Chapter 9
Intangible Assets

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The nature of intangible assets

- AASB 138 provides the following definition for intangibles: “An identifiable non-monetary asset without physical substance”
- Three key characteristics of intangibles:
  1. They are non-monetary (i.e., it is not a financial asset)
  2. They are identifiable
  3. They lack physical substance (i.e., it is not an item of PP&E)

The nature of intangible assets: identifiability

- For an intangible to be identifiable one of the following two criteria must be met:
  - It is separable from the entity, capable of being transferred
    - eg. Customers lists
    - non-contractual customer relationships
  - It arises from a contractual or some other legal right
    - eg trademarks
    - franchise agreements
- Figure 9.3 of text lists items that meet the identifiability criteria
The nature of intangible assets:
lack of physical substance

- Non-physical assets have a number of unique characteristics (see pages 399-400 of text)
- When they should be recognised?
  - Should one wait for a point of discovery?
  - Does an asset exist when the investment is made?
  - Is there an asset at the point employee training occurs?
- How they should be measured?
  - Where is the market?
  - Can the specific benefits be isolated?
  - Are the property rights over the expected benefits fuzzy?

Why are intangibles important?

- Intangibles have been increasing in importance due to:
  - Intensified business competition
  - The advent of information technologies
  - The above factors have resulted in a fundamental corporate change.
  - Significant increase in:
    - Innovation related intangibles
    - Human Resource related intangibles
    - Organisational intangibles

Identifying intangible assets

- An asset is defined in the Conceptual Framework as a resource controlled by the entity.
- Control usually stems from legal or other rights and can be difficult to establish.
- Example: highly trained staff do not qualify as intangibles due to the lack of control the entity has over the staff
- If at all, such benefits may be recognised as part of goodwill (refer later slides on goodwill)
- Note link to identifiability criterion discussed earlier
Recognition & initial measurement:
Measurement issues according to Upton

There are a number of issues surrounding the measurement of intangibles. The following observations were made by Upton (2001)

1. Lack of clear boundaries risks double counting
   Staff morale contributes to a high level of customer satisfaction and increased profitability. Need to take care not to measure these two items separately.

2. Retrospective capitalisation may be a useful measure
   It may be appropriate to expense everything and capitalise amounts once a level of success has been achieved.

Recognition & initial measurement:
Measurement issues according to Upton

3. Recognition of in-process assets may be a useful measure
   As an alternative to the “expense everything” approach. Normally at least some in-process information is valuable.

4. Cross-fertilisation and multigenerational factors
   A researcher trying to find a cure for AIDS may not be successful in this regard, but may assist in finding solutions to other illnesses.

5. Frustrations with the ‘time gap’ and ‘correlation gap’
   Time gap refers to the gap between the outlay and the determination of the outcome. Correlation gap refers to being able to relate expenses to the eventual outcome.

Recognition & initial measurement:
Relevance issues according to Upton

- Upton (2001) also made the following observations re relevance
  - Capitalised cost often doesn't indicate potential or eventual worth > eg oil exploration costs vs value of reserves found
  - Uncertainty does not mean irrelevance
  - Cost may be less relevant than fair value, but may be more reliable
  - Excluding volatile information erroneously implies a constantly steady state.

- Determination of relevance and reliability is subject to a cost/benefit test
Recognition & initial measurement

• Once it has been determined that an item meets the definition of an intangible it must then meet the following recognition criteria before it can be recognised as an asset.
  • It is probable that future economic benefits attributable to the asset will flow to the entity
  • The cost of the asset can be measured reliably.
  • Intangibles that fail the recognition criteria must be expensed.
  • Intangibles are required to be initially measured at cost (purchase price + directly attributable costs)

Recognition & initial measurement

• Intangibles may be acquired in the following ways:
  • By separate acquisition
  • As part of a business combination
  • By way of a government grant
  • By exchanges with another intangible
  • They may be internally generated

  • Each of these options are discussed in detail on the following slides.

