AS 26 – INTANGIBLE ASSETS

Applicability

AS 26, on Intangible Assets is mandatory on or after 1-4-2003 to listed companies or enterprises whose turnover exceeds Rs. 50 crores. For all other enterprises i.e. non-listed companies, partnership firms and other enterprises the AS is applicable on or after 1-4-2004.

From the date AS 26 becomes applicable, AS 8, Accounting for Research and Development, AS 6, Depreciation Accounting, with respect to amortisation of intangible Assets and AS 10, Fixed Assets, Paragraphs relating to patents and know-how shall stand withdrawn.

The AS is a measurement standard meaning thereby it involves accounting along with disclosure requirements in financial Statements.

Issue 1:

Whether the following expenditure incurred will result in creation of an intangible asset?

(a) Benefits arising from research
(b) publishing titles
(c) training expenses
(d) management or technical talent
(e) a portfolio of customers
(f) market share
(g) Advertising for building a brand
(h) Relocating or re-organising part or all of an enterprise.

The expenditure on intangible items which does not meet the definition and recognition criteria of an intangible asset should be recognised as an expense in the period in which it is incurred. AS states that an intangible asset should be recognised if and only if

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and
(b) the cost of the asset can be measured reliably.

Further the intangible asset should also be identifiable as well as the enterprise should be able to exercise control over the intangible asset.

It will be observed that for items mentioned in (a) to (h) above, though they may have intangible value or benefit, they will not be considered as intangible asset since they donot meet the definition criteria of Intangible asset. Either control or identification or future economic benefit or measurement would be missing one way or other. Many a times say in case of advertising, or sales promotion activities, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the enterprise’s internally generated goodwill or of running day-to-day operations.

However, few of the above items may qualify for recognition as intangible assets when acquired separately or acquired in an amalgamation in nature of purchase and their fair value at the date of acquisition can be ascertained.

Issue 2:

Brand unlimited Ltd. a listed company, has trade marks / Brands appearing in its Balance-sheet as at 31-3-03 at acquired cost of Rs. 400 lakhs. The same were acquired on April 1, 1999 and used from that date. Brand unlimited Ltd. is following accounting policy of not amortising the trade marks/ Brands. What treatment Brands Unlimited Ltd. will have to follow from accounting year 2003-04?

As per AS 26, amortisation is recognised whether or not there has been an increase in, the asset’s fair value or recoverable amount. The useful life of an intangible asset may be very long but it is always finite. Thus, the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use, unless there is a persuasive evidence that useful life of an intangible asset will be a specific period longer than ten years.
As per the Transitional provisions, applying the amortisation period as determined by the AS, Brand unlimited Ltd. will be required to amortise the Trade Marks / Brands over a period of 10 years on straight line basis from 1-4-1999.

On 1-4-2003, Brand unlimited Ltd. would be required to restate the carrying amount of Trade Marks / Brands at Rs.240 lakhs and difference of Rs.160 lakhs would be required to be adjusted against opening balance of revenue reserves. The carrying amount of Rs.240 lakhs would be amortised over 6 years which is the balance of the amortisation period as per AS.

**Issue 3:**

X Ltd. a listed company, had incurred Rs.100 lakhs towards VRS for employees in 2001-02. Company decided to amortise the amount over a period of five years. Accordingly, Rs.60 lakhs was appearing as unamortised amount as on 1-4-2003. After AS 26 coming into operation, what treatment X Ltd. should follow for the unamortised amount?

The above is covered by the Transitional provisions enumerated in the Accounting Standard. VRS per se is not an intangible asset but an Intangible item. As per the transitional provisions, the remaining period of amortisation is 3 years as per accounting policy followed by X Ltd., which is shorter as compared to the amortisation period prescribed by the AS (AS 26 prescribes 10 years). Accordingly, X Ltd would be required to amortise the intangible item as per the accounting policy followed by it.

However, should X Ltd. incur VRS expense in accounting year 2003-04, the same will be required to be expensed in 2003-04 and no amortisation will be permissible, as VRS cannot be considered as an Intangible Asset, as it does not meet the definition criteria.

**Note:** Few listed companies in their June quarterly results have adjusted the unamortised amount outstanding as on 01/04/2003 against revenue reserves instead of amortising as per the treatment provided in the transitional provisions.

**Issue 4:**

A Ltd., having turnover in excess of Rs.100 crores got territorial rights to use a Brand for 20 years. A Ltd., paid upfront Rs.10 crores as non-refundable deposit. If premature termination takes place from either party, than balance amount would be refunded considering Rs.50 lakhs p.a. as usage fees. A Ltd. is unsure as to whether Territorial rights would give rise to intangible asset and if so, what should be the amortisation period, 10 or 20 years?

