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FACILITATOR

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#### PROFESSIONAL PROFILE

- ▶ Amit Garg is a Fellow Chartered accountant and leads the Audit and Assurance practice in his firm RNBP & Co. .
- ▶ 20+ years of professional experience in Assurance & Advisory Services; previously with **S.R. Batliboi & Co. LLP** (EY member firm) for over 12 years in Audit & Assurance.
- ▶ Extensive experience in **IFRS, Ind AS, IGAAP**, Ind AS implementation, ICFR, SOX Testing, Business Process re-engineering, statutory audits, tax audits, Capital Market transactions and due diligence.
- ▶ Faculty for IFRS / Ind AS courses at **ICAI, Indian Corporate Law Service Academy (MCA) and Delhi University**. Corporate trainer on Ind AS and IFRS.
- ▶ **Developed and launched FinSoEasy360** — financial reporting software that generates Schedule III compliant Ind AS / AS standalone and consolidated financial statements along with related-party auto-elimination entries, lease accounting and dashboard reports. ([www.finsensor.ai](http://www.finsensor.ai))

REFRESHER COURSE ON ACCOUNTING STANDARDS

# AS 26

## *Intangible Assets*

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A deep-dive workshop for Chartered Accountants — recognition, research vs development, amortisation, useful life, and contentious judgement areas

BY AMIT GARG

# What we will cover

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- 1 Scope & regulatory context
- 2 Definition — identifiability, control, future benefits
- 3 Recognition criteria — the twin tests
- 4 Separate acquisition, business combination, exchange
- 5 Research vs Development — the critical fork
- 6 Six capitalisation conditions for development
- 7 Cost of internally generated intangibles
- 8 Amortisation — the 10-year rebuttable presumption
- 9 Useful life, residual value, review
- 10 Nuance: Website development costs
- 11 Nuance: Software — internal use vs sold externally
- 12 Audit pitfalls & disclosure requirements
- Q & A

# Scope, regulatory context & who must apply



## Notified in 2002 — effective 1-Apr-2003

AS 26 was issued by ICAI in 2002 and is notified under the Companies (Accounting Standards) Rules, 2021. Applies to enterprises following Indian GAAP — Ind AS 38 applies to Ind AS reporting entities. One of the longest-standing ICAI standards without major revision — but its content remains sharply tested in audit practice.



## Carved out of scope

Intangibles covered by other standards (financial assets, mineral rights, exploration of non-regenerative resources, policyholder contracts in insurance), termination benefit obligations, goodwill arising in amalgamation (AS 14), leases (AS 19).



## Interplay with other standards

Interacts with AS 28 (Impairment) — especially for assets with indefinite or very long useful lives and those not yet in use. AS 14 handles goodwill on amalgamation separately. AS 10 handles PPE with embedded intangible content (e.g., software inseparable from hardware).

### REAL-LIFE

## The "Intangible" Dilemma

AS 26 is the hardest AS to audit because judgement pervades every decision:

- Is the item identifiable?
- Is control demonstrated?
- Are future benefits probable?
- Has the research phase ended?
- Can cost be attributed reliably?

Six judgement gates before a single rupee is capitalised.

## DEFINITION

# Three simultaneous tests — all must be met

*Para 6 — An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.*



### Identifiability

Distinguishable from goodwill. An asset is identifiable if it can be separated (sold, transferred, licensed) OR arises from contractual / legal rights — even if not separable from the entity.

#### EXAMPLE

*Brand 'XYZ' acquired in a BTA: separable → identifiable.  
Goodwill = residual.*



### Control

Power to obtain future economic benefits AND to restrict access of others to those benefits. Usually secured through legal rights (patents, copyright, licences). Staff know-how without non-compete clauses = usually NOT controlled.

#### EXAMPLE

*Trained research team — expertise walks out with employees. No control → not an asset.*



### Future benefits

Revenue from sale of products / services, cost savings, or other economic benefits from use of the asset. Probable inflow, supported by reasonable assumptions about economic conditions.

#### EXAMPLE

*Software licence expected to reduce IT costs by ₹50 L p.a. over 5 years → benefits probable.*

## RECOGNITION

# Twin tests — applied every time

*Para 20-21: An intangible asset should be recognised if, and only if, BOTH conditions are met. This applies to purchased AND internally generated intangibles.*



### Condition 1 — Probable future benefits

It is probable that future economic benefits attributable to the asset will flow to the enterprise. Assessment uses reasonable, supportable assumptions and external evidence where possible.

#### PRACTICAL EXAMPLE

*Patent for a novel drug — market research + regulatory trials evidence flow of benefits. Goodwill on trial — benefits speculative; doesn't qualify.*



### Condition 2 — Cost measurable reliably

The cost of the asset can be measured reliably. Purchase cost is straightforward; internally generated cost requires a robust costing system capturing direct and allocable expenditure.

