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

MEMBERS' HANDBOOK

Update No. 148

(Issued 5 June 2014)

This Update relates to the issuance of:

- *Accounting for Acquisitions of Interests in Joint Operations* (Amendments to HKFRS 11 *Joint Arrangements*); and
- *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to HKAS 16 *Property, Plant and Equipment* and HKAS 38 *Intangible Assets*)

Document Reference and Title	Instructions	Explanations
VOLUME II		
Contents of Volume II	Discard existing pages i - ii & replace with revised pages i - ii.	Revised contents pages
HONG KONG ACCOUNTING STANDARDS (HKAS)		
HKAS 16 *Property, Plant and Equipment*	Replace the cover page, pages 4 and 22 with revised cover page, pages 4 and 22. Insert pages 21A-21B after page 21 and pages 32-35 after page 31.	- Note 1
HKAS 38 *Intangible Assets* (Standard)	Replace the standard with revised standard.	- Note 1,3
HKAS 38 *Intangible Assets* (Basis for Conclusions)	Replace the cover page, pages 2-3, 8-9, 15, 17, 21-22, 25-26, 28 and 34 with revised cover page, pages 2-3, 8-9, 15, 17, 21-22, 25-26, 28 and 34. Insert pages 36-38 after page 35.	- Note 1,3
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKFRS 11 *Joint Arrangements* (Standard)	Replace the cover page and pages 2-3 with revised cover page and pages 2-3. Insert pages 40-43 after page 39.	- Note 2

HKFRS 11 *Joint Arrangements* (Basis for Conclusions)	Replace the cover page and page 2-3 with revised cover page and pages 2-3. Insert pages 24-27 after page 23.	- Note 2
HKFRS 11 *Joint Arrangements* (Illustrative Examples)	Replace the cover page and page 2 with revised cover page and page 2. Insert pages 12-15 after page 11.	- Note 2

Note:

1. HKAS 16 and HKAS 38 both establish the principle for the basis of depreciation and amortisation as being the expected pattern of consumption of the future economic benefits of an asset. The amendments clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset.

   The amendments also clarify that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain limited circumstances.

   The amendments are effective for annual periods beginning on or after 1 January 2016 with earlier application permitted.

2. HKFRS 11 addresses the accounting for interests in joint ventures and joint operations. The amendments add new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business. The amendments specify the appropriate accounting treatment for such acquisitions.

   The amendments are effective for annual periods beginning on or after 1 January 2016 with earlier application permitted.

3. The Institute has also taken this opportunity to incorporate the amendments applicable on 1 January 2013 for greater clarity.

Hong Kong Institute of
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MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to June 2014)

HKAS 16
Revised ~~February~~June 2014

Hong Kong Accounting Standard 16

Property, Plant and Equipment

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

Hong Kong Accounting Standard 16 *Property, Plant and Equipment* (HKAS 16) is set out in paragraphs 1-83 and Appendix B. All the paragraphs have equal authority. HKAS 16 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Appendix C

Amendments to HKAS 16 *Clarification of Acceptable Methods of Depreciation and Amortisation*

The following sets out amendments required for this Standard resulting from amendments to HKAS 16 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Paragraph 56 is amended and paragraphs 62A and 81I are added. Paragraphs 60–62 are not amended but are included here for ease of reference. New text is underlined.

Depreciable amount and depreciation period

…

56 The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) …

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

…

Depreciation method

60 The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with HKAS 8.

62 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

62A A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

...

Effective date

…

81I *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to HKAS 16 and HKAS 38), issued in June 2014, amended paragraph 56 and added paragraph 62A. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

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Appendix

Amendments to the Basis for Conclusions on HKAS 16 *Clarification of Acceptable Methods of Depreciation and Amortisation*

This appendix contains amendments to the Basis for Conclusions on HKAS 16 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Conclusions and this appendix will be deleted.

Paragraphs BC33A–BC33G and their related heading are added. New text is underlined.

Depreciation: depreciation method

BC33A The IASB decided to amend IAS 16 to address the concerns regarding the use of a revenue-based method for depreciating an asset. The IASB's decision was in response to a request to clarify the meaning of the term 'consumption of the expected future economic benefits embodied in the asset' when determining the appropriate amortisation method for intangible assets of service concession arrangements (SCA) that are within the scope of IFRIC 12 *Service Concession Arrangements*. The issue raised is related to the application of paragraphs 97–98 of IAS 38 *Intangible Assets* although the IASB decided to address the issue broadly, rather than limit it only to intangible assets arising in an SCA.

BC33B The IASB observed that a revenue-based depreciation method is one that allocates an asset's depreciable amount based on revenues generated in an accounting period as a proportion of the total revenues expected to be generated over the asset's useful economic life. The total revenue amount is affected by the interaction between units (ie quantity) and price and takes into account any expected changes in price.

BC33C The IASB observed that paragraph 60 of IAS 16 states that the depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. The IASB noted that even though revenue could sometimes be considered to be a measurement of the output generated by the asset, revenue does not, as a matter of principle, reflect the way in which an item of property, plant and equipment is used or consumed. The IASB observed that the price component of revenue may be affected by inflation and noted that inflation has no bearing upon the way in which an asset is consumed.

BC33D On the basis of the guidance in IAS 16, the IASB proposed to clarify in the Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation* (Proposed amendments to IAS 16 and IAS 38) (the 'ED') that a method of depreciation that is based on revenue generated from an activity that includes the use of an asset is not appropriate, because it reflects a pattern of economic benefits being generated from operating the business (of which the asset is part) rather than the economic benefits being consumed through the use of the asset.

BC33E During its redeliberations of the ED the IASB decided to reaffirm its conclusion that the use of a revenue-based method is not appropriate, because the principle in paragraph 60 of IAS 16 is that the "depreciation method shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity". A method that is based on revenue generated from an activity that includes the use of an asset would be, in contrast, a method based on the generation of future economic benefits from the use of the asset. As a result of the feedback received on the ED, the IASB also decided not to retain the comments that it had included in the Basis for Conclusions on the ED on the limited circumstances in which a revenue-based method gives the same result as a units of production method. Many respondents to the ED found these comments contradictory to the guidance proposed in the Standard.

BC33F In the ED the IASB proposed to provide guidance to clarify the role of obsolescence in the application of the diminishing balance method. In response to the comments received about the proposed guidance the IASB decided to change the focus of this guidance. The IASB decided to explain that expected future reductions in the selling price of an item could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset. The IASB noted that the expectation of technical or commercial obsolescence is relevant for estimating both the pattern of consumption of future economic benefits and the useful life of an asset. The IASB noted that the diminishing balance method is an accepted depreciation methodology in paragraph 62 of IAS 16, which is capable of reflecting an accelerated consumption of the future economic benefits embodied in the asset.

BC33G Some respondents to the ED suggested that the IASB should define the notion of ‘consumption of economic benefits’ and provide guidance in this respect. During its redeliberations the IASB decided against doing so, noting that explaining the notion of consumption of economic benefits would require a broader project.

Consequential amendment to the Basis for Conclusions on IFRIC 12 *Service Concession Arrangements*

In paragraph BC64, the phrase 'unit of production method' has been amended to 'units of production method'. New text is underlined.

Intangible asset (paragraph 26)

…

BC64 The IFRIC considered whether it would be appropriate for intangible assets under paragraph 26 to be amortised using an 'interest' method of amortisation, ie one that takes account of the time value of money in addition to the consumption of the intangible asset, treating the asset more like a monetary than a non-monetary asset. However, the IFRIC concluded that there was nothing unique about these intangible assets that would justify use of a method of depreciation different from that used for other intangible assets. The IFRIC noted that paragraph 98 of IAS 38 provides for a number of amortisation methods for intangible assets with finite useful lives. These methods include the straight-line method, the diminishing balance method and the unit<u>s</u> of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.

Dissenting opinion

Dissent of Mary Tokar from *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to IAS 16 and IAS 38) as issued in May 2014

DO1 Ms Tokar is dissenting from the publication of this amendment. She does not object to the IASB's objective of clarifying acceptable methods of depreciation and amortisation, nor to its conclusions to preclude revenue-based depreciation and nor to the introduction of a rebuttable presumption that revenue cannot be used as a basis for amortisation of intangibles. She also agrees that expectations of obsolescence should be considered when determining the useful life of an asset and selecting an amortisation or depreciation method that reflects the pattern of consumption of the asset. However, she is concerned that the amendments will not fully resolve the practice issue that was originally raised with the IFRS Interpretations Committee. She believes that the amendments are not sufficiently clear regarding what evidence is required to overcome the presumption and instead support the use of revenue as the basis for amortisation of an intangible asset. She believes that further guidance should be included to explain when the pattern of consumption of economic benefits is the same as the pattern in which revenue is generated.

HKAS 38
Revised ~~March 2010~~June 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong Accounting Standard 38

Intangible Assets

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

CONTENTS

Hong Kong Accounting Standard 38 *Intangible Assets* (HKAS 38) is set out in paragraphs 1-133. All the paragraphs have equal authority. HKAS 38 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of Financial Statements~~Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 38 *Intangible Assets* (HKAS 38) replaces SSAP 29 *Intangible Assets* (issued in 2001), and should be applied:

(a) on acquisition to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 1 January 2005.

(b) to all other intangible assets, for annual periods beginning on or after 1 January 2005.

Earlier application is encouraged.

Reasons for issuing HKAS 38

IN2 Pursuant to its convergence policy, the Hong Kong Institute of Certified Public Accountants ("HKICPA") issues HKAS 38 as part of its project on business combinations to converge with the International Accounting Standards Board ("the Board")'s project on business combinations. The project's objective is to improve the quality of the accounting for business combinations and the subsequent accounting for goodwill and intangible assets acquired in business combinations.

IN3 The project has two phases. The first phase resulted in the HKICPA issuing simultaneously HKFRS 3 *Business Combinations* and HKAS 38 and HKAS 36 *Impairment of Assets* to converge with IFRS 3 and the revised versions of IAS 38 and IAS 36 issued by the Board. The first phase of the project focused primarily on:

(a) the method of accounting for business combinations

(b) the initial measurement of the identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination;

(c) the recognition of provisions for terminating or reducing the activities of an acquiree;

(d) the treatment of any excess of the acquirer's interest in the fair values of identifiable net assets acquired in a business combination over the cost of the combination; and

(e) the accounting for goodwill and intangible assets acquired in a business combination.

IN4 Therefore, the HKICPA's intention while issuing HKAS 38 was to reflect only those changes resulting from the Business Combinations project, and *not* to reconsider all of the previous requirements in SSAP 29. The changes are primarily concerned with clarifying the notion of 'identifiability' as it relates to intangible assets, the useful life and amortisation of intangible assets, and the accounting for in-process research and development projects acquired in business combinations.

