Introductory Course on IFRS

Organized by the
Young Members Empowerment Committee
Of
The Institute of Chartered Accountants of India

Presented by:
CA. Achin Poddar
(ACA, B.com. (H))

Intangible Assets – IAS 38

Objective and Scope

Objective: Prescribe accounting treatment for intangible assets not dealt with specifically in Standard

Scope: Applied to all intangible assets except:

(a) within the scope **of another Standard**;

(b) **financial assets (**IAS 32);

(c) the recognition and measurement of **exploration and evaluation assets** (IFRS 6); and

(d) expenditure on the **development and extraction of minerals, oil, natural gas** and similar non-regenerative resources.

Objective and Scope

Intangible Assets in Tangible Asset

- Management Judgement
- More Significant

Example:

- Computer Software in Compact Disc
- Legal Documentation for License

Lets do the party!

Entity X dealing in computer software is holding computer software worth Rs. 250 Crore for the purpose of sale in ordinary course of action. On closing date Entity X valued the software at Fair Value following the revaluation model as per IAS 38. Comment.

Lets do the party!

Entity X enters into an agreement with Entity Y whereby the Y conveys to the Entity X in return for a monthly payment of Rs. 50 Lacs the right to use its Know-how for next 10 years.

Advise entity X how to account for the agreement.

Definitions

- **Cost** is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset

- **Monetary assets** are money held and assets to be received in fixed or determinable amounts of money.

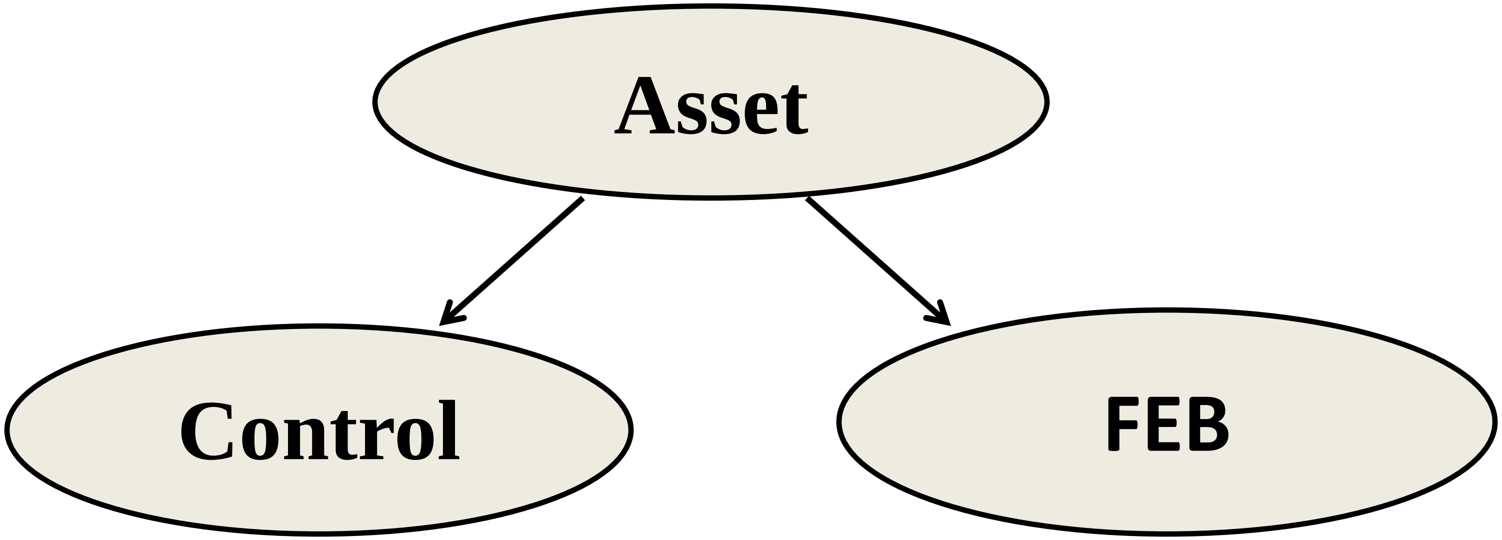
Definitions

- **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.

