

# Intangible Assets and Borrowing Costs

(IAS 38 and 23)

July 2007



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## Today's Agenda

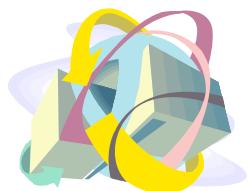
Simple but Comprehensive

Contentious and key issues

Real Life Cases and Examples



IAS 38 Intangible Assets



IAS 23 Borrowing Costs

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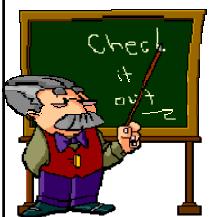
## Intangible Assets (IAS 38)



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## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals
11. Disclosure



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## 1. Objective and Scope

- IAS 38 *Intangible Assets*
  - is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard
  - requires an entity to recognise an intangible asset if, and only if, specified criteria are met
  - specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.
- Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting
  - any accumulated amortisation and
  - accumulated impairment losses thereon

## 1. Objective and Scope

- IAS 38 shall be applied in accounting for intangible assets, except:
  - a) intangible assets that are within the scope of another IFRSs;
  - b) financial assets, as defined in IAS 39 *Financial Instruments: Recognition and Measurement*;
  - c) the recognition and measurement of exploration and evaluation assets (see IFRS 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.

Another IFRSs

## 1. Objective and Scope

- If another standard prescribes the accounting for a specific type of intangible asset, an entity applies that standard instead of IAS 38, for example, it does not apply to:
  - a) intangible assets held by an entity for sale in the ordinary course of business (see IAS 2 and 11).
  - b) deferred tax assets (see IAS 12).
  - c) leases that are within the scope of IAS 17.
  - d) assets arising from employee benefits (see IAS 19).
  - e) financial assets as defined in IAS 39. The recognition and measurement of some financial assets are covered by IAS 27, 28 and 31.
  - f) goodwill acquired in a business combination (see IFRS 3).
  - g) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4.
  - h) non-current intangible assets (or disposal group) classified as held for sale in accordance with IFRS 5.

Another IFRSs

## 1. Objective and Scope



- 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 IAS 16 as property, plant and equipment or
  - under IAS 38 as an intangible asset,

an entity uses judgement to assess [which element is more significant](#).

# 1. Objective and Scope

Example

Is computer software an intangible asset?

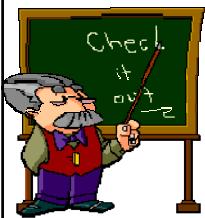
- Computer software for a computer-controlled machine tool that cannot operate without that specific software
- Operating system of a computer, say Windows XP or Linux

When the software is an integral part of the related hardware and it is treated as PPE

The same applies

When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset



## 2. Definition of Intangible Assets

An intangible asset is

- an identifiable non-monetary asset without physical substance.

Identifiability

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.

Control

Future economic benefit

Monetary assets are

- money held and assets to be received in fixed or determined amounts of money

## 2. Definition of Intangible Assets

More clarification on its meaning 

Identifiability

- An asset meets the Identifiability Criterion in the definition of an intangible asset when it:
  - a) **is separable**
    - i.e. 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, 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.

## 2. Definition of Intangible Assets

- 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.
- Its capacity to control such future economic benefits would normally stem from legal rights that are enforceable in a court of law.
- In normal situations, in the absence of legal rights to protect, an entity usually has insufficient control over the expected future economic benefits arising from
  - for example, a team of skilled staff, or customer relationships and loyalty

Identifiability

Control

Normally cannot meet the definition

## 2. Definition of Intangible Assets

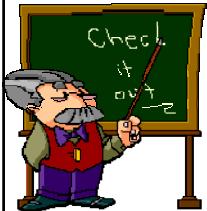
- The future economic benefits flowing from an intangible asset may include
  - revenue from the sale of products or services,
  - cost savings, or
  - other benefits resulting from the use of the asset by the entity.
- For example, the use of intellectual property in a production process
  - may reduce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

Identifiability

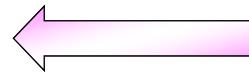
Control

Future economic benefit

## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement



## 3. Recognition and Initial Measurement

### General principle

- 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 (as discussed); and
  - b) the recognition criteria.
- This requirement applies to
  - costs incurred initially to acquire or internally generate an intangible asset (i.e. initial cost) and
  - those incurred subsequently to add to, replace part of, or service it (i.e. subsequent expenditure).

Implies both initial and subsequent costs with same recognition criteria

### 3. Recognition and Initial Measurement

#### Recognition criteria

- 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.
- An entity shall assess the probability
  - 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

#### Initial measurement

- An intangible asset shall be measured initially at cost.

