

Distinctive Financial Reporting

FAC3702



Study unit 4
Intangible assets

Overview

- Terminology
- Recognition & initial measurement of intangible assets
- Cost of internally generated intangible asset
- Recognition of an expense
- Measurement after recognition
- Useful life
- Recoverability of the carrying amount
- Retirements and disposals
- Disclosure
- Tax

Definitions

- Intangible asset
 - Identifiable non-monetary asset
 - Without physical substance
- Research
 - Original & planned investigation
 - Prospect to gain new scientific /technical knowledge and understanding
- Development
 - Application of research findings or other knowledge
 - To plan/design new/substantially improved materials, devices, products, processes, systems or services
 - Prior to commencement of commercial production/use.
- Amortisation
 - Systematic allocation of depreciable amount of an intangible asset over its estimated useful life.

(Similar to depreciation – refer to SU1)

Intangible asset

- Intangible
 - Identifiable
 - Non-monetary asset
 - Without physical substance
- Asset
 - Controlled as result of past event
expected inflow of future economic benefits

Definition not met → expense

Recognition & Initial measurement

- Recognition
 - Meet definition of 'intangible asset'
 - Probable – expected future economic benefits attributable to asset will flow to entity
 - Cost of asset can be measured reliably.
- Measurement
 - Initially @ cost

Cost

- Separate acquisition
 - Purchase price (incl. import duties, non-refundable taxes, discounts and trade rebates)
 - Directly attributable costs of preparing asset for intended use
 - E.g. cost of employee benefits, professional fees, testing
 - **NOT general overheads, extended credit terms (use cash value)**
- Part of business combination
 - Fair value at date of acquisition (IFRS3)
 - Distinguish from goodwill
 - In-process research & development
- Government grants
- Exchange of assets

Example 1

- Company acquires the right to a certain patent and incur various costs. Purchase price will be settled in shares. Need to calculate cost.
 1. Calculate the fair value of shares in the settlement date – trading price x # shares.
 2. Add the VAT exclusive amounts of directly attributed expenses.
(Assuming the company is registered for VAT and entitled to input tax deductions)

