# Educational Material on Indian Accounting Standard (Ind AS) 38, Intangible Assets

The Institute of Chartered Accountants of India
*(Set up by an Act of Parliament)*
New Delhi

# Educational Material on
# Indian Accounting Standard (Ind AS) 38
# *Intangible Assets*

**The Institute of Chartered Accountants of India**
*(Set up by an Act of Parliament)*
NEW DELHI

This Educational Material has been formulated in accordance with the Ind AS notified by the Ministry of Corporate Affairs (MCA) as Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 and other amendments finalised and notified till March 2020.

| | | |
|---|---|---|
| Edition | : | July 2020 |
| Committee/Department | : | Accounting Standards Board |
| E-mail | : | asb@icai.in; indas@icai.in; |
| Website | : | www.icai.org |
| Price | : | ₹ 170/- |
| Published by | : | The Publication & CDS Directorate on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi - 110 002. |
| Printed by | : | Friends Digital Color Print Shop Shop No. 1 , Manjusha Building 57 Nehru Place - 110019 (New Delhi) October \| 2022 \| P3165 (New) |

# Contents

## Foreword

The Institute of Chartered Accountants of India (ICAI) always considers establishment and maintenance of a sound financial reporting system in the country as its primary responsibility. It has made herculean efforts to ensure that the accounting practices in India are at par with leading economies of the world and provide high quality financial reporting framework comparable at global level. ICAI takes various initiatives, from time to time, to provide necessary guidance to its members and other stakeholders to ensure that the Standards are implemented in the same spirit in which these have been formulated. Issuance of Educational Materials on Indian Accounting Standards (Ind AS) is one of such initiatives., which is found to be highly useful to the preparers, auditors and other stakeholders in discharge of their functions.

In the context of 'principle based' Ind AS Framework, Educational Materials developed with the objective of providing guidance on various issues involved in implementation have assumed enhanced relevance and utility to various stakeholders. Implementation guidance covering practical implementation topics are addressed in the Educational Materials in the form of Frequently Asked Questions (FAQs). These FAQs can be viewed as small case studies dealing with implementation of the relevant Ind AS provisions in the given facts. Taking this initiative ahead, the Accounting Standards Board has brought out this Educational Material on Ind AS 38, *Intangible Assets,* covering various aspects of the Ind AS dealing with intangible assets. Ind AS 38, *Intangible Assets* is a comprehensive and robust standard that addresses entire gamut of accounting for variety of intangible assets which continue to evolve in various forms and shapes in this dynamic era of highly connected global economic village.

I would like to congratulate CA. M P Vijay Kumar, Chairman and CA. Sanjeev Singhal, Vice-Chairman, Accounting Standards Board as well as convenor of the Study Group, and other members of the Study Group and the Board who have given their valuable technical contribution in bringing out this publication. I am sure that membership at large and other stakeholders will be immensely benefited by this publication.

| | |
|---|---|
| **New Delhi** | **(CA. Atul Kumar Gupta)** |
| **June 27, 2020** | **President, ICAI** |

## Preface

The implementation of the Indian Accounting Standards (Ind AS) substantially converged with IFRS Standards has been driven by tireless efforts of the Institute of Chartered Accountants of India (ICAI) to make sure that the financial reports of the Indian companies are at par with the globally recognised high quality Financial Reporting Standards. Continuous efforts have been made by the Accounting Standards Board (The Board or ASB) of the ICAI for successfully advocating the need and importance of adoption of Ind AS, a high quality principled based financial reporting standards framework. The Board through its various initiatives is providing guidance to the members and other stakeholders on this 'Principle Based' Ind AS Framework. In its pursuit of high quality effective and efficient implementation, the Board develops and issues implementation guidance such as Educational Materials on Ind AS covering various Technical issues.

As a step in this direction, I am pleased to share that the Board has brought out the Educational Material on Indian Accounting Standard (Ind AS) 38, *Intangible Assets*. Ind AS 38 prescribes the accounting treatment for intangible assets that are not dealt with specifically in another Ind AS. It sets out the criteria for recognising and measuring intangible assets and requires disclosures about them. The standard provides guidance on treatment of costs incurred to generate intangible assets as well as those acquired separately or as part of business combinations or acquired by way of government grant. The Standards also deals with other aspects related to intangible assets, such as, amortisation, impairment, etc.

This Educational Material deals with the implementation of the aforementioned aspects of Ind AS 38 by way of Frequently Asked Questions (FAQs). The Educational Material also contains summary of Ind AS 38, major differences of this Ind AS with corresponding Accounting Standard (AS) 26, Intangible Assets, and Corresponding International Accounting Standard (IAS) 38, Intangible Assets. I may mention that the views expressed in this publication are the views of the Accounting Standards Board and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind AS in a practical situation, reference should be made to the full text of the Standards.

I would like to convey my sincere gratitude to the Hon'ble President, CA. Atul Kumar Gupta and Vice-President, CA. Nihar Niranjan Jambusaria for providing this opportunity of bringing out this implementation guidance on Ind AS in the form of Educational Material. I would also like to congratulate CA. Sanjeev Singhal, Vice-Chairman, ASB as well as convenor of the study group for his excellent leadership and guidance in formulating this publication. I sincerely appreciate the untiring efforts put in by the members of the Group CA. Sarika Gosain, CA. Ghanshyam Daga, CA. Atul Seksaria, CA. Sumit Agarwal and CA. Manish Gupta for preparing the draft of this Educational Material. I would also like to thank all the members of the Board and the Special Invitees on the Board who have given their inputs in finalising this publication.

I would like to place on record appreciation of technical contribution made by CA. Vidhyadhar Kulkarni, Secretary, ASB, CA. Parminder Kaur, Deputy Secretary, CA. Sonia Minocha, Assistant Secretary and CA. Prachi Jain, Executive Officer, in bringing out this publication.

I am sure that, our stakeholders, particularly the preparers and auditors of financial statements, will find this Educational Material useful while discharging their relevant functions.

**New Delhi** **(CA. M P Vijay Kumar)**
**June 27, 2020** **Chairman**
**Accounting Standards Board**

# Educational Material on Indian Accounting Standard (Ind AS) 38 *Intangible Assets*

## I. Ind AS 38 – Summary

*[The purpose of this summary is to help the readers gain a broad understanding of the principal requirements of Ind AS 38 (or 'the Standard'). Reference should be made to the complete text of the Standard for a complete understanding of these requirements or in dealing with a practical situation.]*

### Background and Scope

The Standard prescribes the accounting treatment for intangible assets that are not dealt with specifically in another Standard. It requires an entity to recognise an intangible asset if, and only if, specified criteria are met and also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

Ind AS 38 should be applied in accounting for intangible assets, except the following:

- intangible assets that are within the scope of another Standard (examples are as mentioned below);
- financial assets, as defined in Ind AS 32, *Financial Instruments: Presentation*;
- 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.

Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are within the scope of this Standard and are excluded from the scope of Ind AS 116.

**Intangible Assets**

Intangible Asset is as an identifiable non-monetary asset without physical substance.

For an item to be recognised as an intangible asset it must meet the definition of an intangible asset i.e.,

- identifiability,
- control over a resource and
- existence of future economic benefits

If an item does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date.

**Identifiability**

An asset is identifiable if it satisfies either of the following conditions:

(a) is separable, i.e., 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

(b) 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.

**Control**

An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a Court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.

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 protect, or other ways to control, the relationships with customers, the entity usually has insufficient control over the expected economic benefits from such relationships.

In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

**Future economic benefits**

The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity.

**Recognition and Measurement**

An intangible asset should be recognised if it meets both:

- the definition of intangible asset and
- the recognition criteria mentioned below.

The above requirement applies to costs incurred on initial acquisition or internal generation of an intangible asset and costs incurred subsequently to add to, replace part of, or to service it.

An intangible asset should be recognised if, and only if:

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

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

An intangible asset should be measured initially at cost.

An entity should assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

**Separate Acquisition**

The cost of a separately acquired intangible asset would comprise:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

(b) any directly attributable cost of preparing the asset for its intended use.

The probability recognition criterion is always considered to be satisfied for separately acquired intangible assets.

The standard provides examples of directly attributable costs. It also provides examples of expenditures that are not part of the cost of intangible asset.

**Acquisition as part of a Business Combination**

If an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The fair value, which reflects market participants' expectations indicates that the probability recognition criterion is always considered to be satisfied for intangible assets acquired in a business combination. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information would exist to measure reliably the fair value of the asset. Thus, the reliable measurement criterion is always considered to be satisfied for intangible assets acquired in a business combination.

In accordance with Ind AS 103, Business Combinations, an acquirer should recognise 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 asset and is identifiable.

An intangible asset acquired in a business combination might be separable but only together with a related contract, identifiable asset or liability. In such cases, the acquirer recognises the intangible asset separately from goodwill but together with the related items.

**Acquisition by way of a government grant**

In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a Government grant. In accordance with Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, an entity may choose to recognise both the intangible asset and the grant initially at fair value. If an entity chooses not to recognise the asset initially at fair value, the entity recognises the asset initially at a nominal amount (the other treatment permitted by Ind AS 20) plus any expenditure that is directly attributable to preparing the asset for its intended use.

**Subsequent expenditure on an acquired in-process research and development project**

Subsequent expenditure on an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset is:

(a) recognised as an expense when incurred if it is research expenditure;

(b) recognised as an expense when incurred if it is development expenditure that does not satisfy the recognition criteria (specified below); and

(c) added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria (specified below).

**Internally Generated Intangible Assets**

Internally generated goodwill should not be recognised as an asset.

To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into (a) research phase and (b) development phase.

No intangible asset arising from research (or on the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.

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:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.

(b) its intention to complete the intangible asset and use or sell it.

(c) its ability to use or sell the intangible asset.

(d) how the intangible asset will generate probable future economic benefits.

(e) the availability of adequate technical, \financial and other resources to complete the development and to use or sell the intangible asset.

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

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 and the condition relating to development phase.

**Recognition of an Expense**

Expenditure on an intangible item should be recognised as an expense when it is incurred unless:

(a) it forms part of the cost of an intangible asset that meets the recognition criteria; or

(b) the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, it forms part of the amount recognised as goodwill at the acquisition date (see Ind AS 103, *Business Combinations*).

Expenditure on an intangible item that was previously recognised as an expense shall not be reinstated as part of the cost of an intangible asset at a later date.

### Measurement after recognition

An entity should choose either the cost model or the revaluation model as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class should also be accounted for using the same model, unless there is no active market for those assets. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations.

**Cost Model-** After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

**Revaluation Model-** After initial recognition, an intangible asset should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value should be measured by reference to an active market. 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 revaluation model is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process, the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received by way of a Government grant and recognised at a nominal amount.

### Treatment of Revaluation Gains and Losses

If an intangible asset's carrying amount is increased as a result of a revaluation, the increase should be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase should be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognised in profit or loss. However, the decrease should be recognised in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset.

**Amortisation Method**

The depreciable amount of an intangible asset with a finite useful life should be allocated on a systematic basis over its useful life.

Amortisation should begin when the asset is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Amortisation ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105 and the date that the asset is derecognised.

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method.

The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset. If that pattern cannot be determined reliably, the straight-line method should be used. The method should be applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits.

The amortisation charge for each period should be recognised in profit or loss unless it is required to be included in the carrying amount of another asset used.

**Useful Life**

Useful life is:

(a) the period over which an asset is expected to be available for use by an entity; or

(b) the number of production or similar units expected to be obtained from the asset by an entity.

An entity should assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. 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.

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. An intangible asset that is not amortised is nonetheless subject to assessment of possible impairment in accordance with Ind AS 36, *Impairment of Assets*.

The standard specifies many factors that are considered in determining the useful life of an intangible asset.

The useful life of an intangible asset that arises from contractual or other legal rights should 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. Period of renewal can be included only if there is evidence to support renewal by the entity without significant cost.

**Review of amortisation period and amortisation method**

The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. Such changes shall be accounted for as changes in accounting estimates in accordance with Ind AS 8.

**Intangible assets with indefinite useful life**

An intangible asset with an indefinite useful life shall not be amortised.

**Review of Useful Life Assessment**

The useful life of an intangible asset that is not being amortised should be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate in accordance with Ind AS 8.

**Residual Value**

Residual value of an intangible asset with a finite useful life should be assumed to be zero unless:

- there is a commitment by a third party to purchase the asset at the end of its useful life; or
- there is an active market (as defined in Ind AS 113, *Fair Value Measurement*) for the asset and:
    - residual value can be determined by reference to that market; and
    - it is probable that such a market will exist at the end of the asset's useful life.

A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.

Estimate of residual value is based on the amount recoverable from its disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used.

The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate as per Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

**Derecognition**

An intangible asset should be derecognised:

a) on disposal; or

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

The gain or loss arising from the derecognition is the difference between the net disposal proceeds, if any, and the carrying amount of the asset which should be recognised in profit or loss when the asset is derecognised (unless Ind AS 116, *Leases* requires otherwise on a sale and leaseback). Gains should not be classified as revenue.

The disposal of an intangible asset may occur in a variety of ways (e.g. by sale, by entering into a finance lease, or by donation). The date of disposal of an intangible asset is the date that the recipient obtains control of that asset in accordance with the requirements for determining when a performance obligation is satisfied in Ind AS 115, *Revenue from*

*Contracts with Customers*. Ind AS 116, *Leases* applies to disposal by a sale and leaseback.

