurement of an enterprise's performance and does not allow an accurate assessment of returns on investment in intangible assets; and
 - (ii) if enterprises do not track the returns on investment in intangible assets better, there is a risk of over- or under-investing in important assets. An accounting system that encourages such behaviour will become an increasingly inadequate signal, both for internal control purposes and for external purposes.
- (c) certain research studies, particularly in the United States, have established a cost-value association for research and development expenditures. The studies establish that capitalisation of research and development expenditure yields value-relevant information to investors.
- (d) the fact that some uncertainties exist about the value of an asset does not justify a requirement that no cost should be recognised for the asset.
- (e) it should not matter for recognition purposes whether an asset is purchased externally or developed internally. Particularly, there should be no opportunity for accounting arbitrage depending on whether an enterprise decides to outsource the development of an intangible asset or develop it internally.

IASC's view in approving IAS 38

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

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

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

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

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

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

Initial recognition at cost

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

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

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

BCZ44 IASC rejected a proposal to allow the initial recognition of an intangible asset at fair value (except if the asset is acquired in a business combination, in exchange for a dissimilar asset⁶ or by way of a government grant) because:

- (a) this is consistent with IAS 16 *Property, Plant and Equipment*. IAS 16 prohibits the initial recognition of an item of property, plant or equipment at fair value (except in the specific limited cases as those in IAS 38).
- (b) it is difficult to determine the fair value of an intangible asset reliably if no active market exists for the asset.⁷ Since active markets with the characteristics set out in IAS 38 are highly unlikely to exist for internally generated intangible assets, IASC did not believe that it was necessary to make an exception to the principles generally applied for the initial recognition and measurement of non-financial assets.
- (c) the large majority of commentators on E50 supported the initial recognition of intangible assets at cost and the prohibition of the reinstatement of expenditure on an intangible item that was initially recognised as an expense.

⁶ IAS 16 *Property, Plant and Equipment* (as revised in 2003) requires an entity to measure an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless the exchange transaction lacks commercial substance. Previously, an entity measured such an acquired asset at fair value unless the exchanged assets were similar. The IASB concluded that the same measurement criteria should apply to intangible assets acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets.

⁷ IFRS 13, issued in May 2011, defines an active market.

Application of the recognition criteria for internally generated intangible assets

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

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

2008 Amendments⁸

BC46A Paragraph 68 states that expenditure on an internally developed intangible item shall be recognised as an expense when it is incurred. The Board noted that it was unclear to some constituents how this should be interpreted. For example, some believed that an entity should recognise expenditure on advertising and promotional activities as an expense when it received the goods or services that it would use to develop or communicate the advertisement or promotion. Others believed that an entity should recognise an expense when the advertisement or promotion was delivered to its customers or potential customers. Therefore, the Board decided to amend paragraph 69 to clarify the meaning of 'incurred'.

BC46B The Board noted that advertising and promotional activities enhance or create brands or customer relationships, which in turn generate revenues. Goods or services that are acquired to be used to undertake advertising or promotional activities have no other purpose than to undertake those activities. In other words, the only benefit of those goods or services is to develop or create brands or customer relationships, which in turn generate revenues. Internally generated brands or customer relationships are not recognised as intangible assets.

BC46C The Board concluded that it would be inconsistent for an entity to recognise an asset in respect of an advertisement that it had not yet published if the economic benefits that might flow to the entity as a result of publishing the advertisement are the same as those that might flow to the entity as a result of the brand or customer relationship that it would enhance or create. Therefore, the Board concluded that an entity should not recognise as an asset goods or services that it had received in respect of its future advertising or promotional activities.

BC46D In reaching this conclusion the Board noted that, if an entity pays for advertising goods or services in advance and the other party has not yet provided those goods or services, the entity has a different asset. That asset is the right to receive those goods and services. Therefore, the Board decided to retain paragraph 70, which allows an entity to recognise as an asset the right to receive those goods or services. However, the Board did not believe that this paragraph should be used as a justification for recognising an asset beyond the point at which the entity gained a right to access the related goods or received the related services. Therefore, the Board decided to amend the paragraph to make clear that a prepayment may be recognised by an entity only until that entity has gained a right to access to the related goods or has received the related services.

⁸ This Heading and paragraphs BC46A-BC46I were added by *Improvements to IFRSs* issued in May 2008.