Summary of main changes

Definition of an intangible asset

IN5 SSAP 29 defined an intangible asset 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. The requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative purposes has been removed from the definition of an intangible asset.

IN6 SSAP 29 did not define 'identifiability', but stated that an intangible asset could be distinguished clearly from goodwill if the asset was separable, but that separability was not a necessary condition for identifiability. The Standard states that an asset meets the identifiability criterion in the definition of an intangible asset when it:

(a) is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; 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.

Criteria for initial recognition

IN7 SSAP 29 required an intangible asset to be recognised if, and only if, it was probable that the expected future economic benefits attributable to the asset would flow to the entity, and its cost could be measured reliably. These recognition criteria have been included in the Standard. However, additional guidance has been included to clarify that:

(a) the probability recognition criterion is always considered to be satisfied for intangible assets that are acquired separately or in a business combination.

(b) the fair value of an intangible asset acquired in a business combination can be measured with sufficient reliability to be recognised separately from goodwill.

Subsequent expenditure

IN8 Under SSAP 29, the treatment of subsequent expenditure on an in-process research and development project acquired in a business combination and recognised as an asset separately from goodwill was unclear. The Standard requires such expenditure to be:

(a) recognised as an expense when incurred if it is research expenditure;

(b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria in HKAS 38 for recognising such expenditure as an intangible asset; and

(c) recognised as an intangible asset if it is development expenditure that satisfies the criteria in HKAS 38 for recognising such expenditure as an intangible asset.

Useful life

IN9 SSAP 29 was based on the assumption that the useful life of an intangible asset is always finite, and included a rebuttable presumption that the useful life cannot exceed twenty years from the date the asset is available for use. That rebuttable presumption has been removed. The Standard requires an intangible asset to be regarded as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

IN10 SSAP 29 required that if control over the future economic benefits from an intangible asset was achieved through legal rights granted for a finite period, the useful life of the intangible asset could not exceed the period of those rights, unless the rights were renewable and renewal was virtually certain. The Standard requires that:

(a) the useful life of an intangible asset arising from contractual or other legal rights should not exceed the period of those rights, but may be shorter depending on the period over which the asset is expected to be used by the entity; and

(b) if the rights are conveyed for a limited term that can be renewed, the useful life should include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

Intangible assets with indefinite useful lives

IN11 The Standard requires that:

(a) an intangible asset with an indefinite useful life should not be amortised.

(b) the useful life of such an asset should be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate.

Impairment testing intangible assets with finite useful lives

IN12 SSAP 29 required the recoverable amount of an intangible asset that was amortised over a period exceeding twenty years from the date it was available for use to be estimated at least at each financial year-end, even if there was no indication that the asset was impaired. This requirement has been removed. Therefore, an entity needs to determine the recoverable amount of an intangible asset with a finite useful life that is amortised over a period exceeding twenty years from the date it is available for use only when, in accordance with HKAS 36, there is an indication that the asset may be impaired.

Disclosure

IN13 If an intangible asset is assessed as having an indefinite useful life, the Standard requires an entity to disclose the carrying amount of that asset and the reasons supporting the indefinite useful life assessment.

Hong Kong Accounting Standard 38
Intangible Assets

Objective

1 The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

Scope

2 This Standard shall be applied in accounting for intangible assets, except:

(a) intangible assets that are within the scope of another Standard;

(b) financial assets, as defined in HKAS 32 *Financial Instruments: Presentation*; and

(c) the recognition and measurement of exploration and evaluation assets (see HKFRS 6 *Exploration for and Evaluation of Mineral Resources*); and

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

3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:

(a) intangible assets held by an entity for sale in the ordinary course of business (see HKAS 2 *Inventories* and HKAS 11 *Construction Contracts*).

(b) deferred tax assets (see HKAS 12 *Income Taxes*).

(c) leases that are within the scope of HKAS 17 *Leases*.

(d) assets arising from employee benefits (see HKAS 19 *Employee Benefits*).

(e) financial assets as defined in HKAS 32. The recognition and measurement of some financial assets are covered by HKFRS 10 *Consolidated Financial Statements*, HKAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*~~,~~ and HKAS 28 *Investments in Associates and Joint Ventures* ~~and HKAS 31 *Interests in Joint Ventures*~~.

(f) goodwill acquired in a business combination (see HKFRS 3 *Business Combinations*).

(g) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of HKFRS 4 *Insurance Contracts*. HKFRS 4 sets out specific disclosure requirements for those deferred acquisition costs but not for those intangible assets. Therefore, the disclosure requirements in this Standard apply to those intangible assets.

(h) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

4 Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated under HKAS 16 *Property, Plant and Equipment* or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant. For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

5 This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (eg a prototype), the physical element of the asset is secondary to its intangible component, ie the knowledge embodied in it.

6 In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of HKAS 17 and are within the scope of this Standard.

7 Exclusions from the scope of a Standard may occur if activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the accounting for expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of insurance contracts. Therefore, this Standard does not apply to expenditure on such activities and contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries or by insurers.

Definitions

8 The following terms are used in this Standard with the meanings specified:

~~**An active market is a market in which all the following conditions exist:**~~

~~**(a) the items traded in the market are homogeneous;**~~

~~**(b) willing buyers and sellers can normally be found at any time; and**~~

~~**(c) prices are available to the public.**~~

Amortisation **is the systematic allocation of the depreciable amount of an intangible asset over its useful life.**

An *asset* **is a resource:**

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

Carrying amount **is the amount at which an asset is recognised in the statement of financial position after deducting any accumulated amortisation and accumulated impairment losses thereon.**

Cost **is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other HKFRSs, eg HKFRS 2** ***Share-based Payment*****.**

Depreciable amount **is the cost of an asset, or other amount substituted for cost, less its residual value.**

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.**

Entity-specific value **is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.**

Fair value ~~*of an asset*~~ ~~**is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.**~~ **is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13** ***Fair Value Measurement*****.)**

An *impairment loss* **is the amount by which the carrying amount of an asset exceeds its recoverable amount.**

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

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

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

The *residual value* **of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.**

Useful life **is:**

(a) **the period over which an asset is expected to be available for use by an entity; or**

(b) **the number of production or similar units expected to be obtained from the asset by an entity.**

Intangible assets

9 Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.

10 Not all the items described in paragraph 9 meet the definition of an intangible asset, ie identifiability, control over a resource and existence of future economic benefits. If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date (see paragraph 68).

Identifiability

11 The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognised in a business combination is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.

12 **An asset is identifiable if it either :**

(a) **is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; 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

13 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.

14 Market and technical knowledge may give rise to future economic benefits. An entity controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.

15 An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

16 An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (eg portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

Future economic benefits

17 The future economic benefits flowing from an intangible asset 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. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and measurement

18 The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

(a) the definition of an intangible asset (see paragraphs 8-17); and

(b) the recognition criteria (see paragraphs 21-23).

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it.

19 Paragraphs 25-32 deal with the application of the recognition criteria to separately acquired intangible assets, and paragraphs 33-43 deal with their application to intangible assets acquired in a business combination. Paragraph 44 deals with the initial measurement of intangible assets acquired by way of a government grant, paragraphs 45-47 with exchanges of intangible assets, and paragraphs 48-50 with the treatment of internally generated goodwill. Paragraphs 51-67 deal with the initial recognition and measurement of internally generated intangible assets.

20 The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. 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 an acquired intangible asset or after completion of an internally generated intangible asset—be recognised in the carrying amount of an asset. Consistently with paragraph 63, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally acquired or internally generated) is always recognised in profit or loss as incurred. This is because such expenditure cannot be distinguished from expenditure to develop the business as a whole.

21 An intangible asset shall be recognised if, and only if:

(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.

22 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

23 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

24 An intangible asset shall be measured initially at cost.

Separate acquisition

25 Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets.

26 In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

27 The cost of a separately acquired intangible asset comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

(b) any directly attributable cost of preparing the asset for its intended use.

28 Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in HKAS 19) arising directly from bringing the asset to its working condition;

(b) professional fees arising directly from bringing the asset to its working condition; and

(c) costs of testing whether the asset is functioning properly.

29 Examples of expenditures that are not part of the cost of an intangible asset are:

(a) costs of introducing a new product or service (including costs of advertising and promotional activities);

(b) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(c) administration and other general overhead costs.

30 Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:

(a) costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use; and

(b) initial operating losses, such as those incurred while demand for the asset's output builds up.

31 Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised immediately in profit or loss, and included in their respective classifications of income and expense.

32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with HKAS 23 *Borrowing Costs*.

Acquisition as part of a business combination

33 In accordance with HKFRS 3 *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. Thus, the reliable measurement criterion in paragraph 21(b) is always considered to be satisfied for intangible assets acquired in business combinations.

34 In accordance with this Standard and HKFRS 3 (as revised in 2008), an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset. An acquiree's in-process research and development project meets the definition of an intangible asset when it:

(a) meets the definition of an asset; and

(b) is identifiable, ie is separable or arises from contractual or other legal rights.

~~Measuring the fair value of an i~~Intangible asset acquired in a business combination

35 If an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the asset's fair value.

36 An intangible asset acquired in a business combination might be separable, but only together with a related contract, identifiable asset or liability. In such cases, the acquirer recognises the intangible asset separately from goodwill, but together with the related item.

37 The acquirer may recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. For example, the terms ‘brand’ and ‘brand name’ are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

38 [Deleted]

39-41 [Deleted]~~Quoted market prices in an active market provide the most reliable estimate of the fair value of an intangible asset (see also paragraph 78). The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset’s fair value is estimated .~~

~~40 If no active market exists for an intangible asset, its fair value is the amount that the entity would have paid for the asset, at the acquisition date, in an arm’s length transaction between knowledgeable and willing parties, on the basis of the best information available. In determining this amount, an entity considers the outcome of recent transactions for similar assets. For example, an entity may apply multiples reflecting current market transactions to factors that drive the profitability of the asset (such as revenue, operating profit or earnings before interest, tax, depreciation and amortisation).~~

~~41 Entities that are involved in the purchase and sale of intangible assets may have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in a business combination if their objective is to estimate fair value and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, for example:~~

~~(a) discounting estimated future net cash flows from the asset; or~~

~~(b) estimating the costs the entity avoids by owning the intangible asset and not needing:~~

~~(i) to license it from another party in an arm’s length transaction (as in the ‘relief from royalty’ approach, using discounted net cash flows) ; or~~

~~(ii) to recreate or replace it (as in the cost approach),~~

Subsequent expenditure on an acquired in-process research and development project

42 **Research or development expenditure that:**

(a) relates to an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset; and

(b) is incurred after the acquisition of that project shall be accounted for in accordance with paragraphs 54-62.