**Disclosure Requirements**

The financial statements should disclose, for each class of intangible assets the following (distinguishing between internally generated and other intangible assets):

- whether the useful lives are indefinite or finite;
- If finite, then specify the useful lives or the amortisation rates used;
- amortisation methods used
- gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;
- the line item(s) of the statement of profit and loss in which any amortisation of intangible assets is included;
- a reconciliation of the carrying amount at the beginning and end of the period showing:
  - additions (separately for internally developed, acquired separately or through business combinations); assets classified as held for sale or included in a disposal group classified as held for sale and other disposals;
  - increases or decreases during the period from revaluations and impairment losses recognised or reversed in other comprehensive income;
  - impairment losses recognised or reversed in profit or loss;
  - any amortisation recognised during the period;
  - net exchange differences arising on the translation into the presentation currency, and on the translation of a foreign operation into the presentation currency of the entity; and
  - other changes in the carrying amount during the period.

An entity shall also disclose:

- for an intangible asset having an indefinite useful life:

    - its carrying amount and
    - the reasons supporting the assessment of an indefinite useful life including describing the factor(s) that played a significant role in determining indefinite useful life.
- a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements.
- for intangible assets acquired by way of a government grant and initially recognised at fair value:
    - the fair value initially recognised for these assets;
    - their carrying amount; and
    - whether subsequent measurement is under the cost model or the revaluation model.
- existence and carrying amounts of intangible assets whose title is restricted and
- carrying amounts of intangible assets pledged as security for liabilities.
- amount of contractual commitments for the acquisition of intangible assets.

If intangible assets are accounted for at revalued amounts, an entity shall disclose:

- by class of intangible assets:
    - the effective date of the revaluation;
    - the carrying amount of revalued intangible assets;
    - the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model
- the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution.
- An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

## Intangible Assets-Website Costs

Appendix A of Ind AS 38 provides guidance on whether web site is an internally generated intangible asset that is subject to the requirements of Ind AS 38; and the appropriate accounting treatment of expenditure on web site. The Appendix prescribes that 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 AS 38. Any internal expenditure on the development and operation of an entity's own web site should be accounted for in accordance with Ind AS 38. 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 should be evaluated to determine the appropriate accounting treatment. A web site that is recognised as an intangible asset under this Appendix should be measured after initial recognition by applying the requirements of Ind AS 38. The best estimate of a web site's useful life should be short.

## II – Frequently Asked Questions (FAQ)

### Question 1

Whether an asset would be accounted for applying provisions of Ind AS 16, *Property, Plant and Equipment* or Ind AS 38, *Intangible Assets,* where the asset has both tangible and intangible elements?

### Response

Intangible Asset is defined in Ind AS 38, *Intangible Assets*, as **an identifiable non-monetary asset without physical substance.** Tangible Assets, which are referred to as Property, Plant and Equipment (PPE), are defined in Ind AS 16, *Property, Plant and Equipment* as follows:

***Property, plant and equipment* are tangible items that:**

**(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and**

**(b) are expected to be used during more than one period.**

It might be challenging at times to categorise an asset as tangible or intangible. An intangible asset is often contained in or on a physical substance. With regard to instant issue, paragraph 4 of Ind AS 38, *Intangible Assets* may be noted, which provides as under:

"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 intangible and tangible 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." (Emphasis added)

In accordance with the above, an entity is required to apply judgment to assess as to which element is more significant, tangible or the intangible contained in the asset. An entity is required to evaluate whether the intangible part is integral to the larger asset or whether it is individually separable from the asset, i.e. it has been acquired separately or can be used independently from the tangible asset of which it forms part of.

For example: Computer Hardware purchased alongwith operating system in-built provided by the vendor, the operating system cannot be capitalised separately from the computer as operating system is integral part of the computer itself and should be capitalised as property, plant and equipment. In contrast, accounting software purchased additionally and installed on a computer hardware is recognised separately as intangible asset. The reason being the computer hardware can operate without this specific accounting software (say by installation of another software) and therefore, the accounting software is not the integral part of the computer hardware. Installation of accounting software has been done to the computer to be used for a specific purpose. Therefore, accounting software should be capitalized as intangible asset as per Ind AS 38, *Intangible Assets* (provided the criteria for recognition of intangible asset are satisfied) and the computer system should be capitalized as per the Ind AS 16, *Property, Plant and Equipment*.

**Question 2**

If expenditure incurred results into an asset with physical substance, should the expenditure be accounted as Tangible asset (PPE) or Intangible asset?

**Response**

An intangible asset is defined as "**an identifiable non-monetary asset without physical substance.**"

However, paragraph 5 of Ind AS 38 explains as under:

"This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (eg a prototype), the physical element of the asset is secondary to its intangible component, ie the knowledge embodied in it."

In accordance with the above, Ind AS 38 should also be applied to expenditures that might result in development of an asset with physical substance where the physical element is secondary to its intangible component, i.e. the knowledge embodied in it.

For example, patented artistic related works such as architectural drawings, technical designs, paintings are all intangible assets for its makers/authors/painters etc. because its artistic value is predominant in nature (rather than the painting itself) which drives the value of the asset rather than the physical substance of the painting. Accordingly, it may be treated as intangible asset if it meets the definition and recognition criteria.

**Question 3**

Does Ind AS 38, *Intangible Assets,* contain specific assumptions regarding recognition criterion of intangible assets acquired in certain situations like business combination or separate acquisition as compared to the internally generated intangible asset. What are the key differences in that approach?

**Response**

Yes, the standard explicitly states certain assumptions in relation to fulfillment of recognition criterion for intangible assets acquired from external sources. The key assumptions are summarised below:

Recognition criterion of intangible asset is laid down in paragraph 21 of Ind AS 38. The standard lays down following two general criterion:

"21. An intangible asset shall be recognised if, and only if:

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

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

It may be noted that in respect of intangible asset acquired in a business combination, the standard states that the probability recognition criterion and reliable measurement criterion in paragraphs 21(a) and 21(b) of Ind AS 38 are always considered to be satisfied (refer paragraph 33 of Ind AS 38).

Similarly, in respect of intangible asset acquired by way of separate acquisition the standard states that the probability recognition criterion in paragraph 21(a) Ind AS 38 is always considered to be satisfied (refer paragraph 25 of Ind AS 38). Further, paragraph 26 of Ind AS 38 further states that the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets. Thus, reliable measurement criterion in paragraph 21(b) is also considered to be met.

**Question 4**

One of the conditions for an intangible asset to be classified as such is that it should be identifiable. Further, separability is one of the criteria for an asset to be identifiable as specified under Ind AS 38. Is separability a necessary criterion?

**Response**

Paragraph 12 of Ind AS 38 state as follows:

**"An asset is identifiable if it either:**

**(a)** **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**

(b) **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."**

In accordance with the above, it may be noted that separability is one of the criterion but not a necessary criterion for an asset to be identifiable. If the asset arises from contractual or other legal rights (whether or not transferable or separable from other rights and obligations), then also the criteria of identifiability is met and the asset can be identified as an intangible asset.

For example

- A non-transferrable licence to operate a radio station may be considered as identifiable as it arises from legal rights, even though it may not be separable from the operator. The same should be recognised as an intangible asset, if other elements of definition criteria (control and future economic benefits) and recognition criteria are met.

- An entity X acquires another entity Y and as a part of the purchase consideration, it pays certain amount towards 'Non-compete Fee' so as to restrict the entity Y from competing in the same line of business for the next 5 years. The right arising under the non-compete agreement is contractual right and, hence, is identifiable, although such rights cannot be transferred, sold or separated

**Question 5**

Can expenditure incurred on purchase/ acquisition/ development of Customer or Supplier relationships be recognised as intangible asset?

**Response**

It is important to note that Customer or Supplier relationships result into creation of different types of intangible resources. These intangible resources are known by different names and typical examples are Customer Lists, Customer Contracts, Order or Production Backlogs and Customer Relationships etc. These Customer or Supplier related intangible resources or assets may arise from contractual relationship or non-contractual relationships. Further, these Customer-related intangible resources or assets may be broadly divided into two types i.e. internally generated intangible assets or externally acquired intangible assets. The former category arises from the expenditure incurred by the entity as part of its operating activities, whereas as the latter category arises from certain circumstances like acquisition of businesses in business combination or separate acquisition of an intangible asset or asset exchange transaction or receipt by way of government grant. Ind AS 38, *Intangible Assets,* adopts different approaches for recognition of internally generated intangible assets and those acquired externally. Therefore, the recognition of intangible resources in the form of Customer or Supplier relationships depends upon the category to which it belongs.

Following paragraphs summarise the key principles to be followed for recognition of Intangible assets in the form of Customer or Supplier relationships:

***Customer-related intangible assets relationships generated internally***

Paragraph 9 of Ind AS 38 gives examples of items for which entities may frequently incur expenditure on the acquisition, development, maintenance or enhancement of intangible resources. One of such examples is customer or supplier relationships. Further, paragraph 10 of Ind AS 38 clarifies that not all the items stated in paragraph 9 meet the definition of an intangible asset, i.e., identifiability, control over a resource and existence of future economic benefits.

Further, paragraph 16 of Ind AS 38 may be noted, which provides as under:

"16. 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 protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (eg: portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset."

In accordance with the above, an entity must be able to satisfy the criteria of identifiability, control and existence of future economic benefits for customer relationships to be treated as intangible assets.

Further, apart from fulfilment of the definition of intangible assets, recognition criteria prescribed in paragraph 21 of Ind AS 38, reproduced below, should also be satisfied for recognition as intangible assets. As per paragraph 21 of Ind AS 38, "**An intangible asset should only be recognised if:**

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

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

For example: An entity, a fast-food outlet, builds customer relationships and loyalty through its support services. The entity expects its customers will continue to trade with it. There are no contracts with those customers beyond the tacit agreement to trade food and service for cash. In the absence of legal rights to protect the entity's relationships with its customers or to control the customers' loyalty to the entity, an entity usually has insufficient control over the expected economic benefits from its customer relationships and loyalty for such items (eg a portfolio of customers, market-share, customer relationships and customer loyalty) to meet the definition of an intangible asset.

Therefore, if an item of expenditure (refer paragraph 9 of Ind AS 38 for examples of such expenditures) is within the scope of Ind AS 38 but does not meet the definition of an intangible asset, expenditure to generate it internally is recognised as an expense when it is incurred.

***Customer relationship acquired in a business combination or separate acquisition***

In order to recognise the intangible assets acquired in a business combination or separate acquisition, it is critical to consider the following prescriptions of Ind AS 38, *Intangible Assets* as well as those in Ind AS 103, *Business Combinations*.

## Ind AS 38, *Intangible Assets*

### Recognition and Measurement

According to paragraph 19, application of recognition principles to intangible assets acquired in a business combination and those acquired separately are dealt in paragraphs 33–43 and paragraphs 25-32 of Ind AS 38, respectively.

Paragraph 33 of Ind AS 38 lays down exceptions to the general recognition criterion laid down in paragraph 21 of Ind AS 38 for those acquired in a business combination. According to this paragraph the probability recognition criterion and reliable measurement criterion are always considered to be satisfied for intangible assets acquired in business combinations.

Similarly, paragraph 25 states that the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets. Further, paragraph 26, states that the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

## Ind AS 103, *Business Combinations*

### Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

### Recognition principle

Paragraph 13 of Ind AS 103, *Business Combinations*, provides that "The acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense."

Further, paragraph B31 to B33 provide application guidance in relation to recognition of intangible assets. Paragraph B31 sates that the acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual legal criterion.

It may be noted that intangible assets may arise on the basis of contractual rights or non-contractual rights. The latter types may be separable, hence, may meet the definition of intangible assets though not meeting the contractual-legal criterion of Ind AS 38 (paragraph 12).

Further, following broad guidelines for recognition of different types of Customer-related intangible assets acquired in a business combination[1] may be noted:

**Customer Lists**

A customer list does not usually arise from contractual or other legal rights. However, customer lists are often leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion.

**Order or production backlog**

These normally arise from contracts such as purchase or sales orders, therefore, meet the contractual-legal criterion if an order or production backlog is acquired in a business combination. This is so even if the purchase or sales order can be cancelled.

**Customer related relationships through contracts**

Customer related relationships can be established either through legal contracts or regular contracts through sales or service representatives. In both the situations, the customer relationships meet the contractual-legal criterion for recognition of intangible asset if these relationships are acquired in a business combination. In case of customer relationships arising from legal contracts with customers e.g. a portfolio of investment

---

[1] For more details Refer Illustrative Examples, IFRS 3, *Business Combinations*, published by IASB of IFRS Foundation which is also available at ICAI website at the following link: https://www.icai.org/post.html?post_id=15614

.

contracts, and acquired in a business combination, contractual-legal criterion is met even if the confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.

**Non-Contractual Customer relationships**

Even though this category of customer relationships do not meet the contractual-legal criterion, but may meet the separability criterion for recognition as intangible asset separately from the goodwill. This can be evidenced from the sale or exchange of similar items in purchase or sale transactions by other entities.

Therefore, the expenditure incurred on acquisition of Customer or Supplier relationships in a business combination can be recognised as intangible asset separately from goodwill depending upon the facts and circumstances of each case as explained above.

