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VIRTUAL COACHING CLASSES
ORGANISED BY BOS, ICAI

FINAL LEVEL
PAPER 1: FINANCIAL REPORTING

TOPIC: IND AS 38
INTANGIBLE ASSETS

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Agenda

- Objective and Scope
- Intangible Asset - Definition
- Recognition criteria
- Initial Recognition and Measurement
- Mode of Intangible Asset
- Subsequent recognition
- Amortisation and useful life of IA

Objective

Scope

This standard shall apply in accounting for IA, except

- Financial assets (Ind AS 32)
- Exploration and evaluation assets (Ind AS 106)
- Expenditure on the development and extraction of minerals, oil, natural gas, and similar resources
- Intangible assets arising from insurance contracts issued by insurance companies (Ind AS 104)
- Intangible assets covered by another standard, such as intangibles held for sale (Ind AS 105), deferred tax assets (Ind AS 12), lease assets (Ind AS 116), assets arising from employee benefits (Ind AS 19), goodwill (Ind AS 103), Held by an entity for sale in the ordinary course of business (Ind AS 2), assets arising from contracts with customers (Ind AS 115)

Definitions

An asset is a resource:

a) ***Controlled*** by an entity as a result of past events; and

b) From which ***future economic benefits*** are expected to flow to the entity.

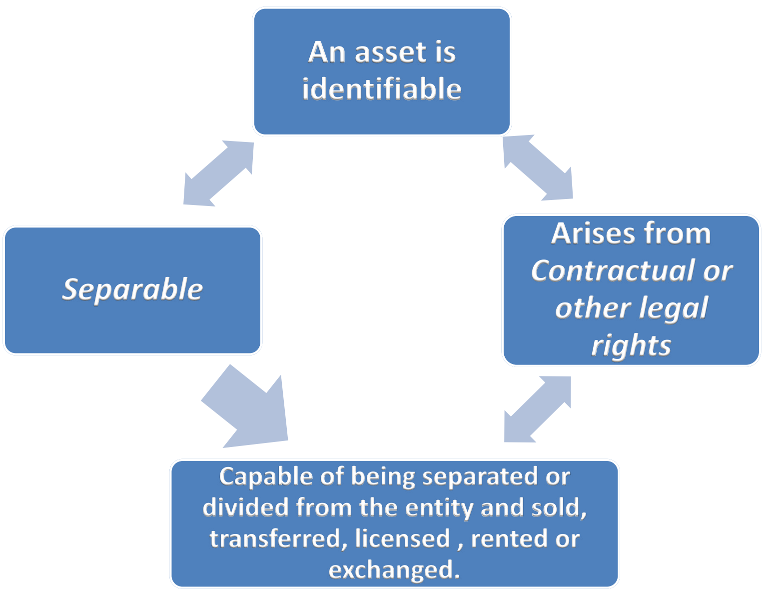
An intangible asset is

- An **Identifiable non-monetary asset without physical substance**.

Monetary assets are

- Money held and assets to be received in fixed or determined amounts of money

Identifiability



Brain Teaser : Identifiability

Illustration 3: Identifiability of Intangible assets

Pluto Ltd. intends to open a new retail store in a new location in the next few weeks. Pluto Ltd has spent a substantial sum on a series of television advertisements to promote this new store. The Company has paid an amount of ₹ 800,000 for advertisements before 31st March, 20X1. ₹ 700,000 of this sum relates to advertisements shown before 31st March, 20X1 and ₹ 100,000 to advertisements shown in April, 20X1. Since 31st March, 20X1. The Company has paid for further advertisements costing ₹ 400,000.

Pluto Ltd is of view that such costs can be carried forward as intangible assets. Since market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of the above costs in the financial statements for the year ended 31st March, 20X1.

Brain Teaser : Identifiability

Solution

Under Ind AS 38 – *Intangible Assets* – intangible assets can only be recognised if they are **identifiable** and have a **cost** which can be reliably measured.

These criteria are very difficult to satisfy for internally developed intangibles.

For these reasons, Ind AS 38 specifically prohibits recognising advertising expenditure as an intangible asset. The issue of how successful the store is likely to be does not affect this prohibition. Therefore, such costs should be recognised as expenses.

