8 ACCOUNTING STANDARD – 26 INTANGIBLE ASSETS

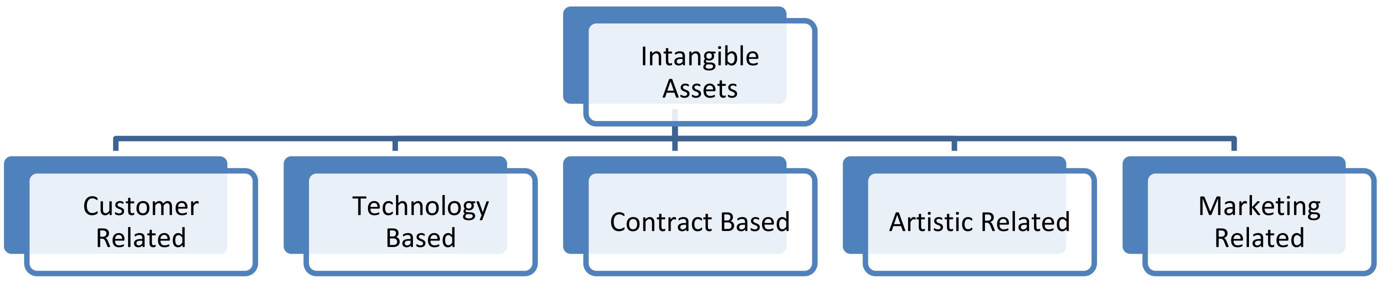
1. MEANING of an ASSET

- Any Resource which is Controlled by the enterprise as a result of past events and,
- From which Future Economic Benefits are expected to flow to the enterprise.

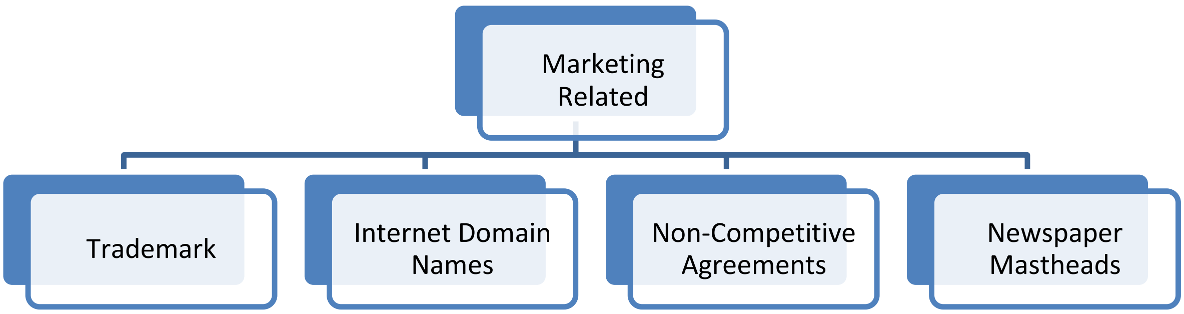
2. MEANING OF INTANGIBLE ASSETS

An Intangible asset is an Asset which has following characteristics:

- Identifiable
- Non – Monetary item
- Without physical substance
- Controlled by the entity
- From which future economic benefits are expected to flow
- Held for use in the ordinary course of business.



Let's run through some examples of each broad category listed above:



- Customer Related
  - Customer lists
  - Customer Contracts
  - Non-Contractual Customer Relationship
  - Customer Relationship

- Artistic Related
  - Musical Words
  - Magazines, Newspapers and other literary
  - Plays, operas and ballets
  - Pictures and photograph

- Contract Based
  - Franchise Agreements
  - Employment Contracts
  - Operating and broadcasting
  - Lease Agreements

- Technology Based
  - Trade Secrets
  - Computer Software
  - Databases
  - Patented Technology

2.1 IDENTIFIABILITY

An asset is **identifiable** if:

1. **It can be sold separately** – You can sell, transfer, or rent it without selling the whole business.

   · *Example:* a) Tally Accounting Software can be sold separately.

   b) A brand name like "Tata Tea" can be sold separately from Tata Group.

2. **It comes from legal or contract rights** – Even if you can't sell it separately, it is still an asset if legal rights exist.