43 Applying the requirements in paragraphs 54-62 means that subsequent expenditure on an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset is:

(a) recognised as an expense when incurred if it is research expenditure;

(b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 57; and

(c) added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 57.

Acquisition by way of a government grant

44 In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may happen when a government transfers or allocates to an entity intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. In accordance with HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, an entity may choose to recognise both the intangible asset and the grant initially at fair value. If an entity chooses not to recognise the asset initially at fair value, the entity recognises the asset initially at a nominal amount (the other treatment permitted by HKAS 20) plus any expenditure that is directly attributable to preparing the asset for its intended use.

Exchanges of assets

45 One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

46 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

47 Paragraph 21(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset ~~for which comparable market transactions do not exist~~ is reliably measurable if (a) the variability in the range of reasonable fair value ~~estimates~~ measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used ~~in estimating~~ when measuring fair value. If an entity is able to ~~determine~~ measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Internally generated goodwill

48 Internally generated goodwill shall not be recognised as an asset.

49 In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (ie it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

50 Differences between the ~~market~~ fair value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the fair value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

Internally generated intangible assets

51 It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

(a) identifying whether and when there is an identifiable asset that will generate expected future economic benefits; and

(b) determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies the requirements and guidance in paragraphs 52-67 to all internally generated intangible assets.

52 To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

(a) a research phase; and

(b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this Standard.

53 If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Research phase

54 No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

55 In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred.

56 Examples of research activities are:

(a) activities aimed at obtaining new knowledge;

(b) the search for, evaluation and final selection of, applications of research findings or other knowledge;

(c) the search for alternatives for materials, devices, products, processes, systems or services; and

(d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development phase

57 An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.

(b) its intention to complete the intangible asset and use or sell it.

(c) its ability to use or sell the intangible asset.

(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the 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.

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

58 In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits. This is because the development phase of a project is further advanced than the research phase.

59 Examples of development activities are:

(a) the design, construction and testing of pre-production or pre-use prototypes and models;

(b) the design of tools, jigs, moulds and dies involving new technology;

(c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and

(d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

60 To demonstrate how an intangible asset will generate probable future economic benefits, an entity assesses the future economic benefits to be received from the asset using the principles in HKAS 36 *Impairment of Assets*. If the asset will generate economic benefits only in combination with other assets, the entity applies the concept of cash-generating units in HKAS 36.

61 Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the entity's ability to secure those resources. In some cases, an entity demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.

62 An entity's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.

63 Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.

64 Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an internally generated intangible asset

65 The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.

66 The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:

(a) costs of materials and services used or consumed in generating the intangible asset;

(b) costs of employee benefits (as defined in HKAS 19) arising from the generation of the intangible asset;

(c) fees to register a legal right; and

(d) amortisation of patents and licences that are used to generate the intangible asset.

HKAS 23 specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

67 The following are not components of the cost of an internally generated intangible asset:

(a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;

(b) identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and

(c) expenditure on training staff to operate the asset.

Example illustrating paragraph 65
An entity is developing a new production process. During 20X5, expenditure incurred was CU1,000[*], of which CU900 was incurred before 1 December 20X5 and CU100 was incurred between 1 December 20X5 and 31 December 20X5. The entity is able to demonstrate that, at 1 December 20X5, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be CU500. *At the end of 20X5, the production process is recognised as an intangible asset at a cost of CU100 (expenditure incurred since the date when the recognition criteria were met, ie 1 December 20X5). The CU900 expenditure incurred before 1 December 20X5 is recognised as an expense because the recognition criteria were not met until 1 December 20X5. This expenditure does not form part of the cost of the production process recognised in the statement of financial position.* During 20X6, expenditure incurred is CU2,000. At the end of 20X6, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be CU1,900. *At the end of 20X6, the cost of the production process is CU2,100 (CU100 expenditure recognised at the end of 20X5 plus CU2,000 expenditure recognised in 20X6). The entity recognises an impairment loss of CU200 to adjust the carrying amount of the process before impairment loss (CU2,100) to its recoverable amount (CU1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in HKAS 36 are met.*

Recognition of an expense

68 **Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:**

(a) **it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 18-67); or**

(b) **the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, it forms part of the amount recognised as goodwill at the acquisition date (see HKFRS 3).**

69 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognises the expenditure as an expense when it receives the services. For example, expenditure on research is recognised as an expense when it is incurred (see paragraph 54), except when it is acquired as part of a business combination. Other examples of expenditure that is recognised as an expense when it is incurred include:

[*] In this Standard, monetary amounts are denominated in 'currency units' (CU).

(a) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with HKAS 16. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) or expenditures for starting new operations or launching new products or processes (ie pre-operating costs).

(b) expenditure on training activities.

(c) expenditure on advertising and promotional activities (including mail order catalogues).

(d) expenditure on relocating or reorganising part or all of an entity.

69A An entity has a right to access goods when it owns them. Similarly, it has a right to access goods when they have been constructed by a supplier in accordance with the terms of a supply contract and the entity could demand delivery of them in return for payment. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver an advertisement to customers.

70 Paragraph 68 does not preclude an entity from recognising a prepayment as an asset when payment for goods has been made in advance of the entity obtaining a right to access those goods. Similarly, paragraph 68 does not preclude an entity from recognising a prepayment as an asset when payment for services has been made in advance of the entity receiving those services.

Past expenses not to be recognised as an asset

71 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

Measurement after recognition

72 An entity shall choose either the cost model in paragraph 74 or the revaluation model in paragraph 75 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.

73 A class of intangible assets is a grouping of assets of a similar nature and use in an entity’s operations. The items within a class of intangible assets are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

Cost model

74 After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Revaluation model

75 After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be ~~determined~~ measured by reference to an active market. Revaluations shall be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.

76 The revaluation model does not allow:

(a) the revaluation of intangible assets that have not previously been recognised as assets; or

(b) the initial recognition of intangible assets at amounts other than cost.

77 The revaluation model is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 65), the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received by way of a government grant and recognised at a nominal amount (see paragraph 44).

78 It is uncommon for an active market ~~with the characteristics described in paragraph 8~~ to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable taxi licences, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public.

79 The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

80 If an intangible asset is revalued, any accumulated amortisation at the date of the revaluation is either:

(a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount; or

(b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.

81 **If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortisation and impairment losses.**

82 **If the fair value of a revalued intangible asset can no longer be ~~determined~~ measured by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.**

83 The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with HKAS 36.

84 If the fair value of the asset can be ~~determined~~ measured by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.

85 **If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.**

86 **If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.**

87 The cumulative revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the entity; in such a case, the amount of the surplus realised is the difference between amortisation based on the revalued carrying amount of the asset and amortisation that would have been recognised based on the asset's historical cost. The transfer from revaluation surplus to retained earnings is not made through profit or loss.

Useful life

88 **An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.**

89 The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised (see paragraphs 97-106), and an intangible asset with an indefinite useful life is not (see paragraphs 107-110). The Illustrative Examples accompanying this Standard illustrate the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.

90 Many factors are considered in determining the useful life of an intangible asset, including:

(a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;

(c) technical, technological, commercial or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.

91 The term 'indefinite' does not mean 'infinite'. The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

92 Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life is short.

93 The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

94 The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.

95 There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

96 Existence of the following factors, among others, indicates that an entity would be able to renew the contractual or other legal rights without significant cost:

(a) there is evidence, possibly based on experience, that the contractual or other legal rights will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;

(b) there is evidence that any conditions necessary to obtain renewal will be satisfied; and

(c) the cost to the entity of renewal is not significant when compared with the future economic benefits expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits expected to flow to the entity from renewal, the 'renewal' cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

Intangible assets with finite useful lives

Amortisation period and amortisation method

97 The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is 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 shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.

98 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.

99 Amortisation is usually recognised in profit or loss. However, sometimes the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the amortisation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see HKAS 2 *Inventories*).

Residual value

100 The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market (as defined in HKFRS 13) for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

101 The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.

102 An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

103 The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortisation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

Review of amortisation period and amortisation method

104 The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with HKAS 8.

105 During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

106 Over time, the pattern of future economic benefits expected to flow to an entity from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Intangible assets with indefinite useful lives

107 An intangible asset with an indefinite useful life shall not be amortised.

108 In accordance with HKAS 36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount

(a) annually, and

(b) whenever there is an indication that the intangible asset may be impaired.

Review of useful life assessment

109 The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with HKAS 8.

110 In accordance with HKAS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with HKAS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.

Recoverability of the carrying amount - impairment losses

111 To determine whether an intangible asset is impaired, an entity applies HKAS 36. That Standard explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.

Retirements and disposals

112 An intangible asset shall be derecognised:

(a) on disposal; or

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

113 The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised (unless HKAS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.

114 The disposal of an intangible asset may occur in a variety of ways (eg by sale, by entering into a finance lease, or by donation). In determining the date of disposal of such an asset, an entity applies the criteria in HKAS 18 *Revenue* for recognising revenue from the sale of goods. HKAS 17 applies to disposal by a sale and leaseback.

115 If in accordance with the recognition principle in paragraph 21 an entity recognises in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognises the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.

115A In the case of a reacquired right in a business combination, if the right is subsequently reissued (sold) to a third party, the related carrying amount, if any, shall be used in determining the gain or loss on reissue.

116 The consideration receivable on disposal of an intangible asset is recognised initially at its fair value. If payment for the intangible asset is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with HKAS 18 reflecting the effective yield on the receivable.

117 Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5.

Disclosure

General

118 An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used;

(b) the amortisation methods used for intangible assets with finite useful lives;

(c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;

(d) the line item(s) of the statement of comprehensive income in which any amortisation of intangible assets is included;

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions, indicating separately those from internal development, those acquired separately, and those acquired through business combinations;

(ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;

(iii) **increases or decreases during the period resulting from revaluations under paragraphs 75, 85 and 86 and from impairment losses recognised or reversed in other comprehensive income in accordance with HKAS 36 (if any);**

(iv) **impairment losses recognised in profit or loss during the period in accordance with HKAS 36 (if any);**

(v) **impairment losses reversed in profit or loss during the period in accordance with HKAS 36 (if any);**

(vi) **any amortisation recognised during the period;**

(vii) **net exchange differences arising on the translation of the financial statements into the presentation currency, and on the translation of a foreign operation into the presentation currency of the entity; and**

(viii) **other changes in the carrying amount during the period.**

119 A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. Examples of separate classes may include:

(a) brand names;

(b) mastheads and publishing titles;

(c) computer software;

(d) licences and franchises;

(e) copyrights, patents and other industrial property rights, service and operating rights;

(f) recipes, formulae, models, designs and prototypes; and

(g) intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

120 An entity discloses information on impaired intangible assets in accordance with HKAS 36 in addition to the information required by paragraph 118(e)(iii)-(v).