Further, it may be noted that if the expenditure to acquire above type of intangible resources in a business combination cannot be recognised as a separate intangible asset, then it may form part of the goodwill recognised at the acquisition date (refer paragraph 68 of Ind AS 38), depending upon the facts and circumstances of the business combination.

**Question 6**

One of the criteria for meeting the definition of intangible asset for an entity is to demonstrate that it controls the asset, i.e., the entity has power to obtain the future economic benefits. Is presence of legal rights a necessary condition to demonstrate this?

**Response**

With regard to control through legal rights or otherwise, paragraph 13 of Ind AS 38 provides as under:

"An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way."

From the above, it is clear that presence of legal rights is not a necessary condition to demonstrate control. However, in such a case, to demonstrate control an entity should be able to control the future economic benefits in some other way. For example, control over the benefits of know-how could be attained through secrecy.

Paragraph 16 of Ind AS 38 further provides that in absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships.

**Question 7**

X Ltd. purchased a franchise from a restaurant chain at a cost of INR 1,00,00,000 under a contract for a period of 10 years. Can the franchise right be recognised as an intangible asset in the books of X Ltd. under Ind AS 38?

**Response**

Ind AS 38, *Intangible Assets,* defines Asset and Intangible Asset as under:

**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.**

In accordance with the above, for considering an asset as an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control over a resource and existence of future economic benefits.

In the given case, the franchise right meets the identifiability criterion as it is arising from contract to purchase the franchise right for 10 years. In addition, X Ltd. will have future economic benefits and control over them from the franchise right. Accordingly, the franchise right meets the definition of intangible asset. The same can be recognised if the following recognition criteria laid down in Ind AS 38 is met:

"**21 An intangible asset shall be recognised if, and only if:**

**(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and**

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

In the instant case, identifiability criterion is fulfilled, future economic benefits from franchise right are expected to flow to the entity and cost can also be measured reliably, therefore, X Ltd. should recognise the franchise right as an intangible asset.

## Question 8

X Ltd. enters into a contract with Y Ltd. for supply of outsourced services. X Ltd. incurs cost to train its employees to be able to provide services to Y Ltd. so that they understand Y Ltd.'s equipment and processes. As per the contract, X Ltd. is entitled to charge from Y Ltd. the costs of training of X Ltd. employees at the beginning of the contract and new employees that X Ltd. hires as a result of expansion of Y Ltd. operations. The contract is within the scope of Ind AS 115, *Revenue from Contracts with Customers*. X Ltd. is of the view that it is entitled to recognise the cost of such training as an asset from the costs incurred to fulfil a contract as per paragraph 95 of Ind AS 115.

Whether the expenditure on training activities can be recognised as intangible asset?

**Response**

Paragraph 95 of Ind AS 115 requires an entity to recognise an asset from the costs incurred to fulfil a contract with a customer if the costs are not within the scope of another Standard, and only if those costs meet all three criteria specified in paragraph 95.

Paragraph 95 of Ind AS 115 states as follows:

"If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, Ind AS 2, *Inventories*, Ind AS 16, *Property, Plant and Equipment* or Ind AS 38, *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);

(b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and

(c) the costs are expected to be recovered."

In view of the above, before assessing the criteria in paragraph 95 of Ind AS 115, the entity first considers whether the training costs incurred to fulfil the contract are within the scope of another Standard.

In this regard, paragraph 5 of Ind AS 38 states as follows:

"This Standard applies to, among other things, **expenditure on advertising, training**, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (eg a prototype), the physical element of the asset is secondary to its intangible component, ie the knowledge embodied in it." (Emphasis added)

Paragraph 5 explicitly includes expenditure on training within the scope of Ind AS 38. Accordingly, the entity applies Ind AS 38 in accounting for the training costs incurred to fulfil the contract with the customer i.e., Y Ltd. However, paragraph 69(b) of Ind AS 38 includes expenditure on training activities as an example of expenditure that is incurred 'to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. Consequently, paragraph 69 states that such expenditure on training activities is recognised as an expense when incurred.

Further, paragraph 15 of Ind AS 38 explains that 'an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset'.

Furthermore, paragraph BC307 of IFRS 15, *Revenue from Contracts with Customers,* in explaining the requirements in IFRS 15 regarding costs to fulfil a contract, states that 'if the other Standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognised under IFRS 15.'

Accordingly, in the given case, the entity recognises the training costs to fulfil the contract with the customer as an expense when incurred.

It may be noted that the entity's ability to charge to the customer the costs of training does not affect this conclusion.

**Question 9**

ABC Ltd. is a key player in media industry. The entity continues to spend large amounts on maintaining its brand and on developing the brand further (e.g. sponsoring local sports events, sponsoring select cultural events and advertising the brand). ABC Ltd. is able to charge premium from its customers because of its brand. ABC Ltd. believes that it would reap the benefits of this expenditure in future over long period, and so, it does not want to charge such expenditure incurred to profit or loss in a single year but amortise the same over future periods. Can the company defer and amortise the expenditure incurred over future years?

**Response**

Paragraph 69 of Ind AS 38 provides that, in some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. Paragraph 69(c) also cites certain specific examples of such expenditure, which includes expenditure on advertising and promotional activities.

In accordance with paragraph 69 it may be noted that expenditure on research, training, advertising and start up activities (unless start-up costs are includible in the cost of an item of property, plant and equipment in accordance with Ind AS 16) will not result in the creation of an intangible asset that can be recognised in the financial statements.

Paragraph BC46B of IAS 38, *Intangible Assets*, inter-alia states that, advertising and promotional activities enhance or create brands or customer relationships, which in turn generate revenues. Internally generated brands or customer relationships are not recognised as intangible assets.

Further, paragraphs 48 and 63 of Ind AS 38 also specifically prohibit recognition of internally generated goodwill and brands as an intangible asset.

In accordance with the above, it may be noted that advertising and promotional activities enhance or create brands or customer relationships, which in turn generate revenues. In some cases, such costs cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or developing the business as a whole or running day to day operations. Further, it is also difficult to determine whether there is an internally generated intangible asset distinguishable from internally generated goodwill.

In the given case, the expenditure that ABC Ltd. is incurring on promotional and advertising activities is to develop or enhance branding, goodwill building or customer relationship and, therefore, should not be amortised over future years and should be charged off to the profit or loss as incurred.

**Question 10**

ABC Private Limited, recruited a player. As per the terms of the contract, the player is prohibited from playing for any other entity and requires the entity to have an employment contract with the player that prevents the player from leaving the entity without mutual agreement. The price the entity paid to acquire this right is derived from the skills and fame of the said player. The entity uses and develops the player through participation in matches.

Whether the cost incurred to obtain the right regarding the player can be recognised as an intangible asset as per Ind AS 38?

**Response**

As per Ind AS 38, for an item to be recognised as an intangible asset, it must meet the definition of an intangible asset, i.e., identifiability, control over a resource and existence of future economic benefits and also recognition criteria.

With regard to establishment of control, paragraph 13 of Ind AS 38 states that, "An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way."

Further, paragraph 15 of Ind AS 38 provides that, "An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, 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."

Since the right in the instant case is contractual, identifiability criterion is satisfied. Based on the facts provided in the given case, the player is prohibited from playing in other teams by the terms of the contract which legally binds the player to stay with ABC Ltd for a number of years.

Accordingly, in the given case, the company would be able to demonstrate control. Future economic benefits are expected to arise from use of the player in matches. Further, cost of obtaining rights is also reliably measurable. Hence, it can recognise the costs incurred to obtain the right regarding the player as an intangible asset. However, careful assessment of relevant facts and circumstances of each case is required to be made.

**Question 11**

PQR Ltd. is a gaming developer company. Few years back, it developed a new game called 'Cloud9'. This game sold over 10,00,000 copies around the world and was extremely profitable. Due to its popularity, PQR Ltd. released a new game in the 'Cloud9' series every year. The games continue to be bestseller. Based on Management expectation, estimates of cash flow projections for the 'cloud9 videogame series' over the next five years have been prepared. Based on these projections, PQR Ltd. believes that cloud9 series brand should be recognised at INR 20,00,000 in its financial statement. PQR Ltd. has also paid INR 10,00,000 to MNC Ltd. to acquire rights of another video game series called the 'Headspace' videogame series. The said series have huge demand in the market.

Discuss the accounting treatment of the above in the financial statements of PQR Ltd.

**Response**

In order to determine the accounting treatment of 'cloud9 videogame series' and 'Headspace', definition of asset and intangible asset given in Ind AS 38 may be noted:

**"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."**

In accordance with the above, for recognising an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control and existence of future economic benefits.

In order to determine whether 'cloud9 videogame series' meet the aforesaid conditions, following provisions of Ind AS 38 regarding Internally Generated Intangible Assets may be noted:

As per paragraph 51 of Ind AS 38, "it is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

(a) identifying whether and when there is an identifiable asset that will generate expected future economic benefits; and

(b) determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies the requirements and guidance in paragraphs 52–67 to all internally generated intangible assets."

As per paragraph 63 and 64 of Ind AS 38, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets. Expenditure on such items cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

In accordance with the above, in the given case, cash flow projections suggest that the cloud9 brand will lead to future economic benefits. However, the asset has been internally generated and therefore the cost of the asset cannot be measured reliably. This means that the Cloud9 brand cannot be recognised as intangible asset in the financial statements.

In order to determine whether 'Headspace' meet the aforesaid conditions, following provisions of Ind AS 38 regarding Separately acquired Intangible Assets may be noted:

As per paragraphs 25 and 26 of Ind AS 38, normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The Headspace game has been purchased for INR 10,00,000 and it is expected to generate future economic benefits to the entity. Since Headspace game is a separately acquired asset and the future benefits are expected to flow to the entity, therefore, an intangible asset should be recognised in respect of the 'Headspace' asset at its cost of INR 10,00,000. After initial recognition, either cost model or revaluation model can be used to measure headspace intangible asset as per guidance given in paragraphs 74-87 of Ind AS 38. In accordance with this, Headspace intangible asset should be carried at its cost/revalued amount (as the case may be) less any accumulated amortisation and any accumulated impairment losses.

**Question 12**

Company M is a renowned application software services company and provides access to its application software to its customers based on their requirements. Z Ltd. enters into a contract with company M to pay fee (based on usage) in exchange for a right to receive access to Company M's application software for a period of five years. Company M's software runs on cloud infrastructure managed and controlled by it. Z Ltd. accesses the software on an 'as needed basis' over the internet or via a dedicated line. Fee is calculated based on usage as per the terms of the contract. The contract does not convey to the customer, any rights over tangible assets.

Whether Z Ltd. can recognise it as a software asset as per Ind AS 38, *Intangible Assets*?

**Response**

Ind AS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. It notes that an asset is a resource controlled by the entity and paragraph 13 of Ind AS 38 specifies that an entity controls an intangible asset if it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

It may be noted that, if a contract conveys to the customer only the right to receive access to the supplier's application software over the contract term, the customer does not receive a software intangible asset at the contract commencement date.

A right to receive future access to the supplier's software does not, at the contract commencement date, give the customer the power to obtain the future economic benefits flowing from the software itself and to restrict others' access to those benefits.

Accordingly, in the given case, Z Ltd. cannot recognise the access to the software over the contract term as intangible asset. However, whether it is a service or software lease needs to be determined separately.

*Note: For more details, please refer to IFRS Interpretation Committee's March 2019 Agenda decision on 'Customer's right to access the supplier's software hosted on the cloud (IAS 38)'.*

**Question 13**

How to recognise and measure the software development costs incurred by an entity?

**Response**

Software development cost is common example of an intangible asset recognised by many entities. Software development cost may be incurred by an entity for developing software for its use or for development of software as a product for sale or licensing in its ordinary course business activities. Further, costs incurred could include internal costs or external costs such as acquisition of technology or software incorporation into the entity's software products offered.

In order to recognise software development costs described above, the entities will follow the principles of Ind AS 38, *Intangible Assets,* in relation to recognition and measurement. The recognition principles prescribed in paragraph 18 of Ind AS 38 require demonstration that the item meets the definition of intangible asset given in paragraphs 8 to 17 and the recognition criteria prescribed in paragraphs 21 to 23 of Ind AS 38. As explained in previous FAQs, the standard has certain specific recognition and measurement requirements for internally generated intangible assets and to those acquired externally in transactions such as business combinations, separate acquisition of individual asset or group of assets, exchange of assets, government grants etc.

**Recognition and Measurement of software acquired externally**

It may be noted that paragraphs 18 to 24 lay down requirements for recognition of measurement of all types of intangible assets. In respect of intangible assets acquired by separate acquisition, paragraphs 25 to 32 deal with application of recognition and measurement requirements (refer paragraph 19 of Ind AS 38).

**Recognition and Measurement of software developed internally**

As mentioned in paragraph 19, the application of general recognition and measurement principles to internally generated intangible assets are dealt with in paragraphs 51 to 67 of Ind AS 38. It may be noted that sometimes, there might arise difficulties in determining whether the internally generated intangible assets meet the requirements of recognition criteria including definition of intangible assets. Therefore, the standard lays down certain additional requirements for internally generated intangible assets in addition to compliance of general requirements for recognition and initial measurement of intangible assets.

One of the critical requirements to be considered in this regard is classification of the generation of the asset i.e. expenditure incurred into two phases viz. (1) Research phase (2) Development Phase.