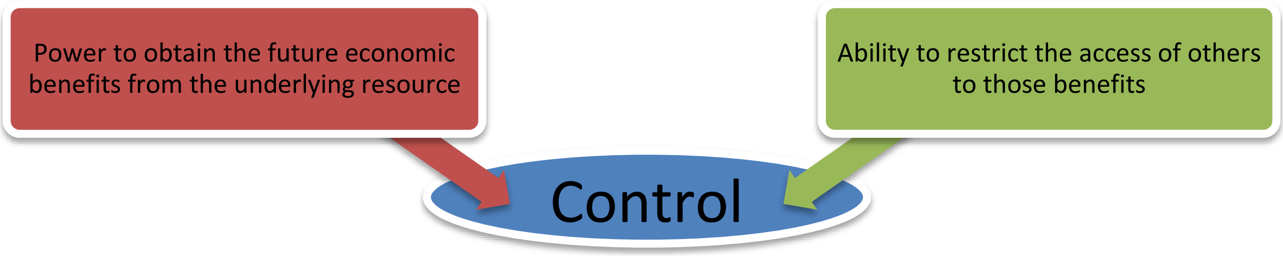
   · *Example:*

   a) A **patent** for a new medicine owned by **Sun Pharma** is valuable, even if not sold separately.

b) Telecome Licence owned by Reliance Jio – arise from a contract between central government and reliance.
c) Franchise Agreement.

Author's Note:
Goodwill is not identifiable if it is internally generated. Therefore, this is not an intangible asset within the scope of AS 26

2.2 CONTROL



EXAMPLES ON CONTROL

Example:
Specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

Example:
Moon Limited has provided training to its staff on various new topics like GST, AS, Ind AS etc. to ensure the compliance as per the required law. Can the company recognise such cost of staff training as intangible asset?
In this case, it is clear that the company will obtain the economic benefits from the work performed by the staff as it increases their efficiency. But it does not have control over them because staff could choose to resign the company at any time. Hence the company lacks the ability to restrict the access of others to those benefits. Therefore, the staff training cost does not meet the definition of an intangible asset.

2.3 FUTURE ECONOMIC BENEFITS

The future economic benefits flowing from an intangible asset may include:
(a) Revenue from the sale of products or services.
(b) Cost savings; or

For clarification, following are not Intangible Assets as per AS 26, hence they should be written off in P&L immediately:
(a) Preliminary expenses (non – identifiable)
(b) Pre-Operating expenses (non – identifiable)

(c) Staff Training Cost
(d) Heavy Advertisement expenses, Marketing and Promotion expenses.

Because Future Economic Benefits are not certain to be received.

3. RECOGNITION OF INTANGIBLE ASSETS

If the following conditions are satisfied then, an intangible asset should be recognized/ recorded in the books of accounts, otherwise treated as an expense:

- It is probable that future economic benefits from the intangible asset will flow to the enterprise; and
- The COST of intangible can be measured reliably.

Author's Note:
Internally generated brands, mastheads, publishing titles, customer lists (if not acquired) and items similar in substance are not recognised as intangible assets.

4. MEASUREMENT OF COST AT INITIAL RECOGNITION

INITIAL MEASURMENT

Intangible Assets should be recognized only at COST.

Case - 1

If Separately Acquired – Cost will be Purchase price including non-refundable duties and taxes and any other directly attributable cost (DAC) of preparing the asset for its intended use.

- Cost of Employee Benefits,
- Professional & Legal Fees,
- Cost of Testing

Cost Excludes: Cost of introducing a new product or brand or service including advertising and promotional activities, Cost of conducting business in a new location or with a new class of customers, Administration and General overhead costs.

Example 4: - Separate Acquisition
Jupiter Ltd acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing.

	Costs incurred include	Cost to be capitalized as per AS 26
Cost of new solar technology	10,00,000	10,00,000
Trade discount provided	(1,00,000)	(1,00,000)
Training course for staff in new technology	50,000	-
Initial testing of new technology	35,000	35,000
Losses incurred while other parts of plant shut down during testing and training	25,000	-
Total	**10,10,000**	**9,35,000**

Case - 2

If payment is deferred beyond normal credit terms:

Cost of Intangible Asset is the CASH PRICE EQUIVALENT at the recognition date.
Remaining Amount is Interest which is Total payment - Cash price equivalent.

