MCM-505
ACCOUNTING THEORY & PRACTICES
UNIT-15 ACCOUNTING FOR INTANGIBLES
(M. COM. SECOND SEMESTER)

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INTANGIBLE ASSETS

- Intangible assets are, to repeat, expenditures that result in the acquisition of special rights, claims and privileges, which indirectly contribute to the earning of the business over its useful life. As intangible assets are abstract, they are governed, as to their character, nature, usefulness and tenure by legislations specially enacted. These regulations provide for rights and responsibilities of the users of the rights, claims and privileges. Common examples of intangible assets are patents, designs, trademarks, copyrights, technical know-how, franchises and goodwill.
- **Patents**
- **Designs**
- **Trademarks**
- **Copyrights**
- **Technical Know-how**
- **Franchises**
- **Fictitious Assets**
- **Goodwill**

USEFUL LIFE OF INTANGIBLE ASSET

- The maximum useful lives of intangibles assets are restricted by the regulations that govern them. For example, patents have a useful life of 14 years. Hence the cost of patent should be written off within 14 years. The period of 14 years commences from the time of its registration. Thus, if a patent is acquired by another business after 4 years of its registration, the useful residual life is 10 years for the acquire. In the event of the ability of the patent to generate income is lost during its useful life, due to development of better products or processes, it becomes obsolete and the entire amount outstanding has to be written off in that year itself.

VALUATION OF GOODWILL

- The valuation of goodwill is on a different footing than other intangible assets. Discernible resources are not expended in developing goodwill. Goodwill is the quantification of the entrepreneurial excellence and it is highly subjective. Goodwill remains dormant and its value is not presented in the books of the business till any change in the structure of the business is anticipated. In the case of sole trading business, it is brought into the books at the time of change in ownership of the business. When the sole trader sells his business to another or when he admits another as a partner into the business, he wants to crystallize the efforts he had taken in the past to create the name for the business. He, therefore, values the goodwill and takes it as part of his capital. In this respect, goodwill reflects the valuation of the qualitative inputs of the businessman to shape the business to its present status.

- **Multiples of Profit/Turnover Method**
- **Capitalization of Expected Returns Method**
- **PV of Super Profit Method**

TREATMENT OF GOODWILL

- Once goodwill is created, it will be shown as an intangible asset. As a portion of assets is written off annually, notionally representing their contribution to the earning of revenue of that year, it is logical that goodwill too has to be written off. However, there is a difference between other assets (both tangible and intangible) and goodwill. Other assets have a cost, either cost of development by the business or by the seller. But, goodwill is created by the business without incurring any monetary cost. Hence, tax authorities do not allow the writing off of goodwill as an allowable cost.
- *To retain the goodwill at its full value till a reduction or amortization is desired,*
- *To retain the cost as an asset and to amortize a portion over an assumed life period. (Goodwill can be written off within forty years of its creation)*
- *To reduce the value of goodwill from the equity of the owners.*

FEW MODERN BREEDS OF INTANGIBLES

- Intellectual Capital
- Human Resource as an Asset
- Brand Names

SUMMARY

- This is the concluding chapter on the steps a business has to take, before actually undertaking the preparation of final accounts. Most of the intangible assets, although do not have physical existence, are created or purchased by utilizing the resources of the business. They represent expenditures, which contribute to the earning of the business during their useful life. These expenditures are treated on par with tangible assets in balance sheet. Patents, designs, trademarks, technical know-how, copyrights, franchises and goodwill are all examples of intangible assets that contribute directly or indirectly to the earning of the business.
- Intangible assets are valued at the cost at which they are created or acquired. Should the cost of creation or acquisition be insignificant, they are written off as revenue expenses in the year in which the cost was incurred. However, when the amount spent is quite large and the writing off the entire expenditure in the year of occurrence will distort the operational results of the business, these expenditures are capitalized and written off according to assumed proportion of their contribution to the earning capacity of the business.

References

- SILM developed by Uttarakhand Open University for MCM-505 (Accounting Theory and Practices), Year 2017,