



ACCOUNTING INTANGIBLE ASSETS

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AUGUST 31, 2021

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INTANGIBLE ASSET (IAS 38)

An intangible asset has been categorized by the International Accounting Standards (IAS) as IAS 38 so as to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another IFRS.

An intangible asset is defined under International Financial Reporting Standards (IFRS®) as an identifiable, non-monetary asset without physical substance. Intangible assets are identified separately on a company's financial statements, and come in two primary forms: legal intangibles and competitive intangibles.

Legal intangibles are also known as intellectual property, and include trade secrets, copyrights, patents, and trademarks. An example would be Coca-Cola's drink formula which is a closely held trade secret that only a few employees know; this is an example of an internally developed intangible asset.



Competitive intangibles include collaboration, leverage, structural activities, and customer loyalty. Human capital is the primary source of competitive intangibles.

To sum up, each intangible asset has **3 main characteristics**:

(a) Identifiable

For an intangible asset to be identifiable, this means that it must be separable or arise from legal/contractual rights.

Separable intangible assets will be items that can be separated from the entity as a whole, meaning that they could be acquired from the entity without having to acquire the entire company. Items which may be categorized as separable intangible assets are commonly items such as licenses or patents where one entity can acquire the rights from another.

In addition to this, brand names are also likely to be separable. A company may operate many different product lines and may be willing to sell one of those brands, which could be done without selling the entire company. It is important to note that internally generated brands cannot be capitalized (i.e. recognized on the statement of financial position).

(b) Non-monetary asset

Non-monetary assets are assets whose value frequently changes in response to changes in economic and market conditions and is not easily convertible to cash or

cash equivalents in the short term. An illustration to this is from the above example of the Coca-Cola brand whose value is tied to the drink and the fluctuations in the market conditions or market perception which are abstract concepts may lead to the increase or decrease of the value and more to this, it is hard to determine the actual monetary value of the brand.

This is unlike bank accounts or long-term investments where a fixed amount will be received and will not qualify as intangible assets because these are monetary assets. Items such as trade receivables or loan receivables are not accounted for under IAS 38, even though they do not have physical substance. Another major asset you cannot physically touch could be an investment in shares in a company.

(c) Without physical substance

To keep it simple, the items covered under IAS 38 are items you cannot touch and they cannot be associated with any physical object owned by a business. They are often technology-based. Therefore, this can include brand names, development costs related to research and development, patents, goodwill and similar items where all the company may physically hold is a legal document rather than a physical item.

Initial recognition of intangible assets

Once it has been determined that an item meets the definition of an intangible asset, the entity must determine whether it meets the recognition criteria. An intangible asset can only be recognized if it is probable that the expected future economic benefits (e.g. revenue from the sale of products or services) that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

How will you recognise the intangible asset?

(a) Purchased intangible assets

The initial recognition rules of intangible assets under IAS 38 are relatively simple. If an asset has been purchased, it will be recognized initially at cost.

(b) Internally generated intangible assets

Generally, internally generated intangible assets cannot be capitalized. The reason why internally generated intangible assets cannot often be capitalized is that it is difficult to establish the true benefit from the asset or even to establish specific costs that can be attributable to items such as brand names. In addition to this, internally generated brands are specifically prohibited from being recognized. This has created a problem where some of the major assets in modern businesses can go unrecognized even though they meet the qualifying criteria for recognition.

(c) Research and development costs

There is realistically one internally generated intangible asset that can be capitalized. These are development costs, where entities incur costs in order to develop new product lines or production methods. These can be capitalized from the point where six development criteria are met. The six criteria can be more easily memorized using the PIRATE mnemonic.

- Probable economic benefits
- Intention to complete the project
- Resources available to complete the project
- Ability to use or sell the item
- Technologically feasible
- Expenses on the project can be identified



If the six criteria are met, then the entity can recognize an asset at cost. A key principle here is that costs can only be recognized as an asset from the point all six are met, up to the date that the project is complete. Any costs incurred before the criteria are met are expensed to the statement of profit or loss as they are incurred. Similarly, any costs associated with research into a new product will be incurred much earlier than the six criteria being met, so these would also be expensed.

EXAMPLE:

Res Co are developing a new line of pharmaceuticals and have spent Tsh200,000,000 up to 1 January 2020. On 1 January 2020 the board gave approval to fully fund the rest of the project following promising results and spent a further Tsh60,000,000 to 1 April 2020. On 1 April 2020 problems were discovered in the trials and approval was not given from the medical regulator for use of the pharmaceuticals. Res Co spent a further Tsh30,000,000 to 1 July 2020, at which point approval was given. From 1 July 2020 to 1 October 2020 Res Co spent Tsh300,000,000 putting the product into the final finished stage of development. The new pharmaceuticals are expected to generate revenues in excess of Tsh2,400,000,000 and have a useful life of five years.

In the financial statements of Res Co, only Tsh300,000,000 of expenditure could be capitalized, as it is only from 1 July 2020 that all of the development criteria are met. Even though the asset is likely to generate significant benefit and a total of Tsh590,000,000 of costs have been incurred as part of research and development, the previously expensed costs cannot be recognized as assets.

As mentioned above that in order to recognize costs spent on research and development as an asset they should match these criteria, but from the example Tsh290,000,000 are not recognized as an asset because it was not probable at that time if it will generate future economic benefits.