# AS-26: INTANGIBLE ASSETS

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|---|---|
| ***Non-Applicability*** | ❖ Intangible assets that are covered by another Accounting Standard<br>• Intangible assets held by an enterprise for sale in ordinary course of business (AS-2)<br>• Deferred tax assets AS-22<br>• Leases that fall within the scope of AS-19<br>• Goodwill arising on amalgamation AS-14 and goodwill arising on consolidation AS-21<br>❖ Financial assets<br>❖ Mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources and<br>❖ Intangible assets arising in insurance enterprises from contract with policy holders. |
| ***Meaning of intangible asset-*** | It is an<br>→ Identifiable<br>→ Non monetary asset<br>→ Without any physical substance<br>→ Held for economic benefits i.e. either for use in production or supply of goods or services, for rental to others or for administrative purposes.<br>→ Under the control of entity |
| ***Essential components*** | ❖ It must be identifiable i.e the asset must be separable from other assets.<br>❖ It must be controlled by the enterprise<br>❖ Future economic benefits must be associated with an intangible asset |
| ***Recognition of intangible asset*** | An intangible asset should be recognized if and only if<br>→ It meets all the essential elements of an intangible assets<br>→ It is probable that future economic benefits will flow to the enterprise<br>→ Cost of the asset can be measured reliably. |
| **MEASUREMENT OF INTANGIBLE ASSETS** | |
| ***Procurement/ Separate Acquisition*** | Cost of Intangible Assets include the following :<br>Purchase price — XX<br>Add : Non-refundable taxes & duties — XX<br>Add : Directly attributable expenditure on making the asset ready for its intended use.* — XX<br>Less: Trade discount & rebates — (XX)<br>**Cost of Asset** — **XX**<br>*Example: Professional fees for legal services |
| ***In Exchange For Another Asset or Shares/ Other Securities*** | Cost of Intangible Asset is<br>➢ Fair Market Value (FMV) of Asset given / Securities Issued<br>or<br>➢ Fair Market Value (FMV) of the Asset acquired<br>whichever is more clearly evident. |
| ***Acquisition By Way Of Government Grant*** | Given at concessional rate — On the basis of their acquisition costs<br>Given free of cost — Record at nominal value |

# Internally Generated Intangible ASSET

| | | |
|---|---|---|
| Research phase | | Development phase * |
| × | Deferred and Ammortised | √ |
| √ | Charge to P&L A/c | × |

***Development Phase*:**
**Amount Capitalised = Lower of Cost or Recoverable Amount**
**Where Recoverable amount = Present value of Future Cash Flows**

**Note**:
→ If an enterprise **cannot distinguish** the research phase from the development phase to create an intangible asset, the expenditure should be treated as if it were incurred in the **research phase** only.
→ Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

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| ***Development phase (PARA 44)*** | An intangible asset arising from development should be recognized if and only if an enterprise can demonstrate **all** of the following:<br>→ Technical feasibility established<br>→ Marketability proved<br>→ Identification of cost incurred<br>→ Realistic expectation that there will be sufficient future revenue to cover cost<br>→ Intention to complete the asset and use or sell it. |
| ***Cost of an Internally Generated Intangible Asset*** | The following are ***not components of the cost*** of an internally generated intangible asset:<br>➢ Selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use.<br>➢ Clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance and<br>➢ Expenditure on training the staff to operate the asset |
| **AMORTISATION PERIOD (PARA 63)** | |
| ***Basis of allocation*** | Depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. |
| ***Presumption as to the useful life*** | It **will not exceed 10 years** from the date when the asset is available for use unless there is persuasive evidence that intangible asset has higher useful life. |
| ***When should it commence?*** | Amortisation should commence when asset is available for use. |
| ***Notes*** | Given the history of rapid changes in technology, computer software and other intangible asset is susceptible to technological obsolescence, it is likely that useful life of the software etc. will be much shorter, say 3-5 years |
| **AMORTISATION METHOD** | |
| ***Which method to follow*** | ❖ The method used should reflect the pattern in which assets economic benefits are consumed by the enterprise (In the ratio of future cash flows)<br>❖ If that pattern cannot be determined reliably, the SLM should be used. |

## Question 1

A company acquired for its internal use a software on 28.01.2020 from the USA for US $ 1,00,000. The exchange rate on that date was ₹ 52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:

a) Import Duty : 20%
b) Purchase Tax : 10%
c) Entry Tax : 5 % (Recoverable later from tax department)
d) Installation expenses : ₹ 25,000
e) Profession fees for Clearance from Customs : ₹ 20,000

Compute the cost of Software to be capitalized.

