

# Intangible Assets & Service Concession

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**Nelson Lam 林智遠**  
MBA MSc BBA ACA ACIS CFA CPA(Aust.)  
CPA(US) FCCA FCPA(Practising) MSCA

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1

## Today's Agenda

Intangible Assets (HKAS 38)

Service Concession Arrangements  
(HK(IFRIC) Interpretation 12)

Simple but  
Comprehensive

Contentious  
and key issues

Real Life Cases  
and Examples



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2

# Today's Agenda



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



## 1. Objective and Scope

- HKAS 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

- HKAS 38 shall be applied in accounting for intangible assets, except:
  - a) intangible assets that are within the scope of another HKFRSs;
  - b) financial assets, as defined in HKAS 39 *Financial Instruments: Recognition and Measurement*;
  - 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.

Another  
HKFRSs

# 1. Objective and Scope

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

Another  
HKFRSs

# 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 HKAS 16 as property, plant and equipment or
  - under HKAS 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

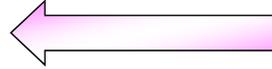
The same applies

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

# Today's Agenda



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 situation, 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

## 2. Definition of Intangible Assets

### 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

# Today's Agenda



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

	Initial Cost	Subsequent Expenditure
<b>SSAP 29</b> Criteria not the same	<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 <i>in excess of its originally assessed standard of performance</i></li> <li>• expenditure can be measured and attributed to the asset reliably.</li> </ul>
<b>HKAS 38</b> 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> <p style="text-align: right;"><i>Same criteria applied to both costs</i></p>	

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

### 3. Recognition and Initial Measurement

However, HKAS 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 HKAS 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 HKAS 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 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.
- 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 paymentsis recognised as interest expense over the period of credit unless it is capitalised in accordance with the capitalisation treatment permitted in HKAS 23 *Borrowing Costs*.

## 3. Recognition and Initial Measurement

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

- 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 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 HKAS 38 and HKFRS 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

Fair Value

- The fair value of intangible assets acquire in business combinations can normally be measured with sufficient reliability to be recognised separately from goodwill.
- If it has a finite useful life,
  - there is a rebuttable presumption that its fair value can be measured reliably.



### 3. Recognition and Initial Measurement

Example

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

Fair Value

- In estimating the fair value of an intangible asset, there is a range of possible outcomes with different probabilities
- Is it a demonstration that inability to measure fair value reliably?

- That uncertainty (a range of possible outcomes with different probabilities)
  - enters into the measurement of the asset's fair value,
  - rather than demonstrates an inability to measure fair value reliably.

### 3. Recognition and Initial Measurement

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

Fair Value

- The acquirer can recognise the group of assets (or complementary assets) as a single asset separately from goodwill
  - if the individual fair values of the assets in the group (or complementary assets) are not reliably measurable.
- If the individual fair values of the complementary assets are reliably measurable, an acquirer may recognise them as a single asset
  - provided the individual assets have similar useful lives.



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31

### 3. Recognition and Initial Measurement

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

Fair Value

- 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 are
  - when the intangible asset arises from legal or other contractual rights and
  - 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 be dependent on immeasurable variables.



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32

### 3. Recognition and Initial Measurement

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

In initially measuring the fair value of an intangible asset

##### Active market exist

- Quoted market prices in an active market provide the most reliable estimate of the fair value of an intangible asset
- The appropriate market price is usually the current bid price.
- If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value,
  - provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

### 3. Recognition and Initial Measurement

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

In initially measuring the fair value of an intangible asset

##### No active market

- Fair value is the amount that the entity would have paid for the asset, at the acquisition date, in an arm's length transaction between knowledgeable and willing parties, on the basis of the best information available.
- In determining this amount, an entity considers the outcome of recent transactions for similar assets.

### 3. Recognition and Initial Measurement

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

In initially measuring the fair value of an intangible asset

#### Other Methods

- For example:
  - multiples of revenue, market shares or profit, or
  - discounting estimated future net cash flows
- May be used for initial measurement of an intangible asset acquired in a business combination
  - if the objective is to estimate fair value and
  - if they reflect current transactions and practices in the industry to which the asset belongs.

Can these methods be used in estimating the fair value under the Revaluation Model in subsequent measurement?