### 3. Recognition and Initial Measurement

Recognition criteria  
(capitalisation) for

Old IAS 38 Criteria not  
the same

#### Initial Cost

#### Subsequent Expenditure

- |  |  |  |
|--|--|--|
|  | <ul style="list-style-type: none"><li>• Probable that future economic benefits that are attributable to the asset will flow to the enterprise</li><li>• Cost measured reliably</li></ul> | <ul style="list-style-type: none"><li>• Probable that will enable to generate future economic benefits <u>in excess of its originally assessed standard of performance</u></li><li>• expenditure can be measured and attributed to the asset reliably.</li></ul> |
|--|--|--|

New IAS 38 Same  
criteria

- |  |   |
|--|---|
|  | <ul style="list-style-type: none"><li>• Probable that the expected future economic benefits that are attributable to the asset will flow to the entity</li><li>• Cost measured reliably</li></ul> |
|--|---|

*Same criteria applied to both costs*

Expenditure not fulfilling the recognition criteria will be charged to P/L

### 3. Recognition and Initial Measurement

However, IAS 38 specifically states that:

- 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 IAS 38.
- 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 be recognised in the carrying amount of an asset.



### 3. Recognition and Initial Measurement

Intangible assets may arise from

1. Separate acquisition
2. Acquisition as part of a business combination
3. Acquisition by way of a government grant
4. Exchange of assets
5. Internally generated goodwill
6. Internally generated intangible assets

### 3. Recognition and Initial Measurement

#### 1. Separate acquisition

- The price an entity pays to acquire separately an intangible asset
  - normally reflects expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity.
  - In other words, the effect of probability is reflected in the cost of the asset. Therefore, the probability recognition criterion is always considered to be satisfied for separately acquired intangible assets.
- The cost of a separately acquired intangible asset can usually be measured reliably
  - in particular when the purchase consideration is in the form of cash or other monetary assets.



Cost comprises?

### 3. Recognition and Initial Measurement

#### 1. Separate acquisition

More guidance is given in IAS 38

- 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.

### 3. Recognition and Initial Measurement

Example

Which cost can or cannot be included?

1. Separate acquisition

- Examples of directly attributable costs are:
  - a) costs of employee benefits (as defined in IAS 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.
- 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.

### 3. Recognition and Initial Measurement

Which should recognition of cost be ceased?

1. Separate acquisition

Ceases when the asset is

- in the condition necessary for it to be capable of operating in the manner intended by management.
  - 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.

### 3. Recognition and Initial Measurement

#### 1. Separate acquisition

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

### 3. Recognition and Initial Measurement

#### Case



#### Galaxy Entertainment Group Limited

- Galaxy accounts for its gaming licence as intangible assets with a carrying amount of HK\$15.4 Billion at 31 Dec. 2006
- Its annual report of 2006 set out the accounting policy as follows:
  - Gaming licence represents the fair value of licence acquired and
    - is amortised over its estimated useful lives on a straight line basis and
    - is tested annually for impairment.

Further discussed later

### 3. Recognition and Initial Measurement

#### 2. Acquisition as part of a business combination

- In accordance with IFRS 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 reflects market expectations about the probability that the future economic benefits embodied in the asset will flow to the entity.
  - In other words, the effect of probability is reflected in the fair value measurement of the intangible asset.
  - Therefore, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations.

### 3. Recognition and Initial Measurement

#### 2. Acquisition as part of a business combination

In accordance with IAS 38 and IFRS 3

- an acquirer recognises at the acquisition date separately from goodwill an intangible asset of the acquiree
  - if the asset's fair value can be measured reliably,
  - irrespective of whether the asset had been recognised by the acquiree before the business combination.



- Some items, like in-process R&D project,
- that were ineligible for recognition in the acquiree's books if it is generally internally,
- may be recognised by the acquirer (separately from goodwill) in the business combination if the item
  - meets the definition of an intangible asset, and
  - The asset's fair value can be measured reliably.

### 3. Recognition and Initial Measurement

Case



- Intangible assets should be recognised separately from goodwill in a business combination
  - where they arise from contractual or other legal rights, or
  - if separable .....
- Intangible assets include
  - the value of in-force long-term assurance business,
  - computer software,
  - trade names,
  - mortgage servicing rights,
  - customer lists,
  - core deposit relationships,
  - credit card customer relationships and
  - merchant or other loan relationships.

### 3. Recognition and Initial Measurement

2. Acquisition as part of a business combination

1. Separate acquisition

Both may result in the recognition of an in-process R&D project

➤ But how should the subsequent expenditure on such acquired in-process R&D project be recognised?

- Such research or development expenditure that is incurred after the acquisition of that in-process R&D project shall be accounted for
  - in the same practice as other research or development expenditure (or internally generated intangible assets),  
i.e. the practice to be discussed later in →

6. Internally generated intangible assets

### 3. Recognition and Initial Measurement

#### 3. Acquisition by way of a government grant

- In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant.
- In accordance with IAS 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 (in accordance with IAS 20), or
  - recognises the asset initially at a nominal amount (the other treatment permitted by IAS 20) plus any expenditure that is directly attributable to preparing the asset for its intended use.

### 3. Recognition and Initial Measurement

#### 4. Exchange of assets

Commercial Substance  
Fair Value of Exchanged Asset

- When an intangible asset is acquired in exchange for an asset, the cost of such 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.
- Similar to the requirements in IAS 16 *Property, Plant and Equipment*
- If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

### 3. Recognition and Initial Measurement

#### 5. Internally generated goodwill`

- Internally generated goodwill shall not be recognised as an asset.
  - Because it is not an identifiable resource (neither separable nor arising from contractual or legal rights) controlled by the entity that can be measured reliably at cost.



