TOPIC 7

INDAS – 38 - INTANGIBLE ASSETS

INDEX

Quote :-

"Strive not to be a Success,

but rather to be a Value".

OBJECTIVE:

1. To prescribe the accounting treatment for intangible assets those are not dealt with specifically in another Standard.
2. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met.

This standard specifies the requirement of recognition, measurement and disclosures of Intangible Assets.

NON - APPLICABILITY:

- Intangible assets covered by other standards – IND AS 2, 12, 19, 32, 103, 104, 105, 116
- Assets arising from Contracts with Customers (IndAS 115)
- The recognition and measurement of exploration and evaluation assets (see IND AS 106, Exploration for and Evaluation of Mineral Resources); and
- Expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However this standard specifically applies to the treatment of:

- Goodwill
- Expenditure on Advertising
- Expenditure on Training
- Research and Development activities
- Patents, Copyrights and Trademarks
- Rights under licensing agreements such as video recordings, plays, picture films.

SPECIAL CASES:

1. **Intangible assets contained in or on a physical substance:**

Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both tangible and intangible elements should be treated under IND AS 16, Property, Plant and Equipment, or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant.

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.

2. **Intangible assets on leases**

- Intangible assets can also be leased under Finance Lease (IND AS 17/116).
- Lease shall account Intangible Assets under Finance Lease after initial recognition.
- Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of IND AS 17, and are within the scope of this Standard.

3. **Intangible assets used in the extractive and insurance industries**

This Standard does not apply to expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of insurance contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries or by insurers.

ASSET:

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

INTANGIBLE ASSETS: An Intangible asset is:

- An identifiable
- Non – Monetary asset
- Without physical substance

IDENTIFIABILITY:

An asset is identifiable if it either:

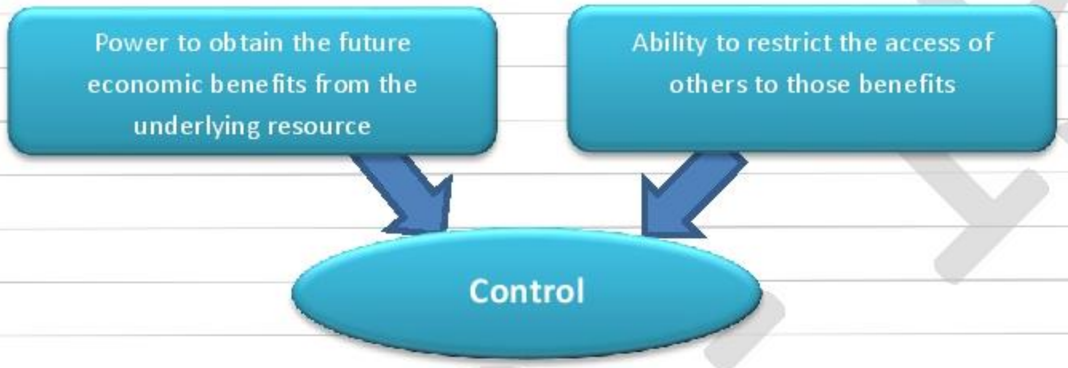
- is **separable**, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
- **arises from contractual or other legal rights**, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Q37. *Sun Ltd has an expertise in consulting business. In past years, company has gained a market share for its services of 30 percent and considers recognising it as an intangible asset. Is the action by company is justified?*

Solution:

Market share does not meet the definition of intangible assets as is not identifiable i.e. It is neither separable and nor arise from contractual or legal rights.

CONTROL



Example 1:

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 2:

An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protectors other ways to control, the relationships with customers or the loyalty of the intangible assets.

Q38: *Company XYZ Ltd has provided training to its staff on various new topics like GST, IndAS etc to ensure the compliance as per the required law. Can the company recognise such cost of staff training as intangible asset?*

Solution:

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 anytime. 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.

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

(c) Other benefits resulting from the use of the asset by the entity.

Ringtones of telecom companies (Airtel, Idea, Reliance etc) are Intangible Assets since it satisfy all the conditions of being an Intangible Asset.

NOTE: For clarification, following are not Intangible Assets as per INDAS – 38, hence they should be written off in P&L immediately:

(a) Preliminary expenses (non – identifiable)

(b) Pre-Operating expenses (non – identifiable)

(c) Staff Training

(d) Heavy Advertisement expenses

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.

Q39: Mercury Ltd is preparing its accounts for the year ended 31 March 20X2 and is unsure about how to treat the following items.

- The company completed a grand marketing and advertising campaign costing Rs 4.8 Lakh. The finance director had authorized this campaign on the basis that it would create Rs 8 lakh of additional profits over the next three years.
- A new product was developed during the year. The expenditure to taled Rs 3 lakh of which Rs 1.5 lakh was incurred prior to 30 September 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at Rs 1.4lakh.
- Staff participated in a training programme which cost the company Rs 5 lakh. The training organization had made a presentation to the directors of the company outlining that incremental profits to the business over the next twelve months would be Rs 7 lakh.

What amounts should appear as intangible assets in accordance with IndAS 38 in Mercury's balance sheet as on 31 March 20X2?