#### PRACTICAL EXAMPLE

*Software development — labour time-sheets + server allocation + consultant fees tracked to project code. Without code-level tracking, reliability fails.*

# How intangibles enter the balance sheet



## Separate acquisition

Purchase for cash or equivalent. Cost = purchase price + directly attributable costs (legal fees, registration, testing for intended use). Simple recognition — criteria are typically satisfied automatically by virtue of payment.



## Business combination / amalgamation

Acquired as part of an amalgamation under AS 14 — recognised at fair value on acquisition date, separately from goodwill IF identifiable. Brands, customer relationships, non-compete covenants, in-process R&D commonly surface here.



## Exchange of assets

Acquired in exchange for another asset — measure at FV of asset given up UNLESS exchange lacks commercial substance or neither FV is reliably measurable (then use carrying amount). Same logic as AS 10.



## Internally generated

Self-created through research + development activities. Most restrictive route — strict additional conditions apply (Slide 9). Historically the biggest area of audit dispute because of the judgement involved.



**The route matters:** A brand purchased in a BTA appears on the balance sheet; the same brand if internally generated does NOT (Para 50). Same asset, different accounting.

# Research vs Development phases

For an internally generated intangible, the enterprise MUST distinguish between Research phase and Development phase. If it cannot distinguish, all costs are treated as Research — i.e., expensed. This is the single most important determination in AS 26.



## RESEARCH PHASE

*Expense — always*

**Para 41:** Original planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

**Indicators:**

- Activities aimed at obtaining new knowledge
- Search for alternatives for materials, systems, processes
- Formulation of possible alternatives, design, evaluation



## DEVELOPMENT PHASE

*Capitalise — if 6 conditions met (Slide 9)*

**Para 44:** Application of research findings or other knowledge to a plan or design for the production of new or substantially improved products / processes prior to commercial production.

**Indicators:**

- Design, construction & testing of pre-production prototypes
- Design of pilot plants not at commercial scale
- Design & construction of tools, jigs, moulds for new technology

## Six conditions — all must be met

*Para 44: Development expenditure is capitalised as an intangible asset if — and only if — the enterprise can demonstrate ALL six of the following. Miss one, expense the lot.*

<b>(a)</b>	<b>Technical feasibility</b> The technical feasibility of completing the asset so that it will be available for use or sale.	<b>(b)</b>	<b>Intention to complete</b> The enterprise's intention to complete the intangible asset and use or sell it.	<b>(c)</b>	<b>Ability to use / sell</b> The ability to use or sell the intangible asset.
<b>(d)</b>	<b>Probable future benefits</b> How the intangible will generate probable future economic benefits — existence of a market, usefulness, if for internal use.	<b>(e)</b>	<b>Availability of resources</b> The availability of adequate technical, financial, and other resources to complete the development.	<b>(f)</b>	<b>Reliably measurable cost</b> The ability to measure reliably the expenditure attributable to the intangible asset during its development.

## MEASUREMENT

# Cost of internally generated intangibles

*Para 53-54: Cost includes ONLY expenditure incurred FROM the date recognition criteria are met. Pre-recognition expenditure stays expensed — no reinstatement allowed (Para 58).*

### INCLUDED IN COST (Para 53)

- **Materials & services** used or consumed in generating the asset
- **Salaries, wages & employment costs** of personnel directly engaged
- **Directly attributable expenditure** (legal registration, amortisation of patents / licences used to generate the asset)
- **Overheads allocated on reasonable basis** (e.g., depreciation of R&D building, rent)
- **Borrowing costs** per AS 16 if qualifying asset

### EXCLUDED FROM COST (Para 54)

- **Selling, administrative & general overheads** not directly attributable
- **Inefficiencies & initial operating losses** before asset achieves planned performance
- **Training staff** to operate the asset
- **Internally generated goodwill** (Para 35)
- **Internally generated brands, mastheads, publishing titles, customer lists** (Para 50)

# The 10-year rebuttable presumption

## CORE PRINCIPLE (Para 63)

Depreciable amount should be allocated on a systematic basis over the best estimate of the asset's useful life. There is a **REBUTTABLE PRESUMPTION** that useful life will not exceed ten years from the date the asset is available for use. The presumption can be rebutted only with persuasive evidence. Amortisation begins when the asset is available for use.



### Method of amortisation

SLM presumed unless another method better reflects pattern of consumption. Method must be consistent — change is a change in estimate (AS 5).



### Residual value

Presumed ZERO — unless (a) third party commits to buy at end of useful life, or (b) active market exists that will still exist at end of life.



### Review requirements

Useful life and amortisation method reviewed at least at each financial year-end. If useful life > 10 yrs OR asset not yet in use, annual impairment test per AS 28.