- BC46E The Board noted that when the entity has received the related goods or services, it ceases to have the right to receive them. Because the entity no longer has an asset that it can recognise, it recognises an expense. However, the Board was concerned that the timing of delivery of goods should not be the determinant of when an expense should be recognised. The date on which physical delivery is obtained could be altered without affecting the commercial substance of the arrangement with the supplier. Therefore, the Board decided that an entity should recognise an expense for goods when they have been completed by the supplier in accordance with a contract to supply them and the entity could ask for delivery in return for payment—in other words, when the entity had gained a right to access the related goods.
- BC46F A number of commentators on the exposure draft of proposed *Improvements to IFRSs* published in 2007 thought that it was unclear when the Board intended an expense to be recognised. In response to those comments, the Board added paragraph 69A to clarify when entities would gain a right to access goods or receive services.
- BC46G The Board also received a number of comments arguing that mail order catalogues are not a form of advertising and promotion but instead give rise to a distribution network. The Board rejected these arguments, believing that the primary objective of mail order catalogues is to advertise goods to customers. To avoid confusion, the Board decided to include mail order catalogues in the Standard as an example of advertising activities.
- BC46H Some respondents who argued that the cost of mail order catalogues should be capitalised suggested that making an analogy to web site costs in SIC-32 *Intangible Assets—Web Site Costs* would be appropriate. The Board agreed and concluded that its proposed amendments would result in accounting that is almost identical to that resulting from the application of SIC-32. In particular, SIC-32 requires the cost of content (to the extent that it is developed to advertise and promote products and services) to be recognised as an expense as it is incurred. The Board concluded that in the case of a mail order catalogue, the majority of the content is intended to advertise and promote products and services. Therefore, permitting the cost of catalogues to be capitalised while at the same time requiring the cost of developing and uploading web site content used to advertise and promote an entity's products to be recognised as an expense would base the accounting on the nature of the media (paper or electronic) used to deliver the content rather than the nature of the expenditure.
- BC46I The Board also noted that SIC-32 permits expenditure on an internally developed web site to be capitalised only in the 'application and infrastructure development stage'. It requires costs associated with developing the functionality and infrastructure that make a web site operate to be capitalised. In the Board's view, the electronic infrastructure capitalised in accordance with SIC-32 is analogous to the property, plant and equipment infrastructure—for example, a sign—that permits advertising to be displayed to the public not the content that is displayed on that sign.

Subsequent accounting for intangible assets

BC47 The Board initially decided that the scope of the first phase of its Business Combinations project should include a consideration of the subsequent accounting for intangible assets acquired in business combinations. To that end, the Board initially focused its attention on the following three issues:

- (a) whether an intangible asset with a finite useful life and acquired in a business combination should continue to be accounted for after initial recognition in accordance with IAS 38.
- (b) whether, and under what circumstances, an intangible asset acquired in a business combination could be regarded as having an indefinite useful life.
- (c) how an intangible asset with an indefinite useful life (assuming such an asset exists) acquired in a business combination should be accounted for after initial recognition.

BC48 However, during its deliberations of the issues in (b) and (c) of paragraph BC47, the Board decided that any conclusions it reached on those issues would equally apply to recognised intangible assets obtained other than in a business combination. The Board observed that amending the requirements in the previous version of IAS 38 only for intangible assets acquired in business combinations would create inconsistencies in the accounting for intangible assets depending on how they are obtained. Thus, similar items would be accounted for in dissimilar ways. The Board concluded that creating such inconsistencies would impair the usefulness of the information provided to users about an entity's intangible assets, because both comparability and reliability (which rests on the notion of representational faithfulness, ie that similar transactions are accounted for in the same way) would be diminished. Therefore, the Board decided that any amendments to the requirements in the previous version of IAS 38 to address the issues in (b) and (c) of paragraph BC47 should apply to all recognised intangible assets, whether generated internally or acquired separately or as part of a business combination.

BC49 Before beginning its deliberations of the issues identified in paragraph BC47, the Board noted the concern expressed by some that, because of the subjectivity involved in distinguishing goodwill from other intangible assets as at the acquisition date, differences between the subsequent treatment of goodwill and other intangible assets increases the potential for intangible assets to be misclassified at the acquisition date. The Board concluded, however, that adopting the separability and contractual or other legal rights criteria provides a reasonably definitive basis for separately identifying and recognising intangible assets acquired in a business combination. Therefore, the Board decided that its analysis of the accounting for intangible assets after initial recognition should have regard only to the nature of those assets and not to the subsequent treatment of goodwill.

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

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

- (a) at cost less any accumulated amortisation and any accumulated impairment losses; or
- (b) at a revalued amount, being the asset's fair value, determined by reference to

an active market,⁹ at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. Under this approach, revaluations must be made with such regularity that at the balance sheet date the carrying amount of the asset does not differ materially from its fair value.

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

- BC51 The Board observed that underpinning the requirement for all intangible assets to be amortised is the notion that they all have determinable and finite useful lives. Setting aside the question of whether, and under what circumstances, an intangible asset could be regarded as having an indefinite useful life, an important issue for the Board to consider was whether a departure from the above requirements would be warranted for intangible assets acquired in a business combination that have finite useful lives.
- BC52 The Board observed that any departure from the above requirements for intangible assets with finite lives acquired in business combinations would create inconsistencies between the accounting for recognised intangible assets based wholly on the means by which they are obtained. In other words, similar items would be accounted for in dissimilar ways. The Board concluded that creating such inconsistencies would impair the usefulness of the information provided to users about an entity's intangible assets, because both comparability and reliability would be diminished.
- BC53 Therefore, the Board decided that intangible assets with finite useful lives acquired in business combinations should continue to be accounted for in accordance with the above requirements after initial recognition.