Solution:

The treatment in Mercury's financials as at 31 March 20X2 will be as follows:

1. **Marketing and advertising campaign**: No intangible asset will be recognised, because it is not possible to identify future economic benefits that are attributable only due to this campaign. All of the expenditure should be expensed in the statement of profit and loss.
2. **New product**: Development expenditure appearing in the balance sheet will be valued at Rs 1.5 lakh. The expenditure prior to the date on which the product becomes technically feasible is recognised in the statement of profit andloss.
3. **Training programme:** No asset will be recognised, because there is no control of the company over the staff and when staff leaves the benefits of the training, whatever they may be, also departs.

MEASUREMENT

INITIAL MEASURMENT: As per INDAS 38, Intangible Assets should be recognized only at COST.

If Separately Acquired – Cost will be purchase price including non-refundable duties and taxes and any other directly attributable cost 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, Admiration and general overhead costs.

If payment is deferred beyond normal credit terms:

Cost of Intangible Asset is the **CASH PRICE EQUIVALENT** at the recognition date.

Total payment - Cash price equivalent:

- is recognised as Interest over the period of credit.
- unless such interest is capitalised in accordance with INDAS 23

Business Combination:

In accordance with IND AS 103, *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is **its fair value at the acquisition date.**

An acquirer recognises at the acquisition date, **separately from goodwill**, an intangible asset of the acquiree, irrespective **of whether the asset had been recognised by the acquiree before the business combination.**

This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset.

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 Received (1st Priority) or Asset Given up (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.**

Acquisition by way of Govt. Grants –

In accordance with IndAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, an entity should recognise both the intangible asset and the grant initially at fair 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.**

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

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.

Q40: Venus India Private Ltd acquired a software for its internal use costing Rs 10,00,000. The amount payable for the software was Rs 6,00,000 immediately and Rs 4,00,000 in one year time. The other expenditure incurred was:-

Purchase tax: Rs 1,00,000

Entry Tax: 10% (recoverable later from tax department)

Legal fees: Rs 87,000

Consultancy fees for implementation: Rs 1,20,000

cost of capital of the company is 10%.

Calculate the cost of the software on initial recognition using the principles of Ind AS 38 Intangible Assets.

Solution:

Particulars	Amount (Rs.)
Cash paid	600,000
Deferred consideration (₹ 400,000/1.1)	3,63,636
Purchase Tax	1,00,000
Entry tax (not to be considered as it is a refundable tax)	-
Legal fees	87,000
Consultancy fees for implementation	1,20,000
Total Cost to be capitalized	**12,70,636**

Q41: On 31st March 20X1, Earth India Ltd paid Rs 50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd's net assets had a fair value of Rs 30,00,000. In addition, Sun Ltd also held the following rights:

Trade Mark named "GRAND" – valued at Rs 1,80,000 using a discounted cash flow technique.

Sole distribution rights to an electronic product. Future cash flows from which are estimated to be Rs 1,50,000 per annum for the next 6 years.

10% is considered an appropriate discount rate. The 6 year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition.

Solution:

Particulars	Amount(Rs.)	Amount(Rs.)
Purchase Consideration (A)		50,00,000
Net Asset acquired	30,00,000	
Trade Mark	1,80,000	
Distribution Rights (1,50,000 x 4.36)	6,54,000	
Total (B)		(38,34,000)
Goodwill on Acquisition		**11,66,000**

Q42: Sun Ltd acquired software from Earth Ltd. in exchange for a telecommunication license. The telecommunication license is carried at Rs 5,00,000 in the books of Sun Ltd. The Software is carried at Rs 10,000 in the books of the Earth Ltd which is not the fair value.

Advice journal entries in the following situations in the books of Sun Ltd and Earth Ltd:-

1) Fair value of software is Rs. 5,20,000 and fair value of telecommunication license is Rs. 5,00,000.
2) Fair Value of Software is not measureable. However similar Telecommunication license is transacted by another company at Rs 4,90,000.
3) Neither Fair Value of Software nor Telecommunication license could be reliably measured.

Solution

Rs in '000		
Situation	**Sun Ltd.**	**Earth Ltd.**
1	Software Dr. 500 To Telecommunication license 500 To Profit on Exchange Nil	Telecom. license Dr. 520 To Software 10 To Profit on Exchange 510
2	Software Dr. 490 Loss on Exchange Dr. 10 To Telecommunication license 500 **Note:** The company may first recognise Impairment loss and then pass an entry. The effect is the same as impairment loss will also be charged to Income Statement.	Telecommunication license Dr. 490 To Software 10 To Profit on Exchange 480
3	Software Dr. 500 To Telecommunication license 500	Telecommunication license Dr. 10 To Software 10

Expenditure on Research & Development:

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 INDAS 38.

Here Entity cannot demonstrate 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.

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 before the start of commercial production or use. 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

Amortization of Patents and licenses that are used to generate the intangible asset

Q43

Expenditure on a new production process in 20X1-20X2:

	Rs
1st April to 31st December	2,700
1st January to 31st March	900
	3,600

The production process met the intangible asset recognition criteria for development on 1st January 20X2. The amount estimated to be recoverable from the process is Rs 1,000.

What is the carrying amount of the intangible asset at 31st March 20X2 and the charge to profit or loss for 20X1-20X2?

Expenditure incurred in FY 20X2-20X3 is Rs 6,000.

At 31st March 20X3, the amount estimated to be recoverable from the process (including future cash outflows to complete the process before it is available for use) is Rs 5,000.

What is the carrying amount of the intangible asset at 31st March 20X3 and the charge to profit or loss for20X2-X3?

