GOODWILL AND INTANGIBLE ASSETS: ASPE 3064

Definition

- An **intangible asset** is an **identifiable** non-monetary asset **without physical substance** that the entity has **control** over
- **identifiable**
    - The definition of an intangible asset requires an intangible asset to be identifiable to **distinguish it from goodwill**.
    - An asset is identifiable if it either:
        a) is **separable**, is capable of being separated from the entity and sold, transferred, licensed, rented or exchanged; or
        b) arises from **contractual or other legal rights,** regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
- **Control =** entity has the power to obtain the future economic benefits flowing from the asset

Recognition and measurement

- An item is recognized as an intangible asset, if it meets the following :
    - It meets the **definition of an intangible asset (identifiable/control)**; **and**
    - It meets the recognition criteria:
        (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 intangible asset is measured initially at cost

Separate acquisition

- The cost of a separately acquired intangible asset comprises:
    - its **purchase price**, including **import duties** and **non-refundable purchase taxes**, after deducting **trade discounts and rebates**; and
    - any **directly attributable cost** of preparing the asset for its intended use

- Examples of directly attributable costs are:
    - costs of employee benefits arising directly from bringing the asset to its working condition;
    - professional fees arising directly from bringing the asset to its working condition; and
    - costs of testing whether the asset is functioning properly.

- Examples of expenditures that are not part of the cost of an intangible asset are:
    - costs of introducing a new product or service (including costs of **advertising and promotional activities**);
    - costs of conducting business in a new location or with a new class of customer (including costs of **staff training**); and
    - administration and other general overhead costs

Internally generated goodwill

- **Goodwill** is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized

- Internally generated goodwill shall not be recognized as an asset

Internally generated intangible assets

- To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:
  - a research phase; **and**
  - a development phase
- **Research**
  - original and planned investigation undertaken to gain new scientific or technical knowledge and understanding
  - expenditure on research is **expensed**
  - examples of research activities:
    - activities aimed at obtaining new knowledge;
    - the **search** for, **evaluation** and **final selection** of research findings/other knowledge;
    - the **search** for alternatives for materials, devices, products, processes, systems or services; and
    - the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.
- **Development**
  - 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
  - under ASPE, you can **capitalize or expense** expenditures during the development phase
  - An intangible asset arising from development can only be capitalized if **all** of the following are met:
    1. the **technical feasibility** of completing the intangible asset so that it will be available for use or sale.
    2. its **intention to complete** the intangible asset and use or sell it.
    3. its **ability to use or sell** the intangible asset.
    4. how the intangible asset will generate probable **future economic benefits**
       - **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**
    5. the availability of **adequate technical, financial and other resources** to complete the development and to use or sell the intangible asset.
    6. its ability to **measure reliably the expenditure** attributable to the intangible asset during its development.
  - If an entity cannot distinguish the research phase from the development phase, the entity treats the expenditure as if it were incurred in the research phase only
  - Examples of development activities are:
    - the design, construction and testing of prototypes and models;
    - the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
    - the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

  - **Internally generated brands**, **mastheads**, **publishing titles**, **customer lists** and items similar in substance are not recognised as intangible assets (these are expensed)

What do you capitalize as development costs?

- costs of materials/services used to generate the intangible asset
- costs of employee salaries, wages and benefits to generate intangible asset
- fees to register a legal right
- amortization of patents and licenses used to generate the intangible asset
- interest costs when the entity's accounting policy is to capitalize interest costs

What not to capitalize as development costs?

- selling, administrative and other general overhead expenditure **unless** this expenditure can be directly attributed to preparing the asset for use;
- cost of training staff to operate the asset.

Recognition of an Expense

- Expense development costs, where **policy choice** is to expense
- Expenditures that are incurred that provide future economic benefits but for which no intangible asset is set up are to be expensed
- Examples include:
  - Research costs
  - Start-up costs
    - Establishment costs such as legal and secretarial costs incurred in establishing a legal entity,
    - expenditure to open a new facility or business (i.e. pre-opening costs)
    - expenditures for starting new operations
    - launching new products or processes (i.e. pre-operating costs)
  - training costs
  - advertising and promotional activities
  - relocating costs
  - reorganization costs
- Expenditure on an intangible item that was initially recognized as an expense (i.e. initially did not meet criteria to capitalize) shall not be capitalized at a later date.

Measurement after recognition

Intangible assets with finite useful lives

- Intangible assets with finite useful lives need to be **amortized**
- Amortization expense = (cost – residual value)/useful life
- Residual value
  - The residual value is assumed to be $NIL unless at the end of the useful life, the asset is expected to have a useful life to another entity and;
    - There is a commitment from a 3rd party to purchase it @ end of useful life; or
    - Residual value can be determined by referring to transactions in an existing market, and the market is expected to exist at the end of the useful life
- The method of amortization should reflect the pattern in which the economic benefits are consumed form the intangible asset; if pattern cannot be determined use **straight line method**
- Must review amortization method and useful life at each year end

Intangible assets with indefinite useful lives

- An intangible asset with an indefinite useful life is not amortized
- Intangible asset with indefinite useful life shall be **tested for impairment** whenever events indicate that its carrying amount may exceed its fair value
- Impairment loss = fair value less carrying value
- **Impairment loss is not reversed** if the fair value subsequently increases

Goodwill

- Goodwill is recognized at the initial cost less any impairment
- Internally generated goodwill is not recognized (i.e. capitalized)
- Goodwill is not amortized
- Goodwill is tested for impairment whenever events indicate that carrying value > fair value
- **How to test for goodwill impairment**
  - When the **carrying amount** of a **reporting unit**, including goodwill, **exceeds its fair value** a goodwill impairment loss shall be recognized in an amount equal to the excess
  - The goodwill impairment loss recognized shall not exceed the carrying amount of goodwill
  - A goodwill impairment loss shall **not be reversed**
- A reporting unit is the level of reporting at which goodwill is tested for impairment; and is either an **operating segment** or a **component of an operating segment**
  - **A component** constitutes a business for which separate financial information is available and management regularly reviews its operating results
  - **An operating segment** is a part of an enterprise:
    - that engages in business from which it may earn revenues and incur expenses
    - for which operating results are regularly reviewed by management
    - for which discrete financial information is available

Comparison to IFRS

- Revaluation model is available under IFRS
- Under IFRS you must capitalize development costs that meet the 6 criteria
- Under IFRS, the impairment testing is to be done annually and whenever events indicate
- Impairment losses can be reversed under IFRS
- Goodwill impairment testing is covered in IAS 36 and the concept is different