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

Intangible Assets

An **intangible asset** is an **identifiable non-monetary** asset without **physical substance**.



Identifiable

- To distinguish from Goodwill
  - Future economic benefits from the assets not separately identified

Identifiable if either:

(a) **Separable,** ie is capable of being separated or divided from the entity regardless of entity intentions; or

(b) arises from **contractual or other legal rights**, regardless of transferability or separability

Control and FEB

CONTROL

- Power to obtain FEB flowing from the underlying resources
- Restrict the access of other

FEB

- Revenue from Sale of product or service
- Cost savings
- Other Benefits

Lets do the party!

Company X providing consultancy services is having a very good team of skilled staff because of which Company X is charging 5% above the market rate for the service. Mr. Samajhdar, CFO, X Ltd. while finalising annual accounts argued that the skilled staff should be reflected as an intangible asset as it meets all the criteria of Intangible Asset given in IAS 38. Comment.

Recognition Criteria

Recognised If, and only if:

(a) Probable expected future economic benefits will flow to the entity; and

(b) the cost can be measured reliably.

Future economic benefits made using reasonable and supportable assumptions over useful life: Estimate of Economic Conditions

Initial Recognition: At **Cost**

Separate Acquisition

- **Meet recognition criteria:** Price paid will reflect probability of FEB and measurability
- Cost : (i) Purchase Price plus duties and taxes
  (ii)directly attributable costs **necessary** to bring the asset to its intended use
- **Recognition of cost ceases** when the asset is in condition capable of being operated for its intended use
- **Deferred payment:** Adjust finance element value at cash price equivalent

Asset Acquired in Business Combination

- Separate from goodwill at ADFV
- Recognised even if not recognised previously. Eg. In-process R&D
- Intangible Asset **recognised separately or in combination** with other assets when they are linked
- Group of complementary assets may be grouped as a single asset Eg. Brand name may represent trade marks and other marks

Other Acquisitions

Govt. Grant

- **Two options** to recognise
  a) Recognise both at fair value OR
  b) recognise at nominal value

- Examples – airport landing rights, license for radio

Exchange of Assets

- Value at **fair value** unless:
  a) the exchange lacks **commercial substance** OR
  b) the fair values of both cannot be **reliably measured**
  carrying amount of the asset given up

- If both reliably measured: Asset given up

Internally Generated Intangible

Research Phase

- **No intangible asset recognised** : as cannot demonstrate expected FEB

Development Phase

- recognised if, and only if, can demonstrate:

  (a) **technical feasibility** of completing

  (b) **intention to complete** and **use** or **sell** it

  (c) **ability to use or sell** the intangible asset

  (d) how **FEB** will be generated

  (e) **availability of adequate TFO resources**

  (f) **ability to measure reliably** the expenditure

Internally Generated Intangible

- Internally generated **goodwill** shall not be recognized: not separable
- Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.
- Prohibit reinstatement of expenditure previously recognised as an expense.

Internally Developed Website Costs (SIC32)

- Passes through various stages:
  a) Planning
  b) Application and Infrastructure Development
  c) Graphical Design Development and
  d) Content Development

- Account for similar to internally Generated Intangibles

- Consider future economic Benefits

Lets do the party!

Company X has undertaken a research project to develop a new formula to reduce the cost of production of its product. During the year company established and arrange all resources (TFO) to undertake the research work. It also estimated reliably the total expenditure to undertake research.

Comment.