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

- BC54 The previous version of IAS 38 required the recoverable amount of an intangible asset with a finite useful life that is being amortised over a period of more than 20 years, whether or not acquired in a business combination, to be measured at least at each financial year-end.
- BC55 The Board observed that the recoverable amount of a long-lived tangible asset needs to be measured only when, in accordance with IAS 36 *Impairment of Assets*, there is an indication that the asset may be impaired. The Board could see no conceptual reason for requiring the recoverable amounts of some identifiable assets being amortised over very long periods to be determined more regularly than for other identifiable assets being amortised or depreciated over similar periods. Therefore, the Board concluded that the recoverable amount of an intangible asset with a finite useful life that is amortised over a period of more than 20 years should be determined only when, in accordance with IAS 36, there is an indication that the asset may be impaired. Consequently, the Board decided to remove the requirement in the previous version of IAS 38 for the recoverable amount of such an intangible asset to be measured at least at each financial year-end.
- BC56 The Board also decided that all of the requirements relating to impairment testing intangible assets should be included in IAS 36 rather than in IAS 38. Therefore, the Board relocated to IAS 36 the requirement in the previous version of IAS 38 that an entity should estimate at the end of each annual reporting period the recoverable amount of an intangible asset not yet available for use, irrespective of whether there is any indication that it may be impaired.

⁹ IFRS 13, issued in May 2011, defines an active market.

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

BC57 In revising IAS 38, the Board considered whether to retain for intangible assets with finite useful lives the requirement in the previous version of IAS 38 for the residual value of an intangible asset to be assumed to be zero unless:

- (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
- (b) there is an active market¹⁰ for the asset and:
 - (i) the asset's residual value can be determined by reference to that market; and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.

BC58 The Board observed that the definition in the previous version of IAS 38 (as amended by IAS 16 when revised in 2003) of residual value required it to be estimated as if the asset were already of the age and in the condition expected at the end of the asset's useful life. Therefore, if the useful life of an intangible asset was shorter than its economic life because the entity expected to sell the asset before the end of that economic life, the asset's residual value would not be zero, irrespective of whether the conditions in paragraph BC57(a) or (b) are met.

BC59 Nevertheless, the Board observed that the requirement for the residual value of an intangible asset to be assumed to be zero unless the specified criteria are met was included in the previous version of IAS 38 as a means of preventing entities from circumventing the requirement in that Standard to amortise all intangible assets. Excluding this requirement from the revised Standard for finite-lived intangible assets would similarly provide a means of circumventing the requirement to amortise such intangible assets—by claiming that the residual value of such an asset was equal to or greater than its carrying amount, an entity could avoid amortising the asset, even though its useful life is finite. The Board concluded that it should not, as part of the Business Combinations project, modify the criteria for permitting a finite-lived intangible asset's residual value to be other than zero. However, the Board decided that this issue should be addressed as part of a forthcoming project on intangible assets.

Useful lives of intangible assets (paragraphs 88-96)

BC60 Consistently with the proposals in the Exposure Draft of Proposed Amendments to IAS 38, the Standard requires an intangible asset to be regarded by an entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

BC61 In developing the Exposure Draft and the revised Standard, the Board observed that the useful life of an intangible asset is related to the expected cash inflows that are associated with that asset. The Board observed that, to be representationally faithful, the amortisation period for an intangible asset generally should reflect that useful life and, by extension, the cash flow streams associated with the asset. The Board concluded that it is possible for management to have the intention and the ability to maintain an intangible asset in such a way that there is no foreseeable limit on the period over which that particular asset is expected to generate net cash inflows for the entity. In other words, it is conceivable that an analysis of all the relevant factors (ie legal, regulatory, contractual, competitive, economic and other) could lead to a conclusion that there is no foreseeable

¹⁰ IFRS 13, issued in May 2011, defines an active market.

limit to the period over which a particular intangible asset is expected to generate net cash inflows for the entity.

- BC62 For example, the Board observed that some intangible assets are based on legal rights that are conveyed in perpetuity rather than for finite terms. As such, those assets may have cash flows associated with them that may be expected to continue for many years or even indefinitely. The Board concluded that if the cash flows are expected to continue for a finite period, the useful life of the asset is limited to that finite period. However, if the cash flows are expected to continue indefinitely, the useful life is indefinite.
- BC63 The previous version of IAS 38 prescribed a presumptive maximum useful life for intangible assets of 20 years. In developing the Exposure Draft and the revised Standard, the Board concluded that such a presumption is inconsistent with the view that the amortisation period for an intangible asset should, to be representationally faithful, reflect its useful life and, by extension, the cash flow streams associated with the asset. Therefore, the Board decided not to include in the revised Standard a presumptive maximum useful life for intangible assets, even if they have finite useful lives.
- BC64 Respondents to the Exposure Draft generally supported the Board's proposal to remove from IAS 38 the presumptive maximum useful life and instead to require useful life to be regarded as indefinite when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period of time over which the intangible asset is expected to generate net cash inflows for the entity. However, some respondents suggested that an inability to determine clearly the useful life of an asset applies equally to many items of property, plant and equipment. Nonetheless, entities are required to determine the useful lives of those items of property, plant and equipment, and allocate their depreciable amounts on a systematic basis over those useful lives. Those respondents suggested that there is no conceptual reason for treating intangible assets differently.
- BC65 In considering these comments, the Board noted the following:
- (a) an intangible asset's useful life would be regarded as indefinite in accordance with IAS 38 only when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period of time over which the asset is expected to generate net cash inflows for the entity. Difficulties in accurately determining an intangible asset's useful life do not provide a basis for regarding that useful life as indefinite.
 - (b) although the useful lives of both intangible and tangible assets are directly related to the period during which they are expected to generate net cash inflows for the entity, the expected physical utility to the entity of a tangible asset places an upper limit on the asset's useful life. In other words, the useful life of a tangible asset could never extend beyond the asset's expected physical utility to the entity.