**No** ..... Why not?

### 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 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** (in accordance with HKAS 20), or
  - 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.

## 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 HKAS 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.



### 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) 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 HKAS 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.

### 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.

- **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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41

### 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.

- **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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42

### 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.

### 3. Recognition and Initial Measurement

#### Research and Development

- **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.



### 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.

### 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

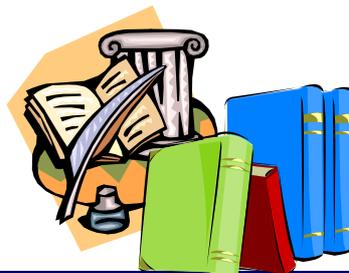
- To demonstrate how an intangible asset will generate probable future economic benefits,
  - an entity assesses the future economic benefits to be received from the asset using the principles in HKAS 36 *Impairment of Assets*.
- If the asset will generate economic benefits only in combination with other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

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 HKAS 38



### 3. Recognition and Initial Measurement

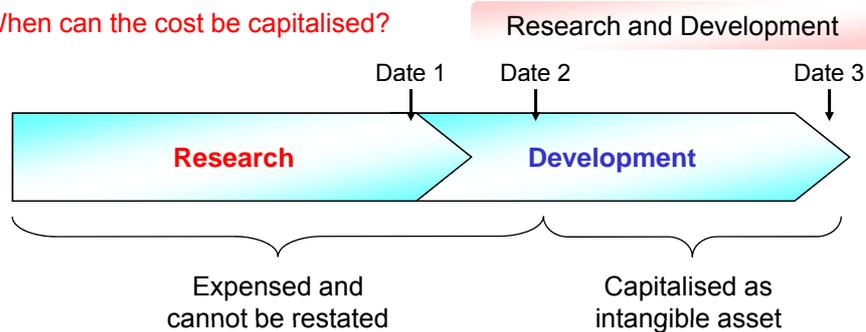
#### Research and Development

- 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.

### 3. Recognition and Initial Measurement

#### Example

When can the cost be capitalised?



Date 1 – Date of development commenced  
Date 2 – Date of recognition criteria meet  
Date 3 – Date of new developed product ready for intended use

### 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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51

### 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.

Expensed

Capitalised

No impairment

Capitalised

Impairment = \$200

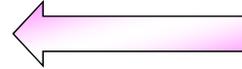
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52

# Today's Agenda



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.



# Today's Agenda



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



## 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

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

### Revaluation Model

- 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 HKAS 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

- 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.

Be careful .....

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

## 5. Measurement after Recognition

### Revaluation Model

Same as  
HKAS 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.

# Today's Agenda



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



## 6. Useful Life

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

**Cost Model**

or

**Revaluation Model**

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

**Finite**

or

**Indefinite**

If finite

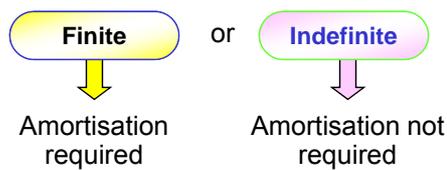
- the length of, or number of production or similar units constituting, that useful life.

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.

## 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 HKAS 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 HKAS 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.

# Today's Agenda



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 HKFRS 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:
  - 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 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

## 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 HKAS 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 HKAS 8.

Amortisation

Amortisation Method

Residual Value

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77

## 7. Finite Useful Life

Example

### Assessing the useful lives of intangible assets

- 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 4 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 HKAS 36 and
- amortised over its remaining four-year useful life.

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78

## 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 HKAS 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'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.

# Today's Agenda



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 HKAS 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 HKAS 8

Indefinite

Be careful .....

- 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 impairment loss.

## 8. Indefinite Useful Life

Example

### Assessing the useful lives of intangible assets

- The route authority may be renewed every 5 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 2 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.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

- 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 HKAS 36
  - annually and
  - whenever there is an indication that it may be impaired.

## 8. Indefinite Useful Life

### Case

The logo for Esprit Holdings Limited, featuring the word "ESPRIT" in a bold, vertical, sans-serif font.

#### 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.

# Today's Agenda



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 HKAS 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 HKAS 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

- 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.