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### 3. Recognition and Initial Measurement

#### 6. Internally generated intangible assets

##### Research and Development

- To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:
  - a research phase; and
  - 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 IAS 38.

If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset

- treats the expenditure on that project as if it were incurred in the research phase only.

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### 3. Recognition and Initial Measurement

#### Research and Development

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



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- **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.

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### 3. Recognition and Initial Measurement

#### Example

#### Research and Development

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.

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### 3. Recognition and Initial Measurement

#### Research and Development



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- **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.

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### 3. Recognition and Initial Measurement

#### Research and Development

- 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.

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### 3. Recognition and Initial Measurement

Example

#### Research and Development

Examples of development activities are:

- a) the design, construction and testing of pre-production or pre-use prototypes and models;
- b) the design of tools, jigs, moulds and dies involving new technology;
- c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

How can probable future economic benefits be demonstrated?

### 3. Recognition and Initial Measurement

#### Research and Development

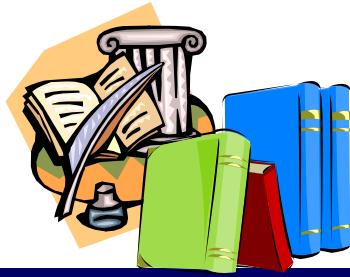
- To demonstrate how an intangible asset will generate probable future economic benefits,
  - an entity assesses the future economic benefits to be received from the asset using the principles in IAS 36 *Impairment of Assets*.
- If the asset will generate economic benefits only in combination with other assets,
  - the entity applies the concept of cash-generating units in IAS 36.

How can probable future economic benefits be demonstrated?

### 3. Recognition and Initial Measurement

#### Research and Development

- Even the recognition criteria are met,
  - internally generated brands, mastheads, publishing titles, customer lists and items similar in substance
    - shall not be recognised as intangible assets.
- Specifically disallowed in IAS 38



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### 3. Recognition and Initial Measurement

#### Research and Development

- The cost of an internally generated intangible asset
  - is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria.
  - prohibits reinstatement of expenditure previously recognised as an expense.

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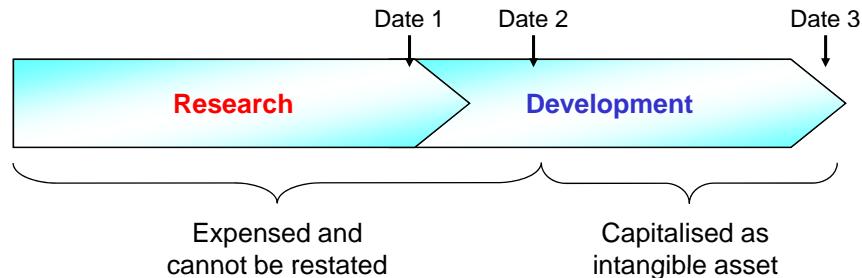
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### 3. Recognition and Initial Measurement

Example

When can the cost be capitalised?

Research and Development



Date 1 – Date of development commenced

Date 2 – Date of recognition criteria meet

Date 3 – Date of new developed product ready for intended use

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### 3. Recognition and Initial Measurement

Research and Development

- 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.



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### 3. Recognition and Initial Measurement

#### Example

##### Research and Development

- 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 IAS 19 Employee Benefits) 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.
- IAS 23 *Borrowing Costs* specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

Can be capitalised

### 3. Recognition and Initial Measurement

#### Example

##### Research and Development

- 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.

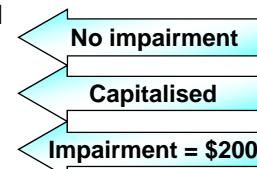
Cannot be capitalised



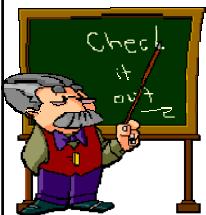
### 3. Recognition and Initial Measurement

#### Example

- An entity is developing a new production process.
- During 2005, expenditure incurred was \$1,000, of which
  - a) \$900 was incurred before 1 Dec. 2005 and
  - b) \$100 was incurred between 1 Dec. 2005 and 31 Dec. 2005
- The entity is able to demonstrate that, at 1 Dec. 2005, the production process met the criteria for recognition as an intangible asset.
- The recoverable amount of the know-how embodied in the process is estimated to be \$500.
- During 2006, expenditure incurred is \$2,000.
- At the end of 2006, the recoverable amount of the know-how embodied in the process is estimated to be \$1,900.



### Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense



## 4. Recognition of Expense

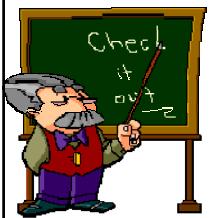
- Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:
  - a) it forms part of the cost of an intangible asset that meets the recognition criteria; or
  - b) the item is acquired in a business combination and cannot be recognised as an intangible asset.If this is the case, this expenditure (included in the cost of the business combination) shall form part of the amount attributed to goodwill at the acquisition date.
- 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.