However, the costs would be recognised on an accruals basis. Therefore, of the advertisements paid for before 31st March, 20X1, ₹ 7,00,000 would be recognised as an expense and ₹ 1,00,000 as a pre-payment in the year ended 31st March, 20X1. The ₹ 4,00,000 cost of advertisements paid for since 31st March, 20X1 would be charged as expenses in the year ended 31st March, 20X2.

Control

An entity controls an asset if the entity has **power**

- To obtain the future economic benefits
- Restricts the access to future economic benefits of others
- Legal rights

In the absence of legal rights to protect , an entity **usually** has insufficient control over the expected future economic benefits.

Example - A team of skilled staff, Customer relationships and loyalty

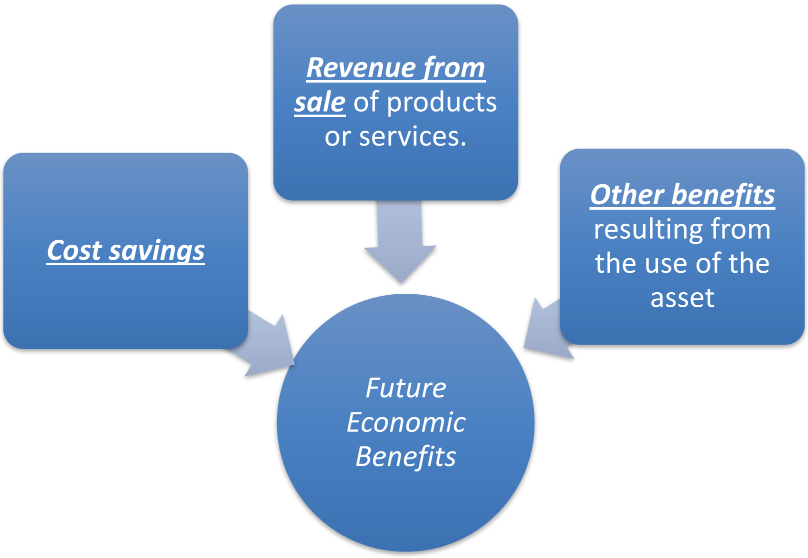
Brain Teaser : Control

Company XYZ ltd has provided training to its staff on various new topics like GST, IFRS/ Ind AS etc to ensure the compliance as per the required law. Can the company recognise such cost of staff training as intangible asset?

Analysis:
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 any time.

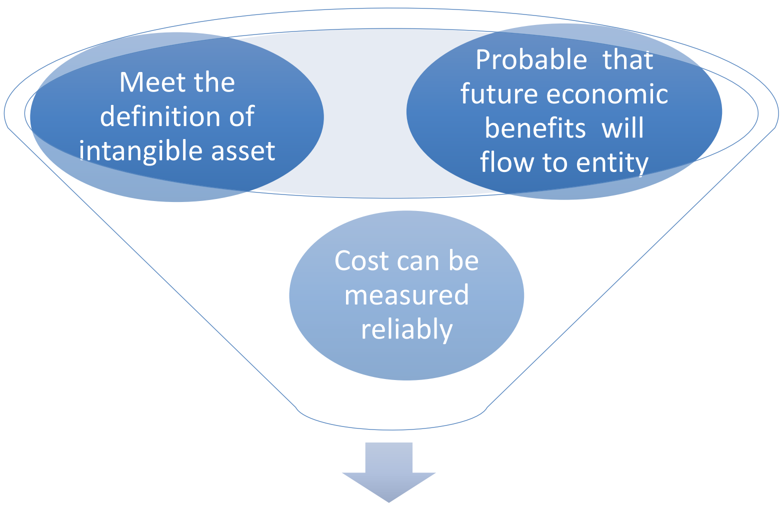
Hence the company lacks the ability to restrict the access of others to those benefits. Therefore the staff training cost does not meet the definition of an intangible asset.

