

AASB 138 “INTANGIBLE ASSETS” (IN PARTICULAR SOFTWARE)

BACKGROUND

AASB 138 *Intangible Assets* is an Australian Equivalent International Financial Reporting Standard (AIFRS) applicable to financial years beginning on or after 1 January 2005.

There is currently no Australian Accounting Standard that comprehensively deals with intangible assets. However there are general requirements contained in a number of standards that are applied to intangible assets. AASB 138 will replace the general requirements in six current Australian standards including AASB 1041 *Revaluation of Non-Current Assets*, AAS 4 *Depreciation*, AAS 10 *Recoverable Amount of Non-Current Assets*, AAS 21 *Acquisitions of Assets*, AAS 13 *Accounting for Research and Development Costs* and AAS 18 *Accounting for Goodwill*. AASB 138 also covers some of the general principals covered in Statement of Accounting Concepts (SAC) 4.

This Policy Summary goes through the main requirements in AASB 138 and also outlines the main differences between the general requirements in the existing AASB and AAS standards regarding intangible assets and the new requirements of AASB 138.

The main impact of this standard on ACT Government agencies is in relation to software, as this is the only material intangible asset that is held by the ACT. As a result, this policy summary emphasises the application of this standard to software.

NEW REQUIREMENTS

Definition

An intangible asset is defined in AASB 138 as an identifiable non-monetary asset without physical substance. This definition includes software.

Software

AASB 138 requires that where software is integral to the related hardware it should be included as property, plant and equipment rather than an intangible asset. For example, the operating system of a computer is integral to the operation of the computer, therefore the computer and operating system should be classified as property, plant and equipment. However application software is not integral to the operation of the computer so should be classified as an intangible asset.

Most ACT Government agencies' software is large application software which should be classified as an intangible asset rather than property, plant and equipment.

Recognition

Under AASB 138, an intangible asset is recognised when it is probable that the expected future economic benefits that are attributable to the asset will flow to the agency and the cost of the asset can be measured reliably.

Software

When an agency purchases software externally this recognition criteria is generally met. However if software is internally generated AASB 138 outlines additional requirements that must be fulfilled in order for internally generated software to be recognised. When assessing whether internally generated software meets the criteria for recognition, an agency is required to classify work performed internally into two phases, the research phase and the development phase.

Examples of activities classified in the research phase are:

- activities aimed at obtaining new knowledge; and
- the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Examples of activities classified in the development phase are:

- the design, construction and testing of software; and
- the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

Costs associated with the research phase cannot be capitalised into the value of internally generated software. Instead the cost is expensed in the year in which it is incurred.

In addition to the general recognition requirements, costs associated with the development phase can only be capitalised into the value of internally generated software when all of the following can be demonstrated by an agency:

- the technical feasibility of completing the software so that it will be available for use;
- its intention to complete and use the software;
- its ability to use the software;
- how the software will generate probable future economic benefits. Among other things, the entity can demonstrate the usefulness of the software;
- the availability of adequate technical, financial and other resources to complete the development and to use the software; and
- its ability to measure reliably the expenditure attributable to the software during its development.

Where software meets the recognition criteria, ACT Government agencies should include that software in the accounting records and record it in their assets register.

ACT Government agencies should note that computer software that does not meet the definition or recognition criteria, and therefore is recorded as expenditure in the financial statements, is not able to be capitalised in subsequent years.

Goodwill

Internally generated goodwill shall not be recognised as an asset. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (i.e. 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.

Differences between the market 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 value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

Different rules apply to goodwill purchased as a result of an acquisition (see AASB 3 *Business Combinations*).

Other Intangibles

Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets. This is because expenditure on these internally generated intangibles cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

These intangible assets must be written-off on transition to AIFRS. See ACT AIFRS Policy Summary on AASB 1 “First-time Adoption of Australian Equivalents to International Financial Reporting Standards”.

