

# IAS 38: Intangible Assets

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## 1. Executive summary

- IAS 38 governs accounting for intangible assets that are identifiable, non-monetary and without physical substance, except where other IFRS apply (e.g., goodwill under IFRS 3).
  - Recognition requires identifiability, control, probable future economic benefits and reliable cost measurement.
  - Initial measurement is at cost (purchase price + directly attributable costs). In business combinations, intangibles are recognised at fair value at acquisition.
  - Subsequent measurement: cost model (cost less accumulated amortisation and impairment) or revaluation model (only if active market exists).
  - Useful life: finite (amortise) or indefinite (no amortisation; annual impairment test).
  - Internally generated intangibles: research costs are expensed; development costs capitalised only when strict criteria are met.
  - Impairment: apply IAS 36; indefinite-life intangibles tested annually.
  - Disclosures are extensive: carrying amounts, amortisation methods, useful lives, revaluation details, reconciliations, R&D capitalised, impairment losses.
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## 2. Standard overview: definition, scope and exclusions

Definition: An intangible asset is an

- **identifiable**
- **non-monetary asset**
- **without physical substance**

that is controlled by the entity and from which future economic benefits are expected.

Scope: IAS 38 applies to intangible assets except where another IFRS requires or permits different accounting (e.g., IFRS 3 for goodwill, IAS 2 for inventories, and IAS 16 for property, plant and equipment – when intangible asset is integral to an item of PPE).

Common exclusions:

- Goodwill acquired in a business combination (IFRS 3).
  - Financial assets (IAS 32/IFRS 9).
  - Mineral rights and exploration (IFRS 6).
  - Leases (IFRS 16) – lease of intangible right-of-use assets are accounted under IFRS 16.
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### 3. Recognition criteria – detailed checklist

Recognition test (must all be met):

1. Identifiability – asset is **separable** (can be sold, transferred, licensed) or arises from contractual/legal rights.
2. Control – entity has power to obtain benefits and restrict others' access.
3. Probable future economic benefits – more likely than not that benefits will flow to the entity.
4. Reliable measurement of cost – cost can be measured reliably.

Recognition checklist (flowchart style, use in answers):

1. Is the asset identifiable? → If no, do not recognise.
2. Does the entity control the asset? → If no, do not recognise.

3. Are future economic benefits probable? → If no, expense.
  4. Can cost be measured reliably? → If no, expense.
  5. If all yes → recognise as intangible asset and measure at cost.
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#### **4. Initial measurement**

General rule: Recognise at cost. Cost includes purchase price, import duties, non-refundable taxes, and directly attributable costs to prepare the asset for its intended use (e.g., legal fees, registration fees, testing).

##### **A. Purchase of intangible asset (example)**

- Scenario: Company A purchases a patent from an external party for R1,200,000. Legal registration and transfer fees amount to R50,000.
- Initial cost:  $R1,200,000 + R50,000 = R1,250,000$ .
- Journal entry on acquisition:
  - Dr Patent (Intangible asset): Cost R1,250,000
  - Cr Bank R1,250,000

##### **B. Business combination (example)**

- Scenario: In a business combination, Company B acquires Company C. At acquisition, a customer list is identified and valued at fair value R2,500,000. Transaction costs of the acquisition are expensed under IFRS 3 and not included in intangible asset cost. Directly attributable costs to register the asset post-acquisition of R30,000 are included.

- Initial recognition at acquisition date: Customer list R2,500,000 (fair value). If additional directly attributable costs are incurred by the acquirer to register, include them: total R2,530,000.

- Journal entry at acquisition (recognition in acquirer's books):

- Dr Customer list (Intangible asset): Cost R2,530,000

- Cr Consideration transferred / Goodwill / Other (as per acquisition accounting) R2,530,000 – separate column in statement of changes in equity, thus recognised as Other Comprehensive Income.

### **C. Exchange transactions**

If an intangible is acquired in exchange for another asset, measure at fair value of asset given up or fair value of asset received, whichever is more reliably measurable. If neither is reliably measurable, use carrying amount of asset given up.

