Can we recognise a brand name as an intangible asset?
(Relevant to Paper 7 – Financial Accounting)

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Introduction

Mr. Lee has operated an ice-cream store named “Royal Ice Cream Laboratory” for many years. The store is famous for its home-made ice cream, which it sells under the “Royal” brand name. The brand has earned a reputation for good quality and is ranked among the top five ice-cream brands by customers. Mr. Lee has estimated that the brand name “Royal” is worth around $5 million.

Can Mr. Lee recognise this $5 million as an intangible asset in the financial statements of the company? To answer this question, we must understand the characteristics of an intangible asset as set out in HKAS 38 “Intangible Assets”.

Characteristics of an Intangible Asset

In accordance with HKAS 38, an intangible asset possesses the following characteristics:

- Identifiability
  An asset is identifiable if it either (1) is separable, i.e. is capable of being separately sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, or (2) arises from contractual or other legal rights.
- Control
  An entity controls an asset if it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.
- Future Economic Benefits
  Future economic benefits are expected to flow to the entity, including revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity.

Recognition of an Intangible Asset

Apart from fulfilment of the characteristics of an intangible asset, an intangible asset should be recognised if, and only if:

- it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and
- the cost of the asset can be measured reliably.

Example 1

Referring back to the above-mentioned brand name “Royal” created by Mr. Lee, the brand is controlled by the company and it is probable that the company will be able to derive future economic benefit from control of the name. However, such internally generated brand names are unable to be identified separately. The brand name has been created as the result of a series of events, such as well-developed marketing campaigns, the use of high quality ingredients, or customers’ loyalty. Therefore, it has not been derived as the result of a single transaction or legal rights.

Moreover, the value attributed to the brand name of $5 million is not being measured on a reliable basis. In this case, the value of the brand name cannot be distinguished from the cost of developing the business as a whole.

Therefore, the “Royal” brand name does not meet the criteria for an intangible asset and cannot be recognised as an intangible asset in accordance with HKAS 38.

Internally Generated Intangible Asset

To assess whether an internally generated intangible asset meets the recognition criteria, we have to develop the asset into two phases: a research phase and a development phase.

Research phase

Research is an original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. In this stage, because it is not probable that future economic benefits could be generated, such expenditures should be recognised as an expense in the period in which they are incurred.

Example 2

Royal Ice Cream Laboratory would like to invent a special new flavour for its home-made ice cream. The company has completed a survey asking customers to choose the flavour that they would most like to see from a list of possible new flavours. The cost spent on this survey was $5,000.

In this case, the company has not yet undertaken the development of the new flavour. It has just collected the opinions of customers in order to gain an understanding of their preferences. Therefore, the research cost of $5,000 should be recognised as an expense in the books of the company.

Development phase

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.

To recognise development costs as an intangible asset, the entity must demonstrate all of the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the entity's intention to complete the intangible asset and use or sell it;
- the entity's ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefit;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the entity's ability to reliably measure the expenditure attributable to the intangible asset during its development.

Example 3

After completing the market research, Royal Ice Cream Laboratory found that customers would prefer to have ice cream in two special flavours — beer and aloe vera

For the development project on the beer flavour, sufficient progress has been made and it was further determined that this special flavour would become the signature product of Royal Ice Cream Laboratory.

For the development project on the aloe vera flavour, sufficient progress has been made. However, the project is now on hold because it was found that the supply of the main ingredient, aloe vera, was not available in sufficient quantities for large-scale production of ice cream.

In this case, the company should capitalise the expenditures on the development project for the beer flavour as an intangible asset. This is because it is expected that the beer flavour would become a signature product of the company and hence could bring in future economic benefit to the company.

However, for the development project on the aloe vera flavour, there is doubt about the completion of the project because of the uncertainty in the supply of the main ingredient of aloe vera. Therefore, the company should recognise expenditures as an expense in the period in which they are incurred.

Measurement after recognition

An intangible asset could be carried either according to the cost model or revaluation model.

Cost Model

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

Revaluation Model

After initial recognition, an intangible asset should 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.

Example 4

At 1 October 2017, Royal Ice Cream Laboratory completed the development of a software used to calculate the best combinations of different ingredients in making ice cream. The total development costs were $6,000,000, and the useful life of the software is considered to be 6 years. No active market exists for the software.

At 31 December 2017, an accountant for the company estimated that the recoverable amount for the software was $5,600,000.

In this case, Royal Ice Cream Laboratory must use a cost model as its accounting policy for intangible assets because an active market is not available.

Amortisation for the year ended 31 December 2017 is $250,000 ($6,000,000 / 6 years × 3/12). Before performing the impairment test, the carrying amount of the software is $5,750,000 ($6,000,000 − $250,000). However, this carrying amount is greater than the software's recoverable amount of $5,600,000. An impairment loss of $150,000 ($5,750,000 − $5,600,000) is then recognised in profit or loss.

At 31 December 2017, the carrying amount of the software is $5,600,000, being equal to costs $6,000,000 less accumulated amortisation $250,000 less accumulated impairment losses $150,000.

Conclusion

This article has summarised HKAS 38 “Intangible Assets” with the help of examples. HKAS 38 clearly sets the criteria for an asset to be recognised as an intangible asset in the financial statements. If any one of the criteria is not satisfied, the company should write off the expenditure as an expense in the period in which it is incurred.