Accounting standard no 26 Intangible Assets

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Comparative international standards and highlights

- IAS 38
- Deals with
  - Identification of intangible assets
    - Including self-generated intangible assets
    - Composite assets – tangible and intangible
  - Initial recognition and derecogintion
  - Capitalisation of intangible assets – that is, when can expenditure be capitalised and taken as cost of intangible assets, and when is it to be taken as revenue expense?
  - Amortisation of intangible assets
    - Useful life
    - Residual value
  - Dealing with self-generated intangible assets
- Practically, the concept of deferred revenue expense has ceased to exist

What is an intangible assets

- Assets that do not have a tangible substance
  - Most intangible assets will also have a tangible manifestation or container
    - For example, computer software is intangible but contained in a tangible media
    - Trade marks are intangible assets, but contains a tangible form/ certification
    - Some intangible assets – eg., goodwill, may not have any tangible form at all
  - Whether the asset is tangible or intangible depends on whether intangible part is main value
- Certain assets are tangible, but require intangible assets to work
  - Best example is a mobile phone
- Where the intangible part does not have a stand-alone value, we do not consider the intangible asset as a separate asset
- Deferred revenue expense and intangible asset
  - Merely because the impact of an expense relates to more than one accounting period does not mean there is an intangible asset

Scope exceptions

- Intangible assets covered by other standards
  - Deferred tax asset for example
- Financial assets
  - Monetary assets – definition of intangible assets excludes monetary assets
- mineral rights
- Intangible assets in insurance business
  - Embedded value, for example
- Current assets
  - The AS deals with only those assets which are held in business for use, and not for disposal
- Goodwill
  - Arising from consolidation – dealt with separately
  - Arising from amalgamation – dealt with separately

Definition of intangible assets

- 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
- Elements of definition
  - Identifiable
    - Paying a price for an asset which is not identifiable – like in acquisition of a business, is not intangible asset
    - Not necessary that the asset should be separable – but it should be identifiable
      - Pure payment of goodwill does not lead to creation of an intangible assets
  - non-monetary
    - Financial assets are not covered
  - asset
    - Entity should have control over the asset; future economic benefits should be expected to flow in
  - without physical substance
  - held for use in the production or supply of goods or services, for rental to others or for administrative purposes
    - Held for disposal or consumption is not an intangible asset

Recognition and initial measurement

- Recognition of a intangible fixed asset goes on more stringent principle than a tangible fixed asset
  - Para 20, AS 26 says intangible asset to be recognised only if
    - Future economic benefits attributable to the asset will flow to the enterprise
    - Cost of the asset can be measured reliable
  - Positive answers to both the questions required
  - Example – entity spends substantial expenditure on launch of a new product
    - Future benefits in terms of sales of the products, attributable to the expenditure, exist?
      - That is, we will measure what would have been expected sales if the expense was not incurreed
    - Cost of the ad campaign determinable?
    - If both conditions exist, an intangible asset will come on books; if not, the expense is treated as revenue
- Value of initial recognition
  - At cost
    - In case of separately acquired intangible assets, cost is easy to find – principles are the same as for any other asset – all costs upto preparing the asset for use
    - In case acquired in a business combination
      - As per AS on Business Combinations
      - If purchase method used, and the fair value of the asset cannot reasonably be measured, it is considered as part of goodwill
    - In case acquired with another asset
      - Splitting of cost
    - In case of self-generated intangible asset – separate principles

Internally generated intangible assets

- Since intangible assets are not physically manifested, principles for internal generation of intangible assets are quite stringent
  - Internally generated goodwill is never taken as intangible asset
  - Para 38-54 of the standard apply to internal generation
- Terms
  - Research phase: gaining of scientific or technical knowledge and understanding
  - Development phase: application of research findings or other knowledge to a plan or design for production of new or substantially improved materials, devices, products, processes, systems or services, prior to commencement of commercial production or use
- During research phase, expenditure on internal generation should be capitalised
- During development phase, subject to several conditions, the expenditure may be capitalised
- If research phase and development phase cannot be distinguished, entity should treat the expenditure as incurred for research phase only