Triggering events

## 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.

## 9. Impairment Losses

### Case



- Assets that have an indefinite useful life
  - are tested for impairment annually.
- Assets that are subject to depreciation and amortisation
  - are reviewed to determine whether there is any indication that the carrying value of these assets may not be recoverable and have suffered an impairment loss.
- If any such indication exists
  - the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.
  - The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.
  - Such impairment loss is recognised in the consolidated profit and loss account
    - except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that asset, in which case it is treated as a revaluation decrease.

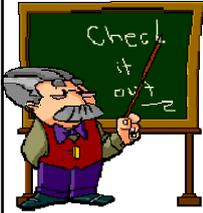
## 9. Impairment Losses



### Timing of impairment test on intangible assets

- This impairment test may be performed at any time during an annual period
  - provided it is performed at the same time every year.
- Different intangible assets may be tested for impairment at different times.
- However, if such an intangible asset was initially recognised during the current annual period
  - that intangible asset shall be tested for impairment before the end of the current annual period.

# Today's Agenda



1. Objective and Scope
2. Definition of intangible asset
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6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals



## 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 HKAS 17 *Leases* requires otherwise on a sale and leaseback).
- Gains shall not be classified as revenue.



## 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.



## 10. Retirements and Disposals



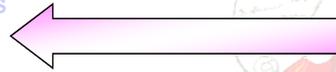
### Amortisation continues even intangible assets no longer used

- 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 HKFRS 5.

# Today's Agenda

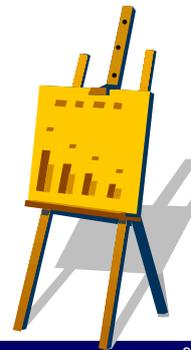


1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
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7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals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



## 11. Disclosures

- HKAS 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.



# 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 HKAS 38 (or because they were acquired or generated before the version of SSAP 29 Intangible Assets issued in 2001 was effective).



# 11. Disclosures

## Case

ESPRIT

### Esprit Holdings Limited

- Begin to adopt all the new/revised IFRS since 2004
  - 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.

# 11. Disclosures

## Case

ESPRIT

### Esprit Holdings Limited

- This view is supported by an independent professional appraiser, who has been appointed by the Group to perform an assessment of the useful life of Esprit trademarks in accordance with the requirements set out in IAS 38.
- Having considered the factors specific to the Group, the appraiser opined that Esprit trademarks should be regarded as an intangible asset with an indefinite useful life.
- Under IAS 38, the Group reevaluates the useful life of Esprit trademarks each year to determine whether events or circumstances continue to support the view of indefinite useful life for this asset.

Only these ..... those required by HKAS 36 for impairment testing should be disclosed too

# 11. Disclosures

## Case

ESPRIT

### Esprit Holdings Limited

- In accordance with IAS 36, the Group completed its annual impairment test for Esprit trademarks by comparing their recoverable amount to their carrying amount as at June 30, 2004.
- The Group appointed independent professional valuers to conduct a valuation of the Esprit trademarks as one corporate asset based on value-in-use calculation.
- The resulting value of the Esprit trademarks as at June 30, 2004 was significantly higher than their carrying amount.

Only these .....

# 11. Disclosures

## Case

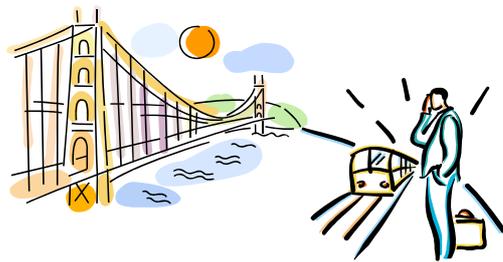
ESPRIT

### Esprit Holdings Limited

- This valuation uses cash flow projections based on financial estimates covering a three-year period, expected royalty rates deriving from the Esprit trademarks in the range of 3% to 8% and a discount rate of 14%.
- The cash flows beyond the three-year period are extrapolated using a steady 3% growth rate.
- This growth rate does not exceed the long-term average growth rate for apparel markets in which the Group operates.
- Management has considered the above assumptions and valuation and also taken into account the business expansion plan going forward, the current wholesale order books and the strategic retail expansion worldwide and believes that there is no impairment in the Esprit trademarks.
- Management believes that any reasonably foreseeable change in any of the above key assumptions would not cause the aggregate carrying amount of trademarks to exceed the aggregate recoverable amount.