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## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition



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## 5. Measurement after Recognition

- An entity shall choose either:

**Cost Model**

**Revaluation Model**

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.

An active market is a market in which all the following conditions exist:

- a) the items traded in the market are homogeneous;
- b) willing buyers and sellers can normally be found at any time; and
- c) prices are available to the public.

## 5. Measurement after Recognition

**Cost Model**

**Revaluation Model**

- After initial recognition, an intangible asset shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses

- 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 IAS 38, fair value shall be determined by reference to an active market.
- Revaluations shall 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.

## 5. Measurement after Recognition

### Revaluation Model

#### Application of revaluation model

- 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.



## 5. Measurement after Recognition

### Revaluation Model

#### Frequency of revaluations

- 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.



## 5. Measurement after Recognition

### Revaluation Model

#### Revaluation effect on accumulated amortisation

- If an intangible asset is revalued, any accumulated amortisation at the date of the revaluation is either:
  - a) restated proportionately with the change in the gross carrying amount of the asset so that
    - the carrying amount of the asset after revaluation equals its revalued amount; or
  - b) eliminated against the gross carrying amount of the asset and
    - the net amount restated to the revalued amount of the asset.

## 5. Measurement after Recognition

### Revaluation Model

#### When there is no active market

Be careful .....

- 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.
- If the fair value of a revalued intangible asset can no longer be determined 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.

This may be an indication of impairment and impairment testing under IAS 36 is then required

## 5. Measurement after Recognition

### Revaluation Model

Same as  
IAS 16 PPE

#### Recognition of revaluation surplus or deficit

- If an intangible asset's carrying amount is increased as a result of a revaluation,
  - the increase shall be credited directly to 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.
- 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 debited directly to equity under the heading of revaluation surplus to the extent of any credit balance in the revaluation surplus in respect of that asset.

## 5. Measurement after Recognition

### Revaluation Model

#### Realisation of revaluation surplus

- 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 intangible asset.
- However, some of the surplus may be realised as the asset is used by an entity .....

## 5. Measurement after Recognition

### Revaluation Model

#### Realisation of revaluation surplus

- In such case (surplus realised as the asset is used by an entity), 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.

Dr Revaluation surplus  
(amortisation based on the revalued carrying amount  
less amortisation based on the asset's historical cost)  
Cr Retained earnings

- Transfers from revaluation surplus to retained earnings are not made through income statement.

## 5. Measurement after Recognition

### Example

- Transystems designs websites and writes bespoke software.
- Further, during the current financial period, the group has capitalised its domain names acquisition costs of \$1 million within tangible non-current assets, and revalued the asset to \$3 million.
- In order to meet the definition of an Intangible Asset, IAS 38 requires identifiability, control and the existence of future economic benefits. It would appear that the domain names should be shown as an intangible asset. Further on actual recognition, the intangible asset should be measured at cost.
- Any subsequent revaluation using the Revaluation Model is only possible if there is an active market for the intangible asset.
- The definition of an 'active market' is quite stringent to the extent that very few intangibles have such a market.
- Thus, the domain name costs should be shown at cost under intangible assets and amortised/reviewed for impairment.
- The revaluation model cannot be used in this case.

## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life



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## 6. Useful Life

- No matter, which of the following model is used by an entity:

**Cost Model**

or

**Revaluation Model**

- IAS 38 sets out that an entity shall assess whether the useful life of an intangible asset is

**Finite**

or

**Indefinite**

If finite

- the length of, or number of production or similar units constituting, that useful life.

An intangible asset has an indefinite useful life when

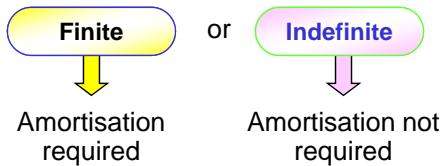
- based on an analysis of all of the relevant factors
- there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

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## 6. Useful Life

- The accounting for an intangible asset is based on its useful life.
  - Many factors are considered in determining the useful life of an intangible asset.



## 6. Useful Life

- 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.

## 6. Useful Life

### Intangible asset arising from contractual or other legal rights

- The useful life of such intangible asset
  - 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.

Finite

Indefinite

- If the contractual or other legal rights can be renewed, the useful life of the intangible asset shall include the renewal period only if
  - there is evidence to support renewal by the entity without significant cost.

## 6. Useful Life

### Example

- 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 each reporting date whether there is any indication that the customer list may be impaired.

## 6. Useful Life

Example

- 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 each reporting date whether there is any indication that it may be impaired.

## 6. Useful Life

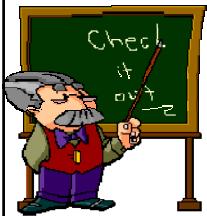
Case



**Beijing Enterprises Holdings Ltd.**

- Further stated its accounting policy on intangible assets as follows:
  - Useful lives of acquired intangible assets are assessed to be either
    - finite or
    - indefinite.
  - Intangible assets with finite useful lives
    - are stated at cost less accumulated amortisation and any accumulated impairment losses.
  - Intangible assets with indefinite useful lives
    - are stated at cost and not amortised.

## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives



## 7. Finite Useful Life

### Amortisation

- The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.
  - Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.
- **Amortisation**
  - shall begin when the asset is available for use,
    - i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
  - shall cease at the earlier of
    - the date that the asset is classified as held for sale (or included in a disposal group held for sale) in accordance with IFRS 5 and
    - the date that the asset is derecognised.

## 7. Finite Useful Life

Amortisation

Amortisation Method

- 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.

Say PPE or Inventories

## 7. Finite Useful Life

Amortisation

Amortisation Method

Residual Value

- 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.
- The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:
  - there is a commitment by a third party to purchase the asset at the end of its useful life; or
  - there is an active market for the asset and:
    - residual value can be determined by reference to that market; and
    - it is probable that such a market will exist at the end of the asset's useful life

## 7. Finite Useful Life

- 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 IAS 8.
- In addition, 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 amortization method shall be changed to reflect the changed pattern.
  - Such changes shall be accounted for as changes in accounting estimates in accordance with IAS 8.

Amortisation

Amortisation Method

Residual Value

## 7. Finite Useful Life

Example

### Assessing the useful lives of intangible assets

- 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 5 years for 60% of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in 5 years.

The patent would be

- amortised over its 5-year useful life to the entity with a residual value equal to the present value of 60% of the patent's fair value at the date it was acquired.
- reviewed for impairment in accordance with IAS 36 by assessing at each reporting date whether there is any indication that it may be impaired.

## 7. Finite Useful Life

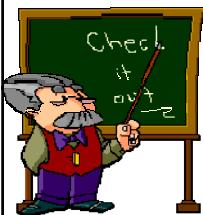
Case



### Galaxy Entertainment Group Limited

- Galaxy accounts for its gaming licence as intangible assets with a carrying amount of HK\$15.4 Billion at 31 Dec. 2006
- Its annual report of 2006 set out the accounting policy as follows:
  - Gaming licence represents the fair value of licence acquired and
    - is amortised over its estimated useful lives on a straight line basis and
    - is tested annually for impairment.

## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives



## 8. Indefinite Useful Life

- An intangible asset with an indefinite useful life shall not be amortised.
- In accordance with IAS 36 *Impairment of Assets*
  - an entity is required to test an intangible asset with an indefinite 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.

Indefinite

## 8. Indefinite Useful Life

- The useful life of such intangible asset 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 (support an indefinite useful life assessment for that asset)
    - such change in the useful life assessment shall be accounted for as a change in an accounting estimate in accordance with IAS 8

Indefinite

Be careful .....

- In accordance with IAS 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 IAS 36, with its carrying amount, and recognising any impairment loss.

## 8. Indefinite Useful Life

Example

### Assessing the useful lives of intangible assets

- 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.

## 8. Indefinite Useful Life

Example

### Assessing the useful lives of intangible assets

- 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.

## 8. Indefinite Useful Life

Example

### Assessing the useful lives of intangible assets

- Same as previous example
  - 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.

## 8. Indefinite Useful Life

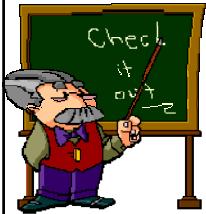
Case



### Esprit Holdings Limited

- Adopted HK GAAP to 30 June 2003
- Begin to adopt all the new/revised IFRS in 2004 Annual Report
  - On the first time adoption of IFRS, the Group reassessed the useful life of previously recognised intangible assets.
  - As a result of this assessment, the acquired Esprit trademarks were classified as an indefinite-lived intangible asset in accordance with IAS 38 *Intangible Assets*.
  - This conclusion is supported by the fact that Esprit trademark legal rights are capable of being renewed indefinitely at insignificant cost and therefore are perpetual in duration, relate to a well known and long established fashion brand since 1968, and based on future financial performance of the Group, they are expected to generate positive cash flows indefinitely.

## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment



## 9. Impairment Losses

- To determine whether an intangible asset is impaired, an entity applies IAS 36 *Impairment of Assets*, that 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.
- In IAS 36, under normal situation

### Triggering events

- An entity shall assess at each reporting date whether there is any indication that an asset may be impaired.
- If any such indication exists, the entity shall estimate the recoverable amount of the asset.

## 9. Impairment Losses

### Triggering events

- However, irrespective of whether there is any indication of impairment, an entity shall also:
    - a) test
      - an intangible asset with an indefinite useful life, or
      - an intangible asset not yet available for use
- for impairment annually by comparing its carrying amount with its recoverable amount.

## 9. Impairment Losses

### Case



#### Galaxy Entertainment Group Limited

- Galaxy's annual report of 2006 set out the accounting policy on impairment of gaming licence as follows:
  - Gaming licence represents the fair value of licence acquired on the acquisition of Galaxy and is amortised on a straight line basis over its estimated useful life, which is the remaining licence period.
  - The Group tests whether the licence has suffered any impairment based on value-in-use calculations.
  - The methodologies are based upon estimates of future results, assumptions as to income and expenses of the business, future economic conditions on growth rates and estimation of the future returns.

## Agenda on IAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals



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## 10. Retirements and Disposals

- An intangible asset shall be derecognised:
  - a) on disposal; or
  - b) when no future economic benefits are expected from its use or disposal.
- 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 IAS 17 Leases requires otherwise on a sale and leaseback).
- Gains shall not be classified as revenue.