121 HKAS 8 requires an entity to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods. Such disclosure may arise from changes in:

(a) the assessment of an intangible asset's useful life;

(b) the amortisation method; or

(c) residual values.

122 An entity shall also disclose:

(a) for an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.

(b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements.

(c) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 44):

(i) the fair value initially recognised for these assets;

(ii) their carrying amount; and

(iii) whether they are measured after recognition under the cost model or the revaluation model.

(d) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.

(e) the amount of contractual commitments for the acquisition of intangible assets.

123 When an entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset is indefinite, the entity considers the list of factors in paragraph 90.

Intangible assets measured after recognition using the revaluation model

124 If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:

(a) by class of intangible assets:

(i) the effective date of the revaluation;

(ii) the carrying amount of revalued intangible assets; and

(iii) the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 74; and

(b) the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders~~; and~~ .

(c) **[deleted]~~the methods and significant assumptions applied in estimating the assets' fair values.~~**

125 It may be necessary to aggregate the classes of revalued assets into larger classes for disclosure purposes. However, classes are not aggregated if this would result in the combination of a class of intangible assets that includes amounts measured under both the cost and revaluation models.

Research and development expenditure

126 An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

127 Research and development expenditure comprises all expenditure that is directly attributable to research or development activities (see paragraphs 66 and 67 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 126).

Other information

128 An entity is encouraged, but not required, to disclose the following information:

(a) a description of any fully amortised intangible asset that is still in use; and

(b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before the version of SSAP 29 *Intangible Assets* issued in 2001 was effective.

Transitional provisions and effective date

129 [Deleted]

130 An entity shall apply this Standard:

(a) to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 1 January 2005; and

(b) to the accounting for all other intangible assets prospectively from the beginning of the first annual period beginning on or after 1 January 2005. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of such intangible assets. If, as a result of that reassessment, the entity changes its assessment of the useful life of an asset, that change shall be accounted for as a change in an accounting estimate in accordance with HKAS 8.

130A An entity shall apply the amendments in paragraph 2 for annual periods beginning on or after 1 January 2006. If an entity applies HKFRS 6 for an earlier period, those amendments shall be applied for that earlier period.

130B HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 85, 86 and 118(e)(iii). 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.

130C HKFRS 3 (as revised in 2008) amended paragraphs 12, 33-35, 68, 69, 94 and 130, deleted paragraphs 38 and 129 and added paragraph 115A. *Improvements to HKFRSs* issued in May 2009 amended paragraphs 36 and 37. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. Therefore, amounts recognised for intangible assets and goodwill in prior business combinations shall not be adjusted. If an entity applies HKFRS 3 (revised 2008) for an earlier period, it shall apply the amendments for that earlier period and disclose the fact.

130D Paragraphs 69, 70 and 98 were amended and paragraph 69A was added by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

130E [Deleted]~~*Improvements to HKFRSs* issued in May 2009 amended paragraphs 40 and 41. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.~~

130F HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraph 3(e). An entity shall apply that amendment when it applies HKFRS 10 and HKFRS 11.

130G HKFRS 13, issued in June 2011, amended paragraphs 8, 33, 47, 50, 75, 78, 82, 84, 100 and 124 and deleted paragraphs 39-41 and 130E. An entity shall apply those amendments when it applies HKFRS 13.

Exchanges of similar assets

131 The requirement in paragraphs 129 and 130(b) to apply this Standard prospectively means that if an exchange of assets was measured before the effective date of this Standard on the basis of the carrying amount of the asset given up, the entity does not restate the carrying amount of the asset acquired to reflect its fair value at the acquisition date.

Early application

132 Entities to which paragraph 130 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 130. However, if an entity applies this Standard before those effective dates, it also shall apply HKFRS 3 and HKAS 36 at the same time.

Withdrawal of SSAP 29

133 This Standard supersedes SSAP 29 *Intangible Assets* (issued in 2001).

Appendix

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at August 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 38.

The International Accounting Standard comparable with HKAS 38 is IAS 38 *Intangible Assets.*

There are no major textual differences between HKAS 38 and IAS 38.

Appendix

Amendments to HKAS 38 *Clarification of Acceptable Methods of Depreciation and Amortisation*

The following sets out amendments required for this Standard resulting from amendments to HKAS 38 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Paragraph 92 is amended. In paragraph 98, the phrase ‘unit of production method’ has been amended to ‘units of production method’. Paragraphs 98A–98C and 130J are added. Paragraph 97 is not amended but is included here for ease of reference. Deleted text is struck through and new text is underlined.

Useful life

…

92 Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it ~~is likely~~ <u>will often be the case</u> that their useful life is short. <u>Expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.</u>

…

Amortisation period and amortisation method

97 The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is 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 shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.

98 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.

98A There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:

(a) in which the intangible asset is expressed as a measure of revenue, as described in paragraph 98C; or

(b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

98B In choosing an appropriate amortisation method in accordance with paragraph 98, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (ie time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortisation, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits.

98C In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortisation. For example, an entity could acquire a concession to explore and extract gold from a gold mine. The expiry of the contract might be based on a fixed amount of total revenue to be generated from the extraction (for example, a contract may allow the extraction of gold from the mine until total cumulative revenue from the sale of gold reaches CU2 billion) and not be based on time or on the amount of gold extracted. In another example, the right to operate a toll road could be based on a fixed total amount of revenue to be generated from cumulative tolls charged (for example, a contract could allow operation of the toll road until the cumulative amount of tolls generated from operating the road reaches CU100 million). In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortising the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortisation is to be determined.

...

Transitional provisions and effective date

…

130J *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to HKAS 16 and HKAS 38), issued in June 2014, amended paragraphs 92 and 98 and added paragraphs 98A–98C. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Basis for Conclusions on
Hong Kong Accounting Standard 38

Intangible Assets

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

HKAS 38 is based on IAS 38 *Intangible Assets*. In approving HKAS 38, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 38. Accordingly, there are no significant differences between HKAS 38 and IAS 38. The IASB's Basis for Conclusions is reproduced below for reference. The paragraph numbers of IAS 38 referred to below generally correspond with those in HKAS 38.

CONTENTS *from paragraph*

BASIS FOR CONCLUSIONS ON IAS 38 *INTANGIBLE ASSETS*

BC16A The Board observed that in a business combination both criteria, the probability criterion and the reliability of measurement criterion, will always be met.

Probability recognition criterion

BC17 In revising IAS 38, the Board observed that the fair value of an intangible asset reflects market expectations about the probability that the future economic benefits associated with the intangible asset will flow to the acquirer. In other words, the effect of probability is reflected in the fair value measurement of an intangible asset.[*] Therefore, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations.

BC18 The Board observed that this highlights a general inconsistency between the recognition criteria for assets and liabilities in the *Framework*[#] (which states that an item meeting the definition of an element should be recognised only if it is probable that any future economic benefits associated with the item will flow to or from the entity, and the item can be measured reliably) and the fair value measurements required in, for example, a business combination. However, the Board concluded that the role of probability as a criterion for recognition in the *Framework* should be considered more generally as part of a forthcoming Concepts project.

Reliability of measurement recognition criterion

BC19 [Deleted]

BC19A In developing IFRS 3, the IASB noted that the fair values of identifiable intangible assets acquired in a business combination are normally measurable with sufficient reliability to be recognised separately from goodwill. The effects of uncertainty because of a range of possible outcomes with different probabilities are reflected in measuring the asset's fair value[†]; the existence of such a range does not demonstrate an inability to measure fair value reliably. IAS 38 (as revised in 2004) included a rebuttable presumption that the fair value of an intangible asset with a finite useful life acquired in a business combination can be measured reliably. The Board had concluded that it might not always be possible to measure reliably the fair value of an asset that has an underlying contractual or legal basis. However, IAS 38 (revised 2004) provided that the only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination that arises from legal or other contractual rights were if it either:

(a) is not separable; or

(b) is separable, but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would depend on immeasurable variables.

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[*] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

[#] References to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

[†] IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

BC19B In developing the 2005 Business Combinations exposure draft, the Board concluded that separate recognition of intangible assets, on the basis of an estimate of fair value, rather than subsuming them in goodwill, provides better information to the users of financial statements even if a significant degree of judgment is required to estimate fair value. For this reason, the Board decided to propose consequential amendments to IAS 38 to remove the reliability of measurement criterion for intangible assets acquired in a business combination. In redeliberating the proposals in the 2005 Business Combinations exposure draft, the Board affirmed those amendments to IAS 38.

BC19C When the Board developed IFRS 3 (as revised in 2008), it decided that if an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure the fair value of the asset reliably. The Board made related amendments to IAS 38 to reflect that decision. However, the Board identified additional amendments that were needed to reflect clearly its decisions on the accounting for intangible assets acquired in a business combination. Consequently, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraphs 36 and 37 of IAS 38 to clarify the Board's intentions.

BC19D Additionally, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraphs 40 and 41 of IAS 38 to clarify the description of valuation techniques commonly used to measure intangible assets at fair value[*] when assets are not traded in an active market. The Board also decided that the amendments should be applied prospectively because retrospective application might require some entities to remeasure fair values associated with previous transactions. The Board does not think this is appropriate because the remeasurement might involve the use of hindsight in those circumstances.

BC20-BC25 [Deleted]

[*] IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs 40 and 41 of IAS 38 have been deleted.

Recognition of expenditure on all internally generated intangible assets as an expense

BCZ38 Those who favour the recognition of expenditure on all internally generated intangible assets (including development expenditure) as an expense argue that:

(a) internally generated intangible assets do not meet the *Framework's* requirements for recognition as an asset because:

(i) the future economic benefits that arise from internally generated intangible assets cannot be distinguished from future economic benefits that arise from internally generated goodwill; and/or

(ii) it is impossible to distinguish reliably the expenditure associated with internally generated intangible assets from the expenditure associated with enhancing internally generated goodwill.

(b) comparability of financial statements will not be achieved. This is because the judgement involved in determining whether it is probable that future economic benefits will flow from internally generated intangible assets is too subjective to result in similar accounting under similar circumstances.

(c) it is not possible to assess reliably the amount that can be recovered from an internally generated intangible asset, unless its fair value can be determined by reference to an active market.[*] Therefore, recognising an internally generated intangible asset for which no active market exists at an amount other than zero may mislead investors.