Future Economic Benefits



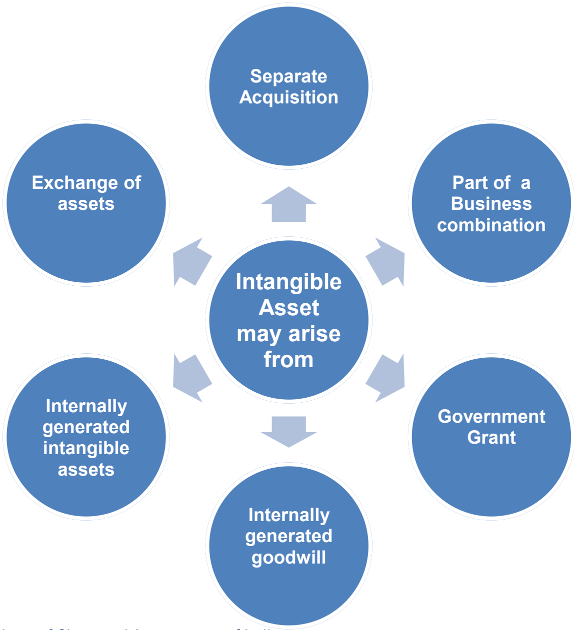
For example , Use of IP in production process may reduce future production costs rather than increase future revenues

Recognition Criteria

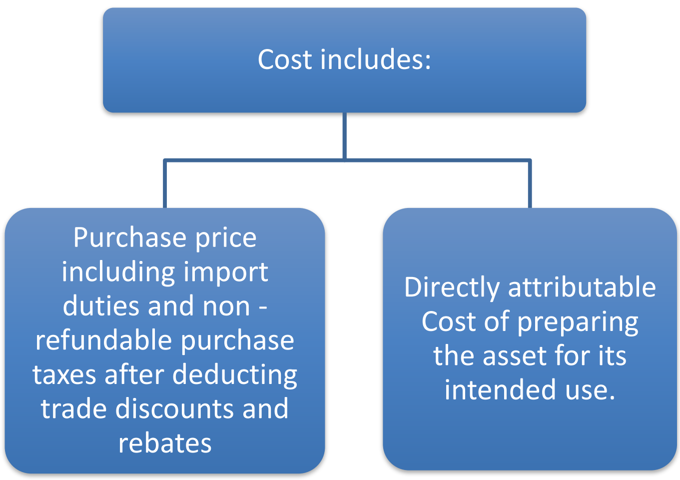


Intangible Asset -Recognition Criteria

Mode of acquisition



Cost of an Asset



Cost of an Asset (Inclusion/Exclusion)

Cost Included	Cost not included
• Cost of employee benefits	• Launching a new product (including advertising and promotional exp).
• Professional Fees	• Business in a new location or with a new class of customer
• Cost of testing	• Administration and other general overhead costs.
	

Deferred Payment credit

- If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent at the recognition date.

- In case payment is deferred beyond normal credit terms: Difference between the **cash price equivalent** and **total paymen**t is recognised as interest over the period of credit unless such interest is capitalised.

Brain Teaser – Separate Acquisition

- OBC Inc. acquired a software for its internal use costing Rs. 10,00,000. The amount payable for the software was Rs. 600,000 immediately and Rs 400,000 in one years time. The other expenditure incurred were:-

- 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
- OBC Inc. cost of capital is 10%.

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

Solution

Particulars	Amount
Cash paid	600,000
Deferred consideration (Rs. 400,000 × 1/1.1)	3,63,636
Purchase Tax	1,00,000
Entry tax	-
Legal fees	87,000
Consultancy fees for implementation	1,20,000
Total Cost to be capitalised	**12,70,636**

Intangible Asset

Mode of Acquisition	Recognition
Separately acquired/ Purchased	At **Cost** (Purchase price inclusive of non refundable taxes + Directly attributable cost incurred for its intended use)
Acquired in Business Combination	Cost equals to **Fair Value** at acquisition date (Intangible asset is recognised separately from goodwill if FV is measured reliably and even if those IA has not been recognised by the acquiree in its books)

Brain Teaser – Business Combination

Illustration 5: Business Combination

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

- Trade Mark named "GRAND" – valued at ₹ 180,000 using a discounted cash flow technique.
- Sole distribution rights to an electronic product; future cash flows from which are estimated to be ₹ 150,000 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.