Measurement of Software

Under AASB 138, externally purchased software is measured at its initial cost, which includes its purchase price and any directly attributable costs. Directly attributable costs include professional fees and employee costs of bringing software into working order and also costs of testing the software. Costs that cannot be capitalised include staff training costs, and administration and other overhead costs.

Internally generated software is initially measured with reference to all directly attributable costs. Examples of directly attributable costs include:

- costs of materials and services used or consumed in generating the software;
- costs of employee benefits arising from the generation of the software; and
- amortisation of patents and licences that are used to generate the software.

Costs that cannot be capitalised include staff training costs, identified inefficiencies before software achieves planned performance, and general administration and other overhead costs.

It is ACT Government policy that computer software should be capitalised where the expenditure is of a capital nature and greater than or equal to the capitalisation threshold of \$50,000. Bulk purchases of the same or similar software meeting the definition and recognition criteria as stated above, and in total exceeding the capitalisation threshold, should be capitalised.

All ACT Government agencies should measure software at cost after initial measurement, even though in limited cases AASB 138 allows software to be measured at fair value after initial measurement. Software is measured at cost as it is difficult to determine fair value with reference to an active market and software has a very short useful life.

Enhancement of Software Previously Capitalised

AASB 138 does not provide specific guidance on enhancement of software. However, the following ACT Government accounting policy applies to all agencies:

- Expenditure incurred on modifying existing systems should only be capitalised if the expenditure enhances the service potential and functionality of existing software in future periods. For capitalisation of the additional enhancement expenditure, it must also be capable of reliable measurement and be greater than or equal to the capitalisation threshold;
- Where an enhancement is considered to be so extensive that it constitutes a replacement of the existing software, any unamortised amounts for the original software should be expensed in the year that the original software is replaced; and
- Where the expenditure merely maintains the software at its current service potential and functionality, then the amount should be expensed.

Amortisation of Software

Under AASB 138, amortisation of software occurs on a systematic basis over its useful life after deducting the residual value. Where an agency can determine the pattern of the expected consumption of the software's future economic benefit, software is amortised based on this pattern. Where the pattern of consumption cannot be determined a straight-line method is used. It is expected that most software will be amortised on a straight-line basis. Amortisation commences when the software is available for use and ceases when the software is classified as held for sale or where the software is derecognised.

The residual value of software will be measured at zero unless there is a commitment from a third party to purchase the software or there is an active market for the software. Therefore, in almost all cases the residual value of software held by ACT Government agencies will be zero.

AASB 138 allows the useful life of an intangible asset to be determined as either indefinite or finite as assessed by the entity. However, as software has a high obsolescence rate, software recorded by ACT Government agencies will be determined to have a finite life with a maximum useful life of five years.

Disclosure of Software

Under AASB 138 para 118, ACT Government agencies are required to make a number of disclosures, distinguishing between internally generated software assets and externally purchased software assets. Further disclosures regarding the amount, nature and description of software are also required.

All disclosures regarding software will be included in the 2005-06 Model Financial Statements.

Examples of Costs that should be Capitalised and Expensed

Internally Developed and Externally Acquired and Modified Software

The following table provides a practical example of cost items that should be capitalised (where the capitalisation limit is met) and those that should be expensed. The table specifically refers to internally developed software. Project Activity/Item 1 (in the table below) represents the research phase while Project Activities/Items 2,3 and 4 represent the development phase, referred to in the 'Recognition' section above.

Project Activity/Item	Activity/Cost Item Description	Expenditure type
1. Initiation Stage (scoping, evaluation and Business case)	<ul style="list-style-type: none"> • Project Scoping tasks including, • Conceptual formulation of alternatives, evaluation of alternatives, determination of the existence of the necessary technology. • Technology evaluation • Selection of alternatives • Business case analysis and the management and planning functions for the project • Developing standards and architectural designs 	Expense (as these costs do not enhance the service potential or functionality of software).
2. Analysis, Design and Development	<ul style="list-style-type: none"> • Detailed analysis of user requirements • Detailed design and specification • Software development configuration and interfaces (including total staff costs and contractor/consultant fees) • Coding • Installation of software 	Capitalise Capitalise Capitalise Capitalise Capitalise
3. Testing production and Implementation	<ul style="list-style-type: none"> • Testing including parallel processing phase up to the point where the system is live at the first site only if implementation at subsequent sites does not enhance the software functionality. • Implementation of the software 	Capitalise Capitalise

