

TOPIC – 8

ACCOUNTING STANDARD - 26

INTANGIBLE ASSETS

TOTAL NO. OF QUESTIONS - 15

Q.AS26.SM.01:

ABC Ltd. developed know-how by incurring expenditure of Rs. 20 lacs. The know-how was used by the company from 1.04.20X1. The useful life of the intangible is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.03.20X8. Pass journal entry to give effect the value of know-how as per AS 26 for the year ending 31.03.20X8.



Q.AS26.SM.02: (MTP May20 & Nov21)

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

Particular	Rs.
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.

Q.AS26.RMP.03: (Exam Jan21)

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 Rs. 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 Rs. 1,50,000.
 - v) Professional fees for clearance from customs Rs. 50,000.
- Compute the cost of software to be Capitalized as per relevant AS.



Q.AS26.RMP.04: (RTP May20; EXAM Nov20)

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	1	2	3	4	5
Estimated future cash flows (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 Accounting Standard 26.

Q.AS26.RMP.05: (RTP Nov20)

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before, the company comes to know 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?

**Q.AS26.RMP.06: (RTP May18 & Nov18, MTP May22)**

A company acquired a patent at a cost of Rs 160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at Rs. 16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be Rs. 50 lakhs, Rs. 30 lakhs, Rs. 60 lakhs, Rs. 70 lakhs and Rs. 40 lakhs. Find out the amortization cost of the patent for each of the years.

Q.AS26.OM.07: (Old Course)

Vishnu Ltd. is engaged in research on a new process design for its product- It had incurred an expenditure of Rs. 265.37 lakhs on research upto 31st March, 2003. The development of the process began on 1st April, 2003 and the Development Phase Expenditure was Rs. 180 lakhs



upto 31st March, 2004. From 1st April, 2004 the Company will implement the new process design which will result in a after-tax cost saving of Rs. 40 lakhs per annum for the next five years. The Company's Cost of Capital is 10%. At what cost should the asset be recorded and what is its amortisation amount?

Q.AS26.RMP.08: (MTP Nov22) (EXAM Nov20)

Honey Ltd. is in the process of developing a new production method. During the financial year ended 31st March, 2021, total expenditure incurred on development of this production method was Rs. 98,00,000. On 1st Jan, 2021, the production method met the criteria as an intangible asset and expenditure incurred till this date was Rs. 68,00,000. Further expenditure incurred on the new method was Rs. 72,00,000 for the year ended 31st March, 2022 and recoverable amount of the know how embodied in the new method for this financial year is Rs. 52,00,000.

You are required to calculate:

- (1) The carrying amount of the Intangible asset on 31st March, 2021.
- (2) The expenditure to be shown in Statement of Profit and Loss for the year ended 31st March, 2022.
- (3) The carrying amount of the Intangible asset on 31st March, 2022.

Q.AS26.RMP.09: (RTP May21)

Naresh Ltd. had the following transactions during the financial year 2019 -2020:

- (i) Naresh Ltd. acquired running business of Sunil Ltd. for Rs. 10,80,000 on 15th May, 2019. The fair value of Sunil Ltd.'s net assets was Rs. 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 2019 to operate a restaurant from Sankalp Ltd. for Rs. 1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were Rs. 60,000 during the financial year 2019-2020.
- (iii) On 20th August, 2019, Naresh Ltd, incurred costs of Rs. 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, 2020.



Q.AS26.SM.10:

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.



Q.AS26.SM.11:

A company with a turnover of Rs.250 crores and an annual advertising budget of Rs.2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of Rs.25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of Rs.2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

**Q.AS26.SM.12:**

AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred Rs.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.

**Q.AS26.SM.13:**

Swift Ltd. acquired a patent at a cost of Rs.80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalised the cost and started amortizing the asset at Rs.10,00,000 per annum. 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.36,00,000, Rs.46,00,000, Rs.44,00,000, Rs.40,00,000 and Rs.34,00,000. Find out the amortisation cost of the patent for each of the years.

**Q.AS26.SM.14**

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?

Q.AS26.RMP.15: (Exam Nov19)

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

- (1) Rs 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 Rs 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 Rs 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 Rs 25,00,000 by disclosing it as a prior period item.
- (4) A company with a turnover of Rs 200 crores and an annual advertising budget of Rs 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 Rs 20 crore from the new product.

The company had debited to its Profit & Loss Account the total expenditure of Rs 50,00,000 incurred on extensive special initial advertisement campaign for the new product.

Q.AS26.RMP.16: (Sep'24 Exma)

- (a) 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	Rs. 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 the asset until 31.03.2024.

SOLUTIONS OF ABOVE QUESTIONS

SOLUTION Q01**Journal Entry**

Particulars		Dr. Amount	Cr. Amount
Profit and Loss A/c (PPI)	Dr.	12,00,000	
Amortisation A/c	Dr.	2,00,000	
To Know How A/c			14,00,000
(Being depreciation of 7 Years out of which 6 years dep charged as Prior Period Item)			

**As per AS 26 "Intangible Assets", 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. Amortisation should commence when the asset is available for use.

SOLUTION: Q02

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, Rs. 90,000 would be recorded as an expense (Rs. 50,000 for completion of detailed program design and Rs. 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)=Rs.1,00,500. Packing cost Rs.16,500 should be recognized as expenses and charged to P&LA/c.

SOLUTION: Q03**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 Rs. (UK £1,46,250 x Rs. 100)	146,25,000
Add: Import duty on cost @ 10% (Rs.)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (Rs.)	8,04,375
	168,91,875
Add: Installation expenses (Rs.)	1,50,000
Add: Professional fee for clearance from customs (Rs.)	50,000
Cost of the software to be capitalized (Rs.)	170,91,875

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

SOLUTION: Q04**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
			1,200

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.