# Today's Agenda

## Service Concession Arrangements (HK(IFRIC) Interpretation 12)



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107

## Background

- An arrangement within the scope of this Interpretation, “Service Concession Arrangements”, typically involves
  - a private sector entity (an operator)
    - constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and
    - operating and maintaining that infrastructure for a specified period of time.
- The operator is paid for its services over the period of the arrangement.
  - The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.
- Such an arrangement is often described as
  - a “build-operate-transfer” (BOT),
  - a “rehabilitate-operate-transfer” (ROT) or
  - a “public-to-private” service concession arrangement.



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108

## Scope of HK(IFRIC)-Int 12

- HK(IFRIC) Interpretation 12
  - gives guidance on the accounting by operators for public-to-private service concession arrangements
- The interpretation applies to public-to-private service concession arrangements if
  - a) the grantor controls or regulates
    - what service the operator must provide with the infrastructure,
    - to whom it must provide them, and
    - at what price; and
  - b) the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of arrangement.



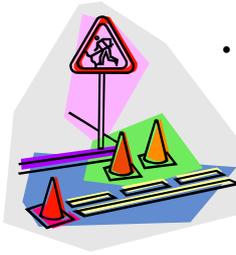
- No need to have complete control
- Sufficient for the price to be regulated, say by capping mechanism

## Scope of HK(IFRIC)-Int 12

- Infrastructure used in a public-to-private service concession arrangement for its entire useful life (whole of life assets) is within the scope of this interpretation
  - if the conditions of (a) above are met
  - in other words, the conditions of (b) above are in substance fulfilled



## Scope of HK(IFRIC)-Int 12



- This interpretation applies to both:
  - a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and
  - b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement.
- However, this interpretation does not specify the derecognition requirements,
  - i.e. does not specify the accounting for infrastructure that was held and recognised as property, plant and equipment by the operator before entering the service arrangement.
  - The derecognition requirements of HKFRS (set out in HKAS 16) apply to such infrastructure.
- This interpretation does not specify the accounting by grantors, for example, the government.

## Issues

- The interpretation sets out general principles on recognising and measuring the obligations (liabilities) and related rights (assets) in service concession arrangements.
- Requirements for disclosing information about service concession arrangements are in HK(SIC)-Int. 29 *Service Concession Arrangements: Disclosures*.
- The issues addressed in the interpretation are:
  - a) Treatment of operator's rights over the infrastructure;
  - b) Recognition and measurement of arrangement consideration;
  - c) Construction or upgrade services;
  - d) Operation services;
  - e) Borrowing costs;
  - f) Subsequent accounting treatment of a financial asset and an intangible asset; and
  - g) Items provided to the operator by the grantor.

# Consensus

## Operator's Rights over the Infrastructure

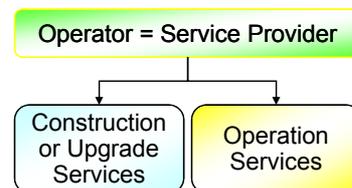
- Infrastructure within the scope of this Interpretation shall not be recognised as property, plant and equipment of the operator
  - because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator.
- The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.



# Consensus

## Recognition and Measurement of Arrangement Consideration

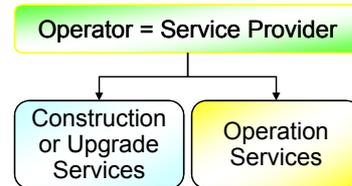
- Under the terms of contractual arrangements within the scope of this Interpretation, the operator acts as a service provider.
- The operator
  - constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and
  - operates and maintains that infrastructure (operation services) for a specified period of time.
- The operator shall recognise and measure revenue in accordance with HKASs 11 and 18 for the services it performs.



