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Accounting Of Intangible Assets Indian as- 26

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Abstract: *This paper summarizes the accounting and disclosure treatment of Intangible assets under the rules promulgated by the set standard for Intangible assets in India.In India, this issue is dealt by the* ***AS-26, "Intangible Assets",*** *issued by the Institute of Charted Accountant (ICAI), the apex accounting institute of India. This standard was issued in 2002 and came into effect from 1-April-2003 and is mandatory for all enterprises.*
Key Words: *AS - 26, Intangible assets, Recognition, Research and Development, Disclosure.*

I. Introduction

The increasing importance and share of intangible assets in the balance sheet has augmented the need of accurate accounting and disclosure of Intangible Assets in the financial statements.In India, this issue is dealt by the **AS-26, "Intangible Assets",** issued by the Institute of Charted Accountant (ICAI), the apex accounting institute of India. This standard was issued in 2002 and came into effect from 1-April-2003 and is mandatory for all enterprises. This standard covers all type of intangible assets **except-**

- Intangible assets that are covered by another accounting standards.
- Financial assets.
- Mineral rights and expenditure on the exploration for, or development and extraction of minerals, oil, natural gas and similar non-regenerative resources.
- Intangible assets arising in insurance enterprises from contracts with policyholders and
- Expenditure in respect of termination benefits.

This standard is used in combination with standards which deals with those issues which are not covered by AS-26. For example, this standard does not deal with lease that fall under AS-19, Leases; goodwill arising on an amalgamation (AS-14, Accounting for Amalgamation) and goodwill arising on consolidation (AS-21, Consolidated Financial Statements); deferred tax assets (AS-22, Accounting for Taxes on Income) and lastly intangible assets held by an enterprise for sale in the ordinary course of business (AS-2, Valuation of Inventories and AS-7, Accounting for Construction Contracts). The emphasis of this chapter is mainly on AS-26. Other standards have also been referred where necessary.

RATIONAL OF THE PAPER

The main objective of this paper is to comprehend and abridge the accounting treatment of intangible assets given in AS-26.This paper has tried to emerge with significant points of AS-26 in a simplified manner.

ACCOUNTING STANDARD- 26

This statement addresses the issues of accounting of Intangible assets acquired individually or acquired in a business combination. It also addresses how goodwill and other Intangible assets should be accounted initially and subsequently in the financial statements. The introduction of this standard is an attempt towards recognition and proper valuation of the economic benefits generated by intangible assets. Because of this standard the firms are now able to identify and value their valuable intangible assets, which were used to combine under the heading goodwill. Moreover, it has uniformed the accounting treatment for the intangible assets. The driving force behind this standard is the need of fair valuation of intangible assets as they have taken an important place in the financial statements.

RECOGNITION OF INTANGIBLE ASSET

An intangible asset can be recognized if it meets the definition and recognition criteria given in the standard. This standard has laid down a proper recognition criteria for intangible assets. According to this standard an intangible asset should be recognized if

- It is probable that the future economic benefits generated by an intangible asset will flow to the enterprise and
- The cost of the asset can be measured reliably.

Considerable amount of judgement is required by the firm to ascertain the degree of certainty attached with the flow of economic benefits. After understanding when we can recognize an intangible asset, the next step is how to recognize these assets i.e. how to value them. An intangible asset should be measured initially at cost. Standard has divided the recognition part of intangibles into two parts ─ primary recognition and secondary recognition. Under primary recognition intangible assets are valued on the basis on which they have acquired or internally generated.
Acquisition can be

- By way of purchase.
- By way of amalgamation.
- By way of government grant.
- By way of exchange for another asset and
- By way of exchange for shares.

Standard has given different treatment under different types of acquisition which is discussed in the following section.

PRIMARY RECOGNITION

Separate acquisition - Under this type of acquisition the measurement of cost of intangible is most reliable. According to the standard, cost of an intangible asset is purchase price + taxes on purchase +installation expenses + any other directly attributable expense – trade discount – refundable taxes. After the estimation of cost, it is capitalized in the books of accounts.

Acquisition as part of an amalgamation - Intangible assets acquired in an amalgamation in the nature of purchase are to be accounted according to AS-14, Accounting for Amalgamation. According to AS - 14 standard, value allocated to identifiable intangible asset should be done on the basis of their fair value at the date of amalgamation (presence of active market) or at the amount that the enterprise would have paid in an arm's length transaction (non-presence of active market). An enterprise whose value cannot be measured reliably should not be recognized separately. It is to be included in Goodwill.