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## 10. Retirements and Disposals

### Replacement for part of an intangible asset

- 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 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.



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## 10. Retirements and Disposals



### Amortisation continues even intangible assets no longer used

- Amortisation of intangible assets with 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 in accordance with IFRS 5.

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## Agenda on IAS 38

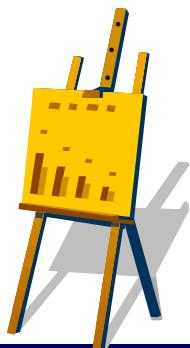


1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals
11. Disclosure



## 11. Disclosures

- IAS 38 introduces some additional disclosure requirements
- Changes are mainly amendments for the changes on finite and indefinite useful life
- Disclosures can be divided into disclosures for:
  - General aspects for all intangible assets
  - Intangible assets measured at revalued amount
  - Research and development expenditure
  - Other information



# 11. Disclosures

## General aspects

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 income statement 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 details of movements

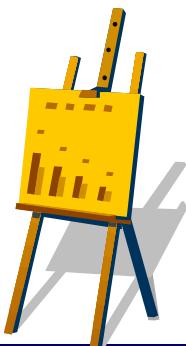


# 11. Disclosures

## General aspects

An entity shall also disclose:

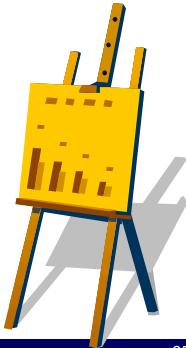
- a) for an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life.  
In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.
- b) a description, the carrying amount and remaining amortisation period of any individual material intangible asset.
- c) the details for intangible assets acquired by way of a government grant and initially recognised at fair value.
- 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.



## 11. Disclosures

### Intangible assets measured at revalued amount

- 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;
  - 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; and
  - c) the methods and significant assumptions applied in estimating the assets' fair values.



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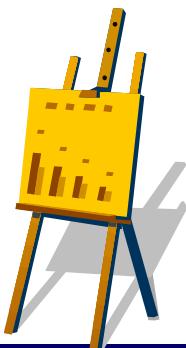
## 11. Disclosures

### Research and development expenditure

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

### Other Information

- 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 IAS 38.



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## Borrowing Costs (IAS 23)

Amendments to IAS  
23 issued in March  
2007



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## Agenda on IAS 23

1. Objective and scope
2. What are borrowing costs?
3. Benchmark treatment: Expense
4. Allowed alternative treatment: Capitalisation



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## 1. Objective and Scope

- The objective of IAS 23 is to prescribe the accounting treatment for borrowing costs.
- IAS 23
  - generally requires the immediate expensing of borrowing costs, but
  - permits, as an allowed alternative treatment, the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.
- IAS 23 shall be applied in accounting for borrowing costs, but does not deal with the actual or input cost of equity, including preferred capital not classified as a liability.

Benchmark  
– Expenses

Allowed Alternative  
– Capitalisation



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## 2. What Are Borrowing Costs?

- Borrowing costs
  - are interest and other costs incurred by an entity in connection with the borrowing of funds.
  - may include:
    - a) interest on bank overdrafts and short-term and long-term borrowings;
    - b) amortisation of discounts or premiums relating to borrowings;
    - c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
    - d) finance charges in respect of finance leases recognised in accordance with IAS 17 *Leases*; and
    - e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.



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### 3. Benchmark Treatment: Expense

#### Recognition

- Borrowing costs shall be recognised as an expense in the period in which they are incurred.
- Under the benchmark treatment
  - borrowing costs are recognised as an expense in the period in which they are incurred regardless of how the borrowings are applied.

Benchmark  
– Expenses

#### Disclosure

- The financial statements shall disclose
  - the accounting policy adopted for borrowing costs.



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### 3. Benchmark Treatment: Expense

#### Amendments to IAS 23 issued in March 2007

- Converged to the practice in US
- Apply to borrowing costs relating to qualifying assets for which it begins capitalisation on or after 1 January 2009
- Remove the option of immediately recognising the borrowing costs as expenses
- IAS 23 does not apply to borrowing costs directly attributable to the acquisition, construction and production of a qualifying assets measured at fair value, say biological asset

Benchmark  
– Expenses



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## 4. Allowed Alternative: Capitalise

### Recognition

- Borrowing costs shall be recognised as an expense in the period in which they are incurred,
  - except to the extent that they are capitalised in accordance with IAS 23.



**Allowed Alternative  
– Capitalisation**

- What kinds of borrowing costs eligible for capitalisation?
- When does capitalisation commence?
- When does capitalisation suspense?
- When does capitalisation cease?

## 4. Allowed Alternative: Capitalise

### Recognition

→ Eligible

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.
  - The amount of borrowing costs eligible for capitalisation shall be determined in accordance with IAS 23.