# Consensus

## Recognition and Measurement of Arrangement Consideration

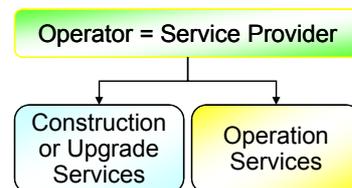
- If the operator performs more than one service (i.e. construction or upgrade services and operation services) under a single contract or arrangement,
  - consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.
- The nature of the consideration determines its subsequent accounting treatment.
  - The subsequent accounting for consideration received as a financial asset and as an intangible asset is detailed the interpretation (to be discussed)



# Consensus

## Recognition and Measurement of Arrangement Consideration

- The operator shall account for revenue and costs relating to construction or upgrade services in accordance with HKAS 11.
- The operator shall account for revenue and costs relating to operation services in accordance with HKAS 18.



HKAS 11

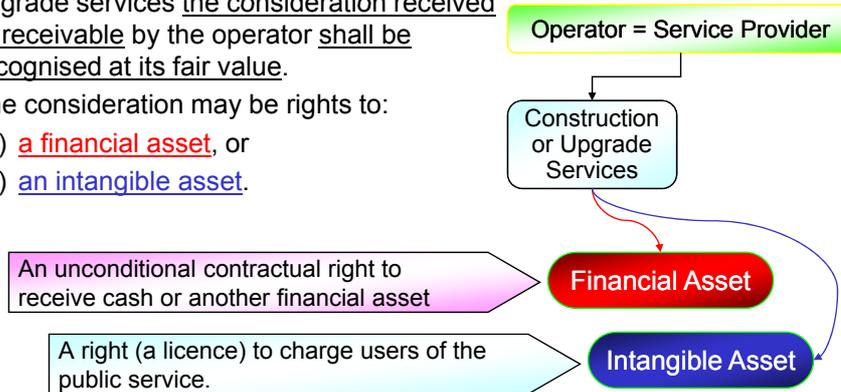
HKAS 18



# Consensus

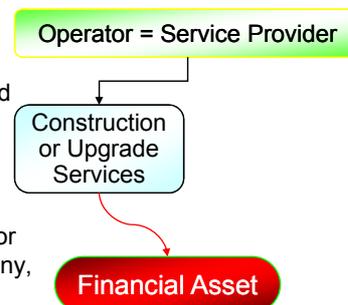
## Construction or Upgrade Services

- If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognised at its fair value.
- The consideration may be rights to:
  - a) a financial asset, or
  - b) an intangible asset.



# Consensus

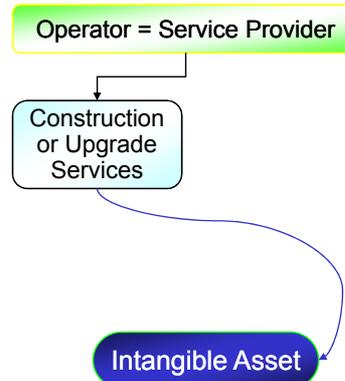
- The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services;
  - the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law.
  - The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.



## Consensus

- The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service.

- A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.

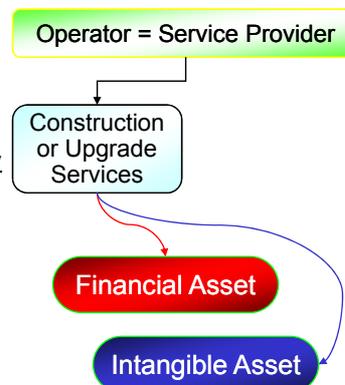


## Consensus

- If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset

- it is necessary to account separately for each component of the operator's consideration.
- The consideration received or receivable for both components shall be recognised initially at the fair value of the consideration received or receivable.

- The nature of the consideration given by the grantor to the operator shall be determined by reference to the contract terms and, when it exists, relevant contract law.



# Consensus

## Case



**China Everbright International Limited** (2006 Annual Report) considered the Interpretation and stated that:

- So far it has concluded that the adoption of them is unlikely to have a significant impact on the Group's results of operations and financial position except for HK(IFRIC) 12, *Service concession arrangements* .....

It further stated that:

- HK(IFRIC) 12 draws a distinction between two types of service concession arrangement.
- In one, the operator receives a financial asset, i.e. an unconditional contractual right to receive cash or another financial asset from the government in return for constructing or upgrading the public sector asset.
- In the other, the operator receives an intangible asset, i.e. no more than a right to charge for use of the public sector asset that it constructs or upgrades. A right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service.

