

MEMBERS' HANDBOOK

HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation

19

Intangible Assets - Web Site Costs

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

References: SSAP 29 *Intangible Assets*

ISSUES

1. An enterprise 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 enterprise'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 enterprise 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 enterprise'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 SSAP 29; and
 - (b) the appropriate accounting treatment of such expenditure.

5. This Interpretation does not apply to expenditure on purchasing, developing, and operating hardware (e.g. web servers, staging servers, production servers and Internet connections) of a web site. Such expenditure is accounted for under SSAP 17, Property, Plant and Equipment. Additionally, when an enterprise incurs expenditure on an Internet service provider hosting the enterprise's web site, the expenditure is recognised as an expense under SSAP 2 paragraph 6 and the Framework when the services are received.
6. SSAP 29 does not apply to intangible assets held by an enterprise for sale in the ordinary course of business (see SSAP 22, Inventories, and SSAP 23, Construction Contracts) or leases that fall within the scope of SSAP 14, Leases. 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 enterprise. 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 enterprise'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 SSAP 29.
8. A web site arising from development should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in SSAP 29 paragraph 19 for recognition and initial measurement, an enterprise can satisfy the requirements in SSAP 29 paragraph 45. In particular, an enterprise may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits under SSAP 29 paragraph 45(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An enterprise 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 should be recognised as an expense when incurred.
9. Any internal expenditure on the development and operation of an enterprise's own web site should be accounted for in accordance with SSAP 29. The nature of each activity for which expenditure is incurred (e.g. training employees and maintaining the web site) and the web site's stage of development or post-development should 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 SSAP 29 paragraphs 42 to 44. Expenditure incurred in this stage should be recognised as an expense when it is incurred.
 - (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 enterprise's own products and services, are similar in nature to the development phase in SSAP 29 paragraphs 45 to 52. Expenditure incurred in these stages should 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, or allocated on a reasonable and consistent basis, to preparing the web site for its intended use. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an enterprise's own products and services) specifically for a web site, or expenditure to enable use of the content (e.g. a fee for acquiring a licence to reproduce) on the web site, should be included in the cost of development when this condition is met. However, in accordance with SSAP 29 paragraph 59, expenditure on an intangible item that was initially recognised as an expense in previous financial statements should not be recognised as part of the cost of an intangible asset at a later date (e.g. when 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 enterprise's own products and services (e.g. digital photos of products), should be recognised as an expense when incurred in accordance with SSAP 29 paragraph 57(c). For example, when accounting for expenditure on professional services for taking digital photos of an enterprise's own products and for enhancing their display, expenditure should be recognised as an expense as the professional services are received during the process, not when the digital photos are displayed on the web site.
 - (d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage should be recognised as an expense when it is incurred unless it meets the criteria in SSAP 29 paragraph 60.
10. A web site that is recognised as an intangible asset under paragraph 8 of this Interpretation should be measured after initial recognition by applying the requirements of SSAP 29 paragraphs 63 to 78. The best estimate of a web site's useful life should be short.

BASIS FOR CONCLUSIONS

11. An intangible asset is defined in SSAP 29 paragraph 7 as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. SSAP 29 paragraph 8 provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset.
12. SSAP 29 paragraph 56 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 SSAP 29 paragraphs 18 to 55. SSAP 29 paragraph 57 requires expenditure on start-up activities to be recognised as an expense when incurred. An enterprise 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 SSAP 29 paragraphs 40 to 55, in addition to the general requirements described in SSAP 29 paragraph 19 for recognition and initial measurement of an intangible asset, apply to expenditure incurred on the development of an enterprise's own web site. As described in SSAP 29 paragraphs 53 to 55, the cost of a web site recognised as an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and preparing the asset for its intended use.
13. SSAP 29 paragraph 42 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 SSAP 29 paragraph 44 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. SSAP 29 paragraph 45 requires an intangible asset arising from the development phase of an internal project to be recognised if an enterprise 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 (SSAP 29 paragraph 45(d)). SSAP 29 paragraph 48 indicates that this criterion is met by assessing the economic benefits to be received from the web site and using the principles in SSAP 31, 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 SSAP 29 paragraph 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 enterprise. 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 enterprise's own products and services is not recognised as an intangible asset, because the enterprise 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 enterprise's own products and services is recognised as an expense when incurred.