Solution

1) Expenditure to be transfer to profit or loss in 20X1-20X2

	Rs
Total Expenditure	3,600
Less. Expenditure during Development phase	(900)
Expenditure to be transfer to profit or loss	2,700

2) Carrying Amount of Intangible Asset on 31st March, 20X2

Expenditure during Development Phase will be capitalised Rs 900

(Recoverable amount is higher being Rs 1,000, hence no impairment)

3) Expenditure to be charged to profit or loss in 20X2-20X3

	Rs
Opening balance of Intangible Asset	900
Add. Further expenditure during development phase	6,000
Expenditure for development phase	6,900
Recoverable Amount	(5,000)
Amount charged to profit or loss (Impairment Loss)	1,900

3) Carrying Amount of Intangible Asset on 31st March, 20X3

Value of Intangible Asset will be recoverable amount i.e. Rs 5,000

SUBSEQUENT EXPENDITURE:

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

- Subsequent Expense **increases the future economic benefits** of Intangible Assets.
- 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.

This standard states that the following types of expenditure should always be recognised as an expense:

(a) expenditure on research (except when it is acquired as part of a business combination);

(b) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with Ind AS 16. Start-up costs may consist of:

(i) establishment costs such as legal and secretarial costs incurred in establishing a legal entity;

(ii) expenditure to open a new facility or business (ie pre-opening costs);

(iii) expenditures for starting new operations or launching new products or processes (ie pre-operating costs);

(c) expenditure on training activities;

(d) expenditure on advertising and promotional activities (including mail order catalogues); and

(e) expenditure on relocating or reorganizing part or all of an entity.

MEASUREMENT AFTER INITIAL RECOGNITION

An enterprise should choose

- **Either** Cost model,
- **Or** Revaluation model

Cost Model

After recognition as an asset, an item of PPE should be carried at:

Cost - Any Accumulated Depreciation - Any Accumulated Impairment losses

Revaluation Model

After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount.

Fair value at the date of revaluation	-
Less: Any subsequent accumulated depreciation	(-)
Less: Any subsequent accumulated impairment losses	(-)
Carrying value	=

Revaluation for entire class of PPE

If an item of Intangible is revalued, **the entire class of IA** to which that asset belongs should be revalued.

FREQUENCY OF REVALUATION:

Revaluations should be made with such regularity that at the end of the reporting period the carrying amount **of the asset does not differ materially from its fair value.**

The frequency of revaluations depends on the **volatility** of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary.

ACCOUNTING TREATMENT OF REVALUATIONS

When IA is revalued, the carrying amount of that asset is adjusted to the revalued amount.

At the date of the revaluation, the asset is treated in one of the following ways:

Technique I: Change in Gross Carrying amount and Accumulated depreciation amount

Gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.

Gross carrying amount -

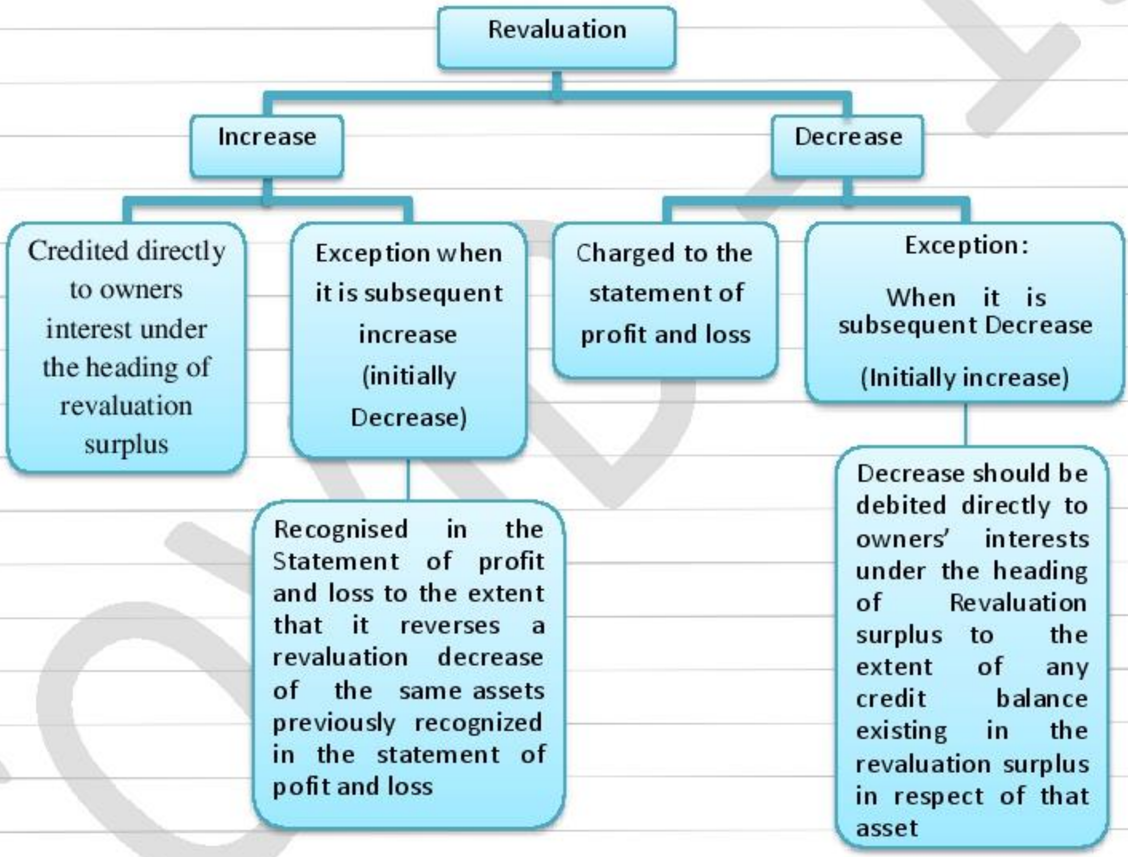
- *May be restated by reference to observable market data, or*
- *May be restated proportionately to the change in the carrying amount.*