Measurement

Subsequent Measurement

Cost Model

OR

Revaluation Model

Apply consistently to an entire class of Intangible Assets

Cost Model : Cost

(-) amortisation

(-) impairment

Revaluation Model

Measure at:

Fair value (-) Amortization (-) Impairment losses

Key points

i) Fair value shall be measured with reference to an **active market**
ii) **Regularity** to ensure that the CA $<$ FV (end of reporting period)
iii) **No active market**: at cost
iv) **Subsequent no active market**: Revalued amount at last date of revaluation

Treatment of Revaluation Gain or loss

Revaluation Gain

- 1st = Revaluation Reserve through OCI
- Subsequent = i) Previous loss in P or L

  ii) Revaluation Reserve (OCI)

Revaluation Loss

- 1st= Trf. to P or L
- Subsequent= i) Revaluation Reserve

  ii) P or L

Derecognised= directly t/f to retained earnings

Useful Lives

Finite life

a) By no. of years or units of production

b) Amortised over the useful life

Indefinite not infinite

a) No foreseeable limit to net cash inflows

b) No amortisation since useful life is indefinite

c) IAS 36

Amortisation – Finite Useful Life

Amortisation: systematic allocation of the depreciable amount of an asset over its useful life

Depreciable Amount – cost or other amount substituted less its residual value

Amortisation Method – Method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If not determine, then SLM.

Amortisation – Finite Useful Life

Amortisation begins - When asset becomes available for use ie. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management

Amortisation ceases:

- On disposal
- On the asset classified as held for sale
- When residual value is more than carrying amount
- When there is no production under usage methods

Amortisation Cost shall be recognised in profit or loss

Revision in Estimates Change in accounting policy

Derecognition of Intangible Assets

When Derecognised

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

Gain/loss on derecognition

- Included in profit or loss (unless IAS 17 requires otherwise on a sale and leaseback).
- Gains shall not be classified as revenue.

Deferred Credit Term for disposal

Implicit Interest Income accounted per IAS 18 Revenue

Disclosure Requirements

- ✓Disclosure by internally generated intangible assets
- ✓Useful Lives – finite or indefinite. If finite useful lives/ amortisation rates
- ✓Amortisation method
- ✓Gross Carrying Amount, Accumulated Amortisation
- ✓For **indefinite useful lives – reasons** for classification
- ✓the amount of **contractual commitments** for the acquisition of intangible assets

Q&A

Presented by

CA Achin Poddar

ACA, B.Com (H)

+9555703168

+9971687101

poddarachin@gmail.com

Introductory Course on IFRS

Organized by the
Young Members Empowerment Committee
Of
The Institute of Chartered Accountants of India

Presented by:
CA. Achin Poddar
(ACA, B.com. (H))

Impairment of Assets
IAS 36

Objective

The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount.

Scope

Applied for all assets, other than:
(a) inventories (see IAS 2 *Inventories);*
(b) assets arising from construction contracts *;*
(c) deferred tax assets (see IAS 12 *Income Taxes);*
(d) assets arising from employee benefits *;*
(e) financial assets that are within the scope of IFRS 9*;*
(f) investment property that is measured at fair value;
(g) biological assets measured at F.V*;*
(h) intangible assets, arising from under IFRS 4*; and*
(i) held for sale (IFRS 5)

Impairment Loss

An **impairment loss** is

- the **amount** by which the
- **carrying amount** of an asset or a cash-generating unit **exceeds**
- its **recoverable amount**