# Consensus

## Case



**China Everbright International Limited** (2006 Annual Report) further clarified that:

- Certain BOT and TOT arrangements of the Group, such as the toll bridge project, waste-water treatment projects, waste-to-energy projects and methane-to-energy project, may be service concession arrangements under HK(IFRIC) 12.
- The Group has already commenced an assessment of the impact of HK(IFRIC) 12 but is not yet in a position to state the impact on the Group's results of operations and financial position.

# Consensus

## Case

### China Communications Construction Company Ltd.

Annual Report of 2006



- IFRIC 12, *Service Concession Arrangements*, effective for annual periods beginning on or after 1 January 2008, was early adopted in 2006.
- The Group is engaged in certain service concession arrangements in which the Group
  - carries out the construction work (e.g. toll highways and bridges) for the granting authority and
  - receives in exchange a right to operate the asset concerned in accordance with pre-established conditions set by the granting authority.
- In accordance with the IFRIC Interpretation 12 Service Concession Arrangement (IFRIC 12), the assets under the concession arrangements may be classified as
  - intangible assets or
  - financial assets.

# Consensus

## Case

### China Communications Construction Company Ltd.

Annual Report of 2006



- The assets are classified
  - as intangibles if the operator receives a right (a license) to charge users of the public service or
  - as financial assets if paid by the granting authority.
- The Group classified the non-current assets linked to the long-term investment in these concession arrangements as
  - “concession assets” within intangible assets classification on the balance sheet if the intangible asset model is adopted.
- Once the underlying infrastructure of the concession arrangements is completed,
  - the concession assets will be amortised over the term of the concession on a straight-line basis under the intangible asset model.

## Consensus

### Contractual Obligations to Restore the Infrastructure to a Specified Level of Serviceability

- The operator may have contractual obligations it must fulfil as a condition of its licence
  - a) to maintain the infrastructure to a specified level of serviceability or
  - b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement.
- These contractual obligations to maintain or restore infrastructure (except for any upgrade element), shall be recognised and measured in accordance with HKAS 37, i.e. at the best estimate of the expenditure that would be required to settle the present obligation at the balance sheet date.



## Consensus

### Borrowing costs incurred by the operator

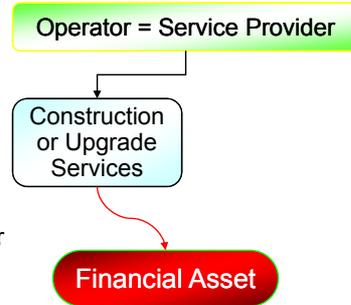
- In accordance with HKAS 23, borrowing costs attributable to the arrangement shall be recognised as an expense in the period in which they are incurred
  - unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service).
- In this case borrowing costs attributable to the arrangement shall be capitalised during the construction phase of the arrangement in accordance with HKAS 23.



# Consensus

## Financial Asset

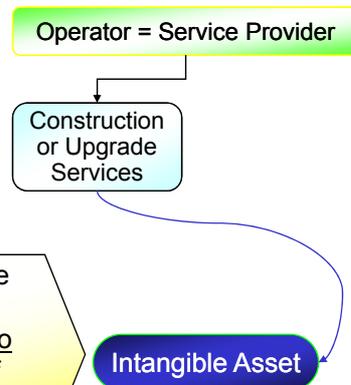
- HKASs 32 and 39 and HKFRS 7 apply to the financial asset recognised under this Interpretation.
- The amount due from or at the direction of the grantor is accounted for in accordance with HKAS 39 as:
  - a) a loan or receivable;
  - b) an available-for-sale financial asset; or
  - c) if so designated upon initial recognition, a financial asset at fair value through profit or loss, if the conditions for that classification are met.
- If the amount due from the grantor is accounted for either as (a) or (b) as above, HKAS 39 requires interest calculated using the effective interest method to be recognised in profit or loss.



# Consensus

## Intangible Asset

- HKAS 38 applies to the intangible asset recognised in accordance with this Interpretation.
- HKAS 38 provide guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets.



In accordance with IAS 38 Intangible Assets, the operator recognises the intangible asset at cost i.e. the fair value of consideration transferred to acquire the asset, which is the fair value of the consideration received or receivable for the construction services delivered.

