

# AS 26 – INTANGIBLE ASSETS

## Illustration 1

ABC Ltd. developed know-how by incurring expenditure of ₹ 20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.

### Solution

#### Journal Entry

	₹	₹
Profit and Loss A/c (Prior period item) Dr.	12,00,000	
Amortization A/c Dr.	2,00,000	
To Know-how A/c*		14,00,000
[Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)]		

## Illustration 2

The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1-20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.

### Solution

In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus, according to AS 26 'Intangible Assets', the company should charge the total amount of ₹ 45 lakhs as an expense in the profit and loss account.

## Illustration 3

A company with a turnover of ₹ 250 crores and an annual advertising budget of ₹ 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore 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 recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

In the given case, advertisement expenditure of ₹ 2 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 ₹ 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 2 crores to the Profit and Loss account of the year is correct.

## Illustration 4

What is meant by Intangible Assets and what are the important factors to consider the recognition of item as an Intangible asset? What is the recognition criteria in accordance with the provisions of AS 26?

### Solution

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Below are the 3 key ingredients to be satisfied to cover an item as an intangible asset under this standard:

- identifiability,
- control over a resource and
- expectation (i.e. probable – 50% plus) of future economic benefits flowing to the enterprise.

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

- a. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
- b. The cost of the asset can be measured reliably.

### Illustration 5

What is the measurement criteria at the time of initial recognition of Intangible assets acquired through separate acquisition?

#### Solution

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The cost of an intangible asset comprises:

- its purchase price,
- any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and
- any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services.
- Any trade discounts and rebates are deducted in arriving at the cost.

### Illustration 6

What is the criteria for recognition and measurement of Internally generated intangible assets. Describe which kind of cost is considered for capitalisation with respect to provisions of AS 26. Whether the same applies for internally generated goodwill also?

#### Solution

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

#### Cost of an Internally Generated Intangible Asset

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria.

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.

### Illustration 7

Advise the complete accounting treatment for Research and development phase as per AS 26.

#### Solution

Research phase means acquisition of knowledge and Development phase means application of knowledge.

The expenditure related to Research phase is expensed off in statement of Profit and loss. However, the expenditure incurred in Development phase is capitalised as a cost of the internally generated intangible asset.

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

### Illustration 8

What is meant by Amortisation of an Intangible asset. What are the different methods for amortisation as per AS 26?

#### Solution

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

- the straight-line method,
- the diminishing balance method and
- the unit of production method.

The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset.

### Illustration 9 (MTP Mar'22, Oct '23) (Past Exam May'18, Nov'23)

Swift Ltd. acquired a patent at a cost of ₹ 80,00,000 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 at ₹ 10,00,000 per annum. The company had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be ₹ 36,00,000, ₹ 46,00,000, ₹ 44,00,000, ₹ 40,00,000 and ₹ 34,00,000. Find out the amortization cost of the patent for each of the years. **(5 Marks)**

#### Solution

Swift Limited amortised ₹ 10,00,000 per annum for the first two years i.e. ₹ 20,00,000. The remaining carrying cost 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:

	Net cash flows ₹	Amortisation Ratio	Amortisation Amount ₹
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total 2,00,00,000	1.000	80,00,000	

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

#### Illustration 10 (MTP Mar'19, Apr'24) (RTP May'18, Nov'19, Nov'22)

AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred ₹ 20 lakhs towards Research. 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 recognised as an expense when it is incurred. Hence, the expenses amounting ₹ 20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 20X2.

#### Illustration 11 (MTP May'20, Oct'21, Apr'23)

During 20X1-X2, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	₹
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above referred cost to be recognized in the books of accounts. **(5 Marks)**

#### 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 program design, coding and testing. In this case, ₹ 90,000 would be recorded as an expense (₹ 50,000 for completion of detailed program design and ₹ 40,000 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 (63,000+ 18,000+ 19,500) = ₹ 1,00,500. Packing cost ₹ 16,500 should be recognized as expenses and charged to P & L A/c.

