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Hong Kong (SIC) Interpretation 32

Intangible Assets — Web Site Costs



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Hong Kong (SIC) Interpretation 32

Intangible Assets - Web Site Costs

HK(SIC) Interpretation 32 *Intangible Assets - Web Site Costs* (HK(SIC)-Int 32) is set out in paragraphs 7-10. HK(SIC)-Int 32 is accompanied by a Basis for Conclusions and appendix illustrating the application of the Interpretation. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

References

- HKFRS 3 *Business Combinations*
- HKFRS 15 *Revenue from Contracts with Customers*
- HKAS 1 *Presentation of Financial Statements* (as revised in 2007)
- HKAS 2 *Inventories*
- ~~HKAS 11 *Construction Contracts*~~
- HKAS 16 *Property, Plant and Equipment*
- HKAS 17 *Lease*
- HKAS 36 *Impairment of Assets*
- HKAS 38 *Intangible Assets*

Issue

- 1 An entity may incur internal expenditure on the development and operation of its own web site for internal or external access. A web site designed for external access may be used for various purposes such as to promote and advertise an entity's own products and services, provide electronic services, and sell products and services. A web site designed for internal access may be used to store company policies and customer details, and search relevant information.
- 2 The stages of a web site's development can be described as follows:
 - (a) Planning - includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences.
 - (b) Application and Infrastructure Development - includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing.
 - (c) Graphical Design Development - includes designing the appearance of web pages.
 - (d) Content Development - includes creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.
- 3 Once development of a web site has been completed, the Operating stage begins. During this stage, an entity maintains and enhances the applications, infrastructure, graphical design and content of the web site.

- 4 When accounting for internal expenditure on the development and operation of an entity's own web site for internal or external access, the issues are:
- (a) whether the web site is an internally generated intangible asset that is subject to the requirements of HKAS 38; and
 - (b) the appropriate accounting treatment of such expenditure.
- 5 This Interpretation does not apply to expenditure on purchasing, developing, and operating hardware (eg web servers, staging servers, production servers and Internet connections) of a web site. Such expenditure is accounted for under HKAS 16 ~~Property, Plant and Equipment~~. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's web site, the expenditure is recognised as an expense under HKAS 1.88 and the *Framework*¹ when the services are received.
- 6 HKAS 38 does not apply to intangible assets held by an entity for sale in the ordinary course of business (see HKAS 2 and ~~HKAS 14~~HKFRS 15) or leases that fall within the scope of HKAS 17. Accordingly, this Interpretation does not apply to expenditure on the development or operation of a web site (or web site software) for sale to another entity. When a web site is leased under an operating lease, the lessor applies this Interpretation. When a web site is leased under a finance lease, the lessee applies this Interpretation after initial recognition of the leased asset.

Conclusions

- 7 An entity's own web site that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of HKAS 38.
- 8 A web site arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in HKAS 38.21 for recognition and initial measurement, an entity can satisfy the requirements in HKAS 38.57. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with HKAS 38.57(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site shall be recognised as an expense when incurred.
- 9 Any internal expenditure on the development and operation of an entity's own web site shall be accounted for in accordance with HKAS 38. The nature of each activity for which expenditure is incurred (eg training employees and maintaining the web site) and the web site's stage of development or post-development shall be evaluated to determine the appropriate accounting treatment (additional guidance is provided in the Appendix to this Interpretation). For example:
- (a) the Planning stage is similar in nature to the research phase in HKAS 38.54-.56. Expenditure incurred in this stage shall be recognised as an expense when it is incurred.

¹ References to the *Framework* are to *Framework for the Preparation and Presentation of Financial Statements*, issued by the HKICPA in 1997. In October 2010 the HKICPA replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

- (b) the Application and Infrastructure Development stage, the Graphical Design stage and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own products and services, are similar in nature to the development phase in HKAS 38.57-.64. Expenditure incurred in these stages shall be included in the cost of a web site recognised as an intangible asset in accordance with paragraph 8 of this Interpretation when the expenditure can be directly attributed and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own products and services) specifically for a web site, or expenditure to enable use of the content (eg a fee for acquiring a licence to reproduce) on the web site, shall be included in the cost of development when this condition is met. However, in accordance with HKAS 38.71, expenditure on an intangible item that was initially recognised as an expense in previous financial statements shall not be recognised as part of the cost of an intangible asset at a later date (eg if the costs of a copyright have been fully amortised, and the content is subsequently provided on a web site).
- (c) expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products), shall be recognised as an expense when incurred in accordance with HKAS 38.69(c). For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure shall be recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.
- (d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage shall be recognised as an expense when it is incurred unless it meets the recognition criteria in HKAS 38.18.
- 10 A web site that is recognised as an intangible asset under paragraph 8 of this Interpretation shall be measured after initial recognition by applying the requirements of HKAS 38.72-.87. The best estimate of a web site's useful life should be short.

Basis for Conclusions

HK(SIC)-Int 32 is based on SIC Interpretation 32 *Intangible Assets -Web Site Costs*. In approving HK(SIC)-Int 32, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the SIC's Basis for Conclusions on SIC Interpretation 32. Accordingly, there are no significant differences between HK(SIC)-Int 32 and SIC Interpretation 32. The SIC's Basis for Conclusions is reproduced below. The paragraph numbers of SIC Interpretation 32 referred to below generally correspond with those in HK(SIC)-Int 32.

- 11 An intangible asset is defined in IAS 38.8 as an identifiable non-monetary asset without physical substance. IAS 38.9 provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset.