According to paragraph 54, no intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

Paragraph 57 deals with recognition and measurement of an internally generated intangible asset during development phases. According to paragraph 57, an intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.
(b) its intention to complete the intangible asset and use or sell it.
(c) its ability to use or sell the intangible asset.
(d) how the intangible asset will generate probable future economic benefits. [Refer: paragraph 17] 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.
(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

**Question 14**

A company engaged in the provision of Information Technology Products and Services incurred following expenditure during the development phase of its software product that is to be offered to its customers. The entity also purchases software from third parties for incorporating into its end software product offered to its customers. The company is in the process of launching it in the market for licensing to customers. The company also takes services of external professional software developers for such software development purpose. Costs incurred in relation to the development of its software product for the year ended 31 March 2020 are as follows:

| **Particulars** | **Amount (INR thousands)** |
|---|---:|
| Purchase price of imported software | 600 |
| Employment costs (Note 1) | 1200 |

| | |
|---|---|
| Testing costs | 1800 |
| Other costs directly related to customisation<br><br>(Note 2) | 450 |
| Professional fees paid for external software developers | 220 |
| Costs of training provided to staff | 195 |
| Costs of advertising in market | 1560 |
| Administrative and general overheads | 825 |

Note 1: The software was developed in nine months ended 31 December 2019 and was capable of operating in the manner intended by the entity. It was brought into use on 31 March 2020. The employment costs are for the period of twelve months (i.e. up to 31 March 2020). The employees were engaged in developing the software and related activities.

Note 2: Other costs directly related to development include an abnormal cost of INR 50,000 in respect of repairing the damage which resulted from a security breach.

What will be the amount of the software development costs that can be capitalised?

**Response**

In the fact pattern give above, the entity should apply the recognition and measurement principles relevant for an internally generated intangible asset. As mentioned in the previous FAQs, the entity has to ensure compliance with additional requirements relating to internally generated intangible assets (paragraph 51 to 67 of Ind AS 38) in addition to general recognition criteria and initial measurement of intangible asset. In the instant case, for the measurement of software development cost, entity must evaluate the costs incurred for recognition of an intangible asset arising from development phase with reference to prescriptions of paragraphs 65 to 67 read with paragraph 24 of Ind AS 38.

“65 The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.

66 The cost of an internally generated intangible asset 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:

(a) costs of materials and services used or consumed in generating the intangible asset;

(b) costs of employee benefits (as defined in Ind AS 19) arising from the generation of the intangible asset;

(c) fees to register a legal right; and

(d) amortisation of patents and licences that are used to generate the intangible asset.

Ind AS 23 specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

67 The following are not components of the cost of an internally generated intangible asset:

(a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;

(b) identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and

(c) expenditure on training staff to operate the asset.”

In accordance with the above-mentioned paragraphs of Ind AS 38, the initial carrying amount of the software is computed as below:

| Particulars | Amount (INR in thousands) | Amount to be capitalised as Intangible Assets (INR in thousands) | Remarks |
|---|---|---|---|
| Purchase price of imported software | 600 | 600 | The cost of materials or/ and services used or consumed in generating the intangible asset and any directly attributable cost of preparing the asset for its intended use. |
| Employment costs (Note 1) | 1200 | 900 | Employment costs for the period of nine months are directly attributable costs. Therefore, cost to be capitalized is INR 900 (i.e., 9/12 x 1200) for nine months as the asset was ready for its intended use by then. It is assumed that INR 100 is equally incurred each month. Capitalisation of eligible costs should cease when the asset is capable of operating in the manner intended by management. |
| Testing costs | 1800 | 1800 | Cost of testing whether the asset is functioning properly is a directly |

| | | | |
|---|---|---|---|
| | | | attributable cost. (Refer paragraph 59 of Ind AS 38) |
| Other costs directly related to development (Note 2) | 450 | 400 | Cost of identified inefficiencies deducted, i.e., INR 450 – INR 50 |
| Professional fees paid for bringing the software to its working condition | 220 | 220 | The cost of materials or/and services used or consumed in generating the intangible asset |
| Costs of training provided to staff | 195 | Nil | Expenditure on training staff to operate the asset cannot be capitalised. (Refer paragraph 67 of Ind AS 38) |
| Costs of advertising in market | 1560 | Nil | Selling, administrative and other general overhead expenditure cannot be capitalised (Refer paragraph 67 of Ind AS 38.) |
| Administrative and general overheads | 825 | Nil | Selling, administrative and other general overhead expenditure cannot be capitalised. (Refer paragraph 67 of Ind AS 38) |
| **Total** | **6,850** | **3,920** | |

Accordingly, the initial carrying value of the software is INR 39,20,000. The remaining costs will be charged to profit or loss.

**Question 15**

D Ltd. a leading publishing house, purchased copyright of a book from its author for publishing the same. As per the terms of the contract, if D Ltd. chooses to make the payment upfront then, copyright consideration of INR 80,00,000 is to be paid (which is in line with general practice in such arrangements). However, the contract also provided that, in case D Ltd. chooses to pay the consideration after 2 years, then it will be required to pay INR 1,00,00,000. At what value should the intangible asset be recognised as per Ind AS 38?

**Response**

As per paragraph 32 of Ind AS 38, "If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalized in accordance with Ind AS 23, *Borrowing Costs*."

In the given case, if the payment for an intangible asset i.e. copyright is deferred beyond normal credit terms, the cash price equivalent INR 80,00,000 should be considered as its cost and the intangible asset will be recorded initially at this value.

The difference of INR 20,00,000 between cash price equivalent (i.e. INR 80,00,000) and the total payment (i.e. INR 1,00,00,000) should be recognised as interest expense over the period of credit (i.e. 2 years in this case), unless it is eligible for capitalisation in accordance with Ind AS 23, *Borrowing Costs*.

**Question 16**

X Limited, as part of a business combination (not a common control business combination as per Appendix C to Ind AS 103), purchased the net assets of Y Limited for INR 3,50,000 on March 31, 2019 which is the consideration for acquiring 100% stake in Y Ltd. The assets and liabilities position of Y Limited just before the acquisition was as follows:

| ***Assets*** | *Carrying Amount (INR)* |
|---|---|
| Property, Plant and Equipment | 1,50,000 |
| Intangible asset 1 | 20,000 |
| Intangible asset 2 | 75,000 |
| Cash & bank | 50,000 |
| ***Liabilities*** | |
| Trade payables | 45,000 |

The fair value of the Property, plant and equipment, intangible asset 1 and intangible asset 2 at the date of acquisition is INR 2,00,000, INR 10,000 and INR 90,000 respectively. In this FAQ, it is assumed that there are no other identifiable intangible assets. Fair value of trade payables at the acquisition date is same as its carrying amount.
How should X Limited account for the net assets acquired from Y Limited in this business combination?

**Response**

Paragraphs 33 and 34 of Ind AS 38 state as follows:

"33. 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**. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the **probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations**. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. Thus, **the reliable measurement criterion in paragraph 21(b) is always considered to be satisfied for intangible assets acquired in business combinations.”** (Emphasis added)

“34. In accordance with this Standard and Ind AS 103, 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. An acquiree’s in-process research and development project meets the definition of an intangible asset when it:

(a) meets the definition of an asset; and

(b) is identifiable, ie is separable or arises from contractual or other legal rights.”

Following paragraphs of Ind AS 103, *Business Combinations,* are also relevant:

“10. As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.”

“18. The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.”

In accordance with the above, in the given case, as of the acquisition date, the identifiable net assets (including both the intangible assets) should be recognised separately from goodwill at their acquisition-date fair values.

Therefore, following would be the amounts at which items acquired in business combination should be recognised as of the acquisition date:

| Assets and liabilities | Amount (INR) |
|---|---|
| Consideration for the Business Combination | 3,50,000 |
| Amount of Non-Controlling Interest | Nil |
| Fair value of previously held equity interests in the acquiree | Nil |
| Total – A | 3,50,000 |
| Property, plant and equipment | 200,000 |
| **Intangible asset 1** | **10,000** |
| **Intangible asset 2** | **90,000** |
| Cash & Bank | 50,000 |
| Trade payables | (45,000) |
| Total B- Net Amount of Identifiable Assets acquired and Liabilities assumed | 3,05,000 |
| Goodwill* (A-B) | 45,000 |

*Note: Deferred tax is ignored for simplicity purposes.*

*Goodwill is arrived at as the difference between consideration paid (INR.3,50,000) and amount of identifiable net assets acquired (INR 3,05,000).

**Question 17**

ABC Ltd. a pharmaceutical company acquires XYZ Ltd., another pharmaceutical company which will be accounted for as a business combination under Ind AS 103. XYZ Ltd. has incurred significant research and development costs in connection with two new drugs that have been undergoing clinical trials. Out of the two drugs, one drug has not been granted necessary regulatory approvals, however ABC Ltd. expects that approval will be given one year. The other drug has recently received regulatory approval. The drugs' revenue-earning potential was one of the principal reasons for ABC Ltd. to acquire XYZ Ltd.

Whether the expenditure on in-process research and development on either of the drugs can be recognised as an intangible asset in the books of ABC Ltd.?

**Response**

As per Ind AS 38, an intangible asset should only be recognised if it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably. However, it may be noted that the Ind AS 38 follows a different approach for the recognition of intangible assets either acquired separately or in a business combination, as compared to those for intangible resources internally generated.

Further the following paragraphs of Ind AS 38 provide guidance on recognition of in-process research and development acquired in a business combination.

"33. 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. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. Thus, the reliable measurement criterion in paragraph 21(b) is always considered to be satisfied for intangible assets acquired in business combinations.

34. In accordance with this Ind AS 38 and Ind AS 103, 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. An acquiree's in-process research and development project meets the definition of an intangible asset when it:

(a) meets the definition of an asset; and

(b) is identifiable, i.e. is separable or arises from contractual or other legal rights."

In accordance with the above, recognition criteria are always considered to be met for identifiable intangible assets acquired in a business combination. Accordingly, intangible assets need to be identifiable to recognise them separately from goodwill. To be identifiable, either the existence of contractual or other legal rights criterion or separability criterion should be met.

It is pertinent to note that expenditure on in-process research and development projects acquired in business combinations is treated differently from expenditure on similar projects developed internally. As per Ind AS 38, the research expenditure related to internal R&D projects cannot be capitalised as an intangible asset. However, entities will be able to recognise on acquisition in a business combination, certain intangible asset that relate to in-process acquired research and development projects. This results in the recognition of many such assets at an earlier stage than if they were internally generated assets, if they can be reliably measured.

In the given case, pursuant to paragraph 34 of Ind AS 38, both the drugs undergoing clinical trials acquired in business combinations meet the definition of an intangible asset because they meet the definition of an asset (resource controlled by the entity from which future economic benefits are expected to flow) and separability criterion is also met assuming that they can be sold separately. The recognition criteria are always considered to be satisfied for identifiable intangible assets acquired in a business combination. Hence, at the acquisition date, both the drugs should be recognised separately from goodwill as in-process research and development intangible assets at their acquisition-date fair values.

However, Ind AS 38 requires that any subsequent expenditure incurred after the acquisition of such in-process research and development projects is to be accounted for in the same way as expenditure to create an internally generated intangible asset in accordance with paragraphs 54 to 62 of Ind AS 38.Subsequent expenditure on an in-process research or development project acquired separately is to be dealt with in accordance with paragraph 43 read with paragraph 42 of Ind AS 38. (see FAQ 18 below for such guidance).

**Question 18**

X Ltd. acquired Y Ltd. on April 30, 2020 which will be accounted as a business combination under Ind AS 103. The purchase consideration is INR 50,00,000. The fair value of the tangible assets at that date is INR 45,00,000. The company estimates the fair value of 'in-process research projects" at INR 10,00,000. No other Intangible asset is acquired by X Ltd. in the transaction. Further, X Ltd. has incurred following expenditure in relation to that research project subsequent to its acquisition on April 30, 2020:

(a) INR 5,00,000 - as research expenses

(b) INR 2,00,000 - to establish technological feasibility

(c) INR 7,00,000 - for further development cost after technological feasibility is established and other conditions laid down in paragraph 57 of Ind AS 38 are met.

At what amount the intangible asset pertaining to research project should be measured under Ind AS 38?

**Response**

Paragraph 34 of Ind AS 38, states that, "In accordance with this Standard and Ind AS 103, 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. An acquiree's in-process research and development project meets the definition of an intangible asset when it:

(a) meets the definition of an asset; and

(b) is identifiable, ie is separable or arises from contractual or other legal rights."

In accordance with the above, it may be noted that in process research and development is recognised as an intangible asset when it meets the definition of an asset and is identifiable, i.e., it is separable or arises from contractual or other legal rights.

Further, the following paragraphs provide guidance on the treatment of subsequent expenditures incurred on the project after its acquisition:

**"Subsequent expenditure on an acquired in-process research and development project**

**42. Research or development expenditure that:**

**(a) relates to an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset; and**

**(b) is incurred after the acquisition of that project**

**shall be accounted for in accordance with paragraphs 54–62.**

43. Applying the requirements in paragraphs 54–62 means that subsequent expenditure on an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset is:

(a) recognised as an expense when incurred if it is research expenditure;
(b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 57; and

(c) added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 57."

In accordance with the above, in the given case, X Ltd. should, at the acquisition date, recognise the acquired 'in house research project' at its acquisition-date fair value, i.e., INR 10,00,000. Subsequent expenditures by the X Ltd i.e. Research cost of INR 5,00,000 and cost of INR 2,00,000 for establishing technical feasibility should be charged to profit or loss. Costs of INR 7,00,000 incurred from the point of establishing the technological feasibility and fulfilling other criteria laid down in paragraph 57, are capitalised as those are costs incurred during development phase.