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

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

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

- BC67 However, the Board also observed that such rights are often conveyed for limited terms that may be renewed. It therefore considered whether renewals should be assumed in determining the useful life of such an intangible asset. The Board noted that some types of licences are initially issued for finite periods but renewals are routinely granted at little cost, provided that licensees have complied with the applicable rules and regulations. Such licences are traded at prices that reflect more than the remaining term, thereby indicating that renewal at minimal cost is the general expectation. However, renewals are not assured for other types of licences and, even if they are renewed, substantial costs may be incurred to secure their renewal.
- BC68 The Board concluded that because the useful lives of some intangible assets depend, in economic terms, on renewal and on the associated costs of renewal, the useful lives assigned to those assets should reflect renewal when there is evidence to support renewal without significant cost.
- BC69 Respondents to the Exposure Draft generally supported this conclusion. Those that disagreed suggested that:
- (a) when the renewal period depends on the decision of a third party and not merely on the fulfilment of specified conditions by the entity, it gives rise to a contingent asset because the third party decision affects not only the cost of renewal but also the probability of obtaining it. Therefore, useful life should reflect renewal only when renewal is not subject to third-party approval.
 - (b) such a requirement would be inconsistent with the basis used to measure intangible assets at the date of a business combination, particularly contractual customer relationships. For example, it is not clear whether the fair value of a contractual customer relationship includes an amount that reflects the probability that the contract will be renewed. The possibility of renewal would have a fair value regardless of the costs required to renew. This means the useful life of a contractual customer relationship could be inconsistent with the basis used to determine the fair value of the relationship.¹¹
- BC70 In relation to (a) above, the Board observed that if renewal by the entity is subject to third-party (eg government) approval, the requirement that there be evidence to support the entity's ability to renew would compel the entity to make an assessment of the likely effect of the third-party approval process on the entity's ability to renew. The Board could see no conceptual basis for narrowing the requirement to situations in which the contractual or legal rights are not subject to the approval of third parties.
- BC71 In relation to (b) above, the Board observed the following:
- (a) the requirements relating to renewal periods address circumstances in which *the entity* is able to renew the contractual or other legal rights, notwithstanding that such renewal may, for example, be conditional on the entity satisfying specified conditions, or subject to third-party approval. Paragraph 94 of the Standard states that "... the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal *by the entity* [emphasis added] without significant cost." The ability to renew a customer contract normally rests with the customer and not with the entity.
 - (b) the respondents seem to regard as a single intangible asset what is, in substance, two intangible assets—one being the customer contract and the other being the related customer relationship. Expected renewals by the customer would affect the fair value of the customer relationship intangible asset, rather than the fair value of the customer contract. Therefore, the useful life of the customer contract would not, under the Standard, extend beyond the term of the contract, nor would the fair value of that customer contract reflect

¹¹ IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

expectations of renewal by the customer. In other words, the useful life of the customer contract would not be inconsistent with the basis used to determine its fair value.

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

Intangible assets with finite useful lives (paragraph 98)¹²

BC72A The last sentence of paragraph 98 previously stated, 'There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight line method.' In practice, this wording was perceived as preventing an entity from using the units of production method to amortise assets if it resulted in a lower amount of accumulated amortisation than the straight-line method. However, using the straight-line method could be inconsistent with the general requirement of paragraph 38 that the amortisation method should reflect the expected pattern of consumption of the expected future economic benefits embodied in an intangible asset. Consequently, the Board decided to delete the last sentence of paragraph 98.

Amortisation method (paragraphs 97–98C)

BC72B The IASB decided to amend IAS 38 to address concerns regarding the use of a revenue-based method for amortising an intangible asset. The IASB's decision was in response to a request to clarify the meaning of the term 'consumption of the expected future economic benefits embodied in the asset' when determining the appropriate amortisation method for intangible assets of service concession arrangements (SCA) that are within the scope of IFRIC 12 *Service Concession Arrangements*. The issue raised is related to the application of paragraphs 97–98 of IAS 38, although the IASB decided to address the issue broadly, rather than limit it only to intangible assets arising in an SCA.

BC72C A revenue-based amortisation method is one that allocates an asset's amortisable amount based on revenues generated in an accounting period as a proportion of the total revenues expected to be generated over the asset's useful economic life. The total revenue amount is affected by the interaction between units (ie quantity) and price and takes into account any expected changes in price. The IASB observed that the price component of revenue may be affected by inflation and noted that inflation has no bearing upon the way in which the asset is consumed.

BC72D The IASB observed that paragraph 97 of IAS 38 states that the amortisation method used shall reflect the pattern in which the intangible asset's future economic benefits are expected to be consumed by the entity.

