CA INTERMEDIATE

MARATHON

Advanced Accounting

AS 26:
Intangible Assets

-By CA Nitin Goel

AS 26 : Intangible Assets

Meaning

- Identifiable
- Non Monetary Assets
- Without physical substance
- Held for economic benefits
- Under control of entity

Recognition Criteria

- Probable future economic benefits
- Cost can be measured reliably

Measurement

Separate Acquisition

Purchase Price (net of trade disc.)
+ Non Refundable taxes
+ Directly Attributable expenditure

Exchange

Same as AS 10

Govt. Grant

Refer AS 12

Internally Generated

Self Generated Goodwill, Brand, etc.

Not to be recognised as cost cannot be measured reliably

Other Intangible Assets (Software, Patents, Copyrights, Trademark etc.)

Research Phase (Acquisition of Knowledge)

Recognised as expense Charged to P&L A/c

Development Phase (Application of Knowledge)

Capitalise & recognise as Intangible asset

Amount capitalised = Lower of

Cost or Recoverable Amount (P.V. of Future cash flows)

(Difference to be tfd. to P&L A/c)

Development Phase

Conditions to be fulfilled

* Technical feasability established
* Marketability proved
* Identification of cost incurred
* Sufficient future revenue to cover cost
* Intention to complete asset

Capitalisation of Expenditure

All directly attributable expenditure
(Cost of material & services consumed, Employee costs, etc.)

Exclusions: Staff training costs, Abnormal losses, Selling, Administrative & General Overheads, Initial operating losses

Recognition of Expense: Following types of expenditure always recognised as expense when incurred

* Expenditure on advertising & promotional activities
* Expenditure on training activities
* Startup costs
* Expenditure on relocating or reorganising

Subsequent Expenditure: Recognise as expense when incurred

Exception: Future economic benefits in excess of original assessed standard of performance & amount can be reliably measured.

Amortisation

- **Period**
  - Softwares & Asset where there is technological Obsolescence
    - 3-5 years
  - Goodwill arising under Amalgamation in Nature of Purchase (AS 14)
    - 5 years
  - Others
    - 10 years unless there is persuasive evidence of higher useful life
- **Method**
  - Pattern in which economic benefits are consumed i.e. Ratio of future cash flows
  - If not obtained, then use SLM

Notes :

- Amortisation should commence when asset is available for use
- Change in useful Life or change in Future cash flows → Prospective Effect
- Impairment Loss (Refer AS 28) = Carrying Amount − Recoverable Amount
- Profit/loss on disposal to be trfd. to P&L A/c.

Asset that incorporates both Tangible & Intangible elements

Assess which element is more significant

- If Tangible element is more significant
  - Apply AS 10
- If Intangible element is more significant
  - Apply AS 26

INTANGIBLE ASSETS

AS 26

Question 1: Inter Jan 2021 (5 Marks)

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹ 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%
(ii) Additional Import Duty 5%
(iii) Entry Tax 2% (Recoverable later from tax department). Credit / Refundable Cost ×
(iv) Installation expenses ₹ 1,50,000.
(v) Professional fees for clearance from customs ₹ 50,000.

Compute the cost of software to be Capitalized as per relevant AS

Solution

Calculation of cost of software (intangible asset) acquired for internal use

	Amount
Purchase cost of the software (UK £)	1,50,000
Less: Trade discount @ 2.5% (UK £)	(3,750)
	1,46,250
Cost in ₹ (UK £1,46,250 x ₹ 100)	1,46,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	1,60,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	1,68,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	**1,70,91,875**

Note: Since entry tax has been mentioned as a recoverable / refundable tax, it is not included as part of the cost of the asset

Question 2: Inter Nov 2023 (5 Marks)

Panna Limited purchased software from Agate Limited for a period of 5 years and capitalized the cost. It provided you the following information:

- Cost of software ₹ 57,60,000.
- Expected Life cycle of the software 5 years

The software was amortized at ₹ 6,40,000 per annum in first three years based on economic benefits derived from the software. After three years, it was found that the software may be used for another 5 years from then. So, Panna Limited got it renewed after expiry of five years for 3 more years.

