

## IND AS 38 – INTANGIBLE ASSETS

### CASE STUDY

X Ltd. is a public listed company. It has been considering the accounting treatment of its intangible assets and how the matters below should be treated in its financial statements for the year to 31 March 20X4.

1. On 1 October 20X3, X Ltd. acquired Y Ltd., a small company that specialises in pharmaceutical drug research and development. The purchase consideration was by way of a share exchange and valued at ₹ 3,50,00,000. The fair value of Y Ltd. Co's net assets was ₹ 1,50,00,000 (excluding any items referred to below). Y Ltd. Co owns a patent for an established successful drug that has a remaining life of eight years. A firm of specialist advisors, ABC Ltd. Co, has estimated the current value of this patent to be ₹ 1,00,00,000, however the company is awaiting the outcome of clinical trials where the drug has been tested to treat a different illness. If the trials are successful, the value of the drug is then estimated to be ₹ 1,50,00,000. Also included in the company's statement of financial position is ₹ 20,00,000 for medical research that has been conducted on behalf of a client.
2. X Ltd. Co has developed and patented a new drug which has been approved for clinical use. The costs of developing the drug were ₹ 1,20,00,000. Based on early assessments of its sales success, ABC Ltd. Co have estimated its market value at ₹ 2,00,00,000, which can be taken as a reliable measurement.
3. X Ltd. Co's manufacturing facilities have recently received a favourable inspection by government medical scientists. As a result of this the company has been granted an exclusive five-year licence to manufacture and distribute a new vaccine. Although the licence had no direct cost to X Ltd. Co, its directors feel its granting is a reflection of the company's standing and have asked ABC Ltd. Co to value the licence. Accordingly, they have placed a value of ₹ 1,00,00,000 on it.
4. In the current accounting period, X Ltd. Co has spent ₹ 30,00,000 sending its staff on specialist training courses. While these courses have been expensive, they have led to a marked improvement in production quality and staff now need less supervision. This in turn has led to an increase in revenue and cost reductions. The directors of X Ltd. Co believe these benefits will continue for at least three years and wish to treat the training costs as an asset.

**Q1. Select whether each of the following items should be capitalised as an intangible asset or recognised as an expense?**

Patent for the new drug	Capitalise	Expense
Licence for the new vaccine	Capitalise	Expense
Specialist training courses undertaken by X Ltd. Staff	Capitalise	Expense
Y Ltd. Co's patent on the existing drug currently licenced for use	Capitalise	Expense

**Q2. Select which TWO of the following are required if X Ltd. Co adopts the revaluation model for the measurement of its intangible assets?**

- A) The entire class of intangible assets must be revalued at the same time
- B) Valid active market for the asset
- C) Can be used at initial recognition of the asset if there is an active market

**Q3. INDAS 38 gives examples of activities that would be regarded as research and therefore not eligible for recognition as an intangible asset.**

**Which of the following would be an example of research costs?**

- A) The design and construction of chosen alternative products or processes
- B) The design of pre-production prototypes and models
- C) The design of possible new or improved product or process alternatives
- D) The design, construction and operation of a pilot plant

**Q4. At what amount should the patent acquired from Y Ltd. Co be valued at 31 March 20X4?**

- A) ₹ 10,000,000
- B) ₹ 9,375,000
- C) ₹ 15,000,000
- D) Nil

**Q5. How should X Ltd. Co treat the goodwill arising on its acquisition of Y Ltd. Co?**

- A) It should be capitalised and amortised over 20 years
- B) It should be capitalised and reviewed for impairment every year
- C) It should be capitalised and reviewed for impairment every five years
- D) It should be written off to retained earnings

**ANSWERS:-****Q1.**

<i>Patent for the new drug</i>	<i>Capitalise</i>	
<i>Licence for the new vaccine</i>	<i>Capitalise</i>	
<i>Specialist training courses undertaken by X Ltd. Staff</i>		<i>Expense</i>
<i>Y Ltd. Co's patent on the existing drug currently licenced for use</i>	<i>Capitalise</i>	

*The patent for the new drug and the licence for the new vaccine will generate probable future economic benefits as they have been approved for clinical use. There is an existence of a market, management have ascertained reliably the costs and that the company can sell or control the assets.*

*Y Ltd. Co's existing patent for a drug already in use should be capitalised as it meets the criteria under IAS 38 of an internally generated intangible asset.*

*Specialist training courses, although they will benefit the business (thus meeting the criteria of an expense from which benefits are expected to flow) they cannot be capitalised as the company does not control the staff (they can leave the company) so failing the control element of the definition of an intangible asset. IAS 38 states that training costs must be expensed as employees do not represent a resource controlled by the entity and therefore cannot recognise the training costs as an intangible asset (IAS 38, para.15).*

**Q2.** *Required if X Ltd. Co adopts the revaluation model*

**A)** *The entire class of intangible assets must be revalued at the same time*

**B)** *Valid active market for the asset*

*On initial recognition, the original cost of the item must be used, it cannot be used from initial recognition, regardless of whether there is an active market or not. The revaluation model may be used, provided the criteria have been met, at a later date.*

*Although prepaid marketing costs may be capitalised, training costs may not be capitalised as part of the intangible asset under IAS 38.*

**Q3.** *(C) The design of possible new or improved product or process alternatives*

*This activity is still at the research stage*

Q4. (B) ₹ 9,375,000

$$\{₹ 100 \text{ Lakh} - [(₹100 \text{ Lakh} / 8) * (6/12)]\}$$

Q5. (B) It should be capitalised and reviewed for impairment every year.

INDAS 36 Impairment of Assets (para.10) requires that goodwill be tested for impairment on an annual basis, regardless of whether there is any indication of impairment.