(d) a requirement to recognise internally generated intangible assets at cost if certain criteria are met results in little, if any, decision useful or predictive information because:

(i) demonstration of technological feasibility or commercial success in order to meet the recognition criteria will generally not be achieved until substantial expenditure has been recognised as an expense. Therefore, the cost recognised for an internally generated intangible asset will not reflect the total expenditure on that asset.

(ii) the cost of an internally generated intangible asset may not have any relationship to the value of the asset.

(e) in some countries, users are suspicious about an enterprise that recognises internally generated intangible assets.

(f) the added costs of maintaining the records necessary to justify and support the recognition of internally generated intangible assets do not justify the benefits.

Recognition of internally generated intangible assets

BCZ39 Those who support the mandatory recognition of internally generated intangible assets (including those resulting from development expenditure) whenever certain criteria are met argue that:

(a) recognition of an internally generated intangible asset if it meets the definition

[*] IFRS 13, issued in May 2011, defines an active market.

alternative treatments in International Accounting Standards.

Differences in recognition criteria for internally generated intangible assets and purchased intangible assets

BCZ42 IAS 38 includes specific recognition criteria for internally generated intangible assets that expand on the general recognition criteria for intangible assets. It is assumed that these criteria are met implicitly whenever an enterprise acquires an intangible asset. Therefore, IAS 38 requires an enterprise to demonstrate that these criteria are met for internally generated intangible assets only.

Initial recognition at cost

BCZ43 Some commentators on E50 and E60 argued that the proposed recognition criteria in E50 and E60 were too restrictive and that they would prevent the recognition of many intangible assets, particularly internally generated intangible assets. Specifically, they disagreed with the proposals (retained in IAS 38) that:

(a) an intangible asset should not be recognised at an amount other than its cost, even if its fair value can be determined reliably; and

(b) expenditure on an intangible asset that has been recognised as an expense in prior periods should not be reinstated.

They argued that these principles contradict the *Framework* and quoted paragraph 83 of the *Framework*[λ], which specifies that an item that meets the definition of an asset should be recognised if, among other things, its "*cost or value* can be measured with reliability". These commentators supported recognising an intangible asset—an internally generated intangible asset—at its fair value, if, among other things, its fair value can be measured reliably.

BCZ44 IASC rejected a proposal to allow the initial recognition of an intangible asset at fair value (except if the asset is acquired in a business combination, in exchange for a dissimilar asset[*] or by way of a government grant) because:

(a) this is consistent with IAS 16 *Property, Plant and Equipment*. IAS 16 prohibits the initial recognition of an item of property, plant or equipment at fair value (except in the specific limited cases as those in IAS 38).

(b) it is difficult to determine the fair value of an intangible asset reliably if no active market exists for the asset.[#] Since active markets with the characteristics set out in IAS 38 are highly unlikely to exist for internally generated intangible assets, IASC did not believe that it was necessary to make an exception to the principles generally applied for the initial recognition and measurement of non-financial assets.

λ now paragraph 4.38 of the *Conceptual Framework*

* IAS 16 *Property, Plant and Equipment* (as revised in 2003) requires an entity to measure an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless the exchange transaction lacks commercial substance. Previously, an entity measured such an acquired asset at fair value unless the exchanged assets were similar. The IASB concluded that the same measurement criteria should apply to intangible assets acquired in exchange for a nonmonetary asset or assets, or a combination of monetary and non-monetary assets.

\# IFRS 13, issued in May 2011, defines an active market.

(b) at a revalued amount, being the asset's fair value, determined by reference to an active market,* at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. Under this approach, revaluations must be made with such regularity that at the balance sheet date the carrying amount of the asset does not differ materially from its fair value.

Whichever of the above methods was used, the previous version of IAS 38 required the depreciable amount of the asset to be amortised on a systematic basis over the best estimate of its useful life.

BC51 The Board observed that underpinning the requirement for all intangible assets to be amortised is the notion that they all have determinable and finite useful lives. Setting aside the question of whether, and under what circumstances, an intangible asset could be regarded as having an indefinite useful life, an important issue for the Board to consider was whether a departure from the above requirements would be warranted for intangible assets acquired in a business combination that have finite useful lives.

BC52 The Board observed that any departure from the above requirements for intangible assets with finite lives acquired in business combinations would create inconsistencies between the accounting for recognised intangible assets based wholly on the means by which they are obtained. In other words, similar items would be accounted for in dissimilar ways. The Board concluded that creating such inconsistencies would impair the usefulness of the information provided to users about an entity's intangible assets, because both comparability and reliability would be diminished.

BC53 Therefore, the Board decided that intangible assets with finite useful lives acquired in business combinations should continue to be accounted for in accordance with the above requirements after initial recognition.

Impairment testing intangible assets with finite useful lives (paragraph 111)

BC54 The previous version of IAS 38 required the recoverable amount of an intangible asset with a finite useful life that is being amortised over a period of more than 20 years, whether or not acquired in a business combination, to be measured at least at each financial year-end.

BC55 The Board observed that the recoverable amount of a long-lived tangible asset needs to be measured only when, in accordance with IAS 36 *Impairment of Assets*, there is an indication that the asset may be impaired. The Board could see no conceptual reason for requiring the recoverable amounts of some identifiable assets being amortised over very long periods to be determined more regularly than for other identifiable assets being amortised or depreciated over similar periods. Therefore, the Board concluded that the recoverable amount of an intangible asset with a finite useful life that is amortised over a period of more than 20 years should be determined only when, in accordance with IAS 36, there is an indication that the asset may be impaired. Consequently, the Board decided to remove the requirement in the previous version of IAS 38 for the recoverable amount of such an intangible asset to be measured at least at each financial year-end.

* IFRS 13, issued in May 2011, defines an active market.

BC56 The Board also decided that all of the requirements relating to impairment testing intangible assets should be included in IAS 36 rather than in IAS 38. Therefore, the Board relocated to IAS 36 the requirement in the previous version of IAS 38 that an entity should estimate at the end of each annual reporting period the recoverable amount of an intangible asset not yet available for use, irrespective of whether there is any indication that it may be impaired.

Residual value of an intangible asset with a finite useful life (paragraph 100)

BC57 In revising IAS 38, the Board considered whether to retain for intangible assets with finite useful lives the requirement in the previous version of IAS 38 for the residual value of an intangible asset to be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market[*] for the asset and:

(i) the asset's residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

BC58 The Board observed that the definition in the previous version of IAS 38 (as amended by IAS 16 when revised in 2003) of residual value required it to be estimated as if the asset were already of the age and in the condition expected at the end of the asset's useful life. Therefore, if the useful life of an intangible asset was shorter than its economic life because the entity expected to sell the asset before the end of that economic life, the asset's residual value would not be zero, irrespective of whether the conditions in paragraph BC57(a) or (b) are met.

BC59 Nevertheless, the Board observed that the requirement for the residual value of an intangible asset to be assumed to be zero unless the specified criteria are met was included in the previous version of IAS 38 as a means of preventing entities from circumventing the requirement in that Standard to amortise all intangible assets. Excluding this requirement from the revised Standard for finite-lived intangible assets would similarly provide a means of circumventing the requirement to amortise such intangible assets—by claiming that the residual value of such an asset was equal to or greater than its carrying amount, an entity could avoid amortising the asset, even though its useful life is finite. The Board concluded that it should not, as part of the Business Combinations project, modify the criteria for permitting a finite-lived intangible asset's residual value to be other than zero. However, the Board decided that this issue should be addressed as part of a forthcoming project on intangible assets.

[*] IFRS 13, issued in May 2011, defines an active market.

have a fair value regardless of the costs required to renew. This means the useful life of a contractual customer relationship could be inconsistent with the basis used to determine the fair value of the relationship.[#]

BC70 In relation to (a) above, the Board observed that if renewal by the entity is subject to third-party (eg government) approval, the requirement that there be evidence to support the entity's ability to renew would compel the entity to make an assessment of the likely effect of the third-party approval process on the entity's ability to renew. The Board could see no conceptual basis for narrowing the requirement to situations in which the contractual or legal rights are not subject to the approval of third parties.

BC71 In relation to (b) above, the Board observed the following:

(a) the requirements relating to renewal periods address circumstances in which *the entity* is able to renew the contractual or other legal rights, notwithstanding that such renewal may, for example, be conditional on the entity satisfying specified conditions, or subject to third-party approval. Paragraph 94 of the Standard states that "… the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal *by the entity* [emphasis added] without significant cost." The ability to renew a customer contract normally rests with the customer and not with the entity.

(b) the respondents seem to regard as a single intangible asset what is, in substance, two intangible assets—one being the customer contract and the other being the related customer relationship. Expected renewals by the customer would affect the fair value of the customer relationship intangible asset, rather than the fair value of the customer contract. Therefore, the useful life of the customer contract would not, under the Standard, extend beyond the term of the contract, nor would the fair value of that customer contract reflect expectations of renewal by the customer. In other words, the useful life of the customer contract would not be inconsistent with the basis used to determine its fair value.

BC72 However, in response to respondents' suggestions, the Board included paragraph 96 in the Standard to provide additional guidance on the circumstances in which an entity should be regarded as being able to renew the contractual or other legal rights without significant cost.

Intangible assets with finite useful lives (paragraph 98)[*]

BC72A The last sentence of paragraph 98 previously stated, 'There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight line method.' In practice, this wording was perceived as preventing an entity from using the unit of production method to amortise assets if it resulted in a lower amount of accumulated amortisation than the straight-line method. However, using the straight-line method could be inconsistent with the general requirement of paragraph 38 that the amortisation method should reflect the expected pattern of consumption of the expected future economic benefits embodied in an intangible asset. Consequently, the Board decided to delete the last sentence of paragraph 98.

[#] IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

[*] This heading and paragraph BC72A were adder by *Improvements to IFRSs* issued in May 2008.

Accounting for intangible assets with indefinite useful lives (paragraphs 107-110)

BC73 Consistently with the proposals in the Exposure Draft, the Standard prohibits the amortisation of intangible assets with indefinite useful lives. Therefore, such assets are measured after initial recognition at:

(a) cost less any accumulated impairment losses; or

(b) a revalued amount, being fair value determined by reference to an active market[*] less any accumulated impairment losses.

Non-amortisation

BC74 In developing the Exposure Draft and the revised Standard, the Board observed that many assets yield benefits to an entity over several periods. Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not be representationally faithful. Respondents to the Exposure Draft generally supported this conclusion.

BC75 Consequently, the Board decided that intangible assets with indefinite useful lives should not be amortised, but should be subject to regular impairment testing. The Board's deliberations on the form of the impairment test, including the frequency of impairment testing, are included in the Basis for Conclusions on IAS 36. The Board further decided that regular re-examinations should be required of the useful life of an intangible asset that is not being amortised to determine whether circumstances continue to support the assessment that the useful life is indefinite.