Case - 3

Acquired through Acquisition/Amalgamation:

In accordance with AS 14, Amalgamation, if an intangible asset is acquired in an acquisition of any company, the cost of that intangible asset is its fair value at the acquisition date.

Case - 4

Exchange of Assets:

Intangible Assets acquired in Exchange for a Non-monetary Asset or Assets or a combination of Monetary and Non-monetary Assets:

Cost of Intangible Asset is **measured at fair value of Asset Given (1st Priority) or Asset Received (2nd Priority) unless:**

(i) Exchange transaction lacks commercial substance; Or

(ii) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

If the PPE acquired is not measured at Fair Value, its cost is measured at the carrying amount of the asset given up.

Example:

Sun Ltd. Having Telecommunication License with Book Value of 5,00,000, Acquired Software.
Earth Ltd. Having Software with Book Value of 10,000, Acquired Telecommunication License.
Fair Value of Telecom License is 5,00,000 and Software is 5,20,000

Situation 1: Both FV are given. Assuming FV of assets given is more reliable.

In the Books of Sun Ltd.

Software A/c	Dr.	5,00,000	
To Telecommunication License A/c			5,00,000

In the Books of Earth Ltd.

Telecommunication License A/c	Dr.	5,20,000	
To Software A/c			10,000
To Gain on Exchange of Asset A/c			5,10,000

Situation 2: FV of Telecommunication License is 4,90,000 & FV of Software is not Measurable

In the Books of Sun Ltd.

Software A/c	Dr.	4,90,000	
Loss on Exchange of Asset A/c (P&L)	Dr.	10,000	
To Telecommunication License A/c			5,00,000
(FV of Telecommunication License given is taken)			

In the Books of Earth Ltd.

Telecommunication License A/c	Dr.	4,90,000	
To Software A/c			10,000
To Gain on Exchange of Asset			4,80,000
(FV of Asset (Telecommunication License) is taken because Asset given FV is not available)			

Situation 3: Both FV are not reliable take BV of assets given

In the Books of Sun Ltd.

Software A/c	Dr.	5,00,000	
To Telecommunication License A/c			5,00,000

In the Books of Earth Ltd.

Telecommunication License A/c	Dr.	10,000	
To Software A/c			10,000

Case - 5

Acquisition by way of Govt. Grants –

In accordance with AS 12, Accounting for Government Grants, an entity should recognise both the intangible asset and the grant initially at Nominal Value

Example:

Government transfers or allocates to an entity intangible assets such as **airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources.**

Case - 6

Internally Generated Goodwill – Cost cannot be measured reliably hence, not recognized.

Case - 7

Internally generated Intangible assets - like Brands, Customer Lists; Good and Trained employees should not be recognized as intangible assets. Publishing Titles such as "India Today", "Champak" cannot be recorded as IA. (Cost can-not be measured reliably).

Therefore, Cost of Self-Generated Intangible Asset comprises of:

Purchase Cost including non-refundable duties and taxes (+) PPE (Equipment) Purchased for Software Development (+) Lease Rent of Premise where software development is carried on (+) Test Run Expenses (+) Legal Cost (+) Any other directly attributable expenses of bringing the Intangible Asset to its useable condition	

5. MEASUREMENT OF EXPENDITURE ON RESEARCH & DEVELOPMENT

***(a)* Research** is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding i.e. Gaining of scientific or technical knowledge.

- Cost of Research activity should not be capitalized as an intangible asset, it should be treated as expense and transfer to P&L a/c as par AS 26.
- Here Entity cannot prove that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred.

Examples of research activities are:

a) Activities aimed at obtaining new knowledge;
b) The search for, evaluation and final selection of, applications of research findings or other knowledge;
c) The search for alternatives for materials, devices, products, processes, systems or services; and
d) The formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

***(b)* Development:** It is the activity which converts the result of the research to a marketable product (Gained knowledge is applied).

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an entity can demonstrate all of the following:

1. Technical feasibility of completion of Intangible asset to make it available for use or sale
2. Intention to complete the intangible asset and use or sell it
3. Ability to use or sell the intangible asset.
4. How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or

the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.

5. Adequate resources (like technical, financial or others) to complete the development.
6. Ability to measure reliably the expenditure attributable to the intangible asset during its development.

Cost of Development Phase or Internally Generated Intangible Assets comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management.