Project Activity/Item	Activity/Cost Item Description	Expenditure type
4. Enhancement of existing applications	<ul style="list-style-type: none"> • Detailed design and specification • Software configuration • Development of interfaces • Coding • Installation of software on hardware necessary to get the software ready for production use at the first site only if the implementation at subsequent sites does not enhance software functionality • Testing • Parallel processing 	<p>Capitalise Capitalise Capitalise Capitalise Capitalise</p> <p>Capitalise Capitalise</p>
5. Recurring maintenance and Infrastructure support	<ul style="list-style-type: none"> • Management/planning functions associated with ensuring the project is completed, including provision of accommodation and office supplies and services for the project team • Data conversion from old systems into the new system • Post implementation review • Training of staff in the use or administration of the software (training room set up, organising, delivering and, attending training, fees paid to vendor to attend a training course) • Ongoing support and system administration • Applications maintenance, including maintenance for software licences which includes provision for delivery of software upgrades • Management of infrastructure resources and cost of infrastructure support • Minor projects where an asset will be acquired or developed but the total expenditure will not exceed the threshold amount • The task being undertaken is unlikely to result in an asset 	<p>Expense</p> <p>Expense Expense Expense</p> <p>Expense Expense</p> <p>Expense</p> <p>Expense Expense</p>
6. Whole of Project, Multi-Stage or other Items	<ul style="list-style-type: none"> • Borrowing costs • Software licences acquired to be configured for the new system • Software licences acquired specifically to develop system if this software is not expected to be used for any other system development. Software licences for tools that are expected to be used for a range of projects should be assted individually and recorded on the appropriate asset register. • Travel costs in the Research phase directly related to the development and of the IT system. • Travel costs in the Development phase directly related to the development and of the IT system • Development of system specific training material that would be considered part of the asset to be developed and delivered for ongoing business use. • Training staff in the use of the project specific tools required to build or configure the software or hardware. • Installation costs at secondary or subsequent sites unless the subsequent implementations require additional analysis, design and configuration to suit meet slightly different 	<p>Expense Capitalise</p> <p>Capitalise</p> <p>Expense</p> <p>Capitalise</p> <p>Capitalise</p> <p>Expense</p> <p>Expense</p>

Project Activity/Item	Activity/Cost Item Description	Expenditure type
	design and configuration to suit meet slightly different business requirements. <ul style="list-style-type: none"> Any vendor support costs. Lease costs for IT hardware (which include leases costs for PC's used by the team and lease costs of the servers/mid-range/mainframe and network infrastructure). Ongoing programming support to correct defects or cater for changes in legislation or modified business rules that do not constitute a significant enhancement to the software. Internal business costs that are difficult to separately identify (ie cost of users time spent assisting in the analysis of the business requirements that are not costed directly to the project). 	Expense Expense Expense Expense

Externally Developed Software

The following table provides a practical example of cost items that should be capitalised (where the capitalisation limit is met) and those that should be expensed. The table specifically refers to externally developed software.

Item	Cost Item Description	Expenditure type
1. Externally purchased off-the-shelf software	<ul style="list-style-type: none"> Purchased software Initial lump sum payment for a licence Software installation costs Training costs Maintenance fees Evaluation and assessment costs 	Capitalise Capitalise Capitalise Expense Expense Expense

The suitability of the purchased software would normally be assessed prior to acquisition and would, therefore, be probable that the service potential or future benefits of the asset would eventuate to justify the purchase. Such software would also have a cost or value that can be reliably measured.