## Question 2

Desire Ltd. acquired a patent at a cost of Rs. 1,00,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset on SLM. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be Rs. 45,00,000, Rs. 42,00,000, Rs. 40,00,000, Rs. 38,00,000 and Rs. 35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e. from SLM to ratio of expected new cash flows).
You are required to compute the amortization cost of the patent for each of the years (1st year to 7th year).

**Solution**

Company amortized Rs. 20,00,000 per annum for the first two years. Hence, Amortization for the first two years (Rs. 20,00,000 X 2) = Rs. 40,00,000.
Remaining carrying cost after two years =Rs. 1,00,00,000 – Rs. 40,00,000 = Rs. 60,00,000
Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost Rs.60 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products
The amortization cost of the patents may be computed as follows:

| Year | Net cash flows | Amortization Ratio | Amortization Amount |
|---|---|---|---|
| 3 | 45,00,000 | 45 | 13,50,000 |
| 4 | 42,00,000 | 42 | 12,60,000 |
| 5 | 40,00,000 | 40 | 12,00,000 |
| 6 | 38,00,000 | 38 | 11,40,000 |
| 7 | 35,00,000 | 35 | 10,50,000 |
| Total | **2,00,00,000** | **200** | **60,00,000** |

## Question 3

M/s. X Ltd. is developing a new production process. During the Financial Year ended 31st March, 2019, the total expenditure incurred on the process was Rs. 60 lacs. The production process met the criteria for recognition as an intangible asset on 1st December, 2018. Expenditure incurred till this date was Rs. 32 lacs.
Further expenditure incurred on the process for the Financial Year ending 31st March, 2020 was Rs. 90 lacs.
From 1st April, 2020, the Company has implemented the new process design and it is likely that this will result in after tax saving of Rs. 20 lakh per annum for next five years.
The cost of capital is 10%. The present value of annuity factor of Rs. 1 for 5 years @ 10% is 3.79.

You are required to work out:
(i) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2019?
(ii) What is the carrying amount of the intangible asset as on 31st March, 2019?
(iii) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2020?
(iv) What is the carrying amount of the intangible asset as on 31st March, 2020?

**Solution**

As per AS 26 'Intangible Assets'

(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019

Rs. 32 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2018. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2019

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 (60-32) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2018).

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

| | (Rs. in lacs) |
|---|---|
| Carrying Amount as on 31.03.2019 | 28 |
| Expenditure during 2019 – 2020 | 90 |
| Book Value | 118 |
| Recoverable Amount (20 * 3.79) | (75.80) |
| Impairment loss | 42.20 |

Rs. 42.20 lakhs to be charged to Profit and loss account for the year ending 31.03.2020

(iv) Carrying value of intangible asset as on 31.03.2020

| | (Rs. in lacs) |
|---|---|
| Book Value | 118 |
| Less: Impairment loss | (42.20) |
| Carrying amount as on 31.03.2020 | 75.80 |

Amortisation - The company can amortise Rs. 75.80 lakhs over a period of five years by charging Rs. 15.16 lakhs per annum from the financial year 2020-2021 onwards

## Question 4

RC Ltd. is showing an intangible asset at Rs. 72 lakhs as on 31-3-20. This asset was acquired for Rs. 120 lakhs as on 01-04-14 and the same was used from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years, on straight line basis.
Comment on the accounting treatment of asset with reference to AS- 26 and also give the necessary rectification journal entry.

**Solution**

As per Para 63 AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. The Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26.
Accordingly, the company would be required to restate the carrying amount of intangible asset as on 31.3.2020 at Rs. 48 lakhs i.e. Rs. 120 lakhs less Rs. 72 lakhs ( Rs. 120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of Rs. 24 Lakhs (Rs. 72 lakhs – Rs. 48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of Rs. 48 lakhs will be amortized over remaining 4 years by amortizingRs. 12 lakhs per year.

The necessary journal entry (for rectification) will be

| | | |
|---|---|---|
| Revenue Reserves Dr. | Rs. 24 Lakhs | |
| To Intangible Assets | | Rs. 24 Lakhs |

(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

## Question 5

K Ltd. launched a project for producing product X in October, 2019. The Company incurred Rs. 40 lakhs towards Research and Development expenses upto 31st March, 2020. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard.

**Solution**

As per AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard.

An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case.

Hence, the expenses amounting Rs. 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2020.

## Question 6

A Company with a turnover of Rs. 375 crores and an annual advertising budget of Rs. 3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of Rs. 37.5 croes from the new product. The company had debited to i ts Profit and Loss account the total expenditure of Rs. 3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct?

**Solution**

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of Rs. 3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs.37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs.3 crores to the Profit and Loss account of the year is correct