15. Under SSAP 29 paragraph 19, an intangible asset is recognised if, and only if, it meets specified criteria. SSAP 29 paragraph 53 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 enterprise acquires or creates content for purposes other than to advertise and promote an enterprise's own products and services, it may be possible to identify an intangible asset (e.g. a licence or a copyright) separate from a web site. However, a separate asset is not recognised when expenditure is directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and preparing the web site for its intended use - the expenditure is included in the cost of developing the web site.
16. SSAP 29 paragraph 57(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 enterprise's own products and services (e.g. digital photos of products) is an advertising and promotional activity, and consequently recognised as an expense when incurred in accordance with SSAP 29 paragraph 57(c).
17. Once development of a web site is complete, an enterprise begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an enterprise's own web site is recognised as an expense when incurred unless it meets the recognition criteria in SSAP 29 paragraph 60. SSAP 29 paragraph 61 explains that if the expenditure is required to maintain the asset at its originally assessed standard of performance, then the expenditure is recognised as an expense when incurred.
18. An intangible asset is measured after initial recognition by applying the requirements of SSAP 29 paragraphs 63 to 78. The Allowed Alternative Treatment in SSAP 29 paragraph 64 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 Benchmark Treatment applies. Additionally, since SSAP 29 paragraph 84 states that an intangible asset always has a finite useful life, a web site that is recognised as an asset is amortised over the best estimate of its useful life under SSAP 29 paragraph 79. As indicated in SSAP 29 paragraph 81, 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: 15 October 2002

Effective Date: This Interpretation becomes effective on 15 October 2002. The effects of adopting this Interpretation should be accounted for using the transition requirements of SSAP 29 paragraphs 118 to 121. Therefore, when a web site does not meet the criteria for recognition as an intangible asset, but was previously recognised as an asset, the item should be derecognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, but was not previously recognised as an asset, the intangible asset should not be recognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, was previously recognised as an asset and initially measured at cost, the amount initially recognised is deemed to have been properly determined.

Appendix

This appendix is illustrative only and does not form part of the Interpretation. 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 the Interpretation and illustrate application of the Interpretation to assist in clarifying its meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

EXAMPLE APPLICATION OF INTERPRETATION 19

Stage / Nature of Expenditure	Accounting treatment
<p>Planning</p> <ul style="list-style-type: none"> • undertaking feasibility studies • defining hardware and software specifications • evaluating alternative products and suppliers • selecting preferences 	Expense when incurred under SSAP 29 paragraph 42
<p>Application and Infrastructure Development</p> <ul style="list-style-type: none"> • purchasing or developing hardware 	Apply the requirements of SSAP 17
<ul style="list-style-type: none"> • obtaining a domain name • developing operating software (e.g. operating system and server software) • developing code for the application • installing developed applications on the web server • stress testing 	Expense when incurred, unless the expenditure is directly attributed, or allocated on a reasonable and consistent basis, to preparing the web site for its intended use, and the web site meets the recognition criteria under SSAP 29 paragraph 19 and SSAP 29 paragraph 45*
<p>Graphical Design Development</p> <ul style="list-style-type: none"> • designing the appearance (e.g. layout and colour) of web pages 	Expense when incurred, unless the expenditure is directly attributed, or allocated on a reasonable and consistent basis, to preparing the web site for its intended use, and the web site meets the recognition criteria under SSAP 29 paragraph 19 and SSAP 29 paragraph 45*
<p>Content Development</p> <ul style="list-style-type: none"> • creating, purchasing, preparing (e.g. 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 enterprise, products or services offered for sale, and topics that subscribers access. 	Expense when incurred under SSAP 29 paragraph 57(c) to the extent that content is developed to advertise and promote an enterprise's own products and services (e.g. digital photos of products). Otherwise, expense when incurred, unless the expenditure is directly attributed, or allocated on a reasonable and consistent basis, to preparing the web site for its intended use, and the web site meets the recognition criteria under SSAP 29 paragraph 19 and SSAP 29 paragraph 45*

<p>Operating</p> <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 	<p>Expense when incurred, unless in rare circumstances it meets the criteria in SSAP 29 paragraph 60, in which case the expenditure is included in the cost of the web site</p>
<p>Other</p> <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 • clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance [e.g. false start testing] • training employees to operate the web site 	<p>Expense when incurred under SSAP 29 paragraphs 53 to 58</p>

* All expenditure on developing a web site solely or primarily for promoting and advertising an enterprise's own products and services is recognised as an expense when incurred under SSAP 29 paragraph 56.