Acquisition by way of government grant **-** Sometimes government allocates intangible assets such as airport landing rights; import licenses etc. to enterprises at nominal consideration or free of charge. These intangibles come under the category of intangible assets acquired by way of government grants. Accounting of these types of intangible assets is done on the basis of **AS-12, Accounting for governmentgrants.** According to this standard, intangible assets acquired **free of charge** by way of government grants are to be recognized at **nominal value** and intangible assets acquired for **nominal consideration** by way of government grants are to be recognized **at the acquisition cost.** Additional expenditure incurred for making the asset ready for use is also to be included.

Acquisition by exchange of assets **-** In this case intangible asset is acquired in full or part exchange of another asset. Cost of these types of intangible assets is determined on the basis of **AS-10, Accounting for Fixed Assets.** According to this standard, the value to be ascertained at fair value of asset obtained or at fair value of asset surrendered whichever is more clearly evident. If fair value is not clearly evident then consider lower value as value of intangible assets.

Acquired goodwill **-** The goodwill which is generated due to acquisition is known as an **acquired goodwill.** Acquired goodwill can be positive or negative. **Positive goodwill** is to be capitalized and shown as an asset in the balance sheet. Under this standard, goodwill is to be tested for impairment annually with an exception of goodwill arising due to amalgamation. This goodwill is to be amortized over 3-5 years (AS-14, Accounting for Amalgamation). **Negative goodwill** is simply credited to the capital reserve account which is a part of shareholder's equity.

Internally generated goodwill **-** Internally generated goodwill includes those expenditures which are incurred by the enterprise for generating future economic benefits but cannot be recognized as intangible assets as they do not meet the recognition criteria. Because of this it cannot be measured reliably. Therefore, internally generated goodwill should not be recognized as an asset.

Internally generated intangible assets -Internally generated intangible assets are those intangible assets which are generated or created by the entity by undertaking the two phase process of research and development. Internally generated intangible assets are accounted on the basis of these two phases of their development. This standard has specifically given some internally generated intangible assets which cannot be recognized as their cost cannot be measured reliably. These internally generated intangible assets are - brands, mastheads, publishing titles, customer list. These assets are not being recognized in financial statements. Remaining internally generated intangible assets will be recognized in the books by following the process specified in this standard. Expenditure on self-generated intangible assets is incurred in two phases: -research phase and development phase. The classification of the generation process in two phases is important as it will decide that expenditure incurred in which phase will be recognized in the book of accounts as an internally generated Intangible Assets.

- Research Phase - Research means planned investigation for gaining knowledge. In research phase, no concrete development of asset takes place. In this phase we come to know about how to develop a new product, service, device, system etc. Expenditure in this phase cannot be stated as an Intangible asset as no asset come into physical existence from which future economic benefits are ascertainable. Therefore, as per AS-26, such expenditure will be charged from profit and loss account as and when it is incurred.
- Development Phase - Development is the application of already gained knowledge in research. Under this phase, findings of research phase came in existing form. According to this statement, internally generated intangible asset can be recognized if it satisfies the following conditions:-

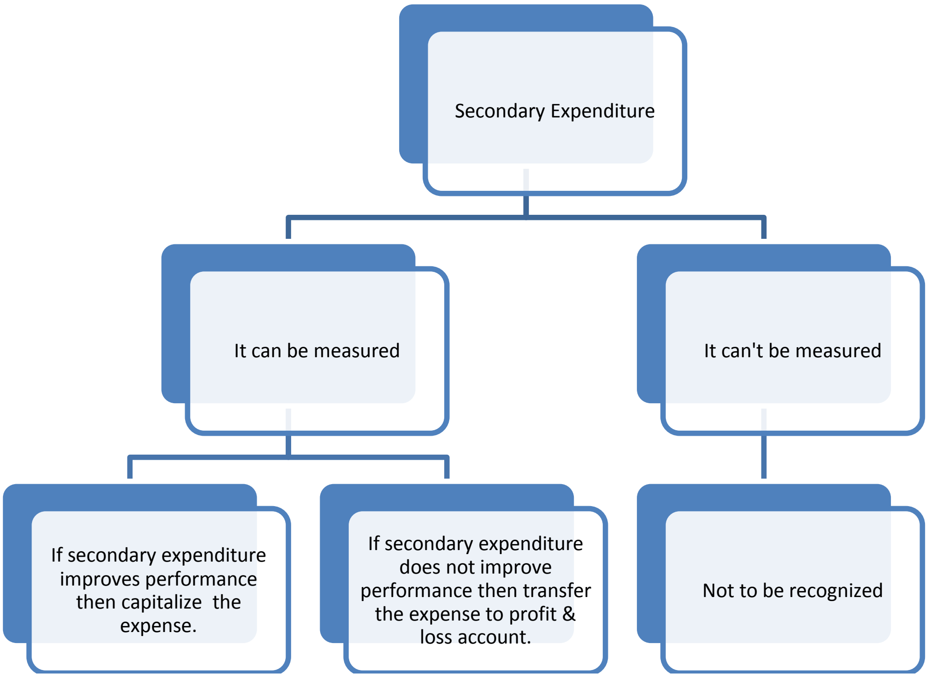
- *Technical feasibility* of completion of intangible asset should be demonstrated by an enterprise.
- An enterprise has to show its *intention to complete*the intangible asset.
- There should be *availability* of adequate *resources* (in all respect) to complete the intangible asset.
- The enterprise should provide detail about *probable future economic benefits.* It has to demonstrate the existence of market for the output to be generated with the help of that intangible asset or internal use of that intangible asset.

