



HM TREASURY

Financial Reporting Advisory Board Paper

SIC INTERPRETATION 32: *Intangible Assets – Web Site Costs*

Issue:	The application of SIC 32: <i>Intangible Assets – Web Site Costs</i> in the context of resource and other accounts covered by the Government Financial Reporting Manual.
Impact on guidance:	The proposed text in Annex A relates to the shadow FReM.
IAS/IFRS adaptation?	No
IPSAS compliant?	N/A
Interpretation for the public sector context?	Yes
Impact on budgetary regime?	No
Alignment with National Accounts	Yes
Impact on Estimates?	No
Recommendation:	That the Board agree that SIC 32 applies in full, as interpreted for the public sector context.
Timing:	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

DETAIL

Background

1. SIC 32: *Intangible assets – Web site costs* was approved by the IASB in March 2002 and became effective from 25 March 2002, and relates to IAS 38 *Intangible Assets*.

2. The Interpretation sets out a consensus view that entities should apply if their financial statements are to be described as being prepared in accordance with IFRSs.

Web site development stages

3. SIC 32 identifies the following stages of website development:

- a. Planning – includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences;
- b. Application and Infrastructure Development – includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing;
- c. Graphical Design Development – includes designing the appearance of web pages;
- d. 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.

4. Once development of a web site has been completed, the Operating stage begins. During this stage, an entity maintains and enhances the applications, infrastructure, graphical design and content of the web site.

Main issues with SIC 32

5. The expenditure incurred in the planning stage of web site development should be recognised as an expense when it is incurred. When accounting for other internal expenditure on the development and operation of an entity's own web site for internal or external access, the issues are:

- a. whether the web site is an internally generated intangible asset that is subject to the requirements of IAS 38 *Intangible Assets*; and
- b. the appropriate accounting treatment of such expenditure.

6. In relation to paragraph 5a, SIC 32 does **not** apply to:

- a. expenditure on purchasing, developing and operating hardware (e.g. web servers, staging servers, production servers and Internet connections) of a web site as such expenditure is accounted for under IAS 16 *Property, Plant and Equipment*. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's web site, the expenditure is recognised as an expense under IAS 1.78 and the *Framework* when the services are received;
- b. expenditure on the development or operation of a website (or web site software) for sale to another entity, i.e. IAS 38 does not apply to intangible assets held by an entity for sale in the ordinary course of business, IAS 2 *Inventories* and IAS 11 *Construction Contracts* refer;

- c. leases that fall within the scope of IAS 17 *Leases*. 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.

7. All expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred.

Consensus

8. An entity's own web site that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the general requirements of IAS 38. A web site arising from development is recognised as an intangible asset if it meets the general recognition and initial measurement criteria in IAS 38.21, and also satisfies the general requirements of IAS 38.57. Any internal expenditure on the development and operation of an entity's own web site shall be accounted for in accordance with IAS 38.

9. IAS 38.21 requires that an intangible asset shall be recognised if, and only if:

- a. it meets the definition of an intangible asset, and
- b. it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity (which may include cost savings or other benefits resulting from the use of the asset by the entity rather than revenue from sales); and
- c. the cost of the asset can be measured reliably;

10. IAS 38.57 requires that an intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

- a. the technical feasibility of completing the intangible asset so that it will be available for use or [sale];
- b. its intention to complete the intangible asset and use or [sell] it;
- c. its ability to use or [sell] the intangible asset;
- d. how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
- e. the availability of adequate technical, financial and other resources to complete the development and to use or [sell] the intangible asset;
- f. its ability to measure reliably the expenditure attributable to the intangible asset during its development.

[Whilst references to the development for sale are a general feature of IAS 38, the Standard does not apply to intangible assets developed for sale in the ordinary course of business. Other sales of websites are unlikely to arise].

11. The nature of each activity for which expenditure is incurred and the web site's stage of development or post-development is evaluated to determine the appropriate accounting treatment. The Interpretation specifies examples of the accounting treatment for costs incurred in the different stages of a web site's development.