- 12 IAS 38.68 requires expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in IAS 38.18-67. IAS 38.69 requires expenditure on start-up activities to be recognised as an expense when incurred. An entity developing its own web site for internal or external access is not undertaking a start-up activity to the extent that an internally generated intangible asset is created. The requirements and guidance in IAS 38.52-67, in addition to the general requirements described in IAS 38.21 for recognition and initial measurement of an intangible asset, apply to expenditure incurred on the development of an entity's own web site. As described in IAS 38.65-67, the cost of a web site recognised as an internally generated intangible asset comprises all expenditure that can be directly attributed and is necessary to creating, producing and preparing the asset for it to be capable of operating in the manner intended by management.
- 13 IAS 38.54 requires expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in IAS 38.56 are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditure incurred in the Planning stage of a web site's development is recognised as an expense when incurred.
- 14 IAS 38.57 requires an intangible asset arising from the development phase of an internal project to be recognised only if an entity can demonstrate fulfilment of the six criteria specified. One of the criteria is to demonstrate how a web site will generate probable future economic benefits (IAS 38.57(d)). IAS 38.60 indicates that this criterion is met by assessing the economic benefits to be received from the web site and using the principles in IAS 36 *Impairment of Assets*, which considers the present value of estimated future cash flows from continuing use of the web site. Future economic benefits flowing from an intangible asset, as stated in IAS 38.17, 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. Therefore, future economic benefits from a web site may be assessed when the web site is capable of generating revenues. A web site developed solely or primarily for advertising and promoting an entity's own products and services is not recognised as an intangible asset, because the entity cannot demonstrate the future economic benefits that will flow. Consequently, all expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred.
- 15 Under IAS 38.21, an intangible asset is recognised if, and only if, it meets specified criteria. IAS 38.65 indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the specified recognition criteria. When an entity acquires or creates content for purposes other than to advertise and promote an entity's own products and services, it may be possible to identify an intangible asset (eg a licence or a copyright) separate from a web site. However, a separate asset is not recognised when expenditure is directly attributed, to creating, producing, and preparing the web site for it to be capable of operating in the manner intended by management—the expenditure is included in the cost of developing the web site.
- 16 IAS 38.69(c) requires expenditure on advertising and promotional activities to be recognised as an expense when incurred. Expenditure incurred on developing content that advertises and promotes an entity's own products and services (eg digital photographs of products) is an advertising and promotional activity, and consequently recognised as an expense when incurred.

- 17 Once development of a web site is complete, an entity begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an entity's own web site is recognised as an expense when incurred unless it meets the recognition criteria in IAS 38.18. IAS 38.20 explains that most subsequent expenditures are likely to maintain the future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria set out in IAS 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 — expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset — be recognised in the carrying amount of an asset*.
- 18 An intangible asset is measured after initial recognition by applying the requirements of IAS 38.72-.87. The revaluation model in IAS 38.75 is applied only when the fair value of an intangible asset can be determined by reference to an active market.† However, as an active market is unlikely to exist for web sites, the cost model applies. Additionally, as indicated in IAS 38.92, many intangible assets are susceptible to technological obsolescence, and given the history of rapid changes in technology, the useful life of web sites will be short.

Date of Issue

December 2004

Effective Date

This Interpretation becomes effective for annual accounting periods beginning on or after 1 January 2005; earlier application is encouraged. Changes in accounting policies shall be accounted for in accordance with HKAS 8.

HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 5. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

HKFRS 15 *Revenue from Contracts with Customers*, issued in July 2014, amended the 'References' section and paragraph 6. An entity shall apply that amendment when it applies HKFRS 15.

This Interpretation supersedes Interpretation 19 *Intangible Asset – Website Costs* (issued in October 2002).

* The new text was added by IFRS 3 *Business Combinations* in 2004.

† IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. IFRS 13 defines an active market.

Appendix to SIC-32

This appendix accompanies, but is not part of, SIC-32. The purpose of the appendix is to illustrate examples of expenditure that occur during each of the stages described in paragraphs 2 and 3 of SIC-32 and illustrate application of SIC-32 to assist in clarifying its meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

Example application of SIC-32

Stage / nature of expenditure	Accounting treatment
Planning <ul style="list-style-type: none"> ● undertaking feasibility studies ● defining hardware and software specifications ● evaluating alternative products and suppliers ● selecting preferences 	Recognise as an expense when incurred in accordance with IAS 38.54
Application and infrastructure development <ul style="list-style-type: none"> ● purchasing or developing hardware ● obtaining a domain name ● developing operating software (eg operating system and server software) ● developing code for the application ● installing developed applications on the web server ● stress testing 	Apply the requirements of IAS 16 Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57 ^(a)
Graphical design development <ul style="list-style-type: none"> ● designing the appearance (eg layout and colour) of web pages 	Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57 ^(a)
Content development <ul style="list-style-type: none"> ● creating, purchasing, preparing (eg creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. Examples of content include information about an entity, products or services offered for sale, and topics that subscribers access 	Recognise as an expense when incurred in accordance with IAS 38.69(c) to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products). Otherwise, recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57 ^(a)

continued...

<i>...continued</i>	
Stage / nature of expenditure	Accounting treatment
Operating <ul style="list-style-type: none"> ● updating graphics and revising content ● adding new functions, features and content ● registering the web site with search engines ● backing up data ● reviewing security access ● analysing usage of the web site 	Assess whether it meets the definition of an intangible asset and the recognition criteria set out in IAS 38.18, in which case the expenditure is recognised in the carrying amount of the web site asset
Other <ul style="list-style-type: none"> ● selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management ● clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (eg false-start testing) ● training employees to operate the web site 	Recognise as an expense when incurred in accordance with IAS 38.65-.70
<p>^(a) All expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred in accordance with IAS 38.68.</p>	