Accumulated depreciation at the date of the revaluation is -

- *Adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.*

Technique 2: Accumulated depreciation is eliminated *against the gross carrying amount of the asset.*

Revaluation - Increase or Decrease



Q44:

1. *Saturn Ltd. acquired an intangible asset on 31st March 20X1 for Rs 1,00,000. The asset was revalued at Rs 1,20,000 on 31st March 20X2and Rs85,000 on 31st March20X3.*
2. *Jupiter Ltd. acquired an intangible asset on 31st March 20X1 for Rs 1,00,000. The asset was revalued at Rs 85,000 on 31st March 20X2 and at Rs 1,05,000 on 31st March20X3.*

Assuming that the year-end for both companies is 31st March, and that they both use the revaluation model, show how each of these transactions should be dealt with in the financial statements.

Solution:

Saturn Ltd.

Rs 20,000 revaluation increase on 31st March, 20X2 should be credited to the revaluation reserve and recognised in other comprehensive income. Rs 20,000 of the revaluation decrease on 31st March, 20X3 should be debited to revaluation reserve and remaining Rs 15,000 should be recognised as an expense.

Jupiter Ltd.

Rs 15,000 revaluation decrease on 31st March, 20X2 should be recognised as an expense in the Statement of Profit and loss. Rs 15,000 out of the Rs 20,000 increase on 31st March, 20X3 should be recognised as income. The remaining Rs 5,000 should be credited to revaluation reserve and recognised in other comprehensive income.

Note: The above amount will be different if amortization of intangible asset is taken into consideration.

USEFUL LIFE OF INTANGIBLE ASSETS:

The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised, and **an intangible asset with an indefinite useful life** is not amortised and tested for impairment.

An intangible asset should be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, **there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.**

In accordance with Ind AS 36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount

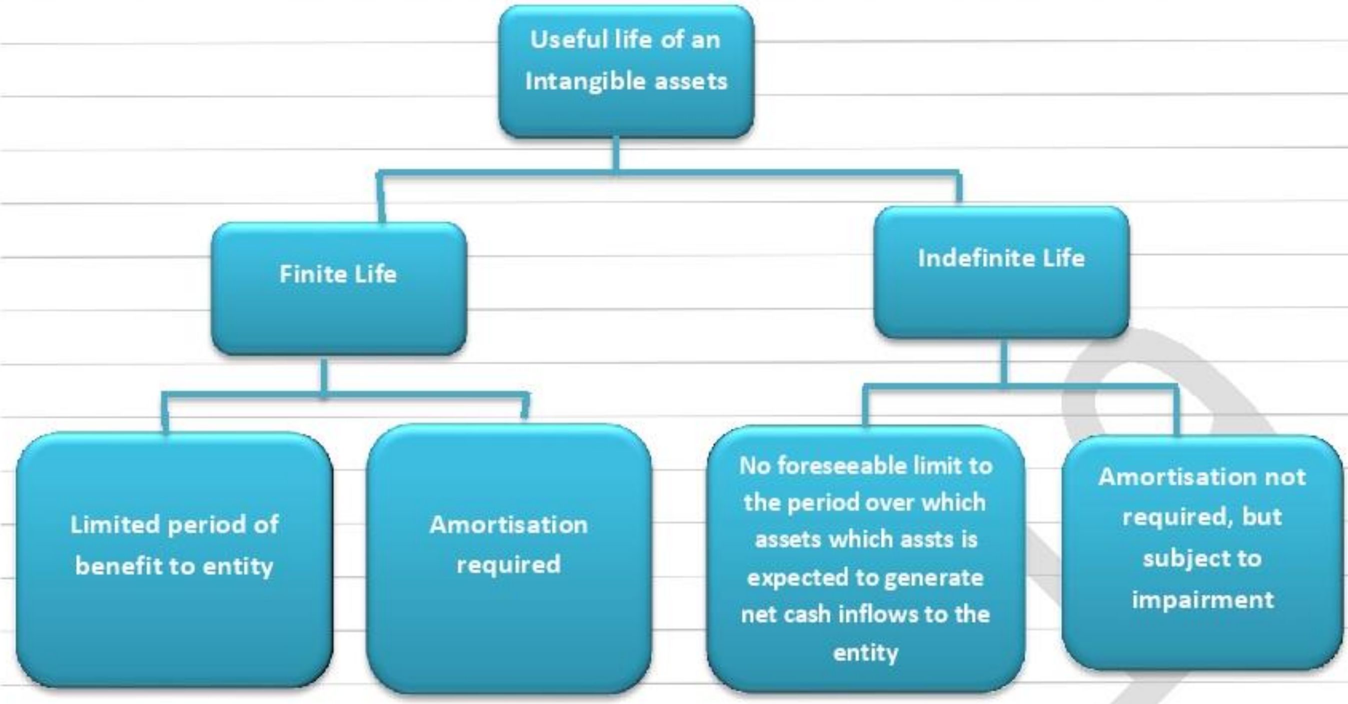
(a) annually; and

(b) whenever there is an indication that the intangible asset may be impaired.