Accordingly, the gross carrying amount of the intangible asset is = INR 17,00,000 (INR 10,00,000 at time of business combination plus INR 7,00,000 as development cost incurred subsequently).

**Question 19**

Q Ltd. is a leading manufacturer of appliances. More than 80% of its revenue is derived through its network of distributors. P Ltd. acquired business from Q Ltd. (both are unrelated), on a slump sale basis which will be accounted as a business combination under Ind AS 103. As part of the acquisition, P Ltd. has also acquired a large network of distributors of Q Ltd. (which is also one of the factors of acquiring business of Q Ltd.). The said acquisition has led to P Ltd. becoming a leading player in this segment.

The knowledge and relationships of the distributors matter significantly in the industry and a new market entrant may not be able to replicate the same easily. The relationship between the entities is governed through contractual agreement which binds them to distribute its products at agreed prices. Distributors cannot market or deal with any other similar product directly or indirectly.

Whether the existing distribution network of Q Ltd, the acquiree, can be recognised as an intangible asset when accounting for acquisition of Q Ltd. appliances business by P Ltd.

**Response**

As per paragraph 21 of Ind AS 38, **"An intangible asset should only be recognised if (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and (b) the cost of the asset can be measured reliably."**

It may be noted that the Ind AS 38 follows a different approach for the recognition of intangible assets either acquired separately or in a business combination, to those intangible resources internally generated.

Further, the following paragraphs of Ind AS 38 provide guidance as follows:

"33. 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. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations. If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. Thus, the reliable measurement criterion in paragraph 21(b) is always considered to be satisfied for intangible assets acquired in business combinations.

34. In accordance with this Standard and Ind AS 103, 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. An acquiree's in-process research and development project meets the definition of an intangible asset when it:

(a) meets the definition of an asset; and

(b) is identifiable, ie is separable or arises from contractual or other legal rights.

35. If an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities that uncertainty enters into the measurement of the asset's fair value."

In accordance with the above, recognition criteria are always considered to be met for identifiable intangible assets acquired in a business combination. Accordingly, intangible assets need to be identifiable to recognise them separately from goodwill. To be identifiable, either the existence of contractual or other legal rights criterion or separability criterion should be met.

In the given case, the distribution network of Q Ltd., acquired by P Ltd., being an arrangement for the marketing of the company's product, is a non-monetary item without physical substance held for the purpose of supply of goods. The distribution network is identifiable (as it is arises from contractual rights). Further, the existence of the distribution network is a factor for the acquisition of the business. This indicates control and future economic benefits of the definition criteria.

Hence, in the given case, at the acquisition date, the distribution network acquired as part of the business acquisition should be recognised as an intangible asset separately from goodwill, at its acquisition-date fair value.

It may be noted that even if the business is acquired on slump sale basis (as in the given case), as of the acquisition date, the acquirer should recognise the identifiable assets acquired and liabilities assumed, separately from goodwill, at their acquisition-date fair values. (Paragraphs 10 and 18 of Ind AS 103). Limited exceptions to this measurement principle are given in paragraphs 24 to 31 of Ind AS 103.

**Question 20**

Entity B is in the business of operating radio stations. It operates its stations in all metro cities. Government of India in order to ensure that radio reaches to the remotest areas of the country has announced a scheme to provide license to radio operators free of cost with the condition of operating in remote areas. As per the said scheme, Entity B got a license to operate radio station in few remote areas free of cost. The license is for a period of five years. What accounting treatment should be done in this case?

**Response**

It may be noted that Ind AS 38 recognises that intangible assets can be acquired in a variety of situations or transactions. One such situation is that entities may receive a government grant in the form of an intangible asset. With regard to acquisition by way of a government grant, paragraph 44 of Ind AS 38, states that, “In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a Government grant. This may happen when a Government transfers or allocates to an entity intangible asset such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. In accordance with Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, an entity may choose to recognise both the intangible asset and the grant initially at fair value. If an entity chooses not to recognise the asset initially at fair value, the entity recognises the asset initially at a nominal amount (the other treatment permitted by Ind AS 20) plus any expenditure that is directly attributable to preparing the asset for its intended use.”

In accordance with the above and Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, an entity may choose to recognise both the intangible asset and the grant initially at fair value. If an entity chooses not to recognise the asset initially at fair value, the entity recognises the asset initially at a nominal amount. Ind AS 20 states that a non-monetary grant at fair value is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it and the grant will be received. Receipt of a grant does not, of itself, provide conclusive evidence that the conditions attached to the grant have been or will be met.

In the given case, the Government has awarded a license to operate the radio station to Entity B free of cost with the condition of operating in remote areas. Based on the above guidance, and subject to it meeting the recognition criteria for grants as per Ind AS 20, Entity B can recognise the intangible asset i.e., license either at its fair value or a nominal amount. The accounting policy should be applied consistently to all intangible assets acquired by way of a government grant.

If Entity B chooses not to recognise the asset initially at fair value, the entity will recognise the asset initially at a nominal amount plus any expenditure that is directly attributable to preparing the asset for its intended use.

**Question 21**

Y Limited, is a mobile service operator and is operating under a licence acquired from the Government, which was awarded three years ago. As per the terms of grant of license, the entity is required that by the 5th year from the date of grant of license, it should reach service coverage of at least 75% of a specific area, for which licence is granted. If the licensee is unable to meet this mandatory condition, then it may result in revocation of license besides imposition of penalties. At the end of three years after grant of license, the entity has only achieved 40% coverage in that specific area.

The Government is currently awarding new licenses for new areas for mobile services, which does not have a minimum coverage related stipulation. Besides, the existing licensees are also allowed to exchange their existing licenses with new ones as an incentive for them to continue to operate and provide much needed mobile connectivity and reach in the country.

The entity, considering the likelihood that it may not be able to meet the minimum service coverage within stipulated term in the license, decides to exchange its existing license with a new one.

How should this exchange transaction of intangible asset be accounted for?

**Response**

Paragraph 45 of Ind AS 38 states that when one or more intangible assets are acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of such an intangible asset is measured at fair values unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Further, paragraph 46 of Ind AS 38 states that, "an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction should reflect the post-tax cash flows. The result of the above analysis may be clear without performance of detailed calculations."

In the given case, the exchange transaction by the entity is undertaken due to its assessment that it is unlikely that it will be able to meet the minimum service coverage stipulation of 75% in next 2 years and it may then result in revocation of license as well as imposition of penalties by the Government. Besides, the entity intends to operate under the new license.

The exchange transaction is considered to have commercial substance as per paragraph 46(a) of Ind AS 38 as its future cash flows are expected to change as a result of this exchange transaction. This is because of the reason that it is unlikely that Y Limited would be able to meet the minimum required coverage condition (as required by original license conditions) and therefore it is likely to incur a penalty payment and could have its licence cancelled as well, if the exchange were not to take place. Thus, the new licence will result in substantial change in the risk, timing and amount of cash flows of Y Limited. There is a change in entity-specific value of the part of the entity's operations affected by the transaction as a result of the exchange and the change is likely to be significant relative to the fair value of the assets exchanged.

Therefore, the exchange transaction of intangible assets as mentioned above should be accounted for as per paragraph 45 of Ind AS 38.

**Question 22 (*Exchange involving no Commercial Substance)***

Goodtel Ltd. and Fairtel Ltd. are two chemical manufacturer companies in Area 1 and Area 2 respectively. Goodtel and Fairtel extended their respective product ranges by granting each other the right to manufacture each other's patented products in their respective areas. Goodtel Ltd. transfers right to manufacture its patented product in Area 1 to Fairtel Ltd. in exchange of right to manufacture Fairtel's patented product in Area 2. The carrying amount and fair value of Goodtel Ltd.'s patented rights in Area 1 is INR 2,20,000 and INR 240,000 and the corresponding values for Fairtel Ltd.'s patented rights in Area 2 are INR 2,25,000 and INR 240,000. The said transaction is not expected to have any significant impact on the cash flows of both the entities.

Explain the accounting treatment for the above transaction with necessary journal entries in the books of Goodtel Ltd. and Fairtel Ltd.

**Response**

Paragraph 45 of Ind AS 38 states that, "when one or more intangible assets are acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of such an intangible asset is measured at fair values unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up."

Further, paragraph 46 of Ind AS 38 states that, "an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction should reflect the post-tax cash flows. The result of the above analysis may be clear without performance of detailed calculations."

In the given case, the transaction lacks commercial substance as the company's cash flows are not expected to significantly change as a result of the exchange relative to the fair value of the assets exchanged, i.e., it is in the same position as it was before the transaction and it is presumed that for both the entities, change, if any, in the entity-specific value of the entity's operations affected by the transaction as a result of the exchange is not significant relative to the fair value of the assets exchanged. Hence, Goodtel Ltd. and Fairtel Ltd. will recognise the asset received at the carrying amount of asset given up. No Gain/Loss from this transaction should be recognised in the books of both the entities.

The following journal entry will be passed in the books of both the entities:

**Books of Goodtel Ltd.**

| Particulars | Debit (in INR) | Credit (in INR) |
|---|---|---|
| Patented rights– Area 2 | 220,000 | |
| Patented rights -Area 1 | | 220,000 |

(Being recognition of the asset received at the carrying amount of the asset given up i.e., Patented right in Area 1 i.e., 2,20,000.)

**Books of Fairtel Ltd.**

| Particulars | Debit (in INR) | Credit (in INR) |
|---|---|---|
| Patented rights – Area 1 | 2,25,000 | |
| Patented rights -Area 2 | | 225,000 |

(Being recognition of the asset received at the carrying amount of the asset given up i.e., Patented right in tower 2 at INR 2,25,000)

**Question 23 (*Exchange involving Commercial Substance)***

LMN Ltd. acquired a Patent right of manufacturing a drug from XYZ Ltd. In exchange LMN Ltd. gives its Intellectual property rights to XYZ Ltd. The said transaction is expected to have significant effect on the configuration of the cash flows and business economics of both the entities relative to the fair value of the assets exchanged. The fair value of Intellectual property rights is INR 2,00,00,000, and the fair value of patent rights is INR 2,20,00,000 but the fair value of Intellectual property rights is more reliable because an active market exists for them. If the carrying amount of Intellectual property rights in the books of LMN Ltd. is INR 1,80,00,000 and the carrying amount of patent rights in the books of XYZ Ltd. is INR 1,60,00,000, explain the accounting treatment for the above transaction with necessary journal entries in the books of both the companies.

**Response**

Paragraph 45 of Ind AS 38 states that, "when one or more intangible assets are acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of such an intangible asset is measured at fair values unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up."

Further, paragraph 46 of Ind AS 38 states that, "an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction should reflect the post-tax cash flows. The result of the above analysis may be clear without performance of detailed calculations."

Further as per paragraph 47 of Ind AS 38, fair value of the asset given up is used to measure the cost of the asset unless the fair value of the asset received is more clearly evident.

In the given case, there is commercial substance in the transaction as it is expected to have significant effect on the configuration of the cash flows and business economics of both the entities relative to the fair value of the assets exchanged. Both entities should record the asset received at the fair value of Intellectual property rights as that is more reliable than the fair value of the Patent right and the difference between this amount and the carrying amount of the asset given up should be recognised in profit or loss as gain or loss on disposal.

The following journal entry should be passed:

**LMN Ltd:**

| **Particulars** | **Debit (in INR)** | **Credit (in INR)** |
|---|---|---|
| Intangible asset (Patent rights) | 2,00,00,000 | |
| Gain on exchange of asset | | 20,00,000 |
| Intangible asset (Intellectual property rights) | | 1,80,00,000 |

(Being recognition of the asset received in exchange transaction at the fair value of the asset given up as that is more clearly evident)

**XYZ Ltd:**

| **Particulars** | **Debit (in INR)** | **Credit (in INR)** |
|---|---|---|
| Intangible asset (Intellectual property rights) | 2,00,00,000 | |
| Gain on exchange of asset | | 40,00,000 |
| Intangible asset (Patent rights) | | 1,60,00,000 |

(Being recognition of the asset received in exchange transaction at the fair value of the asset received as that is more clearly evident)

**Question 24**

Entity X holds patent for a vaccine which has a carrying amount of INR 30 lakhs. Entity X has agreed to exchange its patent for Entity Y's patent. The fair value of Entity X's patent has been assessed as INR 50 lakhs, whereas fair value of Entity Y's patent cannot be measured reliably. It is a sole exchange transaction of two intangible assets and no other form of consideration is involved in the transaction.

At what value should Entity X recognise the intangible asset? Further, whether any gain or loss arises on this transaction?

**Response**

Paragraph 45 of Ind AS 38 provides that, when one or more intangible assets are acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of such an intangible asset is measured at fair values unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Further, paragraph 46 of Ind AS 38 states that, "An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction should reflect the post-tax cash flows. The result of the above analysis may be clear without performance of detailed calculations."