## 4. Allowed Alternative: Capitalise

Recognition

Eligible

Qualifying Asset

- A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
- Under the allowed alternative treatment,
  - borrowing costs that are directly attributable to the acquisition, construction or production of an asset are included in the cost of that asset.
- Such borrowing costs are capitalised as part of the cost of the asset when
  - it is probable that they will result in future economic benefits to the entity and
  - the costs can be measured reliably.
- Other borrowing costs are recognised as an expense in the period in which they are incurred.

Other → to be expensed

## 4. Allowed Alternative: Capitalise

Example

Recognition

Eligible

Qualifying Asset

### Examples of qualifying assets:

- Inventories that require a substantial period of time to bring them to a saleable condition
- Manufacturing plants,
- Power generation facilities
- Investment properties

### Examples of items cannot be qualifying assets:

- Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time
- Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

## 4. Allowed Alternative: Capitalise

Recognition

Eligible

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that
  - would have been avoided if the expenditure on the qualifying asset had not been made.
- When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset,
  - the borrowing costs that directly relate to that qualifying asset can be readily identified.

Qualifying Asset

Attributable borrowing cost

## 4. Allowed Alternative: Capitalise

Recognition

Eligible

- It may be difficult
  - to identify a direct relationship between particular borrowings and a qualifying asset and
  - to determine the borrowings that could otherwise have been avoided.  
e.g. when the financing activity of an entity is coordinated centrally.
- Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group.
- Other complications arise through the use of loans denominated in or linked to foreign currencies, when the group operates in highly inflationary economies, and from fluctuations in exchange rates.
- As a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.

## 4. Allowed Alternative: Capitalise

Recognition

Eligible

Borrowing costs may be incurred from 2 sources in obtaining a qualifying asset:

1. Borrowed specifically for obtaining a qualifying asset
2. Borrowed generally and used for obtaining a qualifying asset



To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset

- the amount of borrowing costs eligible for capitalisation on that asset shall be determined as the **actual borrowing costs** incurred on that borrowing during the period
- less any investment income on the temporary investment of those borrowings.

Qualifying Asset

Attributable borrowing cost

## 4. Allowed Alternative: Capitalise

Recognition

Eligible

- The financing arrangement for a qualifying asset may result in an entity
  - obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset.
  - In such circumstances, the funds are often
    - temporarily invested pending their expenditures on the qualifying asset.
  - In determining the amount of borrowing costs eligible for capitalisation during a period,
    - any investment income earned on such funds is deducted from the borrowing costs incurred.

Qualifying Asset

Attributable borrowing cost

## 4. Allowed Alternative: Capitalise

Case



- Borrowing costs are expensed in the income statement in the period in which they are incurred,
  - except to the extent that they are capitalized as being attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

## 4. Allowed Alternative: Capitalise

Case



**Beijing Enterprises Holdings Ltd.**

- Has early adopted all new IFRS in 2004 and stated that:
  - Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalized as part of the cost of those assets .....
  - Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalized.

## 4. Allowed Alternative: Capitalise

Recognition

Eligible

Borrowing costs may be incurred from 2 sources in obtaining a qualifying asset:

1. Borrowed specifically for obtaining a qualifying asset
2. Borrowed generally and used for obtaining a qualifying asset

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset

- the amount of borrowing costs eligible for capitalisation shall be determined by applying **a capitalisation rate** to the expenditures on that asset.

Qualifying Asset

Attributable borrowing cost

## 4. Allowed Alternative: Capitalise

Recognition

Eligible

Borrowing costs may be incurred from 2 sources in obtaining a qualifying asset:

1. Borrowed specifically for obtaining a qualifying asset
2. Borrowed generally and used for obtaining a qualifying asset

- The **capitalisation rate** shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period,
  - other than borrowings made specifically for the purpose of obtaining a qualifying asset.
  - The amount of borrowing costs capitalised during a period shall not exceed the amount of borrowing costs incurred during that period.

Qualifying Asset

Attributable borrowing cost

## 4. Allowed Alternative: Capitalise

Recognition → Eligible

- In some circumstances, it is appropriate to
  - include all borrowings of the parents and its subsidiaries when computing a weighted average of the borrowing costs
- In other circumstances, it is appropriate for
  - each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.



## 4. Allowed Alternative: Capitalise

Recognition

**Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount**

- When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value
  - the carrying amount is written down or written off in accordance with the requirements of other IFRSs.
- In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other IFRSs.



## 4. Allowed Alternative: Capitalise

Recognition

Commence

- The capitalisation of borrowing costs as part of the cost of a qualifying asset shall commence when:
  - expenditures for the asset are being incurred;
  - borrowing costs are being incurred; and
  - activities that are necessary to prepare the asset for its intended use or sale are in progress.

Qualifying Asset

Attributable borrowing cost

Allowed Alternative – Capitalisation

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## 4. Allowed Alternative: Capitalise

Example

- Entity A constructs a scientific medical equipment for its own use, with a cost of \$50 million and consider it as a qualified asset.
- Borrowing costs capitalised under IAS 23 amounts to \$6 million.
- It also receives a government grant of \$5 million on that asset.
- Can the government grant received be recognised as part of the expenditure on qualified asset?

### Expenditures on a qualifying asset

- include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.
- are reduced by any progress payments received and grants received in connection with the asset (see IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*).