Factors for consideration in determining useful life

- Expected usage
- Technological, Technical, Commercial and other obsolescences
- Industrial Stability and Change in Market demand
- Expected actions by competitors
- Period of control over the asset and legal or similar limits on the use of assets

Whether the useful life is dependent on the useful lives of other assets of the entity.



The depreciable amount of an intangible asset with a finite useful life is allocated on a systematic basis over its useful life. The depreciable amount of an asset is defined as the cost of an asset, or other amount substituted for cost, less its residual value.

Amortization Period:

Amortisation begin when the asset is available for Use

It ceases on earlier of the date (i) when the asset is classified as held for sale or (ii) when asset is derecognised.

Residual Value:

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

- **(a)** *There is a commitment by the third party to purchase the asset at the end of its useful life; or*
- **(b)** *There is a active market for the asset and:*
  - (i) *Residual value can be determined by reference to that market; and*
  - (ii) *It is probable that such a market will exist at the end of the asset's useful life.*

Residual Value is assumed to be zero unless there is

- Commitment by a third party to purchase at end of useful lifei.e. have a guaranteed residual value
- An active market

Amortization Method:

- *The amortization method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise.*
- *If that pattern cannot be determined reliably the Straight Line Method (SLM) should be used.*

Review of Amortization period and method:

- *The amortization period and method should be reviewed at least at each financial year end.*
- *If the expected useful life is significantly different from the previous estimates, the amortization period should be changed accordingly.*
- *If there has been change in expected pattern of economic benefits from the asset, the amortization method should be changed to reflect such changed pattern.*

IMPAIRMENT OF INTANGIBLE ASSETS:

- *Intangible Asset should be impaired if its Recoverable amount is less than the Carrying amount (i.e. book value).*
- *In such case, impairment loss equal to recoverable amount minus carrying amount should be recognized in the P&L a/c.*
- *For an intangible asset with indefinite useful lives, an impairment review is required at least annually.*

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.

Student notes:-

ADDITIONAL QUESTIONS:

Q45.

X Limited engaged in the business of manufacturing fertilizers entered into a technical collaboration agreement with a foreign company Y Inc. As a result, Y Inc would provide the technical know-how enabling X Limited to manufacture fertilizer in a more efficient way. X Limited paid Rs 10,00,00,000 for the use of know-how for a period of 5 years. X Limited estimates the production of fertilizer as follows:

Year	(in metric tons)
1	50,000
2	70,000
3	1,00,000
4	1,20,000
5	1,10,000

At the end of the 1st year, it achieved its targeted production. At the end of 2nd year, 65,000 metric tons of fertilizer was being manufactured, and X Limited considered to revise the estimates for the next 3 years. The revised figures are 85,000, 1,05,000 and 1,15,000 metric tons for year 3, 4 & 5 respectively.

How will X Limited amortise the technical know-how fees as per Ind AS 38?

Solution

Based on the above data, it may be suitable for X Ltd. to use unit of production method for amortisation of techinical know-how.

The total estimated unit to be produced 4,50,00 MT. The technical know-how will be amortised on the basis of the ratio of yearly production to total production.

The first year charge should be a proportion of 50,000/4,50,000 on Rs 10,00,00,000 = Rs 1,11,11,111.

At the end of 2nd year, as per revised estimate the total number of units to be produced in future are 3,70,000 MT (ie 65,000 + 85,000 + 1,05,000 + 1,15,000).

The amortisation for second year will be 65,000 / 3,70,000 on (10,00,00,000 – 1,11,11,111) ie 1,56,15,615 and so on for remaining years unless the estimates are again revised.

Q46.

X Ltd. purchased a patent right on April 1, 20X1, for Rs.3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortization is determined by the management to be the best method. As at April 1, 20X2, management is uncertain that the process can actually be made economically feasible, and decides to write down the patent to an estimated market value of Rs 1,50,000 and decides to amortise over 2 years. As at April 1, 20X3, having perfected the related production process, the asset is now appraised at a value of Rs 3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years. Determine the value of intangible asset at the end of each financial year?

Solution: (as per ICAI module)

Value as on March 31, 20X2

Original cost	Rs 3,00,000
Less: amortisation	(Rs 60,000)
Net Value	Rs 2,40,000

Value as on March 31, 20X3

On April 1, 20X2, the impairment is recorded by writing down the asset to the estimated value of Rs 1,50,000, which necessitates a Rs 90,000 charge to profit & loss (carrying value, Rs 2,40,000 less fair value Rs 1,50,000).

Amortisation provided for the financial year 20X2-20X3 is Rs 75,000 (Rs 1,50,000/2)

Net value is = Rs 1,50,000 – Rs 75,000 = Rs 75,000.

Value as on March 31, 20X4

As of April 1, 20X3, the carrying value of the patent is Rs 75,000.

Revalued amount of patent is Rs 3,00,000.

Out of total revaluation gain of Rs 2,25,000, Rs 90,000 will be charged to profit & loss and balance amount of Rs 1,35,000 (Rs 2,25,000 – Rs 90,000) will be credited to revaluation reserve.

Q47.