Assuming that the exchange transaction has commercial substance as required by Ind AS 38, wherein entity X's timing, amount and risk of cash flows are expected to change significantly as a result of exchange of its patent for the patent of entity Y. Entity X will recognize its acquired patent as part of exchange transaction at INR 50,00,000, which is the reliably measured fair value (i.e. fair value of patent given up in exchange by entity X) since the fair value of the other asset (i.e. entity Y's patent) cannot be measured reliably. In this transaction, a gain of INR 20,00,000 arises to entity X, which should be recognised by entity X in its profit or loss. This gain of INR 20,00,000 represents the difference between the carrying amount of entity X's original patent (INR 30,00,000) and the fair value of the patent given up (INR 50,00,000) to acquire entity Y's patent.

On the other hand, if the transaction lacks commercial substance i.e., entity Y and entity X remains in the same position as they were before the exchange transaction, then in that case, entity X recognizes the patent received from entity Y at the carrying amount of patent in entity X's books (i.e. carrying amount of the asset being given up). In this case, no gain/loss would be recognized by entity X on the exchange transaction.

**Question 25**

Company A is developing a software internally, wherein all research work has been done by its in-house personnel and has been expensed in accordance with paragraphs 54 and 55 of the Ind AS 38. However, the development activities of the same are outsourced to an external software developer. Can the fee paid to the external software developer be capitalized as part of the cost of the internally generated software (i.e. intangible asset)?

**Response**

In addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies the requirements and guidance in paragraphs 52–67 to all internally generated intangible assets.

Paragraph 57 of Ind AS 38 states that:

**"An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:**

**(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.**

**(b) its intention to complete the intangible asset and use or sell it.**

**(c) its ability to use or sell the intangible asset.**

**(d) 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.**

**(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.**

**(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development."**

Further as per paragraph 66 of Ind AS 38, the cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management.

In accordance with the above, the development costs of internally generated intangible assets are capitalised when the same meet all of the above-mentioned conditions. When these conditions are not satisfied, development costs are recognised as expense when incurred.

Accordingly, in the given case, Company A needs to demonstrate whether the development expenses incurred meet the criteria of the above-mentioned paragraph 57. If the fee paid to the external software developer meets these criteria, then the same can be capitalized as part of cost of internally generated intangibles.

It may be noted that whether Company A incurs these development expenses internally or outsources the development activities to an external party, does not influence the criteria of recognising cost of an internally generated intangible asset.

**Question 26**

Company A is a pharma company and for past four years it has been working on a research project related to formulating a new drug. So far, it has spent INR 1,00,00,00 on the said research work which has been charged to the profit or loss. In the current year, approval from the government has been received to develop the same and now Company A wishes to capitalise all the past incurred expenses which were expensed off and recognised in profit and loss in the earlier years. Is the Company's contention of capitalising the previously expensed amount tenable?

**Response**

Paragraph 71 of Ind AS 38 states that, "Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date."

In accordance with the above, in the given case, expenditure on an intangible asset that was initially recognised as an expense should not be recognised as a part of the cost of an intangible asset at a later date, subsequent to getting approval from the government for the development for the same. Hence, Company A cannot capitalise INR 1,00,00,000 subsequently. Accordingly, company's contention is not tenable.

**Question 27**

Company A holds four intangible assets of similar nature and use them in its operations. Further, all of them satisfy the recognition criteria as per Ind AS 38. The Company wants to choose cost model for two of its assets and revaluation model for the other two assets. Is this permissible as per Ind AS 38?

**Response**

For measurement after initial recognition, paragraph 72 of Ind AS 38 states that, "An entity shall choose either the cost model or the 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." Further paragraph 73 of Ind AS 38 provides that a class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. The items within a class of intangible assets are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

Since in the given case, the four intangible assets are of a similar nature and use in the entity's operations, therefore, these should be grouped together as a class for the purpose of subsequent measurement. Hence, it is not permissible to choose cost model for two intangible assets and revaluation model for rest of the two assets. Further, in case Company wants to choose revaluation model as its accounting policy for all of the assets of the same class, it can do so, unless there is no active market for all or any of those assets.

**Question 28**

Company A has adopted the revaluation model for its intangible assets. Is there any defined frequency for revaluation of intangible asset under Ind AS 38?

**Response**

Paragraph 75 of Ind AS 38 provides that, 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.

Further, paragraph 79 of Ind AS 38 states that, "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. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value."

Therefore, as per the abovementioned guidance, there is no defined frequency of the revaluation of intangible assets, however revaluations need to be made regularly so that at the end of each reporting period, the carrying amount of the asset does not differ materially from its fair value. Further in case of certain intangible assets having significant volatile movements in fair value may be revalued frequently. Hence in the present case, the Company cannot choose to do revaluation at arbitrary intervals. It has to decide its accounting policy, depending upon the requirement to revalue the same, including after considering the fair value movements of the intangible assets.

**Question 29**

Company A has developed a software which has been customised as per the requirements of its business and has been capitalised as intangible asset, as the criteria set out in Ind AS 38 are met. Subsequent to capitalisation, Company A observed that one of its competitor companies of similar size and operations has entered into a contract with an external software developer to buy a similar intangible asset. The proposed purchase value of that intangible asset is much higher than its carrying amount.

Based on this negotiation of that similar intangible asset by the competitor company, can it be concluded that an active market for the said intangible asset of Company A exists and hence can it be revalued?

**Response**

Paragraph 78 of Ind AS 38 states that, "it is uncommon for an active market to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable taxi licences, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public."

Apart from the above, it may be noted that Ind AS 113, *Fair Value Measurement*, defines Active Market as "**A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an on-going basis.**"

Based on the above-mentioned guidance, an active market for the intangible asset under question may not exist. This is so because although it has been observed that one of its competitor company of similar size and operations has entered into a contract with an external software developer to buy a similar intangible asset and the proposed transaction value of that intangible asset is much higher than its carrying amount; however, the software developed by company A is customised as per its business requirements and can be characterised as unique asset. Moreover, for an active market to exist, the transactions should be more frequent and sufficient in volume. The prices should also be available to the public and should not be a matter of mere negotiation among off-market transaction of one or two entities. Therefore, the current negotiated contract is not a sufficient indicator that an active market exists for the intangible asset under question. Accordingly, the intangible asset in the given case cannot be revalued.

**Question 30**

Company A holds two intangible assets A and B. These two assets belong to same class of assets and hence in past the Company had chosen to measure these assets based on revaluation model. However, Asset A could not be revalued till date because no active market was available for it so far and hence it was carried at cost less any accumulated amortisation and any accumulated impairment losses. But now an active market exists for the same. On the other hand, Asset B was being revalued since its fair value can be measured by reference to active market so far, however, it has been currently observed that now the active market for Asset B has ceased to exist.

What should be the revised accounting treatments for both intangible assets as per Ind AS 38?

**Response**

With regard to the instant issue following paragraphs of Ind AS 38 may be noted:

**"72. An entity shall choose either the cost model in paragraph 74 or the revaluation model in paragraph 75 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."**

**"81. If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortisation and impairment losses.**

**82. If the fair value of a revalued intangible asset can no longer be measured by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation**

**by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.**

83. The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with Ind AS 36.

84. If the fair value of the asset can be measured by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date."

On the basis of the above-mentioned guidance, in the given case, Asset A which was carried initially at cost less any accumulated amortisation and impairment losses, should now, i.e., subsequently be revalued from the date from which the fair value of the asset can be measured by reference to an active market and should be carried at revalued amount less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. Asset B which was so far carried at revalued amount less any subsequent accumulated amortisation and any subsequent impairment losses, will now be carried at its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. The fact that an active market no longer exists for Asset B indicates that it may be impaired and, therefore, it needs to be tested in accordance with Ind AS 36.

**Question 31**

Company A is a manufacturing company and had purchased a particular intangible asset for INR 1,00,00,000 having useful life of 10 years. By the end of the third year, it has been amortised by INR 30,00,000 resulting in carrying value of INR 70,00,000. Though this intangible asset belongs to the class of assets being revalued; however, it could not be revalued so far since there was no active market for this asset. In the current year, it has been observed that an active market for the said asset exists now. On assessing its current fair value, it is 20% more than its carrying value, i.e. INR 84,00,000. How will Company A record the revaluation of this intangible asset in its financial statements?

**Response**

With regard to the instant case, where the entity is following revaluation model for a class of assets and for one of the assets of that class, active market was not available earlier but now it is available, paragraph 84 of Ind AS 38 may be noted:

"If the fair value of the asset can be measured by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date."

On the basis of the above-mentioned guidance, the intangible assets should now, i.e., subsequently be revalued from the date from which the fair value of the asset can be measured by reference to an active market.
According to paragraph 80 of Ind AS 38, "When an intangible asset 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:

(a) the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated amortisation 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; or

(b) the accumulated amortisation is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated amortisation forms part of the increase or decrease in the carrying amount that is accounted for in accordance with paragraphs 85 and 86."

Paragraph 85 of Ind AS 38 provides that if an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

Based on the abovementioned guidance, if the Company opts for the treatment as per option (a), then the revised carrying amount of the intangible asset will be:

Gross carrying amount INR 1,20,00,000 [(1,00,00,000/70,00,000) X 84,00,000]

Net carrying amount INR 84,00,000

Accumulated amortisation INR 36,00,000 (INR 1,20,00,000-84,00,000)

**Journal entry**

| **Particulars** | **Debit (in INR)** | **Credit (in INR)** |
|---|---|---|
| Intangible Asset (Gross Block) | 20,00,000 | |
| Accumulated amortisation | | 6,00,000 |
| Revaluation Reserve | | 14,00,000 |

(Being revaluation adjustment entry by adjusting the gross carrying amount and accumulated amortisation)

If the balance of accumulated amortisation is eliminated as per option (b), then the revised carrying amount of the intangible will be as follows:

Gross carrying amount is restated to INR 84,00,000 to reflect the fair value and Accumulated amortisation is set at zero.

**Journal entry**

| **Particulars** | **Amount (in INR)** | **Amount (in INR)** |
|---|---|---|
| (i) Accumulated amortisation | 30,00,000 | |
| Intangible Assets (Gross Block) | | 30,00,000 |

| | | |
|---|---|---|
| (Being accumulated amortisation eliminated) | | |
| (ii) Intangible Assets (Gross Block) | 14,00,000 | |
| Revaluation Reserve | | 14,00,000 |
| (Being revaluation increase recognised in revaluation reserve) | | |

**Question 32**

Company A purchased an intangible asset for INR 1,00,00,000. In the first year itself, Company A chose to revalue the same as the conditions laid down under paragraph 75 of Ind AS 38 were satisfied. Accordingly, it was revalued to INR 1,20,00,000. In the next year, based on its movement in its Fair Value in the market, Company A sold its intangible asset for INR 1,30,00,000. How will Company A record these transactions in its books?

**Response**

Paragraph 87 of Ind AS 38 states that, "The cumulative revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the entity; in such a case, the amount of the surplus realised is the difference between amortisation based on the revalued carrying amount of the asset and amortisation that would have been recognised based on the asset's historical cost. The transfer from revaluation surplus to retained earnings is not made through profit or loss."

In the first year, the Company would have recorded a revaluation surplus of INR 20,00,000 (1,20,00,000 – 1,00,00,000) and credited it to other comprehensive income with consequent increase in revaluation reserve within equity.

Based on the above-mentioned guidance, the revaluation surplus included in equity (INR 20,00,000) may be transferred directly to retained earnings and INR 10,00,000 (INR 1,30,00,000 - INR 1,20,00,000) will be shown as gain on sale of intangible asset in the profit or loss.

Note: For the purpose of simplicity, amortisation and deferred tax has been ignored.

**Question 33**

What are the factors which are required to be considered for estimating and determining the useful life by an entity while accounting for Intangible Assets?

**Response**

With regard to useful life of an intangible asset, paragraph 88 of Ind AS 38 provides that "**An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall 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.**"

The amortisation policy of the entity depends on the assessment as to whether the useful life of the asset is finite or indefinite.

As per Paragraph 90 of Ind AS 38 there are many factors which are required to be considered in determining the useful life of an intangible asset which includes the following:

- Expected usage of the asset by the entity
- Production life cycle for the asset and public information on estimates of useful life of similar asset used in a similar way
- Technological, technical, commercial or other type of obsolescence
- Industrial stability in which the asset operates and changes in market demand for products or services output from the asset
- Expected actions by competitors or potential competitors
- Level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level
- Period of control over the asset and legal or similar limits on the use of assets like expiry dates of related leases

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

Therefore, based on the above-mentioned guidance, the entity needs to consider several factors in order to determine the useful life of asset. Following are some of the practical considerations in this regard:

(i) Typical product life cycle for the asset - This could be estimated via entity's own experience with similar products, including considering useful lives disclosed in the financial statements of other entities having similar business and using similar assets.

(ii) The level of maintenance required to maintain the asset's operating capability - This could be estimated for example, by estimating advertising expenditure required to maintain the value of a trademark or brand.

(iii) The period for which the entity has control over the asset - This could include expiry dates of licences or legal restrictions.

(iv) Dependency of the asset's useful life on the useful life of other assets of the entity - This could happen in cases, for example, the use of a trademark or brand or a particular technology might cease if production of the goods represented by that trademark or brand or technology is discontinued.