BC72E On the basis of the guidance in IAS 38 the IASB proposed to clarify in the Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation* (Proposed amendments to IAS 16 and IAS 38) (the 'ED') that a method of amortisation that is based on revenue generated from an activity that includes the use of an asset is not appropriate, because it reflects a pattern of economic benefits being generated from operating the business (of which the asset is part) rather than the economic benefits being consumed through the use of the asset.

BC72F During its redeliberations of the ED the IASB decided to include a rebuttable presumption that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in the intangible asset. The IASB also considered the question of whether there could be circumstances in

¹² This heading and paragraph BC72A were added by *Improvements to IFRSs* issued in May 2008.

which revenue could be used to reflect the pattern in which the future economic benefits of the intangible asset are expected to be consumed.

- BC72G In finalising the proposed amendments to IAS 38, the IASB decided to make clear in the Standard that the presumption precluding the use of revenue as a basis for amortisation could be overcome in two circumstances. One of those circumstances is when it can be demonstrated that revenue is highly correlated with the consumption of the economic benefits embodied in an intangible asset. The IASB also noted that another circumstance in which revenue could be used is when the right embodied by an intangible asset is expressed as a total amount of revenue to be generated (rather than time, for example), in such a way that the generation of revenue is the measurement used to determine when the right expires. The IASB noted that, in this case, the pattern of consumption of future economic benefits that is embodied in the intangible asset is defined by reference to the total revenue earned as a proportion of the contractual maximum and, consequently, the amount of revenue generated contractually reflects the consumption of the benefits that are embodied in the asset.
- BC72H The IASB also analysed situations in which an intangible asset is used in multiple activities to provide multiple revenue streams. Some respondents commented that the application of a units of production method did not seem practicable, because the units of production were not homogeneous. For example, the producer of a motion picture will typically use the intellectual property embodied in the film to generate cash flows through exhibiting the film in theatres, licensing the rights to characters to manufacturers of toys and other goods, selling DVDs or digital copies of the film and licensing broadcast rights to television broadcasters. Some respondents thought that the best way to amortise the cost of the intellectual property embodied in the film was to use a revenue-based method, because revenue was considered a common denominator to reflect a suitable proxy of the pattern of consumption of all the benefits received from the multiple activities in which the intellectual property could be used.
- BC72I The IASB acknowledged that determining an appropriate amortisation method for situations in which an intangible asset is used in multiple activities, and generates multiple cash flow streams in different markets, requires judgement. The IASB considered suggestions that an intangible asset should be componentised for amortisation purposes in circumstances in which the asset is used to generate multiple cash flow streams. It observed that separating an asset into different components is not a new practice in business or in IFRS—it is routinely done for property, plant and equipment and IAS 16 provides guidance in this respect—but refrained from developing guidance in this respect for intangible assets.
- BC72J The IASB also decided to provide guidance on how an entity could identify an amortisation method in response to some respondents who observed that further guidance was required in the application of paragraph 98 of IAS 38, which is limited to providing a description of the amortisation methods most commonly used. During its deliberations the IASB determined that, when choosing an amortisation method, an entity could determine the predominant limiting factor for the use of the intangible asset. For example, a contract could be limited by a number of years (ie time), a number of units produced or an amount of revenue to be generated. The IASB clarified that identifying such a predominant limiting factor is only a starting point for the identification of the amortisation method and an entity may apply another basis if the entity determines that it more closely reflects the expected pattern of consumption of economic benefits.
- BC72K In the ED the IASB proposed to provide guidance to clarify the role of obsolescence in the application of the diminishing balance method. In response to the comments received about the proposed guidance, the IASB decided to change the focus of this guidance to explain that expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset. The IASB noted that the expectation of

technical or commercial obsolescence is relevant for estimating both the pattern of consumption of future economic benefits and the useful life of an asset. The IASB noted that the diminishing balance method is an accepted amortisation methodology in paragraph 98 of IAS 38, which is capable of reflecting an accelerated consumption of the future economic benefits embodied in the asset.

BC72L Some respondents to the ED suggested that the IASB should define the notion of 'consumption of economic benefits' and provide guidance in this respect. During its redeliberations the IASB decided against doing so, noting that explaining the notion of consumption of economic benefits would require a broader project.

Consistency in the use of the phrase 'units of production'

BC72M The IASB decided to make consistent the phrase 'units of production method' and has therefore amended the instances of the phrase 'unit of production method'.

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

BC73 Consistently with the proposals in the Exposure Draft, the Standard prohibits the amortisation of intangible assets with indefinite useful lives. Therefore, such assets are measured after initial recognition at:

- (a) cost less any accumulated impairment losses; or
- (b) a revalued amount, being fair value determined by reference to an active market¹³ less any accumulated impairment losses.

Non-amortisation

BC74 In developing the Exposure Draft and the revised Standard, the Board observed that many assets yield benefits to an entity over several periods. Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not be representationally faithful. Respondents to the Exposure Draft generally supported this conclusion.

BC75 Consequently, the Board decided that intangible assets with indefinite useful lives should not be amortised, but should be subject to regular impairment testing. The Board's deliberations on the form of the impairment test, including the frequency of impairment testing, are included in the Basis for Conclusions on IAS 36. The Board further decided that regular re-examinations should be required of the useful life of an intangible asset that is not being amortised to determine whether circumstances continue to support the assessment that the useful life is indefinite.