Impairment - Steps

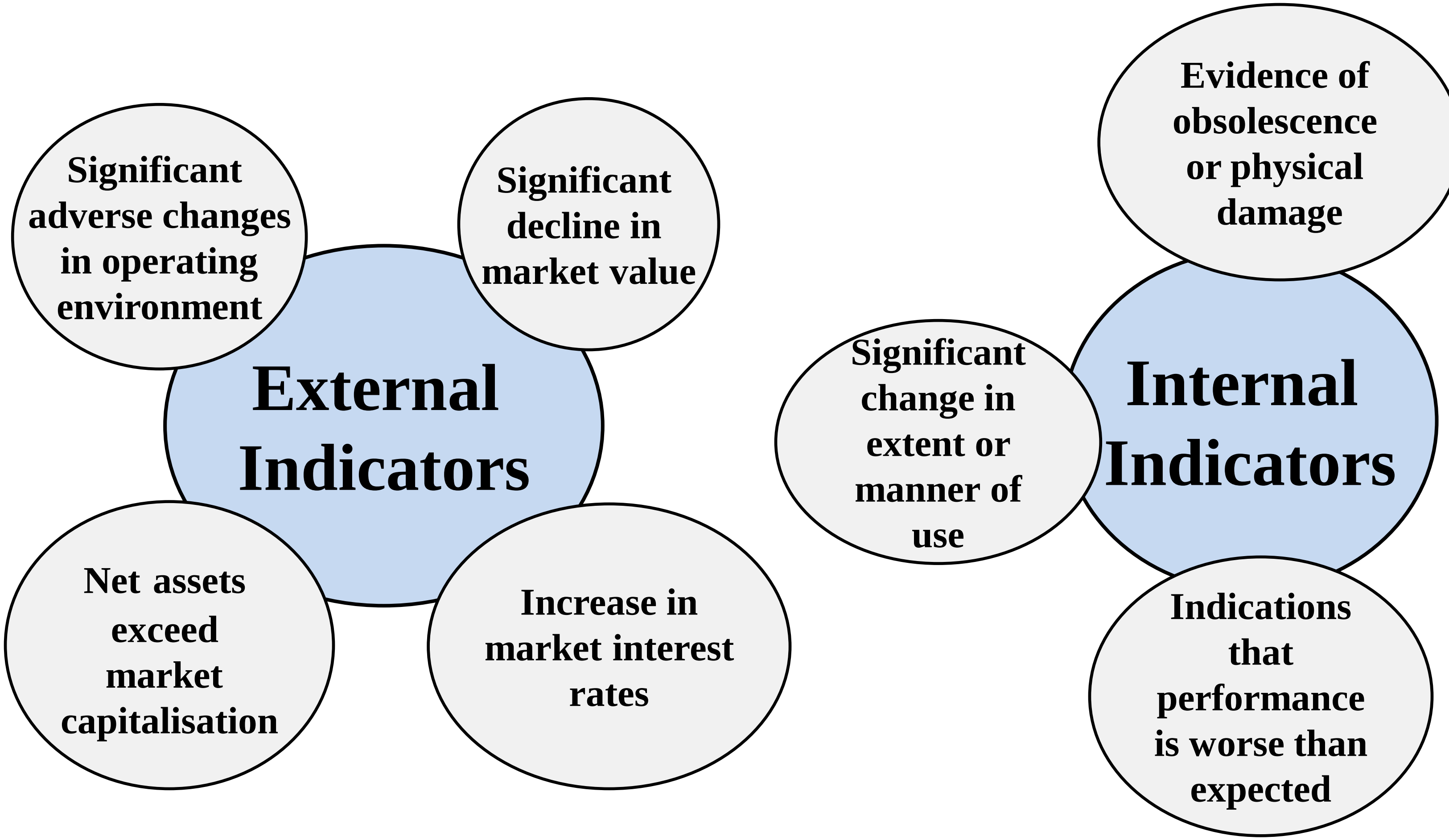
- **<u>Identify</u>** of assets/ Cash Generating Units (CGU) that needs impairment testing
- **<u>Determine Recoverable Amount</u>** of asset/ CGU
- **<u>Recognition and Measurement</u>** of Impairment Loss
- **<u>Reversal</u>** of a previous recognised impairment loss

Identification

- Assess at **each reporting period if any indication** of impairment

- **Compulsorily assess** every year (even without an indication)
  a) Intangible assets with **indefinite useful lives**
  b) Intangible assets **not yet available for use**
  c) Goodwill acquired through **business combination**

Indicators of impairment (cont'd.)



Not an exhaustive list

Lets do the party!