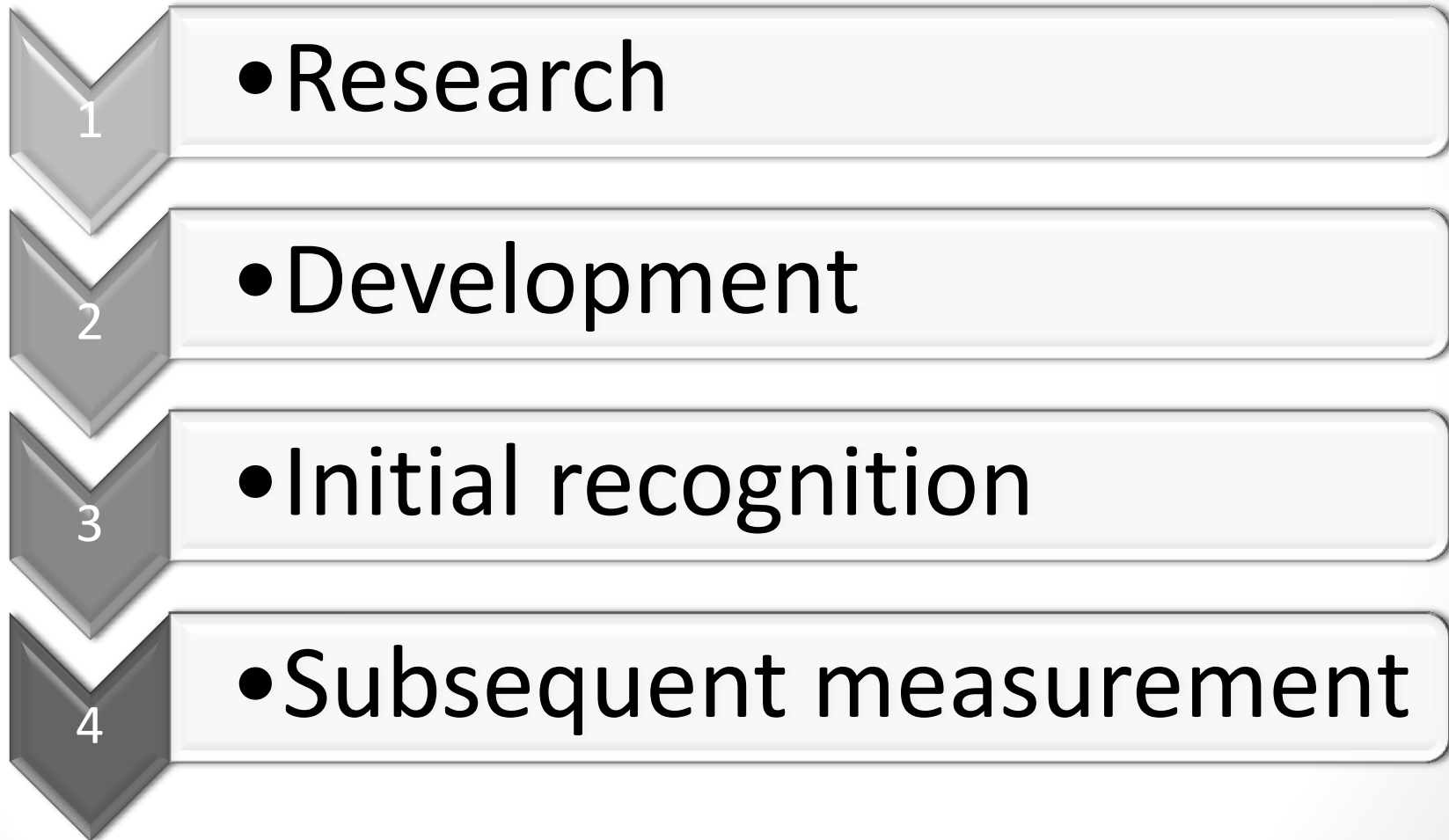
Internally generated goodwill

- Not recognised as asset
 - Not identifiable resource

Internally generated intangible assets

- Research
 - Not recognised as asset – expense costs
 - Economic benefits not yet probable
- Development - Need to demonstrate ALL of the following
 - Technical feasibility - completion
 - Intention to complete – use/dispose
 - Ability to use or sell
 - Generation of probable future economic benefits.
 - Existence of a market , or
 - if it is to be used internally, the usefulness of the intangible asset.
 - Adequate technical, financial and other resources to complete the development, and to use or sell the intangible asset.
 - Ability to measure the expenditure attributable to the intangible asset during its development reliably.

Internally generated intangible assets



Internally generated intangible assets

Cost

- All directly attributable costs
 - NECESSARY to create, produce & prepare asset
 - To be capable of operating
 - Manner intended by management
- Examples
 - Material & services used in generating asset
 - Employee benefits (salaries etc)
 - Fees to register legal right
 - Amortisation of patents/licences used to generate asset
- NOT
 - General overheads
 - Training expenses
 - Clearly identifies inefficiencies
 - Initial operating losses before asset achieves planned performance

Example 3

Recognition as expense

- Expense costs when incurred, UNLESS
 - Forms part of intangible asset's cost
 - Business acquisition –goodwill
- Examples
 - Research costs
 - Start up activities
 - Training
 - Advertising & promotions
 - Relocation & re-organisation costs
- Expenses item CANNOT form part of intangible asset cost at later date.

Measurement AFTER recognition

- Cost
 - Cost less accumulated amortisation
- Revaluation
 - Fair value less subsequent accumulated amortisation
 - Fair value – active market
 - Not allow
 - Revalue intangible assets not previously recognised as assets
 - Initial recognition @ value other than cost
 - Accumulated amortisation @ date of revaluation
 - Restate proportionately with change in **gross carrying amount**
 - Carrying amount of asset = revalued amount OR
 - Eliminated against gross carrying amount of asset
 - Net amount restates to revalued amount of asset

[Example 4]

Useful life

- Contractual or other legal right
 - Limited to period of right
 - Renewable
 - Include renewal periods only if renewal without significant cost

Finite useful life

- Allocate depreciable amount over this period
 - From date **available** for use
 - Cease
 - Classified as 'held for sale'
 - Asset derecognised
- Amortisation per period
 - Pattern of economic benefits or straight line
 - Recognise in profit/loss

[Example 5

Residual value

- Assumed to be NIL, unless
 - Commitment by 3rd party to purchase @ end of life
 - Active market for asset
 - Residual value determinable
 - Probable that market will exist at end of useful life
- Residual value > carrying amount
 - Amortisation = nil

Indefinite useful life

- Test for impairment
 - Annually
 - Whenever indication of possible impairment
- Review useful life each period
 - Indefinite → definite : indication of possible impairment

Retirement and disposals

- Derecognise
 - Disposal
 - No future economic benefits expected from disposal or use of asset

[Example 6]

Disclosure - General

- **Study guide p 151 – 153 NB!!!!**
- General
 - Useful life indefinite or definite (useful life & amortisation rate)
 - Finite – amortisation method
 - Gross carrying amount & accumulated amortisation (Beg & End)
 - P/L – amortisation
 - Reconciliation carrying amount begin & end
 - Additions
 - Held for sale
 - Increases/decreases – revaluation and impairments
 - Impairment losses – P/L
 - Impairment reversals – P/L
 - Amortisation recognised in period
 - Net exchange differences
 - Other changes in carrying amount