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## **5. Subsequent measurement**

Two permitted models:

1. Cost model (most common): Carry at cost less accumulated amortisation and impairment losses.
2. Revaluation model: Carry at revalued amount (fair value at revaluation date) less *subsequent* amortisation and impairment. Revaluation model is permitted only if there is an active market for the intangible asset.

Active market requirement: An active market exists when transactions for the asset occur with sufficient frequency and volume to provide pricing information. For most intangibles (patents, trademarks, customer lists), active markets do not exist; revaluation is therefore rare.

### **Example – revaluation**

Scenario: Company D holds an intangible asset (trademark) originally recognised at cost of R800,000. At revaluation date fair value is R1,200,000. Accumulated amortisation to date is R200,000 (carrying amount therefore R600,000). Revalue to R1,200,000.

Revaluation surplus: New carrying amount R1,200,000 less previous carrying amount R600,000 = R600,000 increase. Recognise: Dr Accumulated amortisation R200,000; Dr Intangible asset R400,000; Cr Revaluation surplus (OCI) R600,000. (Presentation depends on whether asset had accumulated amortisation; revaluation increases go to OCI unless reversing previous impairment charged to profit or loss.)

Journal entries:

- Dr Accumulated amortisation – Trademark R200,000
- Dr Trademark (Intangible asset) R400,000
- Cr Revaluation surplus (OCI) R600,000

Subsequent amortisation: Amortise revalued amount over remaining useful life; transfer revaluation surplus to retained earnings as asset is used (reclassification adjustment).

## 6. Useful life and amortisation

### Finite vs indefinite life:

- Finite life: amortise over useful life. Review useful life and amortisation method at least annually.
- Indefinite life: do not amortise; test for impairment annually (or more frequently if indicators exist).

Amortisation methods: Choose method that best reflects pattern of consumption of economic benefits: straight-line, diminishing balance (reducing balance), units of production.

Residual value: Usually assumed to be zero for intangibles unless there is a commitment by a third party to purchase the asset at the end of its useful life or there is an active market.

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### Worked amortisation example (same asset, three methods)

Asset: Patent cost R1,250,000 (from earlier example). Useful life = 10 years.  
Residual value = R0.

#### 1. Straight-line method

- Annual amortisation =  $R1,250,000 / 10 = R125,000$  p.a.

#### 2. Diminishing balance method (example rate 20% p.a.)

- Year 1 amortisation =  $20\% \times R1,250,000 = R250,000$

- Carrying amount end Year 1 = R1,000,000

- Year 2 amortisation =  $20\% \times R1,000,000 = R200,000$

- Continue similarly.

### 3. Units of production method (example)

Assume total expected units (e.g., units sold or production units) = 1,000,000 units. Cost per unit =  $R1,250,000 / 1,000,000 = R1.25$  per unit. If Year 1 production = 120,000 units  $\rightarrow$  amortisation =  $120,000 \times R1.25 = R150,000$ .

Journal entry for annual amortisation:

- Dr Amortisation expense Rxxx,xxx

- Cr Patent: Accumulated amortisation Rxxx,xxx

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## 7. Internally generated intangible assets

Two phases: research (expense) and development (possible capitalisation).

- **Research phase:** Costs incurred during research are expensed as incurred (no capitalisation).
- **Development phase:** Costs may be capitalised only when all six of the following criteria are met:

1. Technical feasibility of completing the intangible asset so it will be available for use or sale.
2. Intention to complete and use or sell the asset.
3. Ability to use or sell the asset.

4. How the asset will generate probable future economic benefits (e.g., existence of market or internal use).
5. Availability of adequate technical, financial and other resources to complete development and to use or sell the asset.
6. Ability to measure reliably the expenditure attributable to the intangible asset during development.

**Example – research vs development:**

Scenario: Company E spends R2,000,000 on a project. Breakdown: research costs R800,000; development costs R1,200,000. Of the development costs, R300,000 are for feasibility studies that do not meet the capitalisation criteria; the remaining R900,000 meet all six criteria.

Accounting: Expense R800,000 (research) + R300,000 (development not meeting criteria) = R1,100,000 expensed. Capitalise R900,000 as an intangible asset.