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## 4. Allowed Alternative: Capitalise

### Example

- Before the construction of a property in a land, Entity GV has to prepare the construction plan and get the government approval.
- Borrowing costs have been incurred during the above period.
- Are these borrowing costs eligible for capitalisation under IAS 23?

Yes

- The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset.
- They include technical and administrative work prior to the commencement of physical construction,
  - such as the activities associated with obtaining permits prior to the commencement of the physical construction.
- However, such activities exclude
  - the holding of an asset when no production or development that changes the asset's condition is taking place.

## 4. Allowed Alternative: Capitalise

Recognition

Suspense

- Capitalisation of borrowing costs shall be suspended during extended periods in which active development is interrupted.

Except for the following:

- Not normally suspended during a period when substantial technical and administrative work is being carried out.
- Not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.



## 4. Allowed Alternative: Capitalise

Recognition → Cease

- Capitalisation of borrowing costs shall cease
  - when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of borrowing costs shall cease
  - when substantially all the activities necessary to prepare that part for its intended use or sale are completed.



## 4. Allowed Alternative: Capitalise

Example

Recognition → Cease

- Example of a qualifying asset for which each part is capable of being usable while construction continues on other parts
  - A business park comprising several buildings, each of which can be used individually
- Example of a qualifying asset that needs to be complete before any part can be used:
  - An industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

## 4. Allowed Alternative: Capitalise

Example

- Entity A has finished the physical construction of a building for Miss Lee, subject to certain modification according to her specification after her inspection.
- Borrowing costs are incurred during the modification period
- Can these borrowing costs be capitalised?

No

- If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities of the property construction are complete.

## 4. Allowed Alternative: Capitalise

Case



**Wharf (Holdings)** – 2004 Annual Report

- The capitalization of borrowing cost as part of the cost of a qualifying asset
  - commences when expenditure for the asset is incurred, borrowing costs are being incurred and activities to prepare the asset for its intended use or sale are in progress.
- Capitalization of borrowing costs
  - is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

## 4. Allowed Alternative: Capitalise

### Disclosure

- The financial statements shall disclose:
  - a. the accounting policy adopted for borrowing costs;
  - b. the amount of borrowing costs capitalised during the period; and
  - c. the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

## 4. Allowed Alternative: Capitalise

### Example

- On 1 January 20x6 Rechno Co borrowed \$15m to finance the production of two assets, both of which were expected to take a year to build.
- Production started during 2008.
- The loan facility was drawn down on 1 January 2008, and was utilised as follows, with the remaining funds invested temporarily.

	<u>Asset X</u>	<u>Asset Y</u>
	\$m	\$m
1 January 2008	2.5	5.0
1 July 2008	2.5	5.0

- The loan interest rate is 10% and Rechno Co can invest surplus funds at 8%.
- Ignoring compound interest, calculate the borrowing costs which may be capitalised for each of the asset and consequently the cost of each asset at 31 Dec. 2008.

(ACCA BPP Pack)

## 4. Allowed Alternative: Capitalise

Example

	Asset X \$'000	Asset Y \$'000
Borrowing costs		
To 30 June 2008 (\$2.5 m and \$5 m x 10% x 6/12)	125	250
To 31 December 2008 (\$5 m and \$10 m x 10% x 6/12)	<u>250</u>	<u>500</u>
	375	750
Less: investment income		
To 30 June 2008 (\$2.5 m and \$5 m x 8% x 6/12)	(100)	(200)
	<u>275</u>	<u>550</u>
Cost of assets		
Expenditure incurred	5,000	10,000
Borrowing costs	<u>275</u>	<u>550</u>
	<u>5,275</u>	<u>10,550</u>

## 4. Allowed Alternative: Capitalise

Example

- Zenzi Co had the following loans in place in 2008

	1 Jan 2008 \$m	31 Dec 2008 \$m
10% bank loan repayable 2013	120	120
9.5% bank loan repayable 2011	80	80
8.9% debenture repayable 2018	--	150

- The 8.9% debenture was issued to fund the construction of a qualifying asset (a piece of mining equipment), construction of which began on 1 July 2008.
- On 1 Jan 2008, Zenzi Co began construction of a qualifying asset, a piece of machinery for a hydro-electric plant, using existing borrowings.
- Expenditure drawn down for the construction was:  
\$30m on 1 Jan 2008 and \$20m on 1 Oct 2008.
- Calculate the borrowing costs to be capitalised for the hydro-electric plant machine.

(ACCA BPP Pack)

## 4. Allowed Alternative: Capitalise

Example

**Capitalisation rate** = Weighted average rate

$$= \left( 10\% \times \frac{120}{120+80} \right) + \left( 9.5\% \times \frac{80}{120+80} \right)$$

$$= 9.8\%$$

**Borrowing costs** =  $(\$30m \times 9.8\%) + (\$20m \times 9.8\% \times \frac{3}{12})$

$$= \$3.43m$$

## Intangible Assets and Borrowing Costs

(IAS 38 and 23)

July 2007

Full version of slides in PDF can be found in  
[www.NelsonCPA.com.hk](http://www.NelsonCPA.com.hk)



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# Intangible Assets and Borrowing Costs

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