Revaluations

BC76 Having decided that intangible assets with indefinite useful lives should not be amortised, the Board considered whether an entity should be permitted to carry such assets at revalued amounts. The Board could see no conceptual justification for precluding some intangible assets from being carried at revalued amounts solely on the basis that there is no foreseeable limit to the period over which an entity expects to consume the future economic benefits embodied in those assets.

BC77 As a result, the Board decided that the Standard should permit intangible assets with indefinite useful lives to be carried at revalued amounts.

Research and development projects acquired in business combinations

BC78 The Board considered the following issues in relation to in-process research and development (IPR&D) projects acquired in a business combination:

(a) whether the proposed criteria for recognising intangible assets acquired in a business combination separately from goodwill should also be applied to IPR&D projects;

[*] IFRS 13, issued in May 2011, defines an active market.

Subsequent accounting for IPR&D projects acquired in a business combination and recognised as intangible assets

BC83 The Board observed that the previous version of IAS 38 required all recognised intangible assets to be accounted for after initial recognition at:

(a) cost less any accumulated amortisation and any accumulated impairment losses; or

(b) revalued amount, being the asset's fair value, determined by reference to an active market,[#] at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

Such assets included: IPR&D projects acquired in a business combination that satisfied the criteria for recognition separately from goodwill; separately acquired IPR&D projects that satisfied the criteria for recognition as an intangible asset; and recognised internally developed intangible assets arising from development or the development phase of an internal project.

BC84 The Board could see no conceptual justification for changing the approach in the previous version of IAS 38 of applying the same requirements to the subsequent accounting for all recognised intangible assets. Therefore, the Board decided that IPR&D projects acquired in a business combination that satisfy the criteria for recognition as an asset separately from goodwill should be accounted for after initial recognition in accordance with the requirements applying to the subsequent accounting for other recognised intangible assets.

Subsequent expenditure on IPR&D projects acquired in a business combination and recognised as intangible assets (paragraphs 42 and 43)

BC85 The Standard requires subsequent expenditure on an IPR&D project acquired separately or in a business combination and recognised as an intangible asset to be:

(a) recognised as an expense when incurred if it is research expenditure;

(b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 57; and

(c) added to the carrying amount of the acquired IPR&D project if it is development expenditure that satisfies the recognition criteria in paragraph 57.

BC86 In developing this requirement the Board observed that the treatment required under the previous version of IAS 38 of subsequent expenditure on an IPR&D project acquired in a business combination and recognised as an asset separately from goodwill was unclear. Some suggested that the requirements in the previous version of IAS 38 relating to expenditure on research, development, or the research or development phase of an internal project should be applied. However, others argued that those requirements were ostensibly concerned with the initial recognition and measurement of internally generated intangible assets. Instead, the requirements in the previous version of IAS 38 dealing with subsequent expenditure should be applied. Under those requirements, subsequent expenditure on an intangible asset after its purchase or

[#] IFRS 13, issued in May 2011, defines an active market.

Dissenting opinions

Dissent of Geoffrey Whittington from IAS 38 issued in March 2004

DO1 Professor Whittington dissents from the issue of this Standard because it does not explicitly require the probability recognition criterion in paragraph 21(a) to be applied to intangible assets acquired in a business combination, notwithstanding that it applies to all other intangible assets.

DO2 The reason given for this (paragraphs 33 and BC17) is that fair value is the required measurement on acquisition of an intangible asset as part of a business combination, and fair value incorporates probability assessments. Professor Whittington does not believe that the *Framework*[ε] precludes having a prior recognition test based on probability, even when subsequent recognition is at fair value. Moreover, the application of probability may be different for recognition purposes: for example, it may be the 'more likely than not' criterion used in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, rather than the 'expected value' approach used in the measurement of fair value.

DO3 This inconsistency between the recognition criteria in the *Framework* and fair values is acknowledged in paragraph BC18. In Professor Whittington's view, the inconsistency should be resolved before changing the recognition criteria for intangible assets acquired in a business combination.

[ε] The reference to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting.*

Amendments to the Basis for Conclusions on HKAS 38
Clarification of Acceptable Methods of Depreciation and Amortisation

This appendix contains amendments to the Basis for Conclusions on IAS 38 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Conclusions and this appendix will deleted.

In paragraph BC72A the phrase 'unit of production method' has been amended to 'units of production method'. New text is underlined.

Intangible assets with finite useful lives (paragraph 98)[13]

BC72A The last sentence of paragraph 98 previously stated, 'There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method.' In practice, this wording was perceived as preventing an entity from using the units of production method to amortise assets if it resulted in a lower amount of accumulated amortisation than the straight-line method. However, using the straight-line method could be inconsistent with the general requirement of paragraph 38 that the amortisation method should reflect the expected pattern of consumption of the expected future economic benefits embodied in an intangible asset. Consequently, the Board decided to delete the last sentence of paragraph 98.

Paragraphs BC72B–BC72M and their related headings are added. New text is underlined.

Amortisation method (paragraphs 97–98C)

BC72B The IASB decided to amend IAS 38 to address concerns regarding the use of a revenue-based method for amortising an intangible asset. The IASB's decision was in response to a request to clarify the meaning of the term 'consumption of the expected future economic benefits embodied in the asset' when determining the appropriate amortisation method for intangible assets of service concession arrangements (SCA) that are within the scope of IFRIC 12 *Service Concession Arrangements*. The issue raised is related to the application of paragraphs 97–98 of IAS 38, although the IASB decided to address the issue broadly, rather than limit it only to intangible assets arising in an SCA.

BC72C A revenue-based amortisation method is one that allocates an asset's amortisable amount based on revenues generated in an accounting period as a proportion of the total revenues expected to be generated over the asset's useful economic life. The total revenue amount is affected by the interaction between units (ie quantity) and price and takes into account any expected changes in price. The IASB observed that the price component of revenue may be affected by inflation and noted that inflation has no bearing upon the way in which the asset is consumed.

BC72D The IASB observed that paragraph 97 of IAS 38 states that the amortisation method used shall reflect the pattern in which the intangible asset's future economic benefits are expected to be consumed by the entity.

BC72E On the basis of the guidance in IAS 38 the IASB proposed to clarify in the Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation* (Proposed amendments to IAS 16 and IAS 38) (the 'ED') that a method of amortisation that is based on revenue generated from an activity that includes the use of an asset is not appropriate, because it reflects a pattern of economic benefits being generated from operating the business (of which the asset is part) rather than the economic benefits being consumed through the use of the asset.

BC72F During its redeliberations of the ED the IASB decided to include a rebuttable presumption that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in the intangible asset. The IASB also considered the question of whether there could be circumstances in which revenue could be used to reflect the pattern in which the future economic benefits of the intangible asset are expected to be consumed.

BC72G In finalising the proposed amendments to IAS 38, the IASB decided to make clear in the Standard that the presumption precluding the use of revenue as a basis for amortisation could be overcome in two circumstances. One of those circumstances is when it can be demonstrated that revenue is highly correlated with the consumption of the economic benefits embodied in an intangible asset. The IASB also noted that another circumstance in which revenue could be used is when the right embodied by an intangible asset is expressed as a total amount of revenue to be generated (rather than time, for example), in such a way that the generation of revenue is the measurement used to determine when the right expires. The IASB noted that, in this case, the pattern of consumption of future economic benefits that is embodied in the intangible asset is defined by reference to the total revenue earned as a proportion of the contractual maximum and, consequently, the amount of revenue generated contractually reflects the consumption of the benefits that are embodied in the asset.

BC72H The IASB also analysed situations in which an intangible asset is used in multiple activities to provide multiple revenue streams. Some respondents commented that the application of a units of production method did not seem practicable, because the units of production were not homogeneous. For example, the producer of a motion picture will typically use the intellectual property embodied in the film to generate cash flows through exhibiting the film in theatres, licensing the rights to characters to manufacturers of toys and other goods, selling DVDs or digital copies of the film and licensing broadcast rights to television broadcasters. Some respondents thought that the best way to amortise the cost of the intellectual property embodied in the film was to use a revenue-based method, because revenue was considered a common denominator to reflect a suitable proxy of the pattern of consumption of all the benefits received from the multiple activities in which the intellectual property could be used.

BC72I The IASB acknowledged that determining an appropriate amortisation method for situations in which an intangible asset is used in multiple activities, and generates multiple cash flow streams in different markets, requires judgement. The IASB considered suggestions that an intangible asset should be componentised for amortisation purposes in circumstances in which the asset is used to generate multiple cash flow streams. It observed that separating an asset into different components is not a new practice in business or in IFRS—it is routinely done for property, plant and equipment and IAS 16 provides guidance in this respect—but refrained from developing guidance in this respect for intangible assets.

BC72J The IASB also decided to provide guidance on how an entity could identify an amortisation method in response to some respondents who observed that further guidance was required in the application of paragraph 98 of IAS 38, which is limited to providing a description of the amortisation methods most commonly used. During its deliberations the IASB determined that, when choosing an amortisation method, an entity could determine the predominant limiting factor for the use of the intangible asset. For example, a contract could be limited by a number of years (ie time), a number of units produced or an amount of revenue to be generated. The IASB clarified that identifying such a predominant limiting factor is only a starting point for the identification of the amortisation method and an entity may apply another basis if the entity determines that it more closely reflects the expected pattern of consumption of economic benefits.

BC72K In the ED the IASB proposed to provide guidance to clarify the role of obsolescence in the application of the diminishing balance method. In response to the comments received about the proposed guidance, the IASB decided to change the focus of this guidance to explain that expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset. The IASB noted that the expectation of technical or commercial obsolescence is relevant for estimating both the pattern of consumption of future economic benefits and the useful life of an asset. The IASB noted that the diminishing balance method is an accepted amortisation methodology in paragraph 98 of IAS 38, which is capable of reflecting an accelerated consumption of the future economic benefits embodied in the asset.

BC72L Some respondents to the ED suggested that the IASB should define the notion of ‘consumption of economic benefits’ and provide guidance in this respect. During its redeliberations the IASB decided against doing so, noting that explaining the notion of consumption of economic benefits would require a broader project.

Consistency in the use of the phrase ‘units of production’

BC72M The IASB decided to make consistent the phrase ‘units of production method’ and has therefore amended the instances of the phrase ‘unit of production method’.

HKFRS 11
Revised ~~July 2012~~June 2014

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 11

Joint Arrangements

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

CONTENTS

Hong Kong Financial Reporting Standard 11 *Joint Arrangements* (HKFRS 11) is set out in paragraphs 1–27 and Appendices A–D & F. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 11 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Appendix F
Amendments to HKFRS 11 *Accounting for Acquisitions of Interests in Joint Operations*

The following sets out amendments required for this Standard resulting from amendments to HKFRS 11 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

In the Introduction, paragraph IN4A and its related heading and paragraph IN9A are added. New text is underlined.