Examples of directly attributable costs are:

- Cost of materials and services used or consumed in generating the intangible assets.
- Costs of employee benefits arising from the generation of the intangible assets
- Fees to register a legal rights

6. SUBSEQUENT EXPENDITURE

Subsequent Expenditure on already recognized Intangible Asset should be capitalized if the following two conditions are fulfilled:

1. Subsequent Expense increases the future economic benefits of Intangible Assets.
2. Such expense can be measured reliably.

If the above two conditions are not fulfilled than the subsequent expense should be transferred to P&L A/c.

Note: Legal Cost to defend the infringement of Trademark (to stop the infringement) doesn't increase the earning efficiency hence it shall always be transferred to Profit and loss irrespective of whether case is in favour of entity or not.

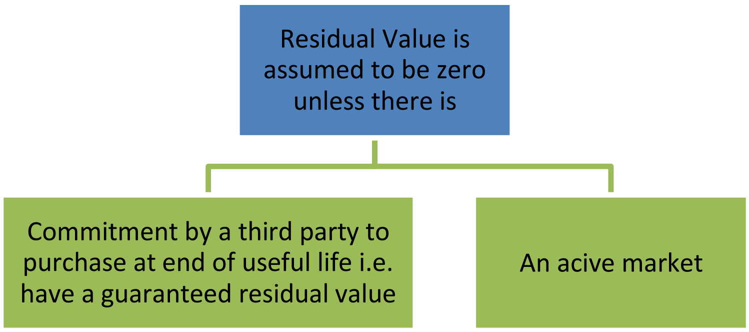
7. AMORTIZATION OF INTANGIBLE ASSET

Amortisation Means	Allocation of the depreciable amount of an intangible asset with a finite useful life on a systematic basis over its useful life
Amortised Period	• The useful life of Intangible Asset is required to estimated based on best available evidence. • There is a rebuttable presumption that the useful life of an intangible asset will not exceed the Ten Years from the date when the asset is available for use unless there is significant evidence that the useful life is more than 10 years. • Factors to be considered to estimate the useful life: ➢ Expected usage ➢ Product Life cycle

	➢ Technical or Technological obsolescence ➢ Industry's Stability ➢ Level of Maintenance Expenses incurred during the year ➢ Contractual Conditions • Examples of Useful life more than 10 year through Contract: Franchise License for 20 Years Telecom License for 30 Years License to operate Toll Roads for 25 Years
Amortisation begins and Ends	• Amortisation starts when Asset is Available for Use • Amortisation ends earlier of the date: ➢ When asset is held for sale; or ➢ When asset is derecognized
Amortisation Method	Intangible Asset should be amortised on the following basis: ➢ In proportion of Expected Economic Benefits (1st Priority) ➢ On SLM basis
Review of Amortisation Period and Method	• The amortization period and method should be reviewed at least at each financial year end. • If there is change in amortisation period or method, it is treated as Change in Accounting Estimate.

8. RESIDUAL VALUE

The residual value of intangibles should be assumed to be Zero unless:



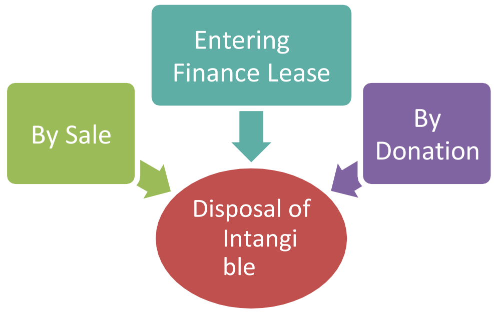
9. RETIREMENT AND DISPOSAL OF INTANGIBLE ASSETS

An intangible asset should be derecognized (eliminated from the Balance sheet) if:

- It is disposed; or
- No future economic benefits are expected from its use.

Gain/Loss arising on retirement or disposal of intangibles should be recognized as income or expense in P&L A/c.

The disposal of an intangible asset may occur in a variety of ways (e.g. by sale, by entering into a finance lease, or by donation).



SOME IMPORTANT POINTS

1. Acquired Customer list may be recognized as Intangible Asset if entity expects to derive benefit from the information on the list for at least one year.