Comparison with requirements under UK GAAP

12. UITF abstract 29 *Website development costs* requires that (similar to SIC 32) planning costs are recognised as an expense. However, UITF abstract 29 requires all other website development costs to be capitalised as tangible fixed assets in accordance with the requirements of FRS 15 *Tangible Fixed Assets*, subject to the following criteria:

- a. the expenditure is separately identifiable;
- b. the technical feasibility and commercial viability of the web site have been assessed with reasonable certainty in the light of factors such as likely market conditions (including competing products), public opinion, and possible legislation;
- c. the web site will generate sales or other revenues directly and the expenditure makes an enduring contribution to the development of the revenue-generating capabilities of the web site;
- d. there is a reasonable expectation that the present value of the future cash flows (i.e. future revenues less attributable costs) to be generated by the web site will be no less than the amounts capitalised in respect of the revenue-generating activity; and
- e. adequate resources exist, or are reasonably expected to be available, to enable the web site project to be completed and to meet any consequential need for increased working capital.

13. However, UITF 29 notes that for not-for-profit entities, an alternative measure of service potential may be permissible, in which case the above criteria can be interpreted as permitting capitalisation only to the extent that the primary purpose of the website is to provide a means of delivery of the specific services offered by the entity in fulfilment of its principal objectives.

Impact of SIC 32 on public sector accounts

14. Entities covered by the FReM may have web site development costs, which if capitalised under UK GAAP would be accounted for as tangible fixed assets. The application of SIC 32 and the relevant IAS 38 criteria, interpreted as at paragraph 13, above, would result in such capitalised costs being recognised as intangible assets.

Impact on disclosures in resource and other accounts

15. The presentation and disclosure requirements of SIC 32 will be taken into account in developing the format of resource and other accounts in the light of the move to EU-adopted IFRS and other initiatives.

IAS/IFRS compliance

16. The proposals are compliant with SIC 32 (IAS 38).

IPSAS compliance

17. IPSASB has not issued an IPSAS on web site development costs.

Proposed text for the shadow Government Financial Reporting Manual

18. See Annex A for the proposed amendments to the shadow FReM.

Impact on the budgetary regime

19. The proposals in practice will effect no material change to the recognition and initial measurement criteria for the recognition of an asset in respect of web site development costs, and so the implementation of SIC 32 will have no impact on the budgetary regime.

Summary and recommendation

20. SIC 32 deals with the recognition and accounting for web site development costs. In practice the implementation of SIC 32 will affect those entities covered by the requirements of the FReM who capitalise website development costs, requiring them to account for such costs as intangible rather than tangible assets

21. The Board is invited to approve the proposed text for the shadow FReM at Annex A.

HM Treasury
29 June 2006

PROPOSED TEXT FOR THE SHADOW GOVERNMENT FINANCIAL REPORTING MANUAL

SIC INTERPRETATION 32: Intangible Assets – Web Site Costs

Applicability

SIC 32 applies in full, as interpreted.

Objectives of SIC 32

The Interpretation provides a consensus view that entity's should apply when accounting for internal expenditure on the development and operation of an entity's own web site for internal or external access, the main issues being:

- a. whether the web site is an internally generated intangible asset that is subject to the requirements of IAS 38 *Intangible Assets*; and
- b. the appropriate accounting treatment of such expenditure.

Interpretation of SIC 32 for the public sector context

Not-for-profit entities in the public sector may have web sites that provide a means of delivery of specific services offered by the entity in fulfilment of its principal objectives. In applying SIC 32, therefore, such entities should interpret the IAS 38 criterion of 'how the intangible asset will generate probable future economic benefits' as being met in the public sector context by this alternative measure of service potential.

Costs associated with a web site that does not satisfy this alternative measure of service potential, but which is designed for the purpose of informing stakeholders of the services or other objectives of the entity, should not be capitalised.