Revaluations

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

¹³ IFRS 13, issued in May 2011, defines an active market.

BC77 As a result, the Board decided that the Standard should permit intangible assets with indefinite useful lives to be carried at revalued amounts.

Revaluation method—proportionate restatement of accumulated amortisation when an intangible asset is revalued

BC77A The IFRS Interpretations Committee reported to the Board that practice differed in calculating the accumulated depreciation for an item of property, plant and equipment that is measured using the revaluation method in cases in which the residual value, the useful life or the depreciation method has been re-estimated before a revaluation.

BC77B The reasons for making the change are further explained in paragraphs BC25A–BC25G of IAS 16.

BC77C The Board noted that the issue in paragraphs BC25A–BC25G of IAS 16 regarding accumulated depreciation upon revaluation could also occur when revaluing an intangible asset under IAS 38, because both IAS 16 and IAS 38 have the same requirements for accumulated depreciation/amortisation when revaluing items of property, plant and equipment/intangible assets. Differences in the revaluation models for items of property, plant and equipment and intangible assets do not result in different models for restating accumulated depreciation/amortisation. For example, IAS 38 requires that the fair value of an intangible asset is measured by reference to an active market. Otherwise, the revaluation model cannot be applied. However, IAS 38 requires fair value measurement by reference to an active market only for the carrying amount of an intangible asset in contrast to its gross carrying amount.

BC77D Consequently, the Board decided to amend paragraph 80(a) to state that:

- (a) the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount; and
- (b) the accumulated amortisation is calculated as the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses.

The Board also decided to amend paragraph 80(b) to be consistent with the wording used in those amendments.

BC77E The Board decided to include wording in paragraph 80(a) to require an entity to take into account accumulated impairment losses when adjusting the amortisation on revaluation. This was to ensure that when future revaluation increases occur, the correct split according to paragraph 85 of IAS 38 and paragraph 119 of IAS 36 is made between profit or loss and other comprehensive income when reversing prior accumulated impairment losses.

Research and development projects acquired in business combinations

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

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

- (c) the treatment of subsequent expenditure on IPR&D projects recognised as assets separately from goodwill.

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

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

Initial recognition separately from goodwill

- BC80 The Board observed that the criteria in IAS 22 *Business Combinations* and the previous version of IAS 38 for recognising an intangible asset acquired in a business combination separately from goodwill applied to all intangible assets, including IPR&D projects. Therefore, in accordance with those Standards, any intangible item acquired in a business combination was recognised as an asset separately from goodwill when it was identifiable and could be measured reliably, and it was probable that any associated future economic benefits would flow to the acquirer. If these criteria were not satisfied, the expenditure on the cost or value of that item, which was included in the cost of the combination, was part of the amount attributed to goodwill.
- BC81 The Board could see no conceptual justification for changing the approach in IAS 22 and the previous version of IAS 38 of using the same criteria for all intangible assets acquired in a business combination when assessing whether those assets should be recognised separately from goodwill. The Board concluded that adopting different criteria would impair the usefulness of the information provided to users about the assets acquired in a combination because both comparability and reliability would be diminished. Therefore, IAS 38 and IFRS 3 require an acquirer to recognise as an asset separately from goodwill any of the acquiree's IPR&D projects that meet the definition of an intangible asset. This will be the case when the IPR&D project meets the definition of an asset and is identifiable, ie is separable or arises from contractual or other legal rights.
- BC82 Some respondents to the Exposure Draft of Proposed Amendments to IAS 38 expressed concern that applying the same criteria to all intangible assets acquired in a business combination to assess whether they should be recognised separately from goodwill results in treating some IPR&D projects acquired in business combinations differently from similar projects started internally. The Board acknowledged this point, but concluded that this does not provide a basis for subsuming those acquired intangible assets within goodwill. Rather, it highlights a need to reconsider the conclusion in the Standard that an intangible asset can never exist in respect of an in-process research project and can exist in respect of an in-process development project only once all of the Standard's criteria for deferral have been satisfied. The Board decided that such a reconsideration is outside the scope of its Business Combinations project.

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

BC83 The Board observed that the previous version of IAS 38 required all recognised intangible assets to be accounted for after initial recognition at:

- (a) cost less any accumulated amortisation and any accumulated impairment losses; or
- (b) revalued amount, being the asset's fair value, determined by reference to an active market,¹⁴ at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

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

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

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

BC85 The Standard requires subsequent expenditure on an IPR&D project acquired separately or in a business combination and recognised as an intangible asset to be:

- (a) recognised as an expense when incurred if it is research expenditure;
- (b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 57; and
- (c) added to the carrying amount of the acquired IPR&D project if it is development expenditure that satisfies the recognition criteria in paragraph 57.

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

- (a) it was probable that the expenditure would enable the asset to generate future economic benefits in excess of its originally assessed standard of performance;

¹⁴ IFRS 13, issued in May 2011, defines an active market.

and

- (b) the expenditure could be measured and attributed to the asset reliably.