- Journal entries:

- Dr Research expense R800,000
- Cr Bank R800,000
- Dr Development expense R300,000
- Cr Bank R300,000
- Dr Internally generated intangible (development): Cost R900,000
- Cr Bank R900,000

Subsequent treatment: Amortise capitalised development costs over useful life; test for impairment.

## 8. Impairment (link to IAS 36)

When to test:

- Intangible assets with indefinite useful lives – test for impairment at least annually.
- Intangible assets with finite useful lives – test when indicators of impairment exist.

Recoverable amount: Higher of fair value less costs of disposal (FVLCD) and value in use (VIU). If carrying amount > recoverable amount → impairment loss = carrying amount – recoverable amount.

Cash-generating unit (CGU): If asset does not generate independent cash inflows, allocate to the smallest identifiable group of assets that generate cash inflows largely independent of other assets.

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### Worked impairment test

Scenario: Company F has a trademark (indefinite life) with carrying amount of R3,200,000. Management estimates: fair value less costs of disposal R2,800,000; value in use (discounted cash flows) R2,400,000. Recoverable amount = higher of R2,800,000 and R2,400,000 = R2,800,000. Impairment loss = R3,200,000 – R2,800,000 = R400,000.

Journal entry:

- Dr Impairment loss (P&L) R400,000
- Cr Trademark: Accumulated Impairment Losses R400,000

If asset is part of CGU: allocate impairment to reduce carrying amounts of assets in CGU on a *pro rata* basis, but not below recoverable amount of each asset (special rules apply).

Reversal of impairment: For intangibles measured under cost model, reversal of impairment is permitted (except for goodwill) if recoverable amount increases; reversal recognised in profit or loss to the extent that it reverses previous impairment. For revalued assets, impairment is treated as revaluation decrease (OCI) to the extent of any revaluation surplus.

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## 9. Derecognition and disposal

Derecognition occurs when: asset is disposed of or no future economic benefits are expected from its use or disposal.

Gain or loss on disposal: difference between net disposal proceeds and carrying amount at disposal date. Recognise in profit or loss.

Journal entries on disposal (example):

- Scenario: Company G sells a patent with carrying amount R500,000 for R650,000 cash.

- Journal entries:

- Dr Bank R650,000

- Dr Patent: Accumulated amortisation (if any) [assume none for simplicity]

- Cr Patent: Cost R500,000

- Cr Profit on disposal (P&L) R150,000

If disposal proceeds < carrying amount: recognise loss in profit or loss.

## 10. Disclosure requirements (IAS 38)

Minimum disclosures for each class of intangible assets:

- Carrying amount at period end.
- Amortisation methods used and amortisation rates or useful lives.
- Reconciliation of carrying amount at beginning and end of period showing additions, disposals, revaluations, amortisation, impairment losses and reversals, and other movements.
- For revalued assets: effective date of revaluation, methods and significant assumptions applied in estimating fair values, carrying amount under cost model if revaluation model used, revaluation surplus movement.
- For intangible assets with indefinite lives: explanation of why indefinite life was determined and description of factors that could change that assessment.
- For capitalised development costs: amount capitalised during the period and amortisation recognised.
- Impairment losses and reversals recognised in profit or loss and where presented.
- Restrictions on title and contractual commitments to acquire intangible assets.
- Aggregate amortisation recognised in profit or loss for the period.

Disclosure templates: include a reconciliation table for each class of intangible assets showing opening balance, additions (purchases and capitalised development), disposals, revaluations, amortisation, impairment losses, transfers, and closing balance.

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## 11. Practical exam tips and common pitfalls

### Exam tips:

- Always run the recognition checklist first in exam answers.
- State the model chosen (cost or revaluation) and justify (active market?).
- Show journal entries for initial recognition, amortisation and impairment.
- For internally generated assets, clearly separate research (expense) and development (capitalise only if criteria met).
- When testing impairment, show calculations for FVLCD and VIU and state recoverable amount.
- Use clear headings and label journal entries and schedules.

### Common pitfalls:

- Capitalising research costs.
  - Treating goodwill as an identifiable intangible (goodwill is separate under IFRS 3).
  - Using revaluation model without an active market.
  - Forgetting to test indefinite-life intangibles annually for impairment.
  - Not disclosing required reconciliation of carrying amounts.
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## 12. Sample exam questions and model answers

### Question 1 – Recognition (short)

Company H purchases a trademark for R900,000 and incurs legal fees of R40,000 to register it. Should the trademark be recognised as an intangible asset and at what amount? Provide journal entry.

