

Chapter 21

IAS 38 - INTANGIBLE ASSETS: GOODWILL, RESEARCH AND DEVELOPMENT

1. Introduction

In this chapter we will consider two types of intangible assets that you are required to know about for the examination. Intangible assets are assets which have a value to the business, but cannot be touched (i.e. have no physical substance).

The two that you must have knowledge of are goodwill, and research and development, and we will consider the accounting treatment of both.

2. Goodwill

Goodwill is the excess of the value of a business over the fair value of the net assets.

Purchased goodwill

This is goodwill that arises when a company purchases another company. It is commonly the case that the consideration paid is greater than the fair value of the net assets, and this excess is the goodwill. This goodwill may be capitalised as a non-current asset, and amortised.

Non-purchased goodwill

An existing company is likely to be worth more, were it to be sold, than the worth of the net tangible assets. A company could therefore want to claim that there was an extra asset of goodwill.

However, non-purchased goodwill should not be recognised in the financial statements. This is because no event has occurred to identify the value of the business.

3. Research and Development

IAS 38 Intangible assets governs the accounting treatment of these costs.

Research

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



Development

This 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 prior to the commencement of commercial production or use'.

Accounting treatment

Research expenditure should all be charged to the Statement of Profit or Loss as an expense in the period in which it is incurred.

Development expenditure should be capitalised and shown as an asset on the Statement of Financial Position if (and only if) the following conditions apply:

- (a) there should be an identifiable product
- (b) the company should have the resources to be able to complete the development
- (c) there should be an identified market for the product
- (d) the expenditure should be measurable

If the costs are capitalised, then they must be amortised in line with the pattern of income resulting.

If the conditions are not fulfilled, then the expenditure should be written off in the Statement of Profit or Loss in the period incurred.

(Note that all the above only applies to intangible assets. If any tangible assets are purchased then they must be capitalised and depreciated as normal.)

Disclosure requirements

The following should be disclosed in the financial statements:

- (a) the amortisation method used for development expenditure
- (b) the amount of amortisation during the period
- (c) a reconciliation between the written down value brought forward and the value carried forward
- (d) the amount of research expenditure charged in the Statement of Profit or Loss for the period.

The position of each development project should be reviewed each year. If any project no longer meets the IAS 38 criteria then it should be written off.

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