

Can We Place Entire Web site Development Cost in One Bucket?

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Introduction:

NK Logistics (Pvt) Ltd is a limited liability company incorporated in and domiciled in Sri Lanka. The company has invested in a fully owned subsidiary called "TT Destinations (Pvt) Ltd" in the audited financial year, i.e.; 2014/2015. Its' principal business activity is to provide transportation service. Normally company organizes tourist trips for both local & foreign tourists. In addition they provide vehicle hiring service, air ticket booking and hotel accommodation service.

Usually businesses tend to charges all the expenses with regards to web development, especially relatively small businesses like "TT Destinations (Pvt) Ltd". They always feel that it is justifiable & easy to charge them to P/L. However firms should consider nature of those expenses before record as an expense.

Discussion of the Issue

Issue

The company was incorporated in September 2014 & soon after its Incorporation Company has developed a website. This was outsourced to a firm called 'xyz studio'. The total cost incurred for the development of this website was LKR 140,000 & the xyz studio sent invoices to the client in following way,

Invoice Date	Description	Amount
25/10/2014	Development of business concept & plan for website	45,000
11/11/2014	Acquiring domain name & the software for website operations, database & applications	37,000
01/01/2015	Overall design of the web site	58,000
Total		140,000

Client has recorded all the invoices as expenses when they making payments. Client's argument was that the website developed for them is only for the information purpose & to promote and advertise their tour packages.

However when we visit the website it is not only for the information purpose but also customers can place their orders online.

So the main issue is whether those expenses are actually expenses or can capitalize as an asset.

Analysis of the issue

Paragraph 21 of LKAS 38 – Intangible Assets requires an enterprise to recognize an intangible asset, whether **purchased** or self-created if, and only if;

- It is 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

Further, section 2 of SIC Interpretation 32 – “Intangible Assets-Web Site Costs” prescribes four stages of web site’s 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.

Section 9 of SIC Interpretation 32 – “Intangible Assets-Web Site Costs” prescribes the accounting treatment of web site developments. Following table exhibits what would be the correct accounting treatment as per section 9 of SIC-32 for the aforementioned expenses.

Expense	Stage as per SIC 32	Accounting Treatment
Development of business concept & plan for website	Planning Stage	Expense
Acquiring domain name & the software for website operations, database & applications	Application and Infrastructure Development	Capitalize
Overall design of the web site	Graphical Design Development	Capitalize

Implication of the Issue

Since the company’s materiality level is too low, this issue had significant effect on both comprehensive income statement & statement of financial position.

- Client has reversed the expense that needed to be capitalized

<i>Intangible Asset</i>	<i>Dr</i>	<i>LKR</i>	<i>95,000</i>
<i>Administration Expenses</i>	<i>Cr</i>	<i>LKR</i>	<i>95,000</i>
- Client has provided amortization charge after deciding the useful life. Client has decided 5 years as useful life of the intangible asset.

<i>Amortization charge</i>	<i>Dr</i>	<i>LKR</i>	<i>5,699</i>
<i>Intangible Asset</i>	<i>Cr</i>	<i>LKR</i>	<i>5,699</i>

Conclusion & Recommendation

- Section 11 of SIC-32 Says that, “By analogy, a web site is another example of an intangible asset.”
- Client was able to demonstrate Future economic benefits flowing from an intangible asset. It’s by the way of,
 - Revenue from the sale of service
 - Cost savings
- Client should revisit the useful life time as both LKAS 38 & SIC 32 suggests,
 - The best estimate of a web site’s useful life should be short.
 - Subsequently it should apply the fair value to the web site. This FV can be determined by reference to an active market. However, as an active market is unlikely to exist for web sites.