**MTP / RTP / Past Exam****Question 1 (MTP Apr'19, Oct'19)**

A Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of Rs. 200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in lakhs)	Net operating cash flow (Rs. in lakhs)
1	300	900
2	600	1,800
3	650	2,300
4	800	3,200
5	800	3,200
6	800	3,200
7	800	3,200
8	800	3,200
9	800	3,200
10	800	3,200

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method. **(5 Marks)**

**Solution**

As per AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used. In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-à-vis production is determined reliably. A Ltd. should amortize the license fee of Rs. 200 lakhs as under:

Year	Net operating Cash in flow (Rs.)	Ratio	Amortize amount (Rs. in lakhs)
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24
9	3,200	0.12	24
10	3,200 0.11 (bal.)	22	
	27,400	1.00	200

**Question 2 (MTP Apr'21)**

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred Rs. 10 lakh on research during first 5 months of the financial year 2020-21. The development of the process began on 1st September, 2020 and up to 31st March, 2021, a sum of Rs. 8 lakhs were incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2021, the Company has implemented the new process design and it is likely that this will result in after tax saving of Rs. 2 lakhs 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 3.7908. Decide the treatment of Research and Development Cost of the project as per AS 26. **(5 Marks)**

**Solution:**

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product Rs. 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 2020- 21. 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 Rs. 8 lakhs incurred up to 31st March, 2021 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	Rs. 2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (Rs. 2 lakhs x 3.7908)	Rs. 7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value Rs. 8 lakhs or present value of future net cash flows Rs. 7.582 lakhs.

Hence, cost of an internally generated intangible asset will be Rs. 7.582 lakhs.

The difference of Rs. 0.418 lakhs (i.e. Rs. 8 lakhs – Rs. 7.582 lakhs) will be amortized by Plymouth for the financial year 2020-21. Amortization - The company can amortise Rs. 7.582 lakhs over a period of five years by charging Rs. 1.516 lakhs per annum from the financial year 2021-2022 onwards.

### Question 3 (MTP Mar'21, Apr'22) (RTP Nov'21)

PIL Ltd. is showing an intangible asset at Rs. 72 lakhs as on 31-3-2022. This asset was acquired for Rs. 120 lakhs as on 01-04-2016 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. You are required to comment on the accounting treatment of asset with reference to AS 26 "Intangible Assets" and also give the necessary rectification journal entry in the books. **(4 Marks)**

#### 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. 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 31.3.2022 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 amortizing Rs. 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 4 (MTP Oct'22) (RTP May'21, May'24)

Surya Ltd. had the following transactions during the year ended 31 st March, 2021.

- It acquired the business of Gomati Limited on a going concern basis for ₹ 25,00,000 on 1<sup>st</sup> June,2020. The fair value of the Net Assets of Gomati Limited was ₹ 18,75,000. Surya Ltd. believes that due to popularity of the products of Gomati Limited in the market, its goodwill exists.
- On 20th August, 2020, Surya Ltd. incurred cost of ₹ 6,00,000 to register the patent for its product. Surya Ltd. expects the Patent's economic life to be 8 years.

(iii) On 1st October, 2020, Surya Ltd. has taken a franchise to operate an ice cream parlour from Volga Ltd. for ₹ 4,50,000 and at an Annual Fee of 10 % of Net Revenues (after deducting expenditure). The franchise expires after six years. Net Revenue for the year ended 31st March, 2021 amounted to ₹ 1,50,000.

Surya Ltd. follows an accounting policy to amortize all Intangibles on Straight Line basis (SLM) over the maximum period permitted by the Accounting Standards taking a full year amortization in the year of acquisition.

Goodwill on acquisition of business is to be amortized over 5 years (SLM).

Prepare an extract showing the Intangible Assets section in the Balance Sheet of Surya Ltd. as at 31<sup>st</sup> March, 2021. **(5 Marks)**

**Solution:**

**Surya Ltd.**

Balance Sheet (Extract relating to intangible asset) as on 31st March 2021

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	14,00,000

**Notes to Accounts (Extract)**

	₹	₹
1. <b>Intangible assets</b>		
Goodwill (Refer to note 1)	5,00,000	
Patents (Refer to Note 2)	5,25,000	
Franchise (Refer to Note 3)	3,75,000	14,00,000

**Working Notes:**

	₹
(1) <b>Goodwill on acquisition of business</b>	
Cash paid for acquiring the business (purchase consideration)	25,00,000
Less: Fair value of net assets acquired	(18,75,000)
Goodwill	6,25,000
Less: Amortization. over 5 years (as per SLM)	(1,25,000)
<b>Balance to be shown in the balance sheet</b>	<b>5,00,000</b>
(2) <b>Patent</b>	6,00,000
Less: Amortization (over 8 years as per SLM)	(75,000)
<b>Balance to be shown in the balance sheet</b>	<b>5,25,000</b>
(3) <b>Franchise</b>	4,50,000
Less: Amortization (over 6 years)	(75,000)
<b>Balance to be shown in the balance sheet</b>	<b>3,75,000</b>

**Question 5 (MTP Mar'23, RTP Nov'20)**

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before the company knows through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya". X Ltd. incurred additional legal fees to stop infringement on

both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks? (5 Marks)

**Solution:**

As per para 59 of AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs must be recognized as an expense.