Q: Entity bought and capitalised computer system for INR 10 crores. Manufacturer dropped price to INR 7 crores shortly thereafter. Is this an indication of impairment?
A: Yes. This relates to change in market value and hence an indication

Q: Entity M, a global player enters retail market in where S is the biggest local player. Is this an impairment indicator for M?
A: Yes. Entity S should perform impairment testing

Q: Entity A is a major supplier to Entity Z. Entity Z announces closure of its unit after balance sheet but before the reporting date of Entity A. What should Entity A do?
A: If Entity A was aware of the intention of Entity Z to close as of balance sheet date, it should test for impairment. Else, it is a non-adjusting event

Recoverable amount

- **Higher of**:
  - fair value less costs to sell
    - amount obtainable from the sale of an asset less the costs of disposal
  - Value in use
    - PV of the future cash flows expected to be derived from an asset (cash-generating unit)

Fair value less costs to sell

- The best evidence is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs of disposal; then
- market price less the costs of disposal.
  - use current bid price.
  - when current bid prices are unavailable - the price of the most recent transaction
- Costs of disposal:
  - legal costs;
  - stamp duty and similar transaction taxes;
  - costs of removing the asset; and
  - direct incremental costs

Fair value less costs to sell

FV hierarchy

Price in a binding sale agreement

Price in an active market

Amount (based on the *best information available)* that could be obtained from disposal in an arms length transaction between knowledgeable and willing parties. An entity considers outcome of recent comparable transactions.

Value in use (VIU)

- The following elements are included in the calculation:
  - estimate of the future cash flows expected from the asset;
  - possible variations in the amount or timing of those future cash flows;
  - the time value of money; and
  - any other factors that market participants would reflect in pricing the future cash flows.

VIU – Cash flow projections

- Cash flow projections are based on:
  - reasonable and supportable assumptions that represent management’s best estimates with greater weight given to external evidence.
  - on the most recent financial budgets/forecasts approved by management;

VIU – Cash flow projections

- budgets/forecasts covering a <u>maximum period of five years</u>, unless a longer period can be justified:
  - estimates beyond the budget period may be included by <u>extrapolation</u> using a <u>steady or declining growth rate for subsequent years</u>, unless an increasing rate can be justified.
  - growth rate must not exceed the <u>long-term industry average</u> (unless it can be justified)

VIU – Discount rate

- Must be a **pre-tax rate** that **reflects current market assessments** of:
  - the time value of money; and
  - the risks specific to the asset cash flow not adjusted.
- Estimated from:
  - rate implicit in current market transactions for similar assets; or
  - from the weighted average cost of capital of a listed entity that has a single asset (or a portfolio of assets)

Cash-generating unit

The smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets

Identifying cash generating units

- Involves judgement
- <u>Factors</u> to be considered for identifying CGU:
  - how management monitors the entity's operations
  - how management makes decisions about continuing or disposing of the entity's assets and operations
- Cash-generating units must be identified consistently from period to period unless a change is justified.

Lets do the party!

Q: Entity A, which distributes electricity, sees fall in market price and is doing impairment testing. One of its power station has carrying value of Rs. 10 crores, value-in-use of Rs. 8 crores. Recently, a similar asset was sold of Rs. 11 crores. Since the asset is not going to be disposed off, management takes value-in-use as the base and does impairment. Is this a correct decision

A: No. Recoverable amount is higher of fair value or value-in-use

Recognition and Measurement

- Where recoverable amount is less than carrying amount, the carrying amount shall be reduced to its recoverable amount
- Reduction is impairment loss which shall be recognised in profit or loss
- Impairment Loss on assets under revaluation method shall be treated as a revaluation decrease per respective standards

Recognition and Measurement

- Where impairment loss is greater than carrying value, a liability shall be recognised if required by the respective standard

- Depreciation/ Amortisation shall be adjusted propectively basis revised carrying amount