X Pharmaceutical Ltd. seeks your opinion in respect of following accounting transactions:

1. Acquired a 4 year license to manufacture a specialized drug at a cost of Rs 1,00,00,000 at the start of the year. Production commenced immediately.
2. Also purchased another company at the start of year. As part of that acquisition the company acquired a brand with a FV of Rs 3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.

3. Spent Rs 1,00,00,000 on an advertising campaign during the first six months. Subsequent sales have shown a significant improvement and it is expected this will continue for 3 years.
4. It has commenced developing a new drug 'Drug-A'. The project cost would be Rs 10,00,00,000. Clinical trial proved successful and such drug is expected to generate revenue over the next 5 years.

   Cost incurred (accumulated) till March 31, 20X1 is Rs 5,00,00,000.

   Balance cost incurred during the financial year 20X1-20X2 is Rs 5,00,00,000.
5. It has also commenced developing another drug 'Drug B'. It has incurred Rs 50,00,000 towards research expenses till March 31, 20X2. The technological feasibility has not yet been established.

How the above transactions will be accounted for in the books of account of X Pharmaceutical Ltd?

Solution

X Pharmaceutical Ltd. is advised as under:

1. It should recognise the drug license as an intangible asset, because it is a separate external purchase, separately identifiable asset and considered successful in respect of feasibility and probable future cash inflows.

   The drug license should be recorded at Rs 1,00,00,000.
2. It should recognise the brand as an intangible asset because it is purchased as part of acquisition and it is separately identifiable. The brand should be amortised over a period of 15 years.

   The brand will be recorded at Rs 3,00,00,000.
3. The advertisement expenses of Rs 1,00,00,000 should be expensed off.
4. The development cost incurred during the financial year 20X1-20X2 should be capitalised.

   Cost of intangible asset (Drug A) as on March 31, 20X2

Opening cost	Rs 5,00,00,000
Development cost	Rs 5,00,00,000
Total cost	Rs 10,00,00,000
5. Research expenses of Rs 50,00,000 incurred for developing 'Drug B' should be expensed off since technological feasibility has not yet established.

Q48.

X Ltd. is engaged in the business of publishing Journals. They acquired 50% stake in Y Ltd., a company in the same industry. X Ltd. paid purchase consideration of Rs 10,00,00,000 and fair value of net asset acquired is Rs 8,50,00,000. The above purchase consideration includes:

(a) Rs 30,00,000 for obtaining the skilled staff of Y Ltd.

(b) Rs 50,00,000 by way of payment towards 'Non-compete Fee' so as to restrict Y Ltd. to compete in the same line of business for next 5years.

How should the above transactions be accounted for by X Ltd?

Solution:

- X Ltd. should recognise an intangible asset in respect of the consideration paid towards 'Non-Compete Fee'.
- However, amount paid for obtaining skilled staff amounting to Rs 30,00,000 does not meet the definition of intangible asset since X Ltd. has not established any right over the resource and should be expensed. The entity has insufficient control over the expected future economic benefits arising from a team of skilled staff.
- Therefore, Rs 50,00,000 will be separately recognised as an intangible asset, whereas amount paid for obtaining skilled staff does not meet the recognition criteria.
- The value of goodwill is Rs 1,00,00,000 (Rs 1,50,00,000 – Rs 50,00,000).

Q49.

X Ltd. purchased a franchise from a restaurant chain at a cost of Rs 1,00,00,000 and the franchise has 10 years life. In addition, the franchise agreement mentions that the franchisee would also pay the franchisor royalty as a percentage of sales made. Can the franchise rights be treated as an intangible asset under Ind AS38?

Solution:

The franchise rights meets the identification criterion in the definition of an intangible asset since it arises from the contractual rights. It is acquired separately and its cost can be measured reliably. In addition X Ltd. will have future economic benefits and control over them from the franchise rights.

X Ltd. should recognise the franchise right as intangible asset and amortise it over 10 years. Royalty as a percentage of sales paid to the franchisor would be a charge to the profit and loss in the books of the X Ltd.

Q50.

An entity regularly places advertisements in newspapers advertising its products and includes a reply slip that informs individuals replying to the advertisement that the entity may pass on the individual's details to other sellers of similar products, unless the individual ticks a box in the advertisement. Over a period of time the entity has assembled a list of customers' names and addresses. The list is provided to other entities for a fee. The entity would like to recognise an asset in respect of the expected future economic benefits to be derived from the list. Can the customer list be treated as an intangible asset under Ind AS38?

Solution:

In this situation, the entity has no legal rights to the customer relationship, but exchange transactions have taken place that evidence separability of the asset and the control that the entity is able to exercise over the asset. Therefore, the list is an intangible asset. However, the entity may not recognise the asset because the cost of generating the customer list internally cannot be distinguished from the cost of developing the business as a whole.

Q51.

A software company X Ltd. is developing new software for the telecom industry. It employs 100 employs engineers trained in that particular discipline who are engaged in the development of the software. X Ltd. feels that it has an excellent HR policy and does not expect any of its employees to leave in the near future. It wants to recognise these set of engineers as a human resources asset in the form of an intangible asset. What would be your advice to X Ltd?

Solution:

Although, without doubt the skill sets of the employees make them extremely valuable to the company, however it does not have control over them. Merely having good HR policies would not make them eligible to be recognised as an intangible asset.

Q52.

X Ltd. has acquired a telecom license from Government to operate mobile telephone in two states of India. Can the cost of acquisition be capitalised as an intangible asset under Ind AS 38?