Brain Teaser – Business Combination

Solution

Particulars	Amount	Amount
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

Intangible Asset

Mode of Acquisition	Recognition
Acquired by way of Govt Grant	An intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. for e.g Airport landing rights, Import licences or quotas or right to access other restricted resources may be acquired free of charge or at nominal value from govt. In accordance with Ind AS 20, record both Intangible asset and grant at **Fair Value**. or recognises the asset initially at a **nominal amount plus any expenditure** that is directly attributable to preparing the asset for its intended use.
Exchanged Assets	FV of asset surrendered **or** FV of Intangible obtained

Intangible Asset

Mode of Acquisition	Recognition
Internally generated Intangible Assets	- **Segregate** in to Research phase and Development phase - Charge all expenses related to **research phase to P&L** - Development cost are **capitalised** if entity is able to demonstrate: • Technical feasibility • Intention to complete the intangible asset and use or sell it • Ability to use or sell the intangible asset • How the intangible asset will generate probable FEB • Adequate technical, financial and other resources to complete the development • Ability to measure the expenditure attributable to the intangible asset - If **not able to distinguish** between research phase and development phase, **treat** the expenditure **as research phase** and expensed off -Cost of IGIA is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria -Internally generated goodwill shall not be recognised as an Intangible Asset (Not an identifiable resource)

Recognition and Measurement - Development

- The cost of an internally generated intangible asset :
- Is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria.
- Prohibits reinstatement of expenditure previously recognised as an expense.

No Capitalisation

- Cost that do not meet the recognition criteria
- Internally generated brands, mastheads, publishing titles, customer lists and similar in substance
- Internally generated goodwill
- **Cost already expensed are never capitalised**

Brain Teaser - Differentiation of R&D Expense

X ltd has been developing a new production process and on 31-10-2016, it has been able to demonstrate that it is likely to enjoy future economic benefits from the research. It incurred Rs. 50 lakhs on this account till 31-10-16 and Rs.24 lakhs afterwards up to 31-03-17. As on 31-03-17 it estimates the recoverable amount of know how embodied in the process at Rs. 22 lakhs.

Analysis:

- *Rs 50 lakhs is research expense to be* ***charged to P/L***
- *Rs 24 lakhs is development expenses –* ***record Intangible asset***
- *Rs 2 lakhs* ***impairment loss*** *to be debited and asset to be reduced*

Brain Teaser

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

1. *Acquired a 4 year license to manufacture a specialised drug at a cost of ₹ 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, X Pharmacy Ltd. acquired a brand with a fair value of ₹ 3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.*
3. *Spent ₹ 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 ₹ 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 31st March, 20X1 is ₹ 5,00,00,000.

   Balance cost incurred during the financial year 20X1-20X2 is ₹ 5,00,00,000.
5. *It has also commenced developing another drug 'Drug B'. It has incurred ₹ 50,00,000 towards research expenses till 31st March, 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 ₹ 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 ₹ 3,00,00,000.
3. The advertisement expenses of ₹ 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 31st March, 20X2

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

Subsequent Measurement

- Can choose either **Cost model** or **Revaluation model** as its accounting policy

- If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model unless there is no active market for those assets.

- Accounting policy should be applied to the whole of a **class of Intangible Asset** and not merely to individual assets within a class.

Subsequent Measurement

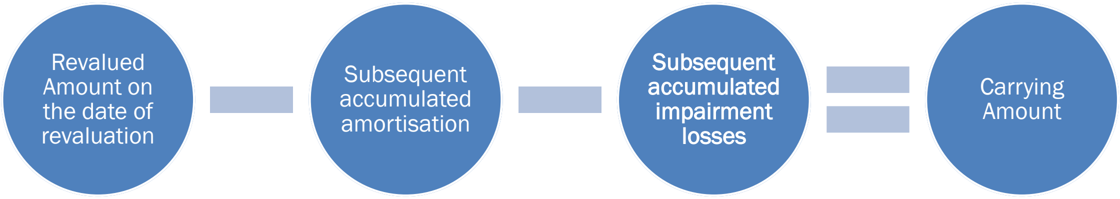
Can choose either **Cost model** or **Revaluation model** as its accounting policy.

Cost model

Cost − Accumulated amortization − Accumulated impairment losses = Carrying Amount

Revaluation Model

✓ After initial recognition, an IA to be carried at revalued amount, being its **fair value** at the revaluation date.