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

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

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

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

Transitional provisions (paragraphs 129-132)

BC90 If an entity elects to apply IFRS 3 from any date before the effective dates outlined in IFRS 3, it is also required to apply IAS 38 prospectively from that same date. Otherwise, IAS 38 applies to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004, and to the accounting for all other intangible assets prospectively from the beginning of the first annual reporting period beginning on or after 31 March 2004. IAS 38 also requires an entity, on initial application, to reassess the useful lives of intangible assets. If, as a result of that reassessment, the entity changes its useful life assessment for an asset, that change is accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC91 The Board's deliberations on the transitional issues relating to the initial recognition of intangible assets acquired in business combinations and the impairment testing of intangible assets are addressed in the Basis for Conclusions on IFRS 3 and the Basis for Conclusions on IAS 36, respectively.

BC92 In developing the requirements outlined in paragraph BC90, the Board considered the following three questions:

- (a) should the useful lives of, and the accounting for, intangible assets already recognised at the effective date of the Standard continue to be determined in accordance with the requirements in the previous version of IAS 38 (ie by amortising over a presumptive maximum period of twenty years), or in accordance with the requirements in the revised Standard?
- (b) if the revised Standard is applied to intangible assets already recognised at its effective date, should the effect of a reassessment of an intangible asset's useful life as a result of the initial application of the Standard be recognised retrospectively or prospectively?

- (c) should entities be required to apply the requirements in the Standard for subsequent expenditure on an acquired IPR&D project recognised as an intangible asset retrospectively to expenditure incurred before the effective date of the revised Standard?
- BC93 In relation to the first question above, the Board noted its previous conclusion that the most representationally faithful method of accounting for intangible assets is to amortise those with finite useful lives over their useful lives with no limit on the amortisation period, and not to amortise those with indefinite useful lives. Thus, the Board concluded that the reliability and comparability of financial statements would be diminished if the Standard was not applied to intangible assets recognised before its effective date.
- BC94 On the second question, the Board observed that a reassessment of an asset's useful life is regarded throughout IFRSs as a change in an accounting estimate, rather than a change in an accounting policy. For example, in accordance with the Standard, as with the previous version of IAS 38, if a new estimate of the expected useful life of an intangible asset is significantly different from previous estimates, the change must be accounted for as a change in accounting estimate in accordance with IAS 8. IAS 8 requires a change in an accounting estimate to be accounted for prospectively by including the effect of the change in profit or loss in:
- (a) the period of the change, if the change in estimate affects that period only; or
 - (b) the period of the change and future periods, if the change in estimate affects both.
- BC95 Similarly, in accordance with IAS 16 *Property, Plant and Equipment*, if a new estimate of the expected useful life of an item of property, plant and equipment is significantly different from previous estimates, the change must be accounted for prospectively by adjusting the depreciation expense for the current and future periods.
- BC96 Therefore, the Board decided that a reassessment of useful life resulting from the initial application of IAS 38, including a reassessment from a finite to an indefinite useful life, should be accounted for as a change in an accounting estimate. Consequently, the effect of such a change should be recognised prospectively.
- BC97 The Board considered the view that because the previous version of IAS 38 required intangible assets to be treated as having a finite useful life, a change to an assessment of indefinite useful life for an intangible asset represents a change in an accounting policy, rather than a change in an accounting estimate. The Board concluded that, even if this were the case, the useful life reassessment should nonetheless be accounted for prospectively. This is because retrospective application would require an entity to determine whether, at the end of each reporting period before the effective date of the Standard, the useful life of an intangible asset was indefinite. Such an assessment requires an entity to make estimates that would have been made at a prior date, and therefore raises problems in relation to the role of hindsight, in particular, whether the benefit of hindsight should be included or excluded from those estimates and, if excluded, how the effect of hindsight can be separated from the other factors existing at the date for which the estimates are required.
- BC98 On the third question, and as noted in paragraph BC86, it was not clear whether the previous version of IAS 38 required subsequent expenditure on acquired IPR&D projects recognised as intangible assets to be accounted for:
- (a) in accordance with its requirements for expenditure on research, development, or the research or development phase of an internal project; or
 - (b) in accordance with its requirements for subsequent expenditure on an intangible asset after its purchase or completion.

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

BC99 Thus, retrospective application of the revised Standard to subsequent expenditure on acquired IPR&D projects incurred before its effective date could result in previously capitalised expenditure being reversed. Such reversal would be required if the expenditure was research expenditure, or it was development expenditure and one or more of the criteria for deferral were not satisfied at the time the expenditure was incurred. The Board concluded that determining whether, at the time the subsequent expenditure was incurred, the criteria for deferral were satisfied raises the same hindsight issues discussed in paragraph BC97: it would require assessments to be made as of a prior date, and therefore raises problems in relation to how the effect of hindsight can be separated from factors existing at the date of the assessment. In addition, such assessments could, in many cases, be impossible: the information needed may not exist or no longer be obtainable.

BC100 Therefore, the Board decided that the Standard's requirements for subsequent expenditure on acquired IPR&D projects recognised as intangible assets should not be applied retrospectively to expenditure incurred before the revised Standard's effective date. The Board noted that any amounts previously included in the carrying amount of such an asset would, in any event, be subject to the requirements for impairment testing in IAS 36.