Solution:

Cost of acquisition of the telecom license can be capitalised as an intangible asset under the head Licenses, as it will lead to future economic benefits for X Ltd.

Q53.

X Ltd. purchased a standardized finance software at a list price of Rs 30,00,000 and paid Rs 50,000 towards purchase tax which is non refundable. In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of Rs 7,00,000 towards customization of the software for its intended use. X Ltd. purchased a 5 year maintenance contract with the vendor company of Rs 2,00,000. At what cost the intangible asset will be recognised?

Solution:

In accordance with Ind AS 38, the cost of a separately acquired intangible asset is its purchases price and non refundable purchase taxes, after deducting trade discounts and rebates and any directly attributable cost of preparing the asset for its intended use.

Therefore, the initial cost of the asset should be:

	Amount (Rs)
List price	30,00,000
Less: trade discount (5%)	(1,50,000)
	28,50,000
Non refundable purchase tax	50,000
Customisation cost	7,00,000
Total cost	36,00,000

The maintenance contract of Rs 2,00,000 is an expense and therefore should be taken as a prepaid expense and charged to profit and loss over a period of 5 years.

Q54.

X Limited in a business combination, purchased the net assets of Y Limited for Rs 4,00,000 on March 31, 20X1. The assets and liabilities position of Y Limited just before the acquisition is as follows:

Assets	Cost (in Rs.)
Property, Plant & Equipment	1,00,000
Intangible asset 1	20,000
Intangible asset 2	50,000
Cash & Bank	1,30,000

Liabilities	
Trade payable	50,000

The fair market value of the PPE, intangible asset 1 and intangible asset 2 is available and they are Rs 1,50,000, Rs 30,000 and Rs 70,000 respectively.

How would X Limited account for the net assets acquired from Y Limited?

Solution:

X Limited will account for the assets acquired from Y Limited in following manner:

Assets	Amount (Rs)
Property, plant and equipment	1,50,000
Goodwill	70,000
Intangible asset 1	30,000
Intangible asset 2	70,000
Cash & Bank	1,30,000
Liabilities	
Trade payable	50,000

Note 1- Goodwill is the difference between fair value of net assets acquired and purchase consideration paid when is calculated as follow:

Goodwill = Rs 4,00,000 – Rs (1,50,000 + 70,000 + 30,000 + 1,30,000 – 50,000) = Rs 70,000.

Q55.

X Ltd. acquired Y Ltd. on April 30, 20X1. The purchase consideration is Rs 50,00,000. The fair value of the tangible assets is Rs 45,00,000. The company estimates the fair value of "in-process research projects" at Rs 10,00,000. No other Intangible asset is acquired by X Ltd. in the transaction. Further, cost incurred by X Ltd. in relation to that research project is as follows:

(a) Rs 5,00,000 – as research expenses

(b) Rs 2,00,000 – to establish technological feasibility

(c) Rs 7,00,000 – for further development cost after technological feasibility is established.

At what amount the intangible asset should be measured under Ind AS 38?

Solution:

X Ltd. should initially recognise the acquired "in house research project" at its fair value i.e., Rs 10,00,000. Research cost of Rs 5,00,000 and cost of Rs 2,00,000 for establishing technical feasibility should be charged to profit & loss. Costs incurred from the point of technological feasibility/asset recognition criteria until the time when development costs are incurred are capitalised.

So the intangible asset should be recognised at Rs 17,00,000 (Rs 10,00,000 + Rs 7,00,000).

Q56.

X Ltd. acquired a patent right of manufacturing drug from Y Ltd. In exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are Rs 20,00,000 and Rs 18,00,000 respectively. At what value patent right should be initially recognised in the books of X Ltd. in following two situations?

(a) X Ltd. did not pay any cash to Y Ltd.

(b) X Ltd. pays Rs 2,00,000 to Y Ltd.

Solution:

If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

The transaction at the fair value of the asset received adjusted for any cash received or paid. Therefore, in case (a) patent is measured at Rs 18,00,000, in case (b) it is measured at Rs 20,00,000 (18,00,000 + 2,00,000).

Q57.

X Garments Ltd. spent Rs 1,00,00,000 towards promotions for a fashion show by way of various on-road shows, contests etc.

After that event, it realised that the brand name of the entity got popular and resultantly, subsequent sales have shown a significant improvement. It is further expected that this hike will have an effect over the next 2-3years.

How the entity should account for the above cost incurred on promoting such show?

Solution:

Expenditure of Rs 1,00,00,000 though increased future economic benefits, but it does not result in creation of an intangible asset.

Such promotional cost should be expensed off.

Q58.

An entity is developing a new production process. During 20X1-20X2, expenditure incurred was Rs 1,000, of which Rs 900 was incurred before March 1, 20X2 and Rs 100 was incurred between March 1, 20X2 and March 31, 20X2. The entity is able to demonstrate that at March 1, 20X2, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs500.

During 20X2-20X3, expenditure incurred is Rs 2,000. At the end of 20X3, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs 1,900.

Solution:

At the end of the financial year 20X2, the production process is recognised as an intangible asset at a cost of Rs 100 (expenditure incurred since the date when the recognition criteria were met, i.e., March 1, 20X2). Rs 900 expenditure incurred before March 1, 20X2 is recognised as an expense because the recognition criteria were not met until March 1, 20X2. This expenditure does not form part of the cost of the production process recognised in the balance sheet.