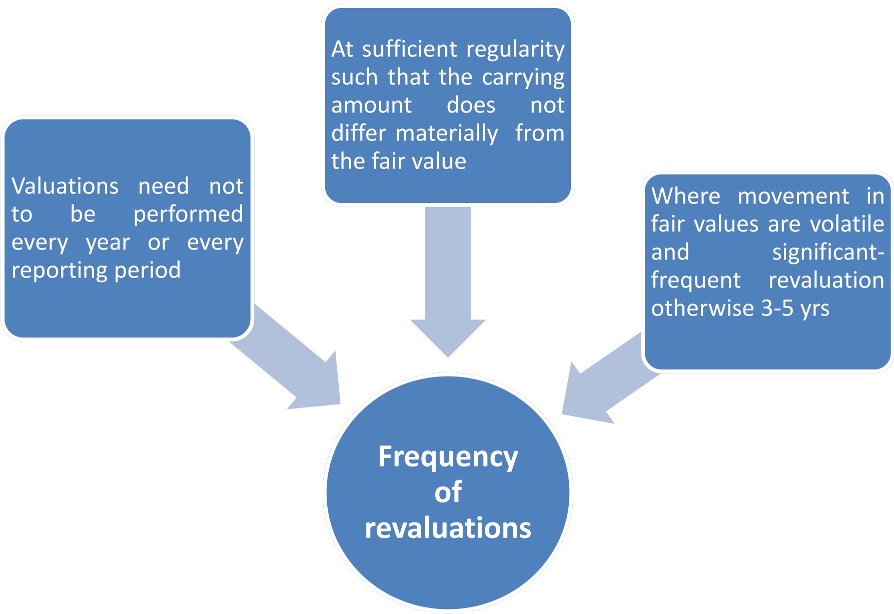


✓For revaluations under Ind AS 38, fair value shall be determined by reference to an active market.

✓If a **single item** of IA is revalued, then the **entire class** of IA to which that item belongs should be revalued unless there is no active market for those assets.

✓Class of assets : *a grouping of assets of a **similar nature** and use in an entity's operations*

Revaluation Model



Revaluation gains and losses

First-time	Increase		Decrease	
	Revaluation reserve (OCI)		P&L	
Subsequent	**Increase**	**Decrease**	**Increase**	**Decrease**
	Revaluation reserve (OCI)	First adjust from RR, then excess in P&L	First charged to P&L to the extent of earlier debit, then remaining to RR	P&L

Transfers from revaluation surplus to retained earnings are made in following circumstances and are not made through profit or loss:

1. When the asset is derecognized, and
2. When the asset is used: Diff between depreciation based on revalued carrying amount and asset's original cost

Utilisation of Revaluation Surplus

Transferred to retained earnings

When the asset is derecognised : whole revaluation surplus is directly transferred to the retained earning.

When the asset is being used revaluation reserve *may* transferred. The amount of revaluation surplus transferred =

(amortisation based on Revalued Carrying amount – amortisation based on original cost)

Transfers from revaluation surplus to retained earnings are not made through profit or loss.

Brain Teaser-Revaluation

Illustration 9 : Revaluation Model

1. *Saturn Ltd. acquired an intangible asset on 31st March, 20X1 for ₹ 1,00,000. The asset was revalued at ₹ 1,20,000 on 31st March, 20X2 and ₹ 85,000 on 31st March, 20X3.*
2. *Jupiter Ltd. acquired an intangible asset on 31st March, 20X1 for ₹ 1,00,000. The asset was revalued at ₹ 85,000 on 31st March, 20X2 and at ₹ 1,05,000 on 31st March, 20X3.*

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. Explain the treatment for revaluation of intangible asset. Ignore computation of amortization on them for ease of understanding.

Brain Teaser-Revaluation

Solution

Saturn Ltd.

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

Jupiter Ltd.

