

## REVISITING WEB SITE COSTS UNDER AASB 138 'INTANGIBLE ASSETS'

### contents

#### Introduction Executive Summary

page 2

#### Major Differences Between AASB Interpretation 132 Abstract 37

page 3

#### Application

page 4

#### Key Terms Definition

page 4

#### Recognition and Measurement

page 6

#### 8 CFO action Items

page 7

#### Conclusion

### Introduction

As we move into the second period of 30 June reporting in accordance with AIFRS, through our implementation experiences, we gain further insights into some nuances of new financial literature. One such issue is the accounting for web site costs. Entities are incurring costs in relation to building, enhancing, maintaining, relaunching, and adding e-commerce facilities to their web sites. Some preparers and auditors have not fully appreciated subtle changes between AASB Interpretation 132 'Intangibles Assets – Web Site Costs' (July 2004) and Abstract 37 'Accounting for Web Site Costs' (January 2001). It is timely to revisit the requirements of AASB Interpretation 132 'Intangibles Assets – Web Site Costs'.

Interpretation 132 'Intangibles Assets – Web Site Costs' seeks to address two issues:

- Whether a web site is an internally generated intangible asset that is subject to the requirements of AASB 138 'Intangible Assets', and
- The appropriate accounting treatment of such expenditure.

### Executive Summary

1. A website developed by an entity for its own use is an internally generated intangible asset, and subject to the recognition and measurement requirements of AASB 138 'Intangible Assets'.
2. All expenditure incurred in developing a web site solely or primarily for promoting and advertising its own products and services is recognised as an expense when incurred.
3. As a general rule, costs incurred during the planning stage are recognised as an expense, whereas other costs are recognised as an intangible asset when it can be demonstrated in accordance with AASB 138 that the web site will generate probable future economic benefits.
4. Generating probable future economic benefits criterion is met by assessing the economic benefits to be received and using the principles in AASB 136 'Impairment of Assets', which considers the present value of estimated future cash flows from the continuing use of asset. 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.
5. Various stages in the development of the web site, and whether costs incurred during the development stages and the operation can be included in the cost of the web site as an intangible asset are identified.

Stage	Accounting Treatment
Planning	Recognise as an expense when incurred in accordance with AASB 138 'Intangible Assets' on the basis that it is akin to 'research'.
Application and Infrastructure Development – Hardware Purchases and Development	Apply the requirements of AASB 116 'Property, Plant and Equipment'.
Application and Infrastructure Development – Other Expenditure	Recognised as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in AASB 138 'Intangible Assets'.
Graphical Design Development	Recognised as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria AASB 138 'Intangible Assets'.
Content Development	Recognise as an expense when incurred to the extent that content is developed to advertise and promote an entity's own products and services.  Otherwise, recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in AASB 138 'Intangible Assets'.
Operating (Begins once development of a web site is complete)	Assess whether such expenditure meets the definition of an intangible asset, and the recognition criteria in AASB 138 'Intangible Assets'. Where these are met, recognise the expenditure in the carrying amount of the web site.
Other	Recognise as an expense as specified in AASB 138 'Intangible Assets'.

### Major Differences between AASB Interpretation 132 and Abstract 37

The major differences between AASB Interpretation 132 'Intangibles Assets – Web Site Costs' and Abstract 37 Accounting for Web Site Costs' include the following.

Interpretation 132 is framed in the context of a specific standard AASB 138 'Intangible Assets' with linkages to AASB 116 'Property, Plant and Equipment', and the tougher AASB 136 'Impairment of Assets'. Abstract 37 was based on the accounting principles in a number of generic standards, including AASB 1011 'Accounting for Research and Developments Costs', AASB 1015 'Acquisition of Assets' and AASB 1021 'Depreciation'. As Interpretation 132 and Abstract 37 are based on different source Standards, the subsequent specific accounting for web site

costs is also different. AASB 138 contains higher recognition standards than previous requirements.

Interpretation 132 provides specific guidance where a web site is *developed solely or primarily* for promoting and advertising its own products and services.

Interpretation 132 requires all costs incurred in the planning stage to be expensed when incurred. Abstract 37 indicated that some planning stage costs could be recognised as an asset, such as the costs of documenting the specifications of the web site, including the technology to be adopted to achieve the desired functionalities.

Abstract 37 indicated that some costs incurred during the operation stage potentially could be

recognised as an asset if they extended the originally assessed standard of performance of the web site. Interpretation 132 applies the general asset recognition criteria to determining the treatment of subsequent expenditure relating to the web site (based on the requirements of AASB 116 'Property, Plant and Equipment'), and concludes that it would be rare for costs incurred in the operating stage to be recognised as an asset.

Both Interpretations indicate that the useful life of web site will be short.