If all the above conditions are satisfied then the development cost is capitalized in the book of accounts. But maximum amortization period has not been specified in the standard.

- Cost of internally generated intangible asset - The cost of internally generated intangible asset is the summation of expenditure incurred from the time when intangible asset meets the criteria for recognition as an intangible asset. The cost include each and every type of cost except staff training expenses, losses incurred before the planned performance of an asset, selling, administrative and general overheads unless directly attributable.

SECONDARY RECOGNITION

Subsequent expenditures are those which are done in later years of usage of an intangible asset. Standard has recognized that if the subsequentexpenditure improves the performance of the asset beyond a standard performance then that expenditure should be capitalized if it can be measured. Otherwise, that expenditure should be transferred to profit and loss account. Expenditures which are not measurable should not be recognized. Consistent with above discussion, subsequent expenditure on brands, mastheads, publishing titles, customer list is always recognized as an expense. The above classification is depicted with the help of the followingflowchart:-



MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

After ascertainment and recognition of intangible assets in the financial statements, the next step is the measurement of their carrying value for subsequent years. Like tangible assets, intangible assets are also required to be valued at the end of each accounting period. Intangible assets are required to be amortized or to be tested for impairment according to their useful life. This standard has chosen **cost model** for subsequent measurement of intangible assets. Unlike other countries, no option has been given to the Indian enterprises to choose from cost or revaluation model. According to cost model, intangible assets should be carried at:-

Cost – Accumulated amortization – Accumulated impairment losses

According to AS-26

Amortization *is the systematic allocation of the depreciable amount (original cost – scrap value) of an intangible asset over its useful life.*

Impairment loss *is the amount by which the carrying amount of an asset exceeds its recoverable amount.*

To understand the concept of "subsequent recognition" further understanding is required about the method of amortization, life of an intangible asset and scrap value. All these concepts are discussed with rules specified by this standard in the following section.

Amortization Method

According to AS-26

"**Amortization method used should reflect the pattern in which the asset's economic benefits are to be consumed by the enterprise".**

Standard has specifically given that a straight line method to be used if pattern of economic benefits cannot be ascertained reliably. Methods which can be used for amortization are **straight line method, diminishing balance method** and **production unit method**. The method to be selected should be consistent with the pattern of consumption of economic benefits and should be consistently followed year after year unless there is a change in pattern of economic benefits. Like depreciation, **amortization is recognized as an expense.** If an intangible asset is used in the production process then amortization of that asset is included in carrying amount of that asset for example in case of inventories.

Residual value/ Scrap value

According to the standard, scrap value should be assumed to be zero unless there is a commitment of purchase by the third party at the end of useful life or there is an active market. But if company adopts written down value method, then it has to provide 5% of cost as scrap value as per Sec205 of Companies Act 1956.

Amortization period

"Amortization period is the period over which the depreciable amount of an intangible asset should be allocated".

Amortization period is the estimated useful life of an intangible asset. A recognized intangible asset shall be amortized over its useful life unless it has an indefinite life i.e. only intangible assets with definite useful life should be amortized. Every accounting standard makes a reputable presumption about the useful life of an intangible asset. Indian Accounting Standard-26 has made a presumption that life of an intangible asset will not exceed 10 years from the date when the asset is available for use. This assumption has been made on the ground that estimates of useful life become less reliable as useful life increases. However, useful life may be more or less than 10 years depending on the factors affecting the intangible asset. While deciding the useful life, the company must keep the following factors in mind:-

- The expected usage of the asset.
- Technical obsolescence.
- Expected actions by competitors.
- Period of control over the asset i.e. legal limits on the use of the asset such as leases.
- Typical product life cycles for the asset.
- The stability of the industry in which the asset operates.
- Changes in the market demand for the output (product or service) of the asset.