2. The product protected by the patented technology is expected to be a source of net cash inflows for at least 15 years. The entity has a commitment from a third party to purchase that patent in five years for 60 per cent of the fair value of the patent and the entity intends to sell the patent in five years.
   The patent would be amortised over its five-year useful life to the entity, with a residual value equal to the present value of 60 per cent of the patent's fair value at the date it was acquired.

3. Intangible Assets should be amortised based on the useful life instead of the legal life (if legal life is different).

4. Assets that incorporate both Tangible & Intangible elements should be treated as under:
   The entity uses judgement to assess which element is more significant i.e. "Which one is more dominating?"
   For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer.
   When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

5. Cost of packing is not a part of development cost of intangible assets. Such a cost is incurred once development is completed. Hence it is not capitalized.

6. Impairment of Intangible Assets: when carrying amount (book value) is higher than recoverable amount then Impairment Loss shall be recognised in profit and loss statement. (AS 28)

7. Purchase Goodwill is recognised as per AS 14 (Amalgamation) and amortised in a maximum period of 5 years. (Purchased Goodwill = PC – Net Assets Acquired)

8. **Francise Cost:**
   - **(a)** Initial One Time Expense to acquire Franchise – Such Expense shall be capitalised and amortised over the period of contract.
   - **(b)** Annual recurring expenses (based on sales) – Always charged to P&L A/c

10. MCQ's from ICAI Resources

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

5. Which of the following expense can be capitalized as per AS 26?
   (a) expenditure on Major advertising
   (b) Expenditure on an intangible item that was initially recognised as an expense in the previous Financial year
   (c) expenditure on training activities of new license acquired
   (d) Subsequent expenditure on Intangible asset which will enhance future benefit expenditure that can be measured reliably

6. AS 26 is applicable to following:
   (a) Deferred tax assets

(b) Rights under licensing agreements for films
(c) Financial Assets
(d) Goodwill arising on an amalgamation

ANSWERS	1	2	3	4	5	6
	c	d	a	b	d	b

11. MCQ's Created by Jai Sir & Team

7. Which of the following is correct?
   a) AS 26 applies to mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources.
   b) AS 26 applies to intangible assets arising in insurance enterprises from contracts with policyholders.
   c) AS 26 applies to intangible assets that are covered by another Accounting Standard.
   d) None of the above.

8. What is an impairment loss?
   (a) The amount by which the carrying amount of an asset exceeds its recoverable amount
   (b) The amount by which the carrying amount of an asset equals its recoverable amount
   (c) The amount by which the carrying amount of an asset is less than its recoverable amount
   (d) The amount by which the carrying amount of an asset is equal to its fair value

9. Company X invests ₹500,000 in an internal project aimed at developing a new software program. However, it is unable to distinguish between the research and development phases of the project. How should Company X treat the expenditure according to the provided data?
   (a) Treat the entire expenditure as incurred in the development phase only
   (b) Treat the entire expenditure as incurred in the research phase only
   (c) Allocate the expenditure equally between the research and development phases
   (d) Cease the project until the phases can be distinguished

10. Company A spends ₹300,000 on research activities aimed at developing a new pharmaceutical drug. According to the provided data, how should Company A treat this expenditure?
   (a) Recognize it as an intangible asset
   (b) Recognize it as an expense when incurred
   (c) Capitalize it as part of development costs
   (d) Allocate it evenly between research and development phases

11. Company Z is developing a new marketing strategy. It has demonstrated technical feasibility and has the intention to complete the project. However, there is uncertainty about the availability of financial resources to complete the development. Should Company Z recognize an intangible asset for this project?
   (a) Yes, because technical feasibility and intention to complete the project have been demonstrated
   (b) Yes, because the project has demonstrated its ability to generate future economic benefits
   (c) No, because there is uncertainty about the availability of financial resources to complete the project.
   (d) No, because the marketing strategy is not yet available for use or sale

12. Company X incurs ₹50,000 on purchasing materials and services for developing a new software program. Additionally, it pays ₹80,000 in salaries, wages, and other employment-related costs for personnel directly engaged in the development. If the overhead costs allocated to the software project amount to ₹20,000 and expenditure on training the staff to use the internally generated software amount to ₹50,000, what is the total cost of internally generating the software?
   (a) ₹100,000
   (b) ₹150,000
   (c) ₹130,000
   (d) ₹200,000

Correct Answer					
Q7	Q8	Q9	Q10	Q11	Q12
D	a	b	b	c	b