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 derecognition
  – 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 asset
  – 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 an intangible fixed asset goes on more stringent principles
  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 reliably
  - 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 incurred
    - 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 life is 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