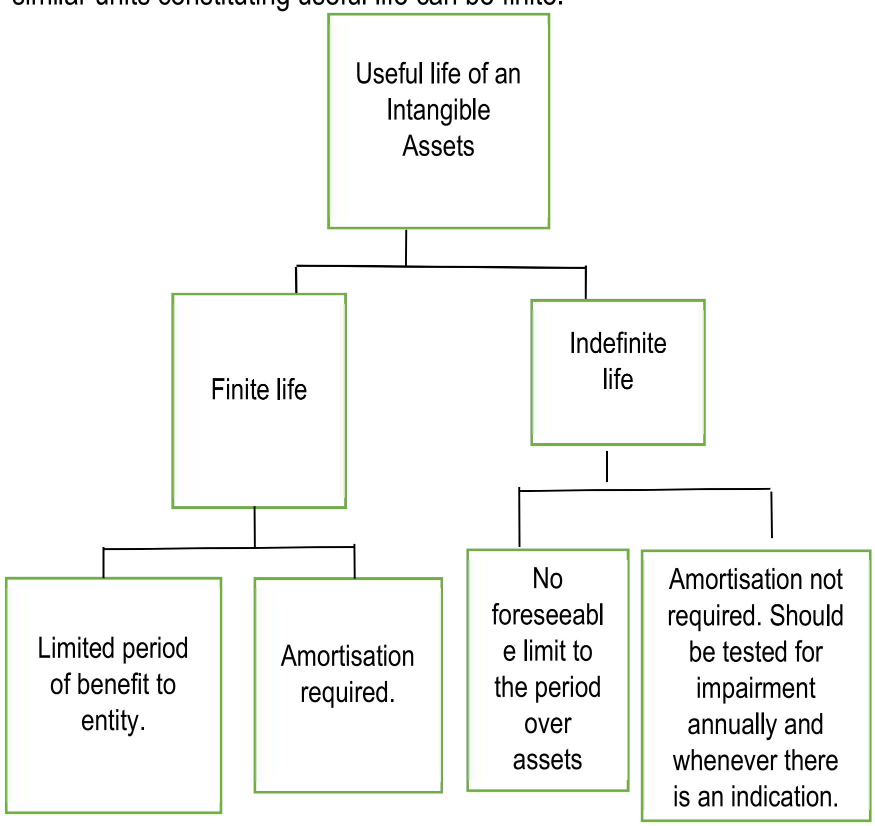
(v) Technical, technological, commercial or other types of obsolescence- New technology invention for production will affect the useful life of the existing technology.

(vi) Period of control over the asset and legal or similar limits on the use of assets These could include examples such as –
    - In case of copyright agreement, the terms of the arrangement, including restrictions of enforceability of the agreement would determine its useful life, i.e., the period over which the benefits from the agreement are derived.
    - In case of broadcasting rights that require renewal, the evidence of whether a renewal will be obtained would determine its useful life. Further, in the absence of evidence that legal rights will be renewed, useful life cannot be extended after the expiry of such rights.

The useful life of an intangible asset may be long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically or arbitrarily short and thereby the entity should first assess whether an intangible asset's useful life is finite or indefinite in accordance with the guidance in Ind AS.

**Indefinite life**: If, based on the all the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows/benefits to the entity, then intangible asset can be regarded to be having indefinite useful life (different from infinite useful life). 'Indefinite' is not the same as 'infinite'.

**Finite life**: Intangible asset can be said to have finite life when number of productions, enforceable period of agreement, the length of project or similar units constituting useful life can be finite.



**Question 34**

How the Useful Life of an Intangible Asset would be determined where in a business combination, the acquirer does not intend to actively use the same or intends to use differently than other market participants or intends to prevent others from using the intangible asset?

**Response**

As per paragraph 90 of Ind AS 38, there are many factors that are considered in determining the useful life of an intangible asset including:

(a) The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;
(b) Typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;
(c) Technical, technological, commercial or other types of obsolescence;
(d) The stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
(e) Expected actions by competitors or potential competitors;
(f) The level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;
(g) The period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
(h) Whether the useful life of the asset is dependent on the useful life of other assets of the entity.

As per paragraph 33 of Ind AS 38 and 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. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow.

Thereby, in the given situation, the acquirer has acquired the intangible assets in a business combination which it does not intend to actively use but does intend to prevent others from using. These assets would likely to contribute to an increase in the cash flows of other assets owned by the acquirer and the acquirer should measure the fair value of such non-financial asset assuming its highest and best use by market participants in accordance with the appropriate valuation premise.

The useful life of such intangible asset should reflect the entity's consumption of the expected benefits related to that asset. The benefit the acquirer receives from holding such intangible asset is the indirect cash flows resulting from the entity preventing others from realising any value from the intangible asset.

***Example***

Entity X, a consumer products manufacturer, acquires an Entity Y, that sells a product that competes with one of entity X's existing products. Entity X plans to discontinue the sale of the competing product within the next six months. Entity X intends to maintain rights to use the trade name, at minimal cost, to prevent a competitor from using it. Entity X's existing product's market share is expected to increase. Entity X does not have any current plans to re-introduce the acquired trade name in the future.

Since, entity X does not intend to actively use the acquired trade name but intends to hold the rights to the trade name to prevent its competitors from using it. Therefore, the useful life of a trade name should be the period during which Entity X intends to hold the rights to the trade name.

**Question 35**

What considerations should be evaluated while determining useful life of intangible assets as indefinite or finite? Kindly elaborate the same along with examples.

**Response**

The useful life of an intangible asset plays an important in its subsequent measurement. Paragraph 88 of Ind AS 38 states that "**An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall 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."**

Paragraph 91 of Ind AS 38 states – "The term 'indefinite' does not mean 'infinite'. The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance."

Accordingly, an intangible asset's useful life is regarded indefinite in accordance with Ind AS 38 only when, based on an analysis of all 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.

To be classified as an indefinite life intangible asset, it will require business, industry and products with a stable track record and high restrictions/barriers to market entry. Additionally, a commitment of management to stay invested for the long period of term to extending to a period over which the intangible asset is expected to provide economic benefits continuously.

Paragraph 94 of Ind AS 38 states that, " **The useful life of an intangible asset that 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. If the contractual or other legal rights are conveyed for a**

**limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods"**

The useful Life of an Intangible Asset that arises from Contractual or other Legal Rights shall be the least of the following:

(a) Period over which the Entity expects to use the Asset or Period over which future economic benefits will be received by the entity

(b) Period of the Contractual or other Legal Rights, i.e. period over which the Entity controls access to these benefits.

In case such rights are given for limited terms but may be renewed, such renewal should be considered in determining useful life of such rights if there is evidence to support that renewals can be obtained without any significant costs. Paragraph 96 of Ind AS 38 specifies the factors that indicate that such rights could be renewed without significant costs.

Also, if contract can be renewed every time by giving a nominal amount and renewal is expected with certainty then useful life of the intangible asset can be indefinite.

Indefinite lives are more justifiable with established brands that have historically demonstrated ability to absorb changes and survive. On the other hand, finite lives are more appropriate for other brands that are relatively new, that depend on an individual's reputation (e.g. a movie star) or that operate in more volatile sectors, where they are more likely to be affected by frequent changes (e.g. Technology or Fashion sector).

As required by paragraph 109 of Ind AS 38, intangible assets with indefinite life should be reviewed at each period, to confirm whether events and circumstances still support the indefinite useful life assessment.  If not, the change from the indefinite to finite useful life should be accounted for as a 'change in accounting estimate'.

Example: X Ltd had acquired a brand from Y Ltd for INR 50,00,00,000. X Ltd contends that since the said brand is very famous, the Company does not need to provide any amortization on the same.

In the given situation, if on the basis of the analysis of the factors stated above, it can be construed that there is no foreseeable limit to the period over which the asset is expected to generate net cash flows for the entity, it can be regarded as an intangible asset with indefinite life. Accordingly, the same should not be amortised. However, it should be tested for impairment in accordance with guidance in paragraph 108 of Ind AS 38.

**Question 36**

ABC Co limited acquired broadcasting rights that would expire in 10 years. The licence can be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition and the licence is expected to contribute to ABC Co's net cash flows indefinitely. Historically, there has been no compelling challenge to the licence renewal. For these reasons, the ABC Co has assessed the same to have an indefinite useful life.

Whether the assessment of the company to consider the life for broadcasting rights for an indefinite period is appropriate?

**Response**

With regard to instant issue, following paragraphs of Ind AS 38 may be noted:

"88 An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall 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."

"**94 The useful life of an intangible asset that 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. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.**"

Based on the facts provided in the question and the guidance mentioned above, the acquired licence is expected to contribute to the entity's net cash inflows indefinitely. Therefore, the useful life of the intangible asset under question would be treated as indefinite. Further, in accordance with paragraphs 107-110 of Ind AS 38, the same would not be amortised until its useful life is determined to be finite.

Further, paragraph 108 of Ind AS 38 states that, "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."

Accordingly, the license should be tested for impairment in accordance with Ind AS 36 and may be subject to impairment.

**Question 37**

What is the useful life of intangible assets that arise from contractual or other legal rights?

**Response**

Paragraph 94 of Ind AS 38 states that, "**The useful life of an intangible asset that 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. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.**"

Hence, the useful life of an intangible asset that arises from contractual or other legal rights should not exceed the period of contractual or other legal rights but may be shorter depending on the period over which the entity expects to use the asset.

Though, the Contractual or legal rights are often granted for a finite period, however, the useful life of the related intangible asset can extend beyond that period only if the legal rights are renewable and there is evidence to support the renewal by the entity without incurring significant cost.

It may be noted that useful life of a reacquired right recognised as an intangible asset in a business combination (for example a right to use the technology acquired by the acquiree under a technology licensing agreement ) is the remaining contractual period of the contract in which the right was granted and should not include renewal periods.

**Question 38**

An entity acquires a copyright that has a remaining legal life of 50 years. The entity determines that the copyright will generate economic benefits for 30 years only. What period should be considered for amortisation when legal life of copyright is in excess of its economic life?

**Response**

Paragraph 95 of Ind AS 38 states that "There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors."

In view of the above, determination of useful life of an intangible asset can be influenced by both economic and legal factors. In the given case, considering the economic factor, i.e., the entity determines that the copyright will generate economic benefits for 30 years only, useful life of the intangible asset is limited to 30 years. Although, legally the copyright is available with the entity for 50 years, but useful life should be shorter of the periods determined using economic and legal factors, which is 30 years in the instant case. This is so because the entity will not use the asset after 30 years and no future economic benefits are expected to be received by the entity beyond 30 years. Therefore, the entity shall amortise the copyright over 30 years.

**Question 39**

Company A is engaged in manufacturing of Tobacco products in India and it has requisite license & other production rights for production of tobacco in India for 10 years period. The licence may be renewed indefinitely at little cost and has been renewed in the past. Company A intends to renew the licence indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the licence renewal. Therefore, Company A has assessed the useful life of the tobacco license as indefinite. During the current year, a government policy has been announced to ban tobacco products after a period of 2 years. Company A reviews useful life of its assets at each financial year end and has continued to conclude the useful life of its tobacco license as indefinite.

Is the approach of Company A correct in respect of assessment of useful life of its tobacco license?

**Response**

In the given case, based on facts Company A was considering the useful life for its tobacco license as indefinite.

With regard to amortisation of intangible assets with indefinite useful lives and review of useful life assessment, the following paragraphs of Ind AS 38 may be noted:

**"107. An intangible asset with an indefinite useful life shall not be amortised.**

108. 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..

**Review of useful life assessment**

**109. The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.**

110. In accordance with Ind AS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with Ind AS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss."

In accordance with the above, in the given case, due to announcement of banning tobacco products by the Government after a period of 2 years, the Company should review the useful life of the intangible asset i.e. Tobacco Licence, which should now be remaining useful life of 2 years during which the license can be used. Further, a change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.

Thus, the tobacco licence should be amortised over its remaining useful life and immediately tested for impairment in accordance with Ind AS 36.

**Question 40**

At the time of the business combination, acquirer expected to continue producing the same line of products which the acquiree had been producing for over 35 years who had developed many new models under the trademark.

At the time of acquisition, the analysis of various economic factors indicated there was no limit to the period over which the trademark would contribute to net cash inflows of the acquirer. Therefore, the trademark was not amortised by the acquirer and considered having an indefinite life. However, management has recently decided that production of the product line will be discontinued over the next four years.

How will be the trademark now be accounted?

**Response**

Paragraph 109 of Ind AS 38 states that, "**The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.**"

Further paragraph 110 of Ind AS 38 states that, "In accordance with Ind AS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with Ind AS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss."

Since in the given case, the management has taken the decision to shut down the product line in next four years and no future economic benefits are expected from the trademark thereafter, the useful life of the acquired trademark is no longer regarded as indefinite. Thereby, the carrying amount of the trademark would be tested for impairment in accordance with Ind AS 36 and would be written down to recoverable amount if there is any impairment, and the carrying amount of the trademark would then be amortised over its remaining four-years useful life.

**Question 41**

A leading media company was awarded rights to telecast an annual sports event for the next ten years. The company estimates an incremental revenue over the next ten years. During the seventh year of the continuation of the rights, the government brings out a new policy requiring all media companies to rebid for the rights and cancelled the existing rights. How should the company account for the rights in the 7$^{th}$ year in which there is change in government policy .

**Response**

As per Ind AS 38, the company would initially estimate the pattern of benefits accruing and amortise the value of the rights over a straightline basis or any other suitable method refelecting the pattern of derivation of the benefits over the period of ten years.