The net cash flows from the software during these 5 years were expected to be as follows:

Particular	**Amount (₹)**
Year 1	₹ 23,04,000
Year 2	₹ 29,44,000
Year 3	₹ 28,16,000
Year 4	₹ 25,60,000
Year 5	₹ 21,76,000

You are required to calculate the amortization cost of the software for each of the years.

Solution

Panna Limited amortised ₹ 6,40,000 per annum for the first three years i.e. ₹ 19,20,000.
Balance carrying amount after 3rd year = 57,60,000 – (6,40,000*3) = ₹ 38,40,000
The remaining carrying amount can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product.
The amortisation may be found as follows:

Year	Net cash flows ₹	Amortisation Ratio	Amortisation Amount ₹
IV	23,04,000	0.180	6,91,200
V	29,44,000	0.230	8,83,200
VI	28,16,000	0.220	8,44,800 ✓
VII	25,60,000	0.200	7,68,000
~~IX~~ VIII	21,76,000	0.170	6,52,800
Total	**1,28,00,000**	**1.000**	~~**57,60,000**~~ 3840000

Question 3: Inter Nov 2020 (5 Marks) / RTP Jan 2026 / RTP Nov 2023

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹ 600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	1	2	3	4	5
Cash Flows (₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per AS 26.

6th year

Solution

Amortization of cost of Patent as per AS 26

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	300	.25	150
2	300	.25	150
3	300	.25	150
4	150	.10	60
5	150	.10	60
6	75	.05	30
		1.00	**600**

600 × 2/8

150 in 2 : 2 : 1

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).
The unamortized amount of the patent after third year will be ₹ 150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

Cost = 600 Lakhs → (300 : 300 : 300 : 150 : 150)
2 : 2 : 2 : 1 : 1

150 : 150 : 150 : 75 : 75 ✓

Bal. CA after 3 yrs = 600 − (150 × 3) = 150
↓ 2 : 2 : 1
Cash flows : 150 : 150 : 75
4 5 : 6

Question 4:

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹ 10 lakh on research during first 5 months of the financial year 2025-26. The development of the process began on 1st September, 2025 and upto 31st March, 2026, a sum of ₹ 8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria.
From 1st April, 2026, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹ 2 lakh per annum for next five years.
The cost of capital is 10%. The present value of annuity factor of ₹ 1 for 5 years @ 10% is 3.7908.
Decide the treatment of Research and Development Cost of the project as per AS 26.

PAL : 10L
Cost = 8L
Rec. Amt. = 2L × 3.7908 = 7.582

Solution

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2025-26. Hence, it should be written off as an expense in that year itself.
Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹ 8 lakhs incurred upto 31st March, 2026 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	2 Lakhs p.a.
Company's cost of capital	10%
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 2 lakhs x 3.7908)	7.582 Lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹ 8 lakhs or present value of future net cash flows ₹ 7.582 lakhs.
Hence, cost of an internally generated intangible asset will be ₹ 7.582 lakhs.
The difference of ₹ 0.418 lakhs (i.e. ₹ 8 lakhs – ₹ 7.582 lakhs) will be amortized by Plymouth for the financial year 2025-26.
Amortisation - The company can amortize ₹ 7.582 lakhs over a period of five years by charging ₹ 1.516 lakhs per annum from the financial year 2026-2027 onwards

7.582/5 = 1.516 p.a.

