

# AS 26

# Intangible Assets

## Question 1

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. (MTP 5 Marks Oct'19, Apr'19)

## Answer 1

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
	<b>27,400</b>	<b>1.00</b>	<b>200</b>



**Question 2**

*K Ltd. launched a project for producing product X in October, 2016. The Company incurred Rs. 40 lakhs towards Research and Development expenses up to 31st March, 2018. 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.*

*(MTP-Mar'19 5 Marks, RTP Nov 19, May 18, RTP Nov'22, Old & New SM)*

**Answer 2**

*As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting Rs.40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2018.*

**Question 3**

*Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred Rs. 10 lakhs 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.*

*(MTP 5 Marks April 21)*

**Answer 3**

**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 amortize 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 4

Sudesh Ltd. acquired a patent at a cost of Rs. 2,40,00,000 for a period of 5 years and the product life-cycle was also 5 years. The company capitalized the cost and started amortizing the asset at Rs. 48,00,000 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 amortization cost of the patent for each of the years if the patent was renewable and Sudesh Ltd. got it renewed after expiry of five years. (MTP 5 Marks Oct '20, Mar'22 & Oct '23) (Same concept different figures RTP Nov'18, Old & New SM, PYP 5 Marks May'18)

#### Answer 4

The entity amortized Rs. 48,00,000 per annum for the first two years i.e. Rs. 96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortization may be found as follows:

Year	Net cash flows Rs.	Amortization Ratio	Amortization Amount Rs.
I	-	0.20	48,00,000
II	-	<u>0.20</u>	48,00,000
III	36,00,000	0.180	25,92,000
IV	46,00,000	0.230	33,12,000
V	44,00,000	0.220	31,68,000
VI	40,00,000	0.200	28,80,000
VII	<u>34,00,000</u>	<u>0.170</u>	<u>24,48,000</u>
Total	<u>2,00,00,000</u>	<u>1.000</u>	<u>2,40,00,000</u>

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs. 1,44,00,000 has been amortized in the ratio of net cash flows arising from the product of Change Ltd.

#### Question 5

During 2019-20, 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.

**(MTP 5 Marks May '20, Oct'21 & April '23, Old & New SM)**

**Answer 5**

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 or working model. 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 Profit & Loss A/c.

**Question 6**

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.

**(MTP 5 Marks April 22, MTP 4 Marks March'21, RTP Nov '21)**

**Answer 6**

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 7**

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

- (i) It acquired the business of Gomati Limited on a going concern basis for ₹ 25,00,000 on 1st 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.



(ii) 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 31st March, 2021. (MTP 5 Marks Oct'22, RTP May '21)

**Answer 7**

**Surya Ltd.**

Balance Sheet (Extract relating to intangible asset) as on 31<sup>st</sup> March 2021

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

**Notes to Accounts (Extract)**

		₹	₹
1.	Intangible assets		
	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)	Goodwill on acquisition of business	
	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)
	Balance to be shown in the balance sheet	5,00,000
(2)	Patent	6,00,000
	Less: Amortization (over 8 years as per SLM)	(75,000)
	Balance to be shown in the balance sheet	5,25,000
(3)	Franchise	4,50,000
	Less: Amortization (over 6 years)	(75,000)
	Balance to be shown in the balance sheet	3,75,000



**Question 8**

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks Prakshal Shahu. 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? . **(MTP 5 Marks March '23, RTP Nov'20)**

**Answer 8**

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 9**

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.

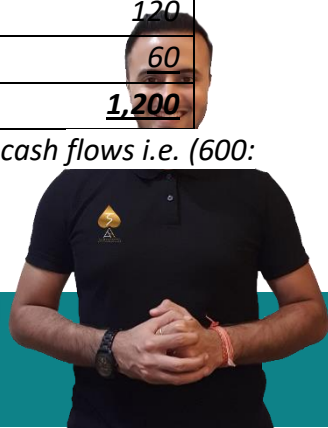
**(RTP May 20),(Same concept different figures PYP 5 Marks Nov'20)**

**Answer 9**

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 10

**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 Accounting Standards.**

**(May 22)**

### Answer 10

AS 26 'Intangible Assets' provides that an intangible asset should be measured initially at cost. After initial organization, 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 11

**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 Accounting Standards.**

**(RTP May 22)**

### Answer 11

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:

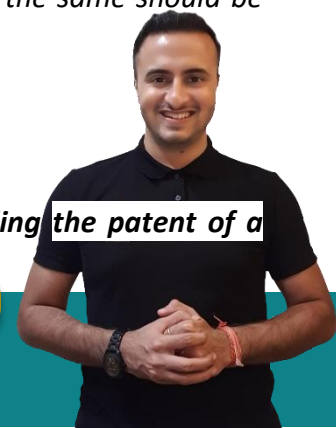
(i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

(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 12

**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 products 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.*

**(RTP May '23, PYP Nov '19 5 Marks) (Same concept different figures RTP May'19, Old & New SM)**

### Answer 12

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 13

*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.*

**(PYP 5 Marks , Jan 21)**



### Answer 13

#### **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
Cost of the software to be capitalized (₹)	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.

### Question 14

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 31st 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?

**(PYP 5 Marks Nov 20 & Dec '21) (Same concept lesser adjustments MTP 5 Marks Sep'22 & Sep '23)**

### Answer 14

**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 1st 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

**Question 15**

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 5<sup>th</sup> year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26. (RTP Nov '23)

**Answer 15**

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
		<b>1.00</b>	<b>600</b>

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