The above factors can be broadly classified as **economic factors** (determine period of future economic benefits) and **legal factors** (determine the period of control on these benefits). Useful life will be shorter of the periods determined by these two factors. Considerable amount of judgement is required in the estimation of useful life of an intangible asset. As said above, useful life of an intangible asset may be more or less than assumed 10 years useful life. Useful life may exceed 10 years but it is always taken as finite. In case of goodwill, useful life assumed is 10 years. Intangible assets which are susceptible to technological obsolescence are likely to have short useful life. In case of **computer software**, 3-5 years useful life is recommended in the standard. In case of **goodwill arising due toamalgamation**, the estimation of useful life is made on the basis of AS-14, Accounting for Amalgamation. According to this standard, goodwill due to amalgamation will be written-off over a period of 5 years. In the above 2 cases, useful-life is less than 10 years. Life more than 10 years can also be considered if justified. Under disclosure requirements of AS-26, the company has to disclose reasons about assuming life more than 10 years. In reasons, the company should describe the factors that played an important role in determining the useful life of the asset.

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REVIEW OF AMORTIZATION PERIOD AND METHOD

Method of amortization, life of amortization and scrap value should be reviewed every year. All effects should be on prospective basis.

IMPAIRMENT LOSSES

"**An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount (carrying amount> recoverable amount)".**

According to this standard, an enterprise should follow the provisions given in this statement (AS-26) **along with Accounting Standard-28, 'Impairment ofAssets'**, to determine whether an intangible asset is impaired. AS-28 specifies the requirements relating to impairment of assets like how to review the carrying amount of its intangible assets, when to recognize an impairment loss etc.

According to this statement, if after acquisition of an intangible asset acquired in an amalgamation in the nature of purchase, **the impairment loss due to non-specified events** or circumstances occurs before the end of the first accounting period starting after acquisition then an enterprise should reduce the value of that intangible asset and the goodwill recognized at the time of amalgamation by the amount of the impairment loss. But if **the impairment loss occurs due to specific events** or circumstances, the impairment loss should be recognized according to the provisions given in AS-28.

RETIREMENT AND DISPOSAL

An Intangible Asset should be removed from the balance sheets from the date of disposal or when no future economic benefits are expected from it. Profit or loss (net proceeds – carrying amount of the asset) arising at the time of disposal or retirement should be transferred to profit and loss account.

DISCLOSURE

Standard has given specific guidelines on disclosure of information related to intangible assets. First, intangible assets are required to be differentiated between internally generated intangible assets and other intangible assets. Then, as per AS-26 the financial statements should disclose the following information about Intangible assets:-

- Useful life.
- Amortization method.
- Gross carrying amount and the accumulated amortization at the beginning and end of the period.
- Change in accounting policy related to intangible assets and effect on financial statements.
- Disclosure of reasons when amortization period is more than 10 years.
- Aggregate amount of R&D recognized as an expense during the period.

TRANSITIONAL PROVISIONS

This section provides the approach in which an enterprise can changeover from its old accounting policy (not according to AS-26) to new accounting policy (compliance with AS-26) on accounting of intangible assets and how this shift will affect the financial statements. For example how an enterprise can shift from an accounting policy of not amortizing intangible assets to an accounting policy of amortizing intangible assets. The following circumstances have been discussed under this section.

- If the **period determined under this standard has expired (1-04-2003)** and the enterprise is following a policy of not amortizing an intangible asset or amortizing over a period greater than the period determined under this standard then the enterprise should eliminate the carrying amount of that intangible asset present in the balance sheet by making a corresponding adjustment in the opening balance of revenue reserves.
- If the **period has not expired** andthe policy of the enterprise is not to amortize an intangible asset then the enterprise has to restate the carrying amount as if the accumulated amortization has been calculated according to provisions of this standard. A corresponding adjustment has to be made to the opening balance of revenue reserves (adjustment amount- difference between the carrying amounts). The restated carrying amount is to be amortized over the remaining period.
- If according to the accounting policy of the enterprise the remaining period is **shorter than the balance of the period** determined as per this standard then the enterprise should amortize the carrying amount of the intangible asset over the remaining period determined as per the accounting policy of the enterprise.
- If according to the accounting policy of the enterprise the remaining period is **longer than the balance of the period** determined as per this standard then the enterprise has to restate the carrying amount as if the accumulated amortization has been calculated according to the provisions of this standard. A corresponding adjustment has to be made to the opening balance of revenue reserves (adjustment amount- difference between the carrying amounts). The restated carrying amount is to be amortized over the remaining period.

II. Conclusion

From the above discussion it can be concluded that the AS-26 has creditably covered vast area related to accounting and disclosure of intangible assets. The standard answered the questions - when and how to recognize intangible assets, their subsequent recognition, which amortization method to be followed what amortization period to be taken, how to disclose intangible assets in the balance sheet etc. This statement has assisted Indian companies in proper accounting and disclosure of intangible assets which in turns help in proper valuation of companies. Proper valuation is essential not only for a company but also for investors, banks, government , tax authorities and other interested parties.

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