Conditions for capitalisation of internally generated assets

- Technical feasibility of completing the intangible asset so that it will be available for use
- Intention to complete the asset and use it or sell it
- Ability to use or sell the intangible asset
- How the asset will generate future economic benefits
  - Existence of a market for the output of the intangible asset or the usefulness of the asset
- Availability of adequate technical, financial and other resources to complete the development
- Ability to measure the expenditure attributable to the intangible asset
- Internally generated brands, customer lists etc are not recognised as intangible assets

Cost of internally generated assets

- Once an expenditure crosses the Research phase and enters Development phase, expenses can be taken towards cost of intangible assets
  - If such expense is directly attributable, or reasonably allocated, to creating producing or making the intangible asset ready for intended use
- Examples of expenses that may be capitalised
  - Materials and services
  - Salaries, wages and employment related costs
  - Fees to register a legal right, amortisation of patents or licenses used to generate the asset
  - Overheads necessary to generate the asset, that can be allocated on reasonable and consistent basis (depreciation, insurance, rent, etc.)
- Following are not capitalised
  - Selling, admin or general overheads
  - Inefficiencies or operating losses before the asset achieves planned performance
  - Expenditure on training of staff to operate the asset
- Once an entity starts capitalising an intangible asset, it also starts testing the same for impairment
- **Expenses booked as revenue in a previous financial year cannot be allocated to cost of intangible assets later – para 58**
- Subsequent to an intangible asset comes to existence, further expense should not be capitalised
  - Unless the expense can be related to increasing the economic value of the asset

Amortisation of intangible assets

- Depreciable amount
  - Cost minus residual value
- Cost
  - Either incurred, or if internally generated, based on principles discussed
- Residual value
  - Assumed to be zero, unless
    - Third party agreement to buy the asset at end of useful life
    - There is an active market
      - Such market value can be established, and the market is expected to continue to exist till the end of useful life
- Useful life
  - Period over which asset is expected to be used;
  - There is a rebuttable presumption that the useful lifeis limited to 10 years
  - Many factors while making estimate of useful life (para 64)
    - Expected usage of the asset
    - Product life cycles
    - Technical or technological obsolescence
    - If the useful life is based on legal rights to use the asset, useful life should not exceed such legal rights, unless the rights are renewable, and renewal is virtually certain
- Amortisation should be on a systematic basis over the best estimate of useful life of the asset
  - If any other basis is not indicative of the consumption pattern of the intangible asset, straight line amortisation should be done over useful life
    - Conflict with Companies Act
      - Only 95% of the cost to be written off
      - Choice between straight line and WDV methods

Impairment losses

- Impairment standard is applicable for determination of recoverable amount, with more stringent rules
- For the following intangible assets, impairment testing is mandatory
  - Asset not yet available for use
  - Assets amortised over more than 10 years

Retirement or disposal

- When the asset ceases to give economic benefits, it is taken to have retired
- If disposed of, there may be gains/losses

Disclosures

- Financial statements shall disclose
  - Each class of intangible assets, with
    - Useful lives
    - Amortisation methods
    - Gross carrying amount
    - Reconciliation of carrying amount at the beginning and end of the period
    - Additions, retirement, disposal
    - Amortisation charge
      - If amortised over more than 10 years, reasons why it is presumed asset will have economic life exceeding 10 years
    - Other changes in carrying amount
- examples of classes
  - brand names;
  - mastheads and publishing titles;
  - computer software;
  - licences and franchises;
  - copyrights, and patents and other industrial property rights, service and operating rights;
  - recipes, formulae, models, designs and prototypes; an
  - intangible assets under development.
- Research and development expense recognised as expenditure