Reasons for amending HKFRS 11 in May 2014

IN4A In June 2014 the HKICPA amended HKFRS 11 to provide guidance on the accounting for acquisitions of interests in joint operations in which the activity constitutes a business.

...

IN9A This HKFRS requires the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in HKFRS 3 *Business Combinations*, to apply all of the principles on business combinations accounting in HKFRS 3 and other HKFRSs except for those principles that conflict with the guidance in this HKFRS. In addition, the acquirer shall disclose the information required by HKFRS 3 and other HKFRSs for business combinations.

Paragraph 21A is added. Paragraphs 20–21 have been included for ease of reference but are not amended. New text is underlined.

Joint operations

20 A joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly.

21 A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the HKFRSs applicable to the particular assets, liabilities, revenues and expenses.

21A When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in HKFRS 3, it shall apply, to the extent of its share in accordance with paragraph 20, all of the principles on business combinations accounting in HKFRS 3, and other HKFRSs, that do not conflict with the guidance in this HKFRS and disclose the information that is required in those HKFRSs in relation to business combinations. This applies to the acquisition of both the initial interest and additional interests in a joint operation in which the activity of the joint operation constitutes a business. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs B33A–B33D.

In Appendix B, the main heading before paragraph B34 is amended and paragraphs B33A–B33D and their related heading are added. New text is underlined.

Financial statements of parties to a joint arrangement (paragraphs 21A–22)

Accounting for acquisitions of interests in joint operations

B33A When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in HKFRS 3, it shall apply, to the extent of its share in accordance with paragraph 20, all of the principles on business combinations accounting in HKFRS 3, and other HKFRSs, that do not conflict with the guidance in this HKFRS and disclose the information required by those HKFRSs in relation to business combinations. The principles on business combinations accounting that do not conflict with the guidance in this HKFRS include but are not limited to:

(a) measuring identifiable assets and liabilities at fair value, other than items for which exceptions are given in HKFRS 3 and other HKFRSs;

(b) recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with HKAS 32 *Financial Instruments: Presentation* and HKFRS 9;[1]

(c) recognising deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets or liabilities, except for deferred tax liabilities that arise from the initial recognition of goodwill, as required by HKFRS 3 and HKAS 12 *Income Taxes* for business combinations;

(d) recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and

[1] If an entity applies these amendments but does not yet apply HKFRS 9, the reference in these amendments to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement*.

(e) testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as required by HKAS 36 *Impairment of Assets* for goodwill acquired in a business combination.

B33B Paragraphs 21A and B33A also apply to the formation of a joint operation if, and only if, an existing business, as defined in HKFRS 3, is contributed to the joint operation on its formation by one of the parties that participate in the joint operation. However, those paragraphs do not apply to the formation of a joint operation if all of the parties that participate in the joint operation only contribute assets or groups of assets that do not constitute businesses to the joint operation on its formation.

B33C A joint operator might increase its interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in HKFRS 3, by acquiring an additional interest in the joint operation. In such cases, previously held interests in the joint operation are not remeasured if the joint operator retains joint control.

B33D Paragraphs 21A and B33A–B33C do not apply on the acquisition of an interest in a joint operation when the parties sharing joint control, including the entity acquiring the interest in the joint operation, are under the common control of the same ultimate controlling party or parties both before and after the acquisition, and that control is not transitory.

In Appendix C, paragraph C1AA and paragraph C14A and its related heading are added.

Effective date

...

C1AA *Accounting for Acquisitions of Interests in Joint Operations* (Amendments to HKFRS 11), issued in June 2014, amended the heading after paragraph B33 and added paragraphs 21A, B33A–B33D and C14A and their related headings. An entity shall apply those amendments prospectively in annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies those amendments in an earlier period it shall disclose that fact.

...

Accounting for acquisitions of interests in joint operations

C14A *Accounting for Acquisitions of Interests in Joint Operations* (Amendments to HKFRS 11), issued in June 2014, amended the heading after paragraph B33 and added paragraphs 21A, B33A–B33D, C1AA and their related headings. An entity shall apply those amendments prospectively for acquisitions of interests in joint operations in which the activities of the joint operations constitute businesses, as defined in HKFRS 3, for those acquisitions occurring from the beginning of the first period in which it applies those amendments. Consequently, amounts recognised for acquisitions of interests in joint operations occurring in prior periods shall not be adjusted.

Consequential amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

Paragraph 39W is added. New text is underlined.

Effective date

...

39W *Accounting for Acquisitions of Interests in Joint Operations* (Amendments to HKFRS 11), issued in June 2014, amended paragraph C5. An entity shall apply that amendment in annual periods beginning on or after 1 January 2016. If an entity applies related amendments to HKFRS 11 from *Accounting for Acquisitions of Interests in Joint Operations* (Amendments to HKFRS 11) in an earlier period, the amendment to paragraph C5 shall be applied in that earlier period.

In Appendix C, paragraph C5 is amended. Deleted text is struck through and new text is underlined.

Appendix C
Exemptions for business combinations

...

C5 The exemption for past business combinations also applies to past acquisitions of investments in associates, ~~and of~~ interests in joint ventures and interests in joint operations in which the activity of the joint operation constitutes a business, as defined in HKFRS 3. Furthermore, the date selected for paragraph C1 applies equally for all such acquisitions.

Basis for Conclusions on
Hong Kong Financial Reporting Standard 11

Joint Arrangements

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

Basis for Conclusions on IFRS 11 *Joint Arrangements*

HKFRS 11 is based on IFRS 11 *Joint Arrangement*. In approving HKFRS 11, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 11. Accordingly, there are no significant differences between HKFRS 11 and IFRS 11. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 11 referred to below generally correspond with those in HKFRS 11.

CONTENTS

Appendix

Amendments to the Basis for Conclusions on IFRS 11 *Accounting for Acquisitions of Interests in Joint Operations*

This appendix contains amendments to the Basis for Conclusions on IFRS 11 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Conclusions and this appendix will deleted.

Paragraphs BC45A–BC45N and BC69C and their related headings are added. New text is underlined.

Accounting for acquisitions of interests in joint operations

BC45A The IFRS Interpretations Committee (the Interpretations Committee) reported to the IASB that practice differed in accounting for the acquisition of interests in jointly controlled operations or jointly controlled assets, as specified in IAS 31.* In particular, the Interpretations Committee noted diversity in practice if the activity of the jointly controlled operations or jointly controlled assets constitutes a business, as defined in IFRS 3.

BC45B The principal approaches observed in practice were:

(a) **IFRS 3 approach:** some preparers of IFRS financial statements, when accounting for the acquisition of interests in jointly controlled operations or jointly controlled assets in which the activity constitutes a business, applied IFRS 3 and the guidance on business combinations in other IFRSs. Identifiable assets and liabilities were measured, subject to the exceptions in IFRS 3, at fair value and the residual was recognised as goodwill. Furthermore, transaction costs were not capitalised and deferred taxes were recognised on initial recognition of assets and liabilities. Only guidance on business combinations in IFRS 3 and other IFRSs that was not appropriate for the acquisition of an interest in jointly controlled operations or jointly controlled assets was not applied, for example, the guidance on non-controlling interests.

(b) **cost approach:** others allocated the total cost of acquiring the interest in the joint operation to the individual identifiable assets on the basis of their relative fair values. Accordingly, any premium paid was allocated to the identifiable assets rather than being recognised as goodwill. Transaction costs were capitalised and deferred taxes were not recognised, because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12 *Income Taxes*.

(c) **hybrid approach:** a third group of preparers of IFRS financial statements only applied the principles on business combinations accounting in IFRS 3 and other IFRSs to issues that were not addressed elsewhere in IFRS. Identifiable assets and liabilities were measured at fair value, with exceptions, and the residual was recognised as a separate asset, ie goodwill. Transaction costs, however, were capitalised and contingent

* IFRS 11 *Joint Arrangements* shall be applied for annual periods beginning on or after 1 January 2013. It replaces IAS 31 *Interests in Joint Ventures*.

liabilities and deferred taxes were not recognised because these issues were considered as being addressed elsewhere in IFRS. Deferred taxes were not recognised, because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12.

BC45C The different approaches have led to different accounting outcomes, in particular:

(a) in accounting for premiums paid in excess of the value of the identifiable net assets;

(b) in capitalising or expensing acquisition-related costs; and

(c) in accounting for deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets and liabilities.

BC45D The IASB noted that the diversity in practice resulted from the fact that IAS 31 did not give specific guidance on the accounting for acquisitions of interests in jointly controlled operations or jointly controlled assets, the activity of which constitutes a business, as defined in IFRS 3. The IASB was concerned that this diversity in practice may continue in the accounting for acquisitions of interests in joint operations, as defined in IFRS 11, when the activities of those joint operations constitute businesses. Arrangements that were formerly 'jointly controlled operations' and 'jointly controlled assets' in IAS 31 are joint operations in IFRS 11 (see paragraph BC26). As was the case in IAS 31, a joint operator recognises its (share in the) assets, liabilities, revenue and expenses relating to such arrangements.

BC45E The IASB considered the guidance in current IFRS on the acquisition of an interest in a business. The IASB recognised that the acquisition of an interest in a joint operation does not meet the definition of a business combination in IFRS 3. Nonetheless, the IASB concluded that the most appropriate approach to account for an acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, is to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs that do not conflict with the guidance in this IFRS.

BC45F The IASB reached this conclusion because:

(a) it considers that separate recognition of goodwill, when present, is preferable to allocating premiums to identifiable assets acquired on the basis of relative fair values;

(b) it thinks that an approach that limits the application of business combinations accounting only to issues that are not addressed elsewhere in IFRS lacks a strong conceptual basis; and

(c) the guidance in IFRS 3 and other IFRSs on business combinations give a comprehensive and consistent set of accounting principles for the different components of such complex transactions as acquisitions of interests in businesses.

BC45G The IASB also concluded that an entity that is acquiring an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, shall disclose the relevant information that is specified in IFRS 3 and other IFRSs on business combinations. This is because these requirements are an integral part of the financial reporting about the acquisition of interests in businesses.

BC45H Consequently, the IASB amended IFRS 11 to address the accounting for both the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, and the related disclosure requirements, as a means to resolve the diversity in practice.