Territorial rights is akin to marketing rights.

By definition an intangible asset is an 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.

Further, AS 26 also mentions that an intangible asset should be recognised if, and only if.

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

(b) the cost of the asset can be measured reliably.

From above, it emerges that territorial rights are identifiable, the enterprise through agreement has control over it, future economic benefits will arise from exploitation of those rights and there is a specific cost attached to those rights. Since Territorial rights meet the definition and recognition criteria, the same will be considered as an Intangible asset.

The second and important question is whether amortisation period should be 10 or 20 years. Since there is persuasive evidence that the intangible asset is available for use for 20 years and that economic benefits are expected to flow from use of such asset, A Ltd. can amortise the territorial rights over a period of 20 years in preference to 10 years as stipulated in the benchmark treatment by AS.

However A Ltd. is well advised to carry out the impairment test on an annual basis in respect of such intangible asset.
**Issue 5:**

Company A Ltd. acquires company B for Rs.20 crores. In addition to identifiable tangible assets, less liabilities, acquired amounting to Rs.16 crores, A Ltd. has acquired intangible asset for which there is no active market. A Ltd. estimates the fair value of the intangible asset by applying the current multiple in the industry to the estimated future revenues which will be generated by the asset. A Ltd. initially calculates that the fair value of the intangible asset is Rs. 6 crores. For what amount should A Ltd. account for the intangible asset in its books?

The above acquisition by A Ltd. of B Ltd. is in nature of purchase. As per AS 26, the transferee recognises an intangible asset if it meets the recognition criteria, even if that intangible asset has not been recognised in the financial statements of the transferor. Further, the AS also states that unless there is an active market for intangible asset acquired in an amalgamation in the nature of purchase, the cost initially recognised for the intangible asset is restricted to an amount that does not create or increase any capital reserve arising at the date of amalgamation. Thus, in case of A Ltd., the use of fair value of Rs.6 crores for the intangible asset would result in negative goodwill / capital reserve of Rs. 2 crore. Therefore, the fair value of the intangible asset will be restricted to Rs. 4 crores in the books of A Ltd.

**Issue 6:**

For the first year in Financial Statements, when figures for intangible assets are given, are comparative figures required to be given for previous year?

AS does not make reference to disclosure of corresponding previous year figures in respect of intangible assets reporting in the first year of application of AS 26. Hence corresponding previous year figures need not be disclosed in the first year of application of AS.

**Issue 7:**

w.e.f. 01-04-2003, whether preliminary expenses such as filing fees with ROC, stamp duty, printing of M/A & A/A, etc can be considered as miscellaneous expenditure (to the extent not written off) on Asset side of balance-sheet to be written off over say five years?

With AS 26 becoming effective from 1-4-2003, (for listed companies and companies having annual turnover in excess of Rs.50 crores) preliminary expenses incurred in establishing legal entity such as legal and secretarial costs shall be required to be written-off in the year of occurrence, irrespective of the fact that such expenses are having a separate treatment under Income Tax Act, 1961.

**Issue 8:**

Health Care Ltd. is in pharmaceutical business. Health Care Ltd. has developed over the past two years a new pharmaceutical drug which recently i.e. in May 2003 got approval from regulatory authorities to market the drug. The company was uncertain whether it would get the approval from regulators. Till such time, company has expensed the development expenses as research and development expenses. The company wants to bring amount of Rs.200 lakhs earlier expensed as an intangible asset in its books since the drug has received approval and that such expense meets the definition criteria of intangible asset. Is the contention of Health Care Ltd. correct?

AS 10 prescribed different accounting treatment for know-how relating to manufacturing process and know-how relating to plans, designs and drawings of building or plant and machinery.

As per AS 10, know-how relating to manufacturing process was to be usually expensed in the year in which it is incurred. However, it is observed that many companies have been capitalizing under fixed assets know-how relating to manufacturing process. Few companies have considered such know-how as deferred revenue expenditure and written-off over five or six years.

Whereas AS 10 required know-how relating to plans, designs and drawings of building or plant and machinery to be capitalised either as part of building or plant and machinery. Depreciation was then calculated on the total cost of those assets, including the cost of know-how capitalised.

With AS 26, Intangible Assets coming effective from 1-4-2003, relevant paragraphs of AS 10 Fixed Assets relating to Intangible assets have been withdrawn.

Accordingly, know-how will now have to be accounted as per AS 26. Thus, Technical know-how either relating to manufacturing process or relating to plans, designs and drawing of buildings or plant and machinery will have to be considered as Intangible assets and amortised on a systematic basis over the best estimate of its useful life but not exceeding ten years.