Revaluation method—proportionate restatement of accumulated amortisation when an intangible asset is revalued

BC100A *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, amended paragraph 80. The Board also decided that the amendment should be required to be applied to all revaluations occurring in annual periods beginning on or after the date of initial application of the amendment and in the immediately preceding annual period. The Board was concerned that the costs of full retrospective application might outweigh the benefits.

Early application (paragraph 132)

BC101 The Board noted that the issue of any Standard reflects its opinion that application of the Standard will result in more useful information being provided to users about an entity's financial position, performance or cash flows. On that basis, a case exists for permitting, and indeed encouraging, entities to apply the revised Standard before its effective date. However, the Board also considered the assertion that permitting a revised Standard to be applied before its effective date potentially diminishes comparability between entities in the period(s) leading up to that effective date, and has the effect of providing entities with an option.

BC102 The Board concluded that the benefit of providing users with more useful information about an entity's financial position and performance by permitting early application of the Standard outweighs the disadvantages of potentially diminished comparability. Therefore, entities are encouraged to apply the requirements of the revised Standard before its effective date, provided they also apply IFRS 3 and IAS 36 (as revised in 2004) at the same time.

Summary of main changes from the Exposure Draft

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

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

History of the development of a standard on intangible assets

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

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

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

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

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

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

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

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

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

Dissenting opinions

Dissent of Geoffrey Whittington from IAS 38 issued in March 2004

- DO1 Professor Whittington dissents from the issue of this Standard because it does not explicitly require the probability recognition criterion in paragraph 21(a) to be applied to intangible assets acquired in a business combination, notwithstanding that it applies to all other intangible assets.
- DO2 The reason given for this (paragraphs 33 and BC17) is that fair value is the required measurement on acquisition of an intangible asset as part of a business combination, and fair value incorporates probability assessments. Professor Whittington does not believe that the *Framework*¹⁵ precludes having a prior recognition test based on probability, even when subsequent recognition is at fair value. Moreover, the application of probability may be different for recognition purposes: for example, it may be the 'more likely than not' criterion used in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, rather than the 'expected value' approach used in the measurement of fair value.
- DO3 This inconsistency between the recognition criteria in the *Framework* and fair values is acknowledged in paragraph BC18. In Professor Whittington's view, the inconsistency should be resolved before changing the recognition criteria for intangible assets acquired in a business combination.

¹⁵ References to the *Framework* in this Dissent are to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was revised.

Dissent of James J Leisenring from amendments issued in May 2008

- DO1 Mr Leisenring dissents from the amendments to IAS 38 *Intangible Assets* made by *Improvements to IFRSs* issued in May 2008.
- DO2 Mr Leisenring believes that the Board's amendments introduce a logical flaw into IAS 38. Paragraph 68 states that 'expenditure on an intangible item shall be recognised as an expense when it is incurred unless' specific conditions apply. The amendments to paragraph 69 include guidance on the accounting for expenditure on a tangible rather than an intangible item and therefore the amendment to paragraph 69 is inconsistent with paragraph 68.
- DO3 Extending the application of IAS 38 to tangible assets used for advertising also raises application concerns. Are signs constructed by a restaurant chain at their location an advertising expense in the period of construction? Would the costs of putting an entity's name on trucks, airplanes and buildings be an advertising expense in the year incurred? The logic of this amendment would suggest an affirmative answer to these questions even though the result of the expenditure benefits several periods.
- DO4 Mr Leisenring believes that if an entity acquires goods, including items such as catalogues, film strips or other materials, the entity should determine whether those goods meet the definition of an asset. In his view, IAS 38 is not relevant for determining whether goods acquired by an entity and which may be used for advertising should be recognised as an asset.
- DO5 Mr Leisenring agrees that the potential benefit that might result from having advertised should not be recognised as an intangible asset in accordance with IAS 38.

Dissent of Mary Tokar from *Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)* as issued in May 2014

- DO1 Ms Tokar is dissenting from the publication of this amendment. She does not object to the IASB's objective of clarifying acceptable methods of depreciation and amortisation, nor to its conclusions to preclude revenue-based depreciation and nor to the introduction of a rebuttable presumption that revenue cannot be used as a basis for amortisation of intangibles. She also agrees that expectations of obsolescence should be considered when determining the useful life of an asset and selecting an amortisation or depreciation method that reflects the pattern of consumption of the asset. However, she is concerned that the amendments will not fully resolve the practice issue that was originally raised with the IFRS Interpretations Committee. She believes that the amendments are not sufficiently clear regarding what evidence is required to overcome the presumption and instead support the use of revenue as the basis for amortisation of an intangible asset. She believes that further guidance should be included to explain when the pattern of consumption of economic benefits is the same as the pattern in which revenue is generated.

Illustrative Examples
Hong Kong Accounting Standard 38

Intangible Assets



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香港會計師公會

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HKAS 38 *Intangible Assets*

Illustrative examples

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

Assessing the useful lives of intangible assets

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

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

Example 1—An acquired customer list

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

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

Example 2—An acquired patent that expires in 15 years

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

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

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

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

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

Example 4—An acquired broadcasting licence that expires in five years

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

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

Example 5—The broadcasting licence in Example 4

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

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

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

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

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

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

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

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

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

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

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

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

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

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