BC45I The IASB noted that the fact patterns raised with the Interpretations Committee were limited to circumstances involving a business, as defined in IFRS 3. The IASB noted that IFRS already provides guidance for the acquisition of an interest in an asset or a group of assets that is not a business, as defined in IFRS 3. Consequently, the amendments apply only when an entity acquires an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3, either on formation of that joint operation or when acquiring an interest in an existing joint operation.

BC45J The Exposure Draft *Acquisition of an Interest in a Joint Operation* (Proposed amendment to IFRS 11), which was published in December 2012, used the term 'relevant principles on business combinations accounting in IFRS 3 and other IFRSs' to describe the principles that have to be applied in accounting for the acquisition of an interest in a joint operation in which the activity constitutes a business. In analysing the comment letters on the Exposure Draft, the IASB noted divergent understanding of what the 'relevant principles on business combinations accounting in IFRS 3 and other IFRSs' are, within the context of the proposed amendment.

BC45K In order to avoid diversity in practice from the application of the term 'relevant principles on business combinations accounting in IFRS 3 and other IFRSs', the IASB decided to replace this term with 'all of the principles on business combinations accounting in IFRS 3 and other IFRSs that do not conflict with the guidance in this IFRS'. In addition, to aid understanding the application guidance includes a non-exhaustive list of five principles related to business combinations accounting in IFRS 3 and other IFRSs that do not conflict with the principles in this IFRS. Four of them relate to the areas in which the Interpretations Committee observed different accounting outcomes from the application of different approaches to the accounting for acquisitions of interests in jointly controlled operations or jointly controlled assets in which the activity constitutes a business (see paragraphs BC45B–BC45C).

BC45L The IASB also noted that the reference to 'all of the principles on business combinations accounting in IFRS 3 and other IFRSs' is ambiguous for acquisitions of additional interests in joint operations that result in the joint operator retaining joint control of the joint operation. It might be understood as a reference to either:

(a) paragraph 42 of IFRS 3 with the result of remeasuring a previously held interest in a joint operation on the acquisition of an additional interest while retaining joint control; or

(b) paragraph 23 of IFRS 10 with the result of not remeasuring a previously held interest in a joint operation on the acquisition of an additional interest while retaining joint control.

BC45M In order to resolve this ambiguity, the IASB decided to clarify that previously held interests in a joint operation are not remeasured if the joint operator retains joint control. Paragraph 23 of IFRS 10 addresses the accounting for the acquisition of an additional interest in a business that is already controlled by the acquirer. This is the analogous transaction to the acquisition of an interest in a business that is already jointly controlled by the acquirer and will continue to be jointly controlled by it. Paragraph 42 of IFRS 3 instead addresses the acquisition of an interest that results in the acquirer obtaining control over the business. This is the analogous transaction to the acquisition of an interest in a business that results in the acquirer obtaining joint control of the business.

BC45N The IASB decided to add a scope exclusion for joint operations under common control to the amendments to IFRS 11. The IASB concluded that the amendments to IFRS 11 should not require the application of all of the principles on business combinations accounting for transactions that would be outside the scope of IFRS 3 if control, rather than joint control, would be obtained or retained by the acquirer.

...

Accounting for acquisitions of interests in joint operations

BC69C The IASB considered the transition provisions and effective date of the amendments to IFRS 11. The IASB noted that applying all of the principles of business combinations accounting in IFRS 3 and other IFRSs that do not conflict with the guidance in this IFRS to transactions that have previously been accounted for by applying one of the divergent approaches presented in paragraph BC45B might involve the use of hindsight in determining the acquisition-date fair values of the identifiable assets and liabilities that are to be recognised as part of the transaction and in performing the impairment test for goodwill. Consequently, the IASB decided that an entity would apply the amendments to IFRS 11 prospectively for transactions occurring in annual periods beginning on or after 1 January 2016 with early application permitted.

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Illustrative Examples
Hong Kong Financial Reporting Standard 11

Joint Arrangements

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

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IFRS 11 *Joint Arrangements*
Illustrative examples

Amendments to the Illustrative Examples on IFRS 11 *Accounting for Acquisitions of Interests in Joint Operations*

This appendix contains amendments to the Illustrative Examples on IFRS 11 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Illustrative Examples and this appendix will be deleted.

These examples accompany, but are not part of, IFRS 11. They illustrate aspects of IFRS 11 but are not intended to provide interpretative guidance.

The footnote to paragraph IE48 is amended. Deleted text is struck through and new text is underlined.

In ~~this~~ these examples monetary amounts are denominated in 'currency units (CU)'.

Paragraphs IE53–IE73 and their related headings are added. New text is underlined.

Example 7—Accounting for acquisitions of interests in joint operations in which the activity constitutes a business

IE53 Companies A, B and C have joint control of Joint Operation D whose activity constitutes a business, as defined in IFRS 3 *Business Combinations*.

IE54 Company E acquires company A's 40 per cent ownership interest in Joint Operation D at a cost of CU300 and incurs acquisition-related costs of CU50.

IE55 The contractual arrangement between the parties that Company E joined as part of the acquisition establishes that Company E's shares in several assets and liabilities differ from its ownership interest in Joint Operation D. The following table sets out Company E's share in the assets and liabilities related to Joint Operation D as established in the contractual arrangement between the parties:

	Company E's share in the assets and liabilities related to Joint Operation D
Property, plant and equipment	48%
Intangible assets (excluding goodwill)	90%
Accounts receivable	40%
Inventory	40%
Retirement benefit obligations	15%
Accounts payable	40%
Contingent liabilities	56%

Analysis

IE56 Company E recognises in its financial statements its share of the assets and liabilities resulting from the contractual arrangement (see paragraph 20).

IE57 It applies the principles on business combinations accounting in IFRS 3 and other IFRSs for identifying, recognising, measuring and classifying the assets acquired, and the liabilities assumed, on the acquisition of the interest in Joint Operation D. This is because Company E acquired an interest in a joint operation in which the activity constitutes a business (see paragraph 21A).

IE58 However, Company E does not apply the principles on business combinations accounting in IFRS 3 and other IFRSs that conflict with the guidance in this IFRS. Consequently, in accordance with paragraph 20, Company E recognises, and therefore measures, in relation to its interest in Joint Operation D, only its share in each of the assets that are jointly held and in each of the liabilities that are incurred jointly, as stated in the contractual arrangement. Company E does not include in its assets and liabilities the shares of the other parties in Joint Operation D.

IE59 IFRS 3 requires the acquirer to measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values with limited exceptions; for example, deferred tax assets and deferred tax liabilities are not measured at fair value but are measured in accordance with IAS 12 *Income Taxes*. Such measurement does not conflict with this IFRS and thus those requirements apply.

IE60 Consequently, Company E determines the fair value, or other measure specified in IFRS 3, of its share in the identifiable assets and liabilities related to Joint Operation D. The following table sets out the fair value or other measure specified by IFRS 3 of Company E's shares in the identifiable assets and liabilities related to Joint Operation D:

	Fair value or other measure specified by IFRS 3 for Company E's shares in the identifiable assets and liabilities of Joint Operation D **CU**
Property, plant and equipment	138
Intangible assets (excluding goodwill)	72
Accounts receivable	84
Inventory	70
Retirement benefit obligations	(12)
Accounts payable	(48)
Contingent liabilities	(52)
Deferred tax liability	(24)
Net assets	**228**

IE61 In accordance with IFRS 3, the excess of the consideration transferred over the amount allocated to Company E's shares in the net identifiable assets is recognised as goodwill:

Consideration transferred	CU300
Company E's shares in the identifiable assets and liabilities relating to its interest in the joint operation	CU228
Goodwill	**CU72**

IE62 Acquisition-related costs of CU50 are not considered to be part of the consideration transferred for the interest in the joint operation. They are recognised as expenses in profit or loss in the period that the costs are incurred and the services are received (see paragraph 53 of IFRS 3).

Example 8—Contributing the right to use know-how to a joint operation in which the activity constitutes a business

IE63 Companies A and B are two companies whose business is the construction of high performance batteries for diverse applications.

IE64 In order to develop batteries for electric vehicles they set up a contractual arrangement (Joint Operation Z) to work together. Companies A and B share joint control of Joint Operation Z. This arrangement is a joint operation in which the activity constitutes a business, as defined in IFRS 3.

IE65 After several years, the joint operators (Companies A and B) concluded that it is feasible to develop a battery for electric vehicles using Material M. However, processing Material M requires specialist know-how and thus far, Material M has only been used in the production of cosmetics.

IE66 In order to get access to existing know-how in processing Material M, Companies A and B arrange for Company C to join as another joint operator by acquiring an interest in Joint Operation Z from Companies A and B and becoming a party to the contractual arrangements.

IE67 Company C's business so far has been solely the development and production of cosmetics. It has long-standing and extensive knowledge in processing Material M.

IE68 In exchange for its share in Joint Operation Z, Company C pays cash to Companies A and B and grants the right to use its know-how in processing Material M for the purposes of Joint Operation Z. In addition, Company C seconds some of its employees who are experienced in processing Material M to Joint Operation Z. However, Company C does not transfer control of the know-how to Companies A and B or Joint Operation Z because it retains all the rights to it. In particular, Company C is entitled to withdraw the right to use its know-how in processing Material M and to withdraw its seconded employees without any restrictions or compensation to Companies A and B or Joint Operation Z if it ceases its participation in Joint Operation Z.

IE69 The fair value of Company C's know-how on the date of the acquisition of the interest in the joint operation is CU1,000. Immediately before the acquisition, the carrying amount of the know-how in the financial statements of Company C was CU300.

Analysis

IE70 Company C has acquired an interest in Joint Operation Z in which the activity of the joint operation constitutes a business, as defined in IFRS 3.

IE71 In accounting for the acquisition of its interest in the joint operation, Company C applies all the principles on business combinations accounting in IFRS 3 and other IFRSs that do not conflict with the guidance in this IFRS (see paragraph 21A). Company C therefore recognises in its financial statements its share of the assets and liabilities resulting from the contractual arrangement (see paragraph 20).

IE72 Company C granted the right to use its know-how in processing Material M to Joint Operation Z as part of joining Joint Operation Z as a joint operator. However, Company C retains control of this right because it is entitled to withdraw the right to use its know-how in processing Material M and to withdraw its seconded employees without any restrictions or any compensation to Companies A and B or Joint Operation Z if it ceases its participation in Joint Operation Z.

IE73 Consequently, Company C continues to recognise the know-how in processing Material M after the acquisition of the interest in Joint Operation Z because it retains all the rights to it. This means that Company C will continue to recognise the know-how based on its carrying amount of CU300. As a consequence of retaining control of the right to use the know-how that it granted to the joint operation, Company C has granted the right to use the know-how to itself. Consequently, Company C does not remeasure the know-how, and it does not recognise a gain or loss on the grant of the right to use it.