Interpretation 132 'Intangible Assets – Web Site Costs' applies when AASB 138 applies. Interpretation 132 'Intangibles Assets – Web Site Costs' is equivalent to SIC 32 'Intangibles Assets – Web Site Costs' issued by the IFRIC. Entities that comply with Interpretation 132 simultaneously comply with SIC 32.

The Interpretation specifically scopes out the following expenditures from its applications as such expenditures are addressed by other Standards.

### Application

Excluded from the Scope	Issue Addressed in a Specific Standard
Expenditure on purchasing, developing, and operating hardware (e.g., web servers, staging servers, production servers and Internet connections) of a web site	AASB 116 'Property, Plant and Equipment'
Expenditure on an Internet service provider hosting the entity's web site	Expenditure is recognised as an expense under AASB 101 'Presentation of Financial Statements', and the 'Framework for the Preparation and Presentation of Financial Statements' when the services are received.
Intangible assets held by an entity for sale in the ordinary course of business	AASB 102 'Inventories' and AASB 111 'Construction Contracts'

When a web site is leased under an operating lease, the lessor applies this Interpretation. When a web site is leased under a finance lease, the lessee applies this Interpretation after initial recognition of the leased asset.

## Key Terms

Key Terms	Explanation
Planning	Includes undertaking feasibility studies, defining objectives and specifications (e.g., hardware and software), evaluating alternatives and selecting preferences.
Application and Infrastructure Development	Includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing.
Graphical Design Development	Includes designing the appearance of web pages.
Content Development	Includes creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.
Operating expenditure	Includes updating graphics and revising content, adding new functions, features and content, registering the web site with search engines, backing up data, reviewing security access, and analysing usage of the web site.
Other expenditure	<p>Selling, administrative and other general overhead expenditure, unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management.</p> <p>Clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (e.g., false-start testing).</p> <p>Training employees to operate the web site.</p>

## Definition

An entity's own web site that arises from development and is for internal or external access is an internally generated intangible asset. An intangible asset is defined in AASB 138 'Intangible Assets' as an identifiable non-monetary asset without physical substance. AASB 138 identifies computer software as a common example of an intangible asset; by analogy a web site is another example of an intangible asset.

## Recognition and Measurement

### Recognition

A web site arising from development is recognised as an intangible asset when, in addition to complying with the general requirements for recognition and initial measurement in AASB 138 'Intangible Assets', an entity can also satisfy the

development requirements of that Standard, i.e.;

Step 1: Probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably; and

Step 2: Expenditure incurred on *development* must be recognised as an intangible asset when the entity can show all of the following:

- The technical feasibility of completing the intangible asset;
- Its intention to complete the tangible asset, and use or sell it;
- Its ability to use or sell the intangible asset;
- How the intangible asset will generate probable future economic benefits, including the existence of a market for the output of the intangible asset, or the intangible asset itself, or where intangible asset is to be used internally, its usefulness;
- The availability of adequate technical, financial and other resources to complete the

development; and

The ability to reliably measure expenditure on an intangible asset during its development.

An entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits when the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. This is a particular point of emphasis in the Interpretation. However, it should be noted that Interpretation 132 is written in a profit-seeking context, having been drawn down from SIC 32, and this point would receive less emphasis in the Australian not-for-profit context where service potential is still an important consideration.

Where a web site is *developed solely or primarily* for promoting and advertising its own products and services it is unable to demonstrate how it will generate probable future economic benefits, and consequently all expenditure on development is recognised as an expense when incurred.

Example: Accounting Policy

'The primary focus of the CPA Australia website is advertising, branding and information tool for the organisation and its members. UIG Interpretation 132 advises that, given this focus, the CPA Australia web sites could not be considered an internally generated intangible asset. All development, maintenance and operational expenditure have been treated as expenses incurred in the period' (source CPA Australia Annual Report 2006).

## Internal Expenditure

Any internal expenditure on the development and operation of an entity's own web site is accounted for in accordance with AASB 138. The nature of each activity for which expenditure is incurred (e.g. training employees and maintaining the web site) and the web site's stage of development or post-development must be evaluated to determine the appropriate accounting treatment.

**Planning:** Expenditure incurred in the planning stage is recognised as an expense when it is incurred. It is considered similar in nature to the research phase in AASB 138.

## Application and infrastructure development stage, graphical design stage and the content development stage:

Expenditure incurred in this stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own products and services, must be included in the cost of a web site recognised as an intangible when the expenditure can be directly attributed and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. Such expenditure is considered similar in nature to the development phase in AASB 138.

Expenditure on purchasing or creating content specifically for a web site, or expenditure to enable use of the content (e.g., a fee for acquiring a licence to reproduce) on the web site, must be included in the cost of development.