Accordingly, in the given case, as per Ind AS 38, the company should amortise the rights over the useful life, which was originally determined as 10 years

With regard to cancellation of the existing rights in seventh year, following paragraph of Ind AS 38 may be noted:

**"112. An intangible asset shall be derecognised:**

**(a) on disposal; or**

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

**113. The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised (unless Ind AS 116 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue."**

In view of the above, since the rights have been cancelled by the government in the 7th year and no future economic benefits are expected from its use or disposal, hence the same should be derecognised in the 7th year and the carrying amount of the rights shall be charged to the profit and loss.

**Question 42**

How the renewal cost of the intangible asset should be accounted for in the books of accounts?

**Response**

Paragraph 18 of Ind AS 38 states that "The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

(a) the definition of an intangible asset (see paragraphs 8–17); and

(b) the recognition criteria (see paragraphs 21–23).

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it."

Paragraph 96 of Ind AS 38 states that, "Existence of the following factors, among others, indicates that an entity would be able to renew the contractual or other legal rights without significant cost:

(a) There is evidence, possibly based on experience, that the contractual or other legal rights will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;

(b) There is evidence that any conditions necessary to obtain renewal will be satisfied; and

(c) The cost to the entity of renewal is not significant when compared with the future economic benefits expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits expected to flow to the entity from renewal, the 'renewal' cost represents, in substance, the cost to acquire a new intangible asset at the renewal date."

Based on the above, where the renewal cost is significant, then it should be capitalised as a new intangible asset, if the recognition criteria are met and the carrying amount of the replaced intangible asset should be fully amortised by the renewal date.

**Question 43**

What are the key considerations for selection of amortisation method for intangible assets with finite life?

**Response**

Paragraph 97 of Ind AS states that– "**The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105 and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be**

**determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset."**

Paragraph 98 of Ind AS 38 states that *"A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits."*

Further, as per Paragraph 98A of Ind AS 38, there is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. However, this presumption can be overcome only in the limited circumstances.

Paragraph 98B of Ind AS 38 provides that in choosing an appropriate amortisation method the predominant limiting factor that is inherent in the intangible asset needs to be determined.

On the basis the aforesaid guidance, it can be said that the amortisation method is selected based on the expected pattern of consumption of future economic benefits from an intangible asset. If that pattern cannot be reliably determined, straight-line method should be used.

For example, the straight-line method will often be the most appropriate method to use if the consumption of future economic benefits is through the passage of time (like in case of patents and licences that operate for a fixed number of years). The unit of production method is likely to be the most appropriate method if the consumption of future economic benefits is through usage or production (for example, when minerals are extracted). The amortisation method used depends on the entity's expectation of consumption of economic benefits from the asset and the entity's ability to reliably measure the asset's expected usage or production.

In limited circumstances where revenue is established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue can be an appropriate basis for amortisation.

**Question 44**

XYZ Ltd. in need of increasing its productivity, imported a machinery for INR 50,00,000. The company also purchased its Technical know-how and paid INR 30,00,000 as consideration for it. Useful life of the machine is expected to be 20 years and that of Technical know-how is 10 years, which is further renewable for 5 years without significant cost. Since, the Technical know-how is purchased particularly for the machine; XYZ ltd. amortized the Technical know-how over the life of underlying asset, i.e., over the useful life of machine. Is this an appropriate accounting treatment?

**Response**

Paragraph 94 of Ind AS 38 inter-alia states that, "**The useful life of an intangible asset that 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. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost……….**"

Further, Paragraph 97 of Ind AS 38 inter-alia states that, "**The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management…**………."

In accordance with the above, an intangible asset should be amortised over a period which is shorter of its useful life or the period during which the entity expects to use the asset which in the instant case can relate to the life of underlying asset. Technical know-how falls under the definition of an intangible asset as per Ind AS 38 and its useful life is also determinable applying the principles of Ind AS 38 to the facts of the case. In the instant case, the entity has legal right over technical knowhow for 10 years, which can be renewed for next 5 years without significant cost. Therefore, subject to fulfillment of conditions laid down in paragraph 94 above, it can be concluded that XYZ Ltd. has legal right over the technical know-how for 15 years. Therefore, the useful life of this technical know-how i.e., intangible asset can be 15 years considering the fact that the entity has a related tangible asset with higher estimated useful life. However, its useful life cannot exceed its legal or contractual right regardless of the fact that a related tangible asset is estimated to have a longer useful life. The entity will amortise the Technical know-how over the shorter of the two, i.e. it will amortize such intangible asset over a period of 15 years if conditions provided in paragraph 94 are complied with. The entity may also need to reconsider its estimation of useful life of the machinery longer than the useful life of a related intangible asset.

The appropriateness of depreciating the machinery over an estimated useful life greater than the period for which underlying technology is available should be examined independently basis guidance under Ind AS 16.

**Question 45**

What are the factors which are required to be considered in determining residual value?

**Response**

Paragraph 100 of Ind AS 38 states that, "The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market (as defined in Ind AS 113) 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."

Further, paragraph 102 of Ind AS 38 provides that an estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used.

The residual value is based on current prices at the date when the estimate of residual value is made and does not take into account the expected future inflation after the date when the estimate is made.

However, if a third party has committed to buy the asset at the end of its useful life, its residual value would be the amount payable by the third party, adjusted to exclude future inflation.

**Question 46**

Whether there is any requirement to review residual value of the intangible asset after initial recognition? How should the change in the residual value of an intangible asset be accounted in accordance with Ind AS 38?

**Response**

With regard to residual value, following paragraphs of Ind AS 38 may be noted:

**"100. The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:**

- **(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or**
- **(b) there is an active market (as defined in Ind AS 113) 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."**

"102. An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with Ind AS 8, Accounting *Policies, Changes in Accounting Estimates and Errors*."

"103. The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortisation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount."

Accordingly, the residual value of an intangible asset should be reviewed at each financial year-end and if it differs from previous estimate, it should be changed. The change should be accounted for as a change in an accounting estimate.

**Question 47**

An entity has an intangible asset in the form of a product protected by patented technology which is expected to be a source of net cash inflows for at least 15 years. The entity has a commitment from a third party to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in five years. Company is amortising the asset in 15 years considering its residual value to be Zero. Whether the accounting treatment done by the Company is in accordance with Ind AS 38?

**Response**

In order to determine the amortisation of the intangible asset in the instant case, which has finite useful life, two elements need to be determined; useful life and residual value.

**Useful life is defined as:**

**(a) the period over which an asset is expected to be available for use by an entity; or**

**(b) the number of production or similar units expected to be obtained from the asset by an entity.**

In the instant case, since the entity expects that the asset will be available for use by it for the period of 5 years and thereafter it will be transferred, the useful life of the asset is 5 years.

With regard to residual value, following paragraphs of Ind AS 38 may be noted:

***"*100. The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:**

**(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or**

**(b) there is an active market (as defined in Ind AS 113) 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.**

101. The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.

102. An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used………"

In view of the above, the depreciable amount of the patent will be determined after deducting the residual value, which is 60 per cent of its fair value at the date of its acquisition. Accordingly, the patent will be amortised over its useful life of 5 years, with a residual value equal to 60 per cent of its fair value at the date of its acquisition. The patent will also be reviewed for impairment in accordance with Ind AS 36. Therefore, the accounting policy of amortising the asset over a period of 15 years considering its residual value of Zero is not in accordance with Ind AS 38.

**Question 48**

For the intangible assets with finite useful life, whether the amortisation period and amortisation method be reviewed periodically by an entity. If yes, what should be the period?

**Response**

Paragraph 104 of Ind AS 38 states that, "**The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with Ind AS 8.**"

Accordingly, the amortisation period and amortisation method should be reviewed at least at each financial year end.

**Question 49**

What are the underlying conditions for de-recognition of capitalised expenditure on intangible asset?

**Response**

Paragraph 112 of Ind AS 38 states that, ***"*An intangible asset shall be derecognised:**

**(a) On disposal; or**

**(b) When no future economic benefits are expected from its use or disposal.*"***

Example: An entity is developing a new IT system that met the recognition criteria for capitalisation as an internally generated intangible asset in the previous year. Now in the current year, entity's management decides to terminate the development of the aforesaid IT system. As a result of this, the entity cancels the contract to develop the IT system and terminates the staff members who were involved in the development of that project. Also, the partially completed IT system would have no alternative use and no residual value.

Therefore, the entity should de-recognise the asset in the current year as no future economic benefits are expected from its use or disposal and charge it to profit and loss.

## Appendix I

***Note: The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 38, Intangible Assets and Accounting Standard (AS) 26, Intangible Assets***

**Major differences between Ind AS 38, Intangible Assets and AS 26, Intangible Assets**

(i) AS 26 (paragraph 5) does not apply to accounting issues of specialised nature that arise in respect of accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares. Ind AS 38 does not include any such exclusion specifically as these are covered by other accounting standards.

Ind AS 38 contains scope exclusion with regard to the amortisation method to entities that opt to amortise intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

(ii) AS 26 defines an intangible asset as 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 whereas in Ind AS 38, the requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative purposes has been removed from the definition of an intangible asset. (Paragraph 8 of Ind AS 38 )

(iii) AS does not define 'identifiability', but states that an intangible asset could be distinguished from goodwill if the asset was separable, but separability is not a necessary condition for identifiability. Ind AS 38 requires an asset to be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable, or when it 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. As per Ind AS 38, in the case of separately acquired intangibles, the criterion of probable inflow of expected future economic benefits is always considered satisfied, even if there is uncertainty about the timing or the amount of the inflow. However, there is no such provision in AS 26. (Paragraph 25 of Ind AS 38)

(iv) In Ind AS 38, there is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. Ind AS 38 allows use of revenue based method of amortisation of intangible asset, in a limited way. AS 26 does not specifically deal with revenue based amortisation method.

(v) Under Ind AS 38, if payment for an intangible asset is deferred beyond normal credit terms, the difference between cash price equivalent and the total payments is recognised as interest expense over the period of credit unless it is capitalised as per Ind AS 23. However, there is no such provision in AS 26. (Paragraph 32 of Ind AS 38)

(vi) Ind AS 38 deals in detail with intangible assets acquired in a business combination. On the other hand, AS 26 refers only to intangible assets acquired in an amalgamation in the nature of purchase and does not refer to business combinations as a whole.

(vii) AS 26 is silent regarding the treatment of subsequent expenditure on an in-process research and development project acquired in a business combination whereas Ind AS 38 gives guidance for the treatment of such expenditure. (Paragraphs 42 and 43 of Ind AS 38)

(viii) As per Ind AS 38, when intangible assets are acquired free of charge or for nominal consideration by way of government grant, an entity should, in accordance with Ind AS 20, record both the grant and the intangible asset at fair value or alternatively, at nominal amount plus any expenditure that is attributable to preparing the asset for its intended use. As per AS 26, intangible assets acquired free of charge or for nominal consideration by way of government grant is recognised at nominal value or at acquisition cost, as appropriate plus any expenditure that is attributable to making the asset ready for intended use.(Paragraph

33 of AS 26 and paragraph 44 of Ind AS 38)

(ix) AS 26 is based on the assumption that the useful life of an intangible asset is always finite, and includes a rebuttable presumption that the useful life cannot exceed ten years from the date the asset is available for use. That rebuttable presumption is not there in Ind AS 38. Further, Ind AS 38 recognizes that the useful life of an intangible asset can even be indefinite subject to fulfilment of certain conditions, in which case it should not be amortised but should be tested for impairment.

(x) In Ind AS 38, guidance is available on cessation of capitalisation of expenditure (Paragraph 30 of Ind AS 38), de-recognition of a part of an intangible asset (Paragraph 115 of Ind AS 38) and useful life of a reacquired right in a business combination (Paragraph 94 of Ind AS 38). There is no such guidance in AS 26 on these aspects.

(xi) Ind AS 38 permits an entity to choose either the cost model or the revaluation model as its accounting policy, whereas in AS 26, revaluation model is not permitted.

(xii) Ind AS 38 provides more guidance on recognition of intangible items recognised as expense. Ind AS 38 clarifies that in respect of prepaid expenses, recognition of an asset would be permitted only upto the point at which the entity has the right to access the goods or upto the receipt of services. Further, unlike AS 26, mail order catalogues have been specifically identified as a form of advertising and promotional activities which are required to be expensed.

(xiii) As per AS 26 (Paragraph 73), there will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under straight-line method. Ind AS 38 does not contain any such provision.

(xiv) Under Ind AS 38, the residual value is reviewed at least at each financial year-end. If it increases to an amount equal to or greater than the asset's carrying amount, amortisation charge is zero unless the residual value subsequently decreases to an amount below the asset's carrying amount. However, AS 26 specifically requires that the residual value is not subsequently increased for changes in prices or value. (Paragraph 77 of AS 26)

(xv) Ind AS 38 also requires certain additional disclosures as compared to AS 26.

(xvi) Intangible assets retired from use and held for sale are covered by the AS 26. However, Ind AS 38 does not include such intangible assets since they would be covered by Ind AS 105.

## Appendix II

***Note: The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 38, Intangible Assets and the corresponding International Accounting Standard (IAS) 38, Intangible Assets issued by the International Accounting Standards Board.***

### Major differences between Ind AS 38, *Intangible Assets* and IAS 38, *Intangible Assets*

There is only one difference between the two standards as mentioned below:

Paragraph 7AA has been inserted in Ind AS 38 to scope out the entity that opts to amortise the intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period as provided in paragraph D22 of Appendix D to Ind AS 101.