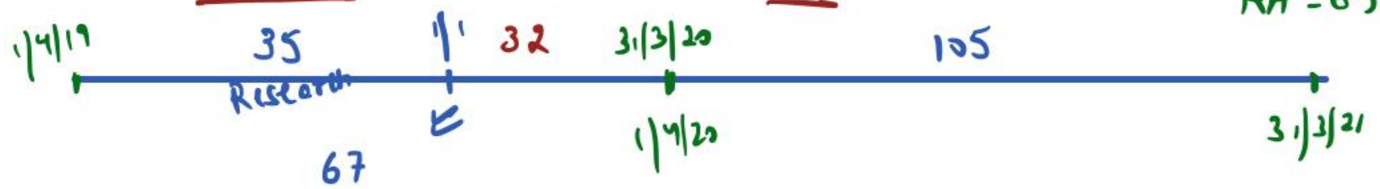
Question 5: Inter Dec 2021 (5 Marks)

Surgical Ltd, is developing a new production process of surgical equipment. During the financial year ended 31st March 2020 the total expenditure incurred on the process was ₹ 67 lakhs. The production process met the criteria for recognition as an intangible asset on 1st January 2020. Expenditure incurred till this date was ₹ 35 lakhs. Further expenditure incurred on the process for the financial year ending 31st March 2021 ₹ 105 lakhs. As on 31st March 2021, the recoverable amount of technique embodied in the process is estimated to be ₹ 89 lakhs. This includes estimates of future cash outflows and inflows. Under the provisions of AS 26, you are required to ascertain:

32
105
137

35 (i) The expenditure to be charged to Profit & Loss Account for year ended 31st March 2020;
32 (ii) Carrying amount of the intangible asset as on 31st March 2020;
(iii) Expenditure to be charged to Profit and Loss Account for the year ended 31st March 2021;
(iv) Carrying amount of the intangible asset as on 31st March 2021.

RA = 89



Solution

As per AS 26 'Intangible Assets'

(i) **Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020** ₹ 35 lakhs is recognized as an expense because the recognition criteria were not met until 1stJanuary 2020. 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 31.03.2020** Intangible under development

At the end of financial year, on 31st March 2020, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹ 32 (67-35) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st January 2020).

(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2021

	(₹ in lacs)
Carrying Amount as on 31.03.2020	32
Expenditure during 2020 – 2021	105
Book Value	137
Recoverable Amount	(89)
Impairment loss	48

₹ 48 lakhs to be charged to Profit and loss account for the year ending 31.03.2021

(iv) Carrying value of intangible asset as on 31.03.2021

	(₹ in lacs)
Book Value	137
Less: Impairment loss	(48)
Carrying amount as on 31.03.2021	89

Question 6: Inter Sep 2024 (4 Marks)

In the following cases, record Journal Entries for amortization in the books of Huge Ltd. for the year ended 31st March, 2024 with reference to AS-26:

(i) The company had acquired Patent Rights for ₹ 340 lakhs on 01.04.2022. The estimated product life is 4 years. Amortization was decided in the ratio of estimated future cash flows which are as under:

1st Year	₹ 140 Lakhs	2nd Year	₹ 350 Lakhs
3rd Year	₹ 280 Lakhs	4th Year	₹ 420 Lakhs

(ii) The company had developed know-how by incurring expenditure of ₹ 80 lakhs. The know-how has been used by the company since 01.04.2018. Its useful life is 8 years from the year of commencement of its use. The company has not amortised asset until 31.03.2024.

1/4/18 to 31/3/23 : 5 years
4 Prior Period

Solution

(i) Journal Entry for the year ended on 31st March 2024

			₹ in lakhs	**₹ in lakhs**
31.3.24	Amortization A/c (340 × 350/ 1,190)	Dr.	100	
	To Patent Rights A/c			100
	P&L A/c	Dr.	100	
	To Amortization A/c			100

Working note

Huge Limited amortised ₹ 340 lakhs during next 4 years on the basis of net cash flows arising of the product. The amortisation for second year will be worked out as under:

₹ 340 x 350 /1,190 (140+350+280+420) = ₹ 100 lakhs

(ii)

Particulars		₹ in lakhs	₹ in lakhs
Prior period item (5x10)	Dr.	50	
Amortization A/c	Dr.	10	
To Know-how A/c			60
[Being amortization of 6 years (out of which amortization of 5 years charged as prior period item i.e. 80 x 6 /8 = 60 lakhs)]			
Profit and Loss A/c	Dr.	60	
To Amortization A/c			10
To Prior Period Item			50
(Being amount transferred to Profit and Loss account)			

Question 7: RTP Nov 2021

A company is showing an intangible asset at ₹ 88 lakhs as on 01.04.2020. This asset was acquired for ₹ 120 lakhs on 01.04.2016 and the same was available for use 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 accounting treatment of the above with reference to relevant Accounting Standard.