**Question 6 (RTP Nov'23, May 20) (Past Exam Nov'20)**

A company acquired patent right for Rs.1200 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

Year	Estimated future cash flows	1	2	3	4	5
(Rs. in lakhs)		600	600	600	300	300

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be Rs. 150 lakhs. You are required to determine the amortization pattern under AS 26. (5 Marks)

**Solution:****Amortization of cost of patent as per AS 26**

Year	Estimated future cash flow (Rs. in lakhs)	Amortization Ratio	Amortized Amount (Rs. in lakhs)
1	600	.25	300
2	600	.25	300
3	600	.25	300
4	300	.40 (Revised)	120
5	300	.40 (Revised)	120
6	150	.20 (Revised)	60
			<b>1,200</b>

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be Rs. 300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

**Question 7 (RTP May'22)**

PQR Ltd. has acquired a Brand from another company for Rs. 100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the AS.

**Solution:**

AS 26 'Intangible Assets' provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence no amortization needs to be provided is not correct as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

### Question 8 (RTP May 22)

X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of AS.

#### Solution:

As per AS 26 on 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 that meets the recognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.

### Question 9 (RTP May'19, May'23) (Past Exam Nov'19)

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 2021-22, 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.

(5 Marks)

#### 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.

- (i) 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.
- (ii) 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, 2022 because no benefit will arise in the future.
- (iii) 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
- (iv) 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 10 (Past Exam, Jan'21)**

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).
- (iv) Installation expenses ₹ 1,50,000.

Professional fees for clearance from customs ₹ 50,000. Compute the cost of software to be Capitalized as per relevant AS. **(5 Marks)**

**Solution:**

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

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ ( 3,750)
	£1,46,250
Cost in ₹ (UK £1,46,250 x ₹ 100)	146,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	168,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
<b>Cost of the software to be capitalized (₹)</b>	<b>170,91,875</b>

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 11 (Past Exam Nov'20, Dec'21)**

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹ 80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹ 42 lakhs. Further expenditure incurred on the process for the financial year ending 31<sup>st</sup> March, 2020 was ₹ 90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹ 82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out :

- 1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019 ?
- 2) What is the carrying amount of the intangible asset as on 31st March, 2019?
- 3) What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020 ?
- 4) What is the carrying amount of the intangible asset as on 31st March, 2020? **(5 Marks)**

**Solution:****As per AS 26 'Intangible Assets'****(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019**

₹ 42 lakhs is recognized as an expense because the recognition criteria were not met until 1<sup>st</sup> November, 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 ₹ 38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st November 2018)

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

	(₹ in lacs)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss to be charged to Profit and loss account	46

₹ 46 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**

	(₹ in lacs)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

**MCQs**

1. Which of the following is not covered within the scope of AS 26?
  - (a) Intangible assets held-for-sale in the ordinary course of business
  - (b) Assets arising from employee benefits
  - (c) (a) & (b) both
  - (d) Research and development activities
  
2. Intangible asset is recognised if it:
  - (a) meets the definition of an intangible asset
  - (b) is probable that future economic benefits will flow
  - (c) the cost can be measured reliably
  - (d) meets all of the above parameters
  
3. Sun Limited has purchased a computer with various additional software. These are integral part of the computer. Which of the following are true in the context of AS 26:
  - (a) Recognise Computer and software as tangible asset
  - (b) Recognise tangible and intangible separately
  - (c) Recognise computer and software as intangible asset
  - (d) Does not recognize the software as an asset.
  
4. Hexa Ltd developed a technology to enhance the battery life of mobile devices. Hexa has capitalised development expenditure of ₹ 5,00,000. Hexa estimates the life of the technology developed to be 3 years but the company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortisation charge in the second year of the product's life?
  - (a) ₹ 2,50,000
  - (b) ₹ 1,75,000
  - (c) ₹ 1,66,667
  - (d) ₹ 1,85,000

**ANSWERS/SOLUTIONS****MCQs**

1. (c) 2. (d) 3. (a) 4. (b)