IMPACT ON CURRENT PRACTICE

Significant Impacts

There are no significant impacts arising from the change to the new requirements in AASB 138 *Intangible Assets*.

Insignificant Impacts

A number of changes proposed in AASB 138 *Intangible Assets* may have an insignificant impact on ACT Government agencies. These insignificant impacts are outlined below.

Residual value

AASB 138 para 100 requires the residual value of an intangible asset with a finite useful life to be assumed to be zero unless:

- there is a commitment by a third party to purchase the asset at the end of its useful life; or
- residual value can be determined by reference to an active market for the asset.

However existing AAS 4 para 14.1.1 states that the estimated residual value may be calculated using the residual value prevailing at the date of the estimate for similar assets that have reached the end of their useful lives and have operated under conditions similar to those for which the asset will be used by the entity.

In most, if not all cases, ACT Government agencies will record a nil residual value for software under the new requirements in AASB 138. Therefore where ACT Government agencies currently have a residual value for software assets, they will need to adjust their carrying value to reflect no residual value.

Definition of Intangible Assets

Currently there is no specific definition of intangible assets under current Australian requirements. Intangibles fall under the general definition of an asset in SAC 4 as:

‘future economic benefit controlled by the entity as a result of past transactions or other past events’.

AASB 138 contains a more specific definition stating that an intangible asset is:

‘an identifiable non-monetary asset without physical substance’.

Even though AASB 138 has a more specific definition this will not have a practical impact on ACT Government agencies. That is, software that meets the current definition will meet the new definition under AASB 138.

Classification

AASB 138 states that where the tangible and intangible elements of an asset cannot be separated, the element which is more significant will determine whether the intangible component is classified as property, plant and equipment or as an intangible asset.

Under current requirements the intangible element would always be classified as an intangible asset.

As most software created or purchased by ACT Government agencies will be application software, this change will not have a major impact on the ACT.

Recognition of Intangible Assets

Both AASB 138 and current GAAP have the same general recognition criteria for an intangible asset. In addition to the general recognition requirements, AASB 138 requires internally generated intangibles to be divided into two categories called the research phase and the development phase. Costs related to the Research phase are expensed and the costs in the development phase can be capitalised where additional criteria are met.

In the ACT Accounting Policy Manual (APM), the development and implementation of internally developed software was divided into a number of stages, with the cost relating to each stage designated as either capital or expense. The designation of costs in the APM is consistent with the designation of costs as either research or development activities in accordance with AASB 138.

Therefore, previous internally generated software expenditure that was capitalised can continue to be capitalised on adoption of AIFRSs. That is, it does not have to be derecognised on transition to AIFRSs. Further, after transition, most types of expenditure currently classified as capital and expenses will continue to be classified in the same way. Also, after initial adoption of AIFRSs, AASB 138 para 71 states that costs recognised as an expense cannot be subsequently capitalised.

Amortisation method

The amortisation method provided in AASB 138 is slightly different to current practice. However, as the majority of ACT Government agencies currently amortise software using the straight-line method, this change will not have a major impact on the ACT.

Separate Disclosure of Internally Generated and Externally Purchased Software

AASB 138 para 118 requires some software disclosures to be separated into internally generated software and externally purchased software (see above in the 'Disclosures' section). Under current Australian GAAP these disclosures need not be separated in this way.

Internally Generated Intangibles

AASB 138 para 63 prohibits the recognition of internally generated brands, mastheads, publishing titles, customer lists and items similar in substance. There is no such prohibition under existing AASB 1015, AASB 1021 or AASB 1041.

This will not have a major impact on the ACT as very few, if any agencies will have internally generated brands, mastheads, publishing titles, customer lists and items similar in substance.

Disclosure – Materiality of Software

AASB 138 requires that a description, the carrying amount and remaining amortisation period of any individual software asset that is material to the entity's financial report be separately disclosed. This is not required under current Australian GAAP.

However, as it is very unlikely that any individual software asset will be material to an ACT Government agency's financial report, this change will not have a major impact on the ACT.