Answer 1:

- Trademark is identifiable, entity controls it, probable future benefits expected, cost measurable. Recognise at cost R900,000 + R40,000 = R940,000.

- Journal: Dr Trademark R940,000; Cr Bank R940,000.

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### Question 2 – Internally generated asset (worked)

Company I incurs R3,000,000 on a project: R1,200,000 research; R1,800,000 development. Of development, R600,000 meets capitalisation criteria; R1,200,000 does not. Prepare accounting entries.

Answer 2:

- Expense research R1,200,000 and development not meeting criteria R1,200,000 → total expense R2,400,000. Capitalise R600,000.

- Entries: Dr Research expense R1,200,000; Cr Bank R1,200,000. Dr Development expense R1,200,000; Cr Bank R1,200,000. Dr Internally generated intangible: Cost R600,000; Cr Bank R600,000.

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### Question 3 – Amortisation schedules (worked)

Patent cost R1,250,000; useful life 10 years; straight-line amortisation. Prepare first 3 years amortisation and carrying amounts.

Answer 3:

- Annual amortisation R125,000. Year 1 closing R1,125,000; Year 2 closing R1,000,000; Year 3 closing R875,000. Journal each year: Dr Amortisation expense R125,000; Cr Patent: Accumulated amortisation R125,000.

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### Question 4 – Impairment (worked)

Trademark carrying amount R3,200,000. FVLCD R2,800,000; VIU R2,400,000. Calculate impairment and journal entry.

Answer 4:

- Recoverable amount = R2,800,000. Impairment = R3,200,000 – R2,800,000 = R400,000. Journal: Dr Impairment loss R400,000; Cr Trademark: Accumulated impairment losses R400,000.

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### Question 5 – Revaluation (worked)

Company J revalues an intangible from carrying amount R600,000 to fair value R1,200,000. Show entries.

Answer 5:

- Increase R600,000 to be recognised in OCI (revaluation surplus) unless reversing prior impairment in P&L. Journal: Dr Accumulated amortisation (if

any) and Dr Intangible R400,000; Cr Revaluation surplus R600,000 (example depends on accumulated amortisation).

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#### Question 6 – Disposal (worked)

Company K sells an intangible with carrying amount R500,000 for R350,000. Show journal entries and P&L effect.

Answer 6:

- Loss on disposal R150,000. Journal: Dr Bank R350,000; Dr Loss on disposal R150,000; Cr Intangible R500,000.

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#### Question 7 – Exchange Transaction (short)

Company L exchanges an intangible asset for another asset. How to measure initial recognition?

Answer 7:

- Measure at fair value of asset received or fair value of asset given up, whichever is more reliably measurable. If neither is reliably measurable, use carrying amount of asset given up.

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Question 8 – Useful life assessment (short)

List factors to consider when determining useful life of an intangible asset.

Answer 8:

- Expected use, legal/contractual life, effects of obsolescence, typical product life cycles, maintenance policy, technical/market changes, expected residual value.

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Question 9 – Capitalisation criteria (short)

List the six criteria for capitalising development costs.

Answer 9:

1. Technical feasibility; 2. Intention to complete; 3. Ability to use or sell; 4. Probable future economic benefits; 5. Adequate resources to complete; 6. Reliable measurement of expenditure.

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Question 10 – Disclosure (short)

Name five required disclosures for intangible assets.

Answer 10:

- Carrying amounts by class; amortisation methods and useful lives; reconciliation of carrying amounts; revaluation details; amounts of capitalised development costs and impairment losses.

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### 13. Change in Estimate

When an impairment test has been performed, and it has been found that the intangible asset needs to be impaired, that situation must be treated as a **change in estimate**. The most common way to effect a change in estimate is by using the reallocation method. What this means is that in the year following the impairment, the carrying amount at the beginning of the subsequent year now becomes the **new depreciable amount** for calculating amortisation.

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### 14. Comprehensive Question Bank with Solutions

Appears in a separate PDF on this web page.