120c/10 = 12c   1/4/16 to 1/4/20
120 − (12×4) = 72

Solution

As per 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. 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 01.04.2020 at ₹ 72 lakhs i.e. ₹ 120 lakhs less ₹ 48 lakhs.

The difference of ₹ 16 Lakhs (₹ 88 lakhs – ₹ 72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 72 lakhs will be amortised over remaining 6 years by amortizing ₹ 12 lakhs per year. Necessary journal entry will be

Prior Period Item -

Revenue Reserves Dr. ₹ 16 Lakhs
To Intangible Assets ₹ 16 Lakhs
(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

Question 8: ICAI Study Material / Inter Nov 2019 (5 Marks) / RTP May 2023

As per provisions of AS-26, how would you deal to the following situations:

(1) ₹ 23,00,000 paid by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.

(2) During the year 2018-19, a company spent ₹ 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

(3) A company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹ 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product

Solution

As per AS 26 "Intangible Assets", subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless

a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

b) expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(1) In the given case, the legal expenses to defend the patent of a product amounting ₹ 23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(2) The company is required to expense the entire amount of ₹ 7,00,000 in the Profit and Loss account for the year ended 31st March, 2019 because no benefit will arise in the future.

(3) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹ 25,00,000 and it should be recognized as expense

(4) Expenditure of ₹ 50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

Question 9: RTP Jan 2025

During 2023-2024, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

	Amount (₹)	
Completion of detailed programme and design (Phase 1)	25,000	Research : P&L
Coding and Testing for establishing technical feasibility (Phase 2)	20,000	
Other coding costs (Phase 3)	42,000	
Testing costs (Phase 4)	12,000	Dev. Phase
Product masters for training materials (Phase 5)	13,000	
Duplication of computer software and training materials, from product masters (2,000 units) (Phase 6)	40,000	P&L
Packing the product (1,000 units) (Phase 7)	11,000	

After completion of phase 2, it was established that the computer software is technically feasible for the market. What amount should be capitalized as software costs in the books of the company, on the Balance Sheet date?

Solution

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed programme design or working model.

In this case, ₹ 45,000 would be recorded as an expense (₹ 25,000 for completion of detailed program design and ₹ 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (₹ 42,000 + ₹ 12,000 + ₹ 13,000) ₹ 67,000.

Duplication of computer software and training materials, from product masters and packing the products are the cost incurred after development phase. Hence, the same shall be expensed off during the year it is incurred.

Question 10: RTP May 2024 / RTP May 2021

Naresh Ltd. had the following transactions during the financial year 2022-2023:

(i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2022. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.

(ii) Naresh Ltd. had taken a franchise on July 2022 to operate a restaurant from Sankalp Ltd. for ₹ 1,80,000 & at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during financial year 22-23.

(iii) On 20th August, 2022, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product.

Naresh Ltd. expects the patent's economic life to be 8 years. Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2023.

Solution

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2023

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: Amortisation as per AS 14 i.e. over 5 years (as per SLM) 1/5	(1,12,800)
	Balance to be shown in the balance sheet	**4,51,200**
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years) 1/6	(30,000)
	Balance to be shown in the balance sheet	**1,50,000**
(3)	Patent	2,40,000
	Less: Amortisation (over 8 years as per SLM) 1/8	(30,000)
	Balance to be shown in the balance sheet	**2,10,000**