Carrying amount of CGU

- Must include all assets that generate the relevant cash flows in the calculation of recoverable amount including goodwill
- Goodwill:
  - does not generate cash flows independently of other assets; therefore
  - it must be allocated to one or more CGUs (or groups of CGU’s) at the acquisition date

Goodwill allocation to CGUs

- Goodwill is allocated to the lowest level at which goodwill is monitored for internal reporting purposes.
  - this might represent a group of CGUs to which the goodwill relates but to which it cannot be allocated on an individual basis
  - It should not be larger than an operating segment determined in accordance with IFRS 8

Impairment testing of CGUs

- To which goodwill has not been allocated
  - When there are indications of impairment
- To which goodwill has been allocated
  - Annually
  - When there are indications of impairment

Impairment of CGU

- If the carrying amount exceeds recoverable amount the CGU is impaired
- Impairment is allocated to the assets of the CGU in the following order:
  - Goodwill
  - Other assets on a pro rata basis
- An impairment loss shall be recognised in profit or loss.

Most recent detailed calculation

- It may not be necessary to calculate the recoverable amount of the CGU to which goodwill has been allocated every year
- Last time's calculation may be used if:
  - there has been no change in the composition of the CGU;
  - the recoverable amount of the CGU exceeded its carrying amount by a substantial margin; and
  - relevant variables have not changed so the likelihood is remote

Corporate assets

- In testing for impairment must include all assets that generate the relevant cash flows in the calculation of recoverable amount including corporate assets
- Key characteristics of corporate assets:
  - they do not generate cash inflows independently of other assets or groups of assets; and
  - their carrying amount cannot be fully attributed to the cash-generating unit under review.
- Corporate assets include headquarters building

Corporate assets impairment review

- If not possible to allocate corporate assets to a CGU on a reasonable and consistent basis
  - compare the carrying amount of the CGU without the corporate asset to its recoverable amount and recognise any impairment loss;
  - identify the smallest group of CGUs to which the corporate asset can be allocated; and
  - compare the carrying amount of that group of CGUs to its recoverable amount and recognise any impairment loss

Reversals of impairment losses

- If there is a change in estimate leading to a reversal of impairment:
  - carrying amount of the asset/CGU is increased; but
  - the new carrying amount must not exceed the carrying amount that would have been determined had no earlier loss been recognised

- Reversal of impairment loss shall be recognised in profit or loss except for revalued asset in which case it shall be treated as a revaluation increase (in OCI), however, to the extent impairment was earlier recongised in P&L, reversal is also in P&L.

Reversals of impairment losses – CGUs

- Allocate the reversal to increase the carrying amount of the assets (not goodwill) pro – rata with the carrying amounts of those assets

- Impairment of goodwill cannot be reversed

Lets do the party!

Q: Plant A produces raw material to Plant B. Plant A also sells to external customers.

Plant B. Plant B produces intermediary goods and sells 100% to Plant C which sells its production to external customers. Production of Plant B does not have an active market. How may CGUs are there?

A:Two. Plant A and Plant C. Plant B does not have cash inflows independent of Plant C and hence has to be clubbed with Plant C

Disclosure Requirements

- ✓ Impairment loss recognised/ reversed in profit or loss and line items of statement of comprehensive income where impairment loss is included
- ✓ Impairment loss recognised/ reversed on revalued assets recognised in other comprehensive income
- ✓ For each asset/ CGU impairment recognised/ reversed during the period details of
  a) Events leading to recognition/ reversal
  b) Amount of impairment loss recognised/ reversed
  c) Nature of asset/ description of CGU and component assets
  d) Recoverable amount and if it is equal to FV less cost of disposal or value-in-use
  e) If recoverable amount is fair value, the details of fair value hierarchy
  f) If recoverable amount if value-in-use, discount rate use

Q&A

Presented by

CA Achin Poddar

ACA, B.Com (H)

+9555703168

+9971687101

poddarachin@gmail.com