Expenditure incurred in the content development stage, to the extent that content is developed to advertise and promote an entity's own products and services (e.g., digital photographs of products), must be recognised as an expense when incurred. When accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure is recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.

**Operating Stage:** Expenditure incurred in operating stage is recognised as an expense when it is incurred, unless it meets the intangible asset definition and recognition criteria in AASB 138.

### Subsequent Measurement

A web site that is recognised as an intangible asset is measured after initial recognition by applying cost or revaluation model in AASB 138.

### Useful Life

The best estimate of a web site's useful life must be short.

### Application of IASB 138 Principles to Web Site Costs

Developing a web site for internal or external access is not undertaking a start-up activity to the extent that an internally generated intangible asset is created. AASB 138 requires expenditure on start-up activities to be recognised as an expense when incurred.

The cost of a web site is recognised as an internally generated intangible asset when it comprises all expenditure that can be *directly attributed* and is necessary to creating, producing and preparing the asset for it to be capable of operating as intended by management.

One of the criteria is to demonstrate how a web site will generate probable future economic benefits is met by assessing the economic benefits to be received from the web site and using the principles in AASB 136 'Impairment of Assets', i.e., which considers the present value of estimated future cash flows from continuing use of the asset (e.g., web site). 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.

When an entity acquires or creates content, it may be possible to identify an intangible asset (e.g., a licence or a copyright) separate from a

web site. A separate asset is not recognised when expenditure is directly attributed to creating, producing, and preparing the web site for it to be capable of operating in the manner intended by management. The expenditure is included in the cost of developing the web site.

Subsequent expenditure to enhance or maintain an entity's own web site is recognised as an expense when incurred unless it meets the recognition criteria in AASB 138. AASB 138 notes that most subsequent expenditures are likely to maintain the future economic benefits embodied in an existing intangible asset, rather than meet the definition of an intangible asset and the recognition criteria set out in AASB 138. *Only rarely* will subsequent expenditure be recognised in the carrying amount of an asset.

### CFO Action

The CFO may wish to consider the following action items in relation to web site cost:

1. Consider whether the existing accounting policy for web site costs requires review
2. Determine the materiality parameters of web site expenditures
3. Understand the definition and recognition requirements of AASB 138 'Intangible Assets' as Interpretation 132 heavily references them
4. Determine whether the web site is *developed solely or primarily* for promoting and advertising its own products and services
5. Identify whether the web site is capable of generating revenues, including direct revenues from enabling orders to be placed
6. Develop an internal accounting policy for web site cost to assist with addressing issues associated building, enhancing, maintaining, relaunching, and adding e-commerce facilities
7. Consider whether an internal accounting policy should be subject to external review before finalisation and
8. Where the existing accounting policy for web site costs does not reflect the requirements of AASB 132, apply 'Accounting Policies, Changes in Accounting Estimates and Errors'.



## Conclusion

AASB 138 'Intangible Assets' is one of the newer AIFRS that preparers and auditor are coming to grips with from an implementation perspective. Interpretation 132 'Intangible Assets – Web Site Costs' draws heavily on the principles of AASB 138 'Intangible Assets', and contains some differences from previous Australian GAAP. Generalising, it is likely that less expenditure, and of a differing nature, would meet the recognition requirements of Interpretation 132 when compared to the 'similar' requirements of Abstract 37 'Accounting for Web Site Costs'. Entities should periodically review existing accounting policies to ensure that they reflect the

requirements of Standards and Interpretations.

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12 e-GAAP Updates were issued during 2006 (12 in 2005). To date in 2007 the following e-GAAP Updates have been released: No. 1/2007 'Leases – Arrangements and Incentives', and No. 2/2007 'Revisiting Web Site Costs under AASB 138 Intangible Assets'.

This communication provides general information current at the time of release. It is not intended that the information provide advice and should not be relied on as such. Professional advice should be sought prior to

Area	Requirement	Comment
General	Disclosure information that identifies and explains the amounts recognised in the financial report from exploration and evaluation of mineral resources must be provided.	
Accounting Policies	The accounting policies for exploration and evaluation expenditure including recognition of associated assets must be disclosed.	
The elements and cash flows	Disclose the assets, liabilities, income and expenses, and operating and investing cash flows from exploration and evaluation.	
Exploration and evaluation assets (Australian requirement only)	Where exploration and evaluation assets are recognised, provide an explanation that the recoverability of the carrying amount of exploration and evaluation assets is dependent on the successful development and commercial exploitation or sale of the respective area of interest.	
Comparatives	Where it is impracticable to provide comparative information that relates to annual reporting periods beginning before 1 January 2005, disclose that fact.	
First time application (Australian requirement only)	For annual reporting periods beginning before 1 January 2006, an entity applying AASB 6 must disclose the fact that it is applying that Standard, being the Australian equivalent to IFRS 6.	

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