SOLUTION: Q05

As per 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 incurred for both trademarks must be recognized as an expense.

SOLUTION: Q06

Company amortized Rs 16,00,000 per annum for the first two years. Hence, Amortization for the first two years (Rs 16,00,000 X 2) = Rs 32,00,000.

Remaining carrying cost after two years = Rs 1,60,00,000 – Rs 32,00,000
= Rs 1,28,00,000

Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost Rs128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.

The amortization cost of the patents may be computed as follows:

Year	Net cash flows Rs	Amortization Ratio	Amortization Amount Rs
I	-	0.1	16,00,000
II	-	0.1	16,00,000
III	50,00,000	0.2	25,60,000
IV	30,00,000	0.12	15,36,000
V	60,00,000	0.24	30,72,000
VI	70,00,000	0.28	35,84,000
VII	40,00,000	0.16	20,48,000
Total	250,00,000	1.000	160,00,000

SOLUTION Q07

Research Expenditure: As per Para 41 of AS-26, the expenditure on research Rs. 265.37 lakhs should be expensed in the year in which it is incurred. It is presumed that the entire expenditure of Rs. 265.37 lakhs is incurred in financial year 2002-2003. Hence, it should be written off as an expense in that year itself.

Development Expenditure: As per para 44 of AS-26, the expenditure on development can be treated as an asset only if all the conditions listed in that paragraph are satisfied. It is presumed that the company has duly complied with this requirement.

Cost of internally generated intangible asset: Para 53 specifies the items which can be included in the cost of an internally generated intangible asset, while Para 54 specifies the exclusions there from. It is presumed that the expenditure of Rs.180 lakhs is determined in accordance with Para 53 and 54 of AS-26.

Discounting Future Cash Flows: As per Para 30 of AS-26, fair value of an intangible asset can be estimated by discounting estimated future net cash flows. Even if this paragraph is primarily related to estimation of fair value of an intangible asset acquired in the course of amalgamation in the nature of purchase, the concept can be extended for internally generated intangible asset also.

Cost savings from the new process design for five = Rs. 40 lakhs per year

Company's Cost of Capital = 10%

Annuity Factor at 10% for five years = 3.7908

(from the annuity tables)

Present value of future cash flows = Rs. 40 x 3.7908 = Rs. 151.63 lakhs

Carrying Amount of the Asset: Since the Present Value of Future Cash Flows is only Rs. 151.63 lakhs, (which is lower than the cost of Rs.180 lakhs), it is prudent to recognise an impairment loss of Rs. 180.00 lakhs - Rs. 151.63 lakhs = Rs. 28.37 lakhs in the financial year 2003-2004.

Amortisation Period and Amount: The Company can amortise Rs. 151.63 lakhs over a five-year period by charging Rs. 30.33 lakhs per annum from the financial year 2004-2005 onwards.

SOLUTION Q08

As per AS 26 'Intangible Assets'

(i) Carrying value of intangible asset as on 31.03.2021

At the end of financial year, on 31st March 2021, the production process will be recognized (i.e., carrying amount) as an intangible asset at a cost of Rs. 30 (98-68) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st January, 2021).

(ii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2022

	(Rs. in lacs)
Carrying Amount as on 31.03.2021	30
Expenditure during 2021-2022	72
Book Value	102
Recoverable Amount	(52)
Impairment loss	50

Rs. 50 lakhs to be charged to Profit and loss account for the year ending 31.03.2022.

(iii) Carrying value of intangible asset as on 31.03.2022

	(Rs. in lacs)
Book Value	102
Less: Impairment loss	(50)
Carrying amount as on 31.03.2022	52

SOLUTION: Q09Naresh Ltd.Balance Sheet (Extract relating to intangible asset) as on 31st March 2020

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

Notes to Accounts (Extract)

	Rs.	Rs.
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:

	Rs.
(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)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years)	(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)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

Note: Amortisation shall commence from the date when Asset is acquired or available for use. Hence, in this question, policy followed by company to charge full year amortization in the year of purchase is not justified.

SOLUTION Q10

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.

SOLUTION Q11

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. Marketing & Promotional Expenses can't give us an assumption of FEB. Hence, FEB is not certain to be received.

In the given case, advertisement expenditure of Rs.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 Rs.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 Rs.2 crores to the Profit and Loss account of the year is correct.

SOLUTION Q12

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. Hence, the expenses amounting Rs.20 lakhs incurred on the research has to be written off in the current year ending 31st March, 20X2.

SOLUTION Q13

Swift Limited amortised Rs.10,00,000 per annum for the first two years i.e. Rs.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:

Year	Net Cash Flows	Amortisation Ratio	Amortisation Amt.
1	-	0.125	10,00,000
2	-	0.125	10,00,000
3	36,00,000	0.180	10,80,000
4	46,00,000	0.230	13,80,000
5	44,00,000	0.220	13,20,000
6	40,00,000	0.200	12,00,000
7	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., Rs.60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

Note: The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years

SOLUTION Q14

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. For details, refer para 6.16.

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.

ANSWER: Q15

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 Rs 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 Rs 7,00,000 in the Profit and Loss account for the year ended 31st March, 2019 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 Rs 25,00,000 and it should be recognized as expense
- (iv) Expenditure of Rs 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.

ANSWER: Q16

(a) (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
31.3.24	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:

$$₹ 340 \times 350 / 1,190 (140+350+280+420) = ₹ 100 \text{ lakhs}$$

(ii)

Particulars		₹ in lakhs	₹ in lakhs
Prior period item	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. $80 \times 6 / 8 = 60$ 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)			



Student Notes:-