Recognition & initial measurement: Separate acquisition

• AASB 138 considers that the probability recognition criteria is always considered to be satisfied for separately acquired intangibles
• Cost can usually be measured reliably, although there may be issues where the acquirer is giving up non-monetary assets, rather than cash
Recognition & initial measurement: Acquisition as part of business combination

- Intangibles acquired as part of a business combination are not initially measured at cost, but at fair value in accordance with AASB 3 Business Combinations.
- Fair value measures used may include:
  - quoted market prices in an active market > rare for intangibles that an active market exists
  - recent transactions in the same or similar items > due to the unique nature of intangibles this is also uncommon
  - using other measurement techniques > eg PV/earnings multiple techniques

Recognition & initial measurement: Via government grant/ exchanges

Acquisition via government grant
- The asset and the grant are both recognised at FV
- Examples include radio/TV station operating licences

Exchanges of intangible assets
- Given infrequent comparable market transactions in exchanges of intangible assets, cost is determined by FV
- If FV measurement is unreliable, carrying value is applied

Recognition & initial measurement: Internally generated intangibles: R&D

- Determining when to commence capitalising costs depends on whether the asset was generated in the research or development phase

Research
- Original planned investigation to gain knowledge, understanding (earlier stages of a project)
- Eg the search for new knowledge/ search for alternative processes
- Accounting treatment > all research costs are expensed
Recognition & initial measurement: Internally generated intangibles: R&D

Development

- Knowledge applied to a plan or design to pre-commercially produce something new or improved
- Eg. The design and construction of a pilot plant/ design of pre-production prototypes
- Accounting treatment
  - development costs that meet the recognition criteria (refer next slide) may be capitalised
  - expenditure from the date the recognition criteria was first met can be capitalised
  - previously expensed items cannot be reinstated and capitalised

Recognition & initial measurement: Internally generated intangibles: R&D

- For development costs to be capitalised, the entity must meet all of the following criteria:
  - Technical feasibility
  - Intention to complete and sell
  - Ability to use or sell
  - Existence of a market
  - Availability of resources
  - Ability to measure costs reliably

Recognition & initial measurement: Internally generated intangibles: other assets

- The following are specifically excluded from recognition per AASB 138:
  - Goodwill
  - Internally generated brands
  - Mastheads
  - Publishing titles
  - Customer lists
- These intangibles can only be recognised at their FV when acquired as part of a business combination
Recognition & initial measurement: Internally generated intangibles: other assets

- AASB 3 allows an intangible purchased as part of a business combination to be recognised at fair value
- **BUT**
- AASB 138 does not allow an internally generated intangible to be recognised at fair value
- Why is this so?
- The AASB considers that business combinations are unique types of transactions.

Principles developed for business combinations should not be applied in other circumstances because:

- The due diligence associated with a business combination provides a cost-effective context for recognising intangible assets.
- The recognition of an intangible asset acquired in a business combination would not increase net assets of the acquirer. It merely substitutes one asset (an intangible asset) for what would otherwise be recognised as another asset (goodwill). The risks of undermining the quality of financial statements by overstating net assets are arguably higher if an internally generated intangible asset is recognised.

Measurement after initial recognition: Measurement basis

- Choice of cost or revaluation models available (consistent with accounting for PP&E)
- Where the revaluation model is applied, the FV must be determined by reference to an active market
- As there is no active market for unique assets (which includes most intangibles), such items must be measured under the cost model
- Subsequent expenditure on intangibles are required to be expensed.
- The exception to this is subsequent development expenditure which meets the criteria on slide 17.
Measurement after initial recognition:
Amortisation of intangible assets

- Need to assess whether the useful life is finite or indefinite (i.e., there is no foreseeable end to the life of the asset)

**Finite**
- Amortisation principles are the same as for depreciating PP&E
- Straight-line method most commonly used
- Residual value assumed to be zero in most cases
- Amortisation period generally over life of contract (may include contract renewal period)

**Indefinite**
- No amortisation charge
- Subject to annual impairment tests

Retirements & disposals and disclosure

**Retirements and disposals**
- Identical to that for property, plant & equipment under AASB 116

**Key disclosure requirements**
- Similar to those for PP&E
- Refer Figures 9.8 – 9.10 of text for sample disclosures

Proposals for changes: accounting for internally generated intangibles

- In 2008, the AASB published a Discussion Paper (DP) entitled *Initial Accounting for Internally Generated Intangible Assets*.
- DP published at the request of the IASB.
- AASB 138 requires outlays relating to internally generated intangibles to be classified as research and development, providing criteria that must be met before any development outlays can be capitalised.
- The DP analyses different ways in which internally generated intangibles could be recognised.
Innovative measure of intangibles: market value of an entity

Intellectual capital consists of human capital and structural capital. Intellectual capital includes customer capital and operational capital. Customer capital is everything that is related to the customer, such as the customer base, customer relationships, and customer loyalty. Operational capital can be broken down into process capital (value-creating and non-value-creating processes), culture and knowledge (capital, intangible rights, trademarks, patents, know-how, etc.).

Human capital can be broken down into competence, relationships and values.