At the end of 20X3, the cost of the production process is Rs 2,100 (Rs 100 expenditure recognised at the end of 20X2 plus Rs 2,000 expenditure recognised in 20X3). The entity recognises an impairment loss of Rs 200 to adjust the carrying amount of the process before impairment loss (Rs 2,100) to its recoverable amount (Rs 1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in Ind AS 36 are met.

Q59.

X Ltd. is engaged is developing computer software. The expenditures incurred by X Ltd. in pursuance of its development of software is given below:

- Paid Rs 2,00,000 towards salaries of the program designers.
- Incurred Rs 5,00,000 towards other cost of completion of program design.
- Incurred Rs 2,00,000 towards cost of coding and establishing technical feasibility.
- Paid Rs 7,00,000 for other direct cost after establishment of technical feasibility.
- Incurred Rs 2,00,000 towards other testing costs.
- A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to Rs 70,000.
- On March 15, 20X1, the development phase was completed and a cash flow budget was prepared.

Net profit for the year was estimated to be equal Rs 40,00,000. How X Ltd. should account for the above mentioned cost?

Solution:

(A)

Costs incurred in creating computer software, should be charged to research & development expenses when incurred until technical feasibility/asset recognition criteria have been established for the product. Here, technical feasibility is established after completion of detailed program design.

In this case, Rs 9,00,000 (salary cost of Rs 2,00,000, program design cost of Rs 5,00,000 and coding and technical feasibility cost of Rs 2,00,000) would be recorded as expense in Profit and Loss since it belongs to research phase.

(B)

Cost incurred from the point of technical feasibility are capitalised as software costs. But the conference cost of Rs 70,000 would be expensed off.

In this situation, direct cost after establishment of technical feasibility of Rs 7,00,000 and testing cost of Rs 2,00,000 will be capitalised.

The cost of software capitalised is = Rs (7,00,000 + 2,00,000) = Rs 9,00,000.

Q60.

X Ltd. has started developing a new production process in financial year 20X1-20X2. Total expenditure incurred till September 30, 20X3, was Rs 1,00,00,000 . The expenditure on the development of the production process meets the recognition criteria on July 1, 20X1. The records of X Ltd. show that, out of total Rs 1,00,00,000, Rs 70,00,000 were incurred during July to September, 20X1. X Ltd. publishes its financial results quarterly. How X Ltd. should account for the development expenditure?

Solution:

X Ltd. should recognise the intangible asset at Rs 70,00,000 and Rs 30,00,000 which was already recognised as an expenses in first quarter should not be capitalised.

Q61.

X Ltd. decides to revalue its intangible assets on April 1, 20X1. On the date of revaluation, the intangible assets stand at a cost of Rs 1,00,00,000 and accumulated amortization is Rs 40,00,000. The intangible assets are revalued at Rs 1,50,00,000. How should X Ltd. account for the revalued intangible assets in its books of account?

Solution:

The intangible assets are revalued to Rs 1,50,00,000 on an amortised replacement cost basis, which is a 150% increase from its original cost. Thereby applying the existing ratio of accumulated depreciation to the cost the revalued gross amount would be Rs 2,50,00,000 gross and Rs 1,00,00,000 on amortisation.

Appendix A: Intangible Assets - Web Site Costs

This Appendix does not apply to expenditure on purchasing, developing, and operating **hardware** (eg web servers, staging servers, production servers and Internet connections of a web site) Such expenditure is accounted for under Ind AS 16.

This appendix also does not apply to expenditure on development or operation of a web site (or web site software) **for sale to another entity.**

When a web site is leased under an operating lease, the lessor applies this Appendix. When a web site is leased under a finance lease, the lease applies this Appendix after initial recognition of the leased asset.

The Issues:

An entity may incur internal expenditure on the development and operation of its own web site for internal or external access.

1. **Web site for external access:** is generally to promote and advertise an entity's own products and services, sell products and services etc.
2. **Web site for internal access:** is generally to companies polices, customer details and search relevant information.

a. When accounting for internal expenditure on the development and operation of an entity's own web site, the issues are:

(i) Whether the web site is an internally generated intangible asset that is subject to the requirements of Ind AS 38; and

The appropriate accounting treatment of such expenditure.

Accounting principles:

An entity's own web site that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of Ind AS38. The nature of each activity for which expenditure is incurred (eg training employees and maintaining the web site) and the web site's stage of development or post-development shall be evaluated to determine the appropriate accounting treatment:

(a) **Planning stage:** is similar in nature of the research phase, expenditure in this stage shall be recognised as expense when incurred.

(b) **The application and infrastructure development stage, the Graphical stage, and the Content Development stage:** to the extent that the content is developed for purpose **other than** to advertise, promote or sell own products or services, are similar in nature to the development phase in paragraphs 57-64 of Ind AS 38. Expenditure incurred in these stages shall be include as an intangible asset.

(c) **Expenditure** incurred in the Content Development stage, to the extent that content is developed <u>to advertise and promote an entity's own products and services,</u> shall be recognised as an expense, when incurred.

(d) **The operating stage** begins once development, of a web site is complete. Expenditures incurred at the stages shall be recognised as an expense when it is incurred, unless it meets the recognition criteria of Ind AS 38, in which case it will be part of the cost of the Intangible asset.

A Web site cost recognised as an intangible asset shall be measured after initial recognition either by applying the cost model or the revaluation model.

Useful life

The best estimate of a web site's useful life shall be short.

Student Notes:-

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