# Consensus

## Case

### **MTR Corporation Limited** (2007 Circular)

- As part of the Rail Merger, the Company will be required to pay the Upfront Payment.
- This Upfront Payment, net of the consideration for the Purchased Rail Assets, will be capitalised as a service concession asset under Hong Kong (IFRIC) 12 “Service Concession Arrangements” and amortised over the term of the Concession Period. (page 38)

# Consensus

## Case

### **MTR Corporation Limited** (2007 Circular)

- Under the terms of the SCA, the tangible assets that form part of the railway network are subject to a service concession arrangement whereby MTRC will have the right to access, use and operate these assets. These tangible assets comprise of tangible assets that exist on the date of the proposed Rail Merger (“Initial Concession Property”) and those assets that are subsequently acquired after the date of the proposed Rail Merger (“Additional Concession Property”).
- Ownership of the Initial Concession Property will remain with KCRC.
- As the Initial Concession Property assets will not be acquired by MTRC under the terms of the Transaction Documents, they will continue to form part of KCRC’s fixed assets.
- Under HK(IFRIC) 12 “Service Concession Arrangements”, MTRC would not recognise such railway assets on its balance sheet and would recognise a service concession asset in respect of payments to acquire the right to operate the railway assets of KCRC.
- Accordingly, the railway assets of KCRC would remain recognised in KCRC’s financial statements as fixed assets. (Page VII-7)

# Consensus

## Case

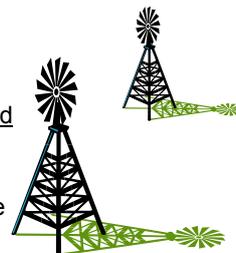
### MTR Corporation Limited (2007 Circular)

- Recognition of a service concession asset at carrying value of HK\$15,335 million upon application of HK(IFRIC) 12 “Service Concession Arrangements” in respect of:
  - the acquisition of initial concession assets of HK\$14,847 million which comprise of
    - upfront payment of HK\$3,895 million (HK\$4,250 million less consideration of HK\$355 million for the acquisition of certain stores and spares);
    - the net present value of the fixed annual payments of HK\$750 million discounted at an interest rate of 6.75%, which is the estimated incremental cost of borrowing for the Company for the long-term, amounting to HK\$10,687 million;
    - the assumption of certain obligations of KCRC in the amounts of HK\$265 million by the Company forming part of the cost of acquiring the service concession asset;
  - the capitalisation of costs of HK\$389 million previously incurred by the Company and classified as “deferred expenditure” which are directly attributable to the cost of acquiring the service concession asset; and
  - the assumption of certain liabilities of a capital nature amounting to HK\$99 million representing additional concession property acquired on the merger date. (Page VII-10)

# Consensus

## Items provided to the operator by the grantor

- Infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognised as property, plant and equipment of the operator.
- The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes.
  - If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in HKAS 20.
  - They are recognised as assets of the operator, measured at fair value on initial recognition.
  - The operator shall recognise a liability in respect of unfulfilled obligations it has assumed in exchange for the assets.



## Effective Date and Transition

- An entity shall apply this Interpretation for
  - annual periods beginning on or after 1 January 2008.
- Earlier application is permitted.
- If an entity applies this Interpretation for a period beginning before 1 January 2008,
  - it shall disclose that fact.



## Effective Date and Transition

- Subject to the operator's impracticability to apply this interpretation, changes in accounting policies are accounted for in accordance with HKAS 8,
  - i.e. retrospectively.
- If, for any particular service arrangement, it is impracticable for an operator to apply this Interpretation retrospectively at the start of the earliest period presented, it shall:
  - a) recognise financial assets and intangible assets that existed at the start of the earliest period presented;
  - b) use the previous carrying amounts of those financial and intangible assets (however previously classified) as their carrying amounts as at that date; and
  - c) test financial and intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts shall be tested for impairment as at the start of the current period.

# Intangible Assets & Service Concession

26 June 2008

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



Nelson Lam 林智遠  
nelson@nelsoncpa.com.hk  
www.nelsoncpa.com.hk

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135

# Intangible Assets & Service Concession

26 June 2008

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Nelson Lam 林智遠  
nelson@nelsoncpa.com.hk  
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136