Disclosure – General (2)

- Information re impaired intangible assets
- Nature & amount of change in accounting estimate
 - Assessment of useful life
 - Amortisation limit
 - Residual values
- Indefinite useful life
 - Carrying amount
 - Reasons why useful life is regarded as indefinite
- Material intangible assets
 - Description, carrying amount & remaining amortisation period
- Restricted intangible assets
- Grants
- Contractual commitments – acquisition of intangible asset

Disclosure

REVALUATION

- Revaluation
 - Effective date of revaluation
 - Carrying amount of revalued intangible assets
 - Carrying amount if asset was not revalued
- Revaluation surplus
 - Begin, end, movement & restrictions
- Method & significant assumptions

RESEARCH & DEVELOPMENT EXPENDITURE

- Total R&D expense recognised during period

TAX

Tax calculation

- Profit before tax
- Exempt differences
- Temporary differences
 - Amortisation
 - Impairment loss
 - Tax allowance on intangible asset
- Taxable income

- Tax (TI x tax rate)

Patents, designs, copyrights, knowledge S11(gC)

- Deduct expenditure actually incurred to acquire
 - **Invention/patent**
 - **Design**
 - **Copyrights**
 - **Other property of similar nature (other than trade marks)**
 - **Knowledge re above**
- Deduction
 - < R 5 000 deduct immediately
 - > R 5 000
 - **5% pa**
 - **10% pa**
- Not proportioned for part of year
- Acquired from connected person
 - Deduction based on lesser of cost for CP or market value

Research & development

S11B

- R&D conducted in RSA
 - Result/potentially result identifiable intangible asset
 - Exclude
 - Social sciences, arts, humanities or management
 - Market research, sales or marketing promotion
- Deduction
 - Expenditure actually incurred in year of assessment
 - Iro R&D undertaken directly by taxpayer, or
 - Payment to other person for R&D obo taxpayer
 - Registration of invention etc
 - Obtaining extension of period of legal protection/registration period etc.
- Allowance
 - Building/machinery/plant/implement/utensil/other capital used for purposes of R&D
 - 40% of cost of that asset in year brought into use
 - 20% in subsequent years

Scientific/technological R&D

S11D

- 150% expenditure actually incurred
 - Activities in SA
 - Discovery – novel/practical & non-obvious information
 - Devising/developing/creation of any invention (patent), design, computer program or knowledge essential to the use thereof
 - Scientific/technological nature
 - Intended to be used in production of income
- Assets
 - 50/30/20 of cost from year brought into use
 - Owned by taxpayer
 - Brought into use solely for purpose above
 - Not previously used by anyone else
 - Intended to be used in production of income
- Exclusions – listed p 148

Registration of intellectual property

S11(gB)

- Obtaining, restoration, extension, registration or renewal
- Deductible
 - Expense in year actually incurred
 - If in production of income
 - Also exp incurred under similar laws in other country
- Deduction iro registration/renewal of trademark
 - NOT acquisition thereof

Comprehensive example

p149

Approaching the question

- 1) READ REQUIRED
- 2) Time line
 - 1/1/05 – 28/2/05 (*Research motor engine electronic component*)
 - 1/3/05 – 30/8/05 (*Develop MEEC*)
 - 1/6/05 – 31/12/05 (*Research swimming pool component*)
- 3) Identify costs to be allocated
 - 3) Laboratory maintenance
 - 4) Water, electricity and service
- 4) Calculate costs to R@D
 - Engineers : #, time spent (p149)
 - Laboratory technicians (p150)
 - Consumables – based on number of months
 - Costs identified in (3)
 - Depreciation on R&D equipment used

Approaching the question (2)

- 5) Amortisation of development cost
 - Development cost/expected # unit sales x period
- 6) Employee benefit cost
 - Total employee benefit cost (salaries)
 - Less: allocated to research cost
 - Less: allocated to development cost
- 7) Depreciation of R&D Equipment
 - Total provision (Cost x ratio)
 - Less: Allocated amount (calc 4)
- 8) Depreciation – plant & machinery
 - $[(\text{Cost} - \text{residual value})/\text{useful life}] \times \text{period used}$
- 9) Allocation of depreciation
 - Provided for the year (Calc 7+8)
 - Less: allocated to research costs (calc 4)
 - Less: Capitalises as development cost (calc 4)

Approaching the question (3)

10) Impairment loss

- Recoverable amount – value in use (given)
- Carrying amount on 31/12/05
 - Development cost (*calc 4*) – amortisation (*calc 5*)

DISCLOSURE

11) Notes – accounting policy

- 11) Internal generated intangible assets – development costs
- 12) Research costs
- 13) PPE
- 14) Impairment of non-financial assets

12) Profit before tax (know format)

13) PPE

14) Internal generated intangible asset