₹ 15,000 revaluation decrease on 31st March, 20X2 should be recognised as an expense in the Statement of Profit and loss. ₹ 15,000 out of the ₹ 20,000 increase on 31st March, 20X3 should be recognised as income. The remaining ₹ 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-Contractual or other legal right

Useful life of Intangible asset arises from contractual or other legal rights:

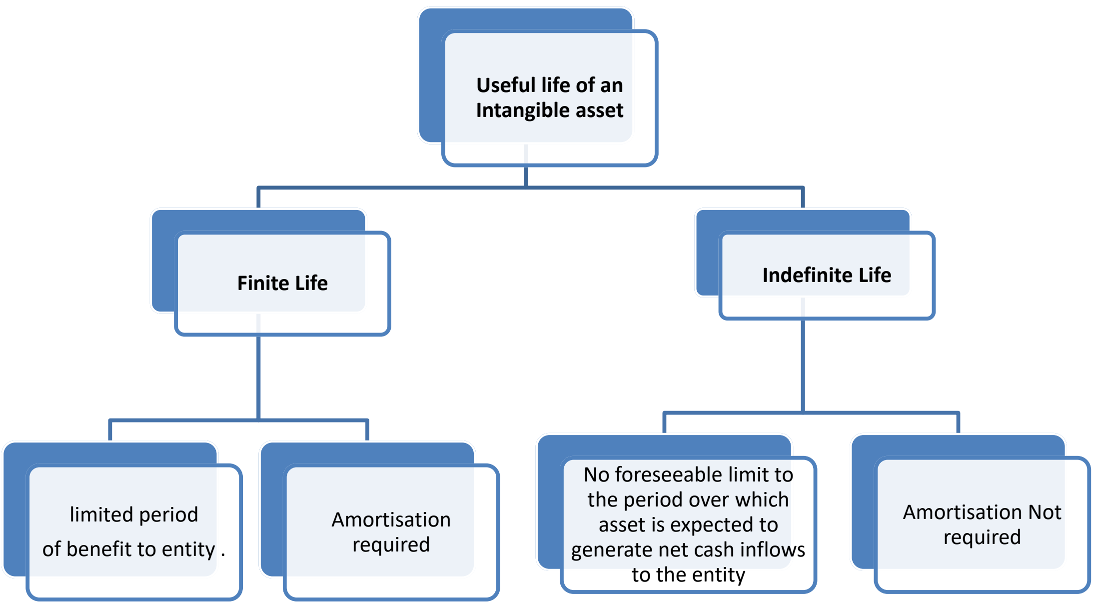
- Shall ***not exceed*** the period of the contractual or other legal rights.
- But ***may be shorter*** depending on the period over which the entity expects to use the asset.

Useful life and renewal:

- Useful life can include the renewal period only if –

there is evidence to support renewal by the entity without significant cost.

Useful life



Amortisation-Finite Useful life

Amortisation

- **Meaning**
  - Allocation of the depreciable amount of an intangible asset with a finite useful life on a systematic basis over its useful life.
- **Begin**
  - When the asset is available for use.
- **Cease**
  - Earlier of the date
  - -when asset is classified as held for sale
  - -when asset is derecognized

Amortization - Points to remember

Amortization method may be Diminishing balance, straight line, unit of production method

The amortization method used shall *reflect the pattern* in which the asset's future economic benefits are expected to be consumed by the entity.

If pattern cannot be determined reliably, the straight –line method shall be used

The amortization charge for each period shall be recognized in profit or loss unless this or another standard permits or requires it to be included in the carrying amount of another asset. *(Say PPE or inventories)*

Amortisation - Points to remember

The amortization period and the amortization method shall be ***reviewed at least at each financial year-end.***

If the expected useful life of the asset is different from previous estimates, the amortization period shall be changed accordingly.

Such changes shall be accounted for as changes in accounting estimates.

Brain Teaser- Amortisation

Illustration 10

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

Brain Teaser- Amortisation

Solution

Based on the above data, it may be suitable for X Ltd. to use unit of production method for amortisation of technical 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 ₹ 10,00,00,000 = ₹ 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.

Indefinite Useful lives

Review each period

- An intangible asset with an indefinite useful **life** shall **<u>not be amortized.</u>**
- An entity is required to **<u>test for impairment</u>** by comparing its

  - recoverable amount with its carrying amount

  (a) annually

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

No Amortization

Tested for impairment- Ind AS 36

Retirements and disposals

An intangible asset shall be derecognized:

(a) on disposal

(b) when no future economic benefits are expected from its use or disposal.

<u>Amount of Gain or Loss</u>
Difference between the net disposal proceeds and the carrying amount of the asset

→ Recognized in profit or loss when the asset is derecognized

→ Gains shall not be classified as revenue.

THANK YOU

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