# Factors to consider & rebutting the 10-year cap

Para 64 lists 8 factors to assess useful life. Think demand, obsolescence, legal-life, stability of industry, competitor activity, maintenance expenditure, product life cycles, dependencies on other assets.

## WHEN REBUTTAL WORKS

### Hydroelectric generation right — 60 years

**Facts:** Exclusive right to generate hydroelectric power for 60 years, granted by State government.

**Evidence for rebuttal:**

- Legal life is 60 years (contract clause)
- Alternative power generation costs higher in region
- Demand for power expected for full 60 years
- No technology displacement foreseeable

→ Amortise over 60 years, with annual impairment test (AS 28).

## WHEN REBUTTAL FAILS

### Enterprise software — claim 15 years

**Facts:** Management argues 15-year useful life based on implementation investment.

**Rebuttal fails because:**

- Technology evolves rapidly; 15-yr horizon not credible
- Vendor roadmap changes may force upgrade
- Industry competitors typically replace in 5-8 years
- No contractual cash flows supporting 15-yr use

→ Default to 10 years (or shorter based on vendor support period).

# Website development costs

*ICAI ASB issued a specific clarification:* The AS 26 framework applies to website costs — not as a bucket, but stage-by-stage.

## FIVE STAGES OF WEBSITE DEVELOPMENT

<b>1. Planning</b>	<b>EXPENSE</b>	<i>Feasibility study, vendor selection, requirements gathering.</i>
<b>2. Application &amp; infrastructure</b>	<b>CAPITALISE</b>	<i>Domain registration, server hardware, software licences — if recognition criteria met.</i>
<b>3. Graphical design</b>	<b>CAPITALISE</b>	<i>Page templates, colour schemes, initial design (not later cosmetic refreshes).</i>
<b>4. Content development</b>	<b>EXPENSE</b>	<i>Text, images, product descriptions — expensed as incurred (routine editorial).</i>
<b>5. Operating — hosting &amp; maintenance</b>	<b>EXPENSE</b>	<i>Hosting fees, security patches, routine updates after the website goes live.</i>

# Software — internal use vs sold externally

*The accounting pathway turns on the intended use. Same development activity, different balance sheet outcome.*



## INTERNAL USE SOFTWARE

### Treated as intangible under AS 26

**Typical examples:** ERP implementation, CRM platform, payroll system, accounting software.

**Capitalise when:** Expenditure during development phase (after R-vs-D fork resolved) meeting six Para 44 conditions.

**Expense:** Training users, data migration (unless integral to configuration), ongoing customisation after go-live, annual AMC / support fees.

**Useful life:** Generally 3-7 years. Vendor support horizon often the key cap.



## SOFTWARE SOLD EXTERNALLY

### Inventory treatment for units sold; intangible for master

**Typical examples:** SaaS product, packaged software, a publisher's book (digital or print).

**The master / source code** meets AS 26 criteria and is capitalised as intangible.

**Cost of copies sold / reproduced** (media, packaging) = inventory (AS 2), not intangible.

**Revenue from licences** = AS 9 (Revenue); amortise the master over expected useful life of the product family.

# What AS 26 never lets you capitalise

Three hard prohibitions — no amount of internal policy, management intent or auditor persuasion can shift them.



## Internally generated goodwill

Para 35. Not identifiable resource. Expenditure to maintain or generate customer relationships, market position, synergies — all expensed.



## Brands, mastheads, titles

Para 50. Expenditure to create internally — cannot be distinguished from the cost of developing the business as a whole. Applies to brands, mastheads, publishing titles, customer lists. Not capitalised, even if commercially valuable.



## Research phase expenditure

Para 41-42. Until the Development threshold is crossed, all R-phase costs flow through P&L. Subsequent capitalisation of past-expensed costs is PROHIBITED (Para 58).

## IMPAIRMENT — THE COMPULSORY ANNUAL TEST

**Para 83-86 read with AS 28:** An annual AS 28 impairment test is **MANDATORY** (regardless of impairment indicators) for intangible assets that are (a) not yet available for use, or (b) being amortised over a period exceeding ten years. For all other intangibles, test only when indicators arise — as with PPE.

# Where AS 26 goes wrong in practice



## COMMON AUDIT FINDINGS

### Top seven issues inspectors raise

- 1 Research costs capitalised** — fork not documented; 6 conditions not demonstrated at file date.
- 2 Internally generated brand on balance sheet** — direct Para 50 breach; most commonly seen in consumer-goods companies.
- 3 Useful life exceeds 10 yrs without rebuttal evidence** — company's subjective view not supported.
- 4 Amortisation not started** — asset 'available for use' but still sitting in intangibles-under-development.
- 5 Annual AS 28 test skipped** — where useful life > 10 yrs or asset not yet in use.
- 6 Training & AMC charges capitalised** — Para 54 violation; commonly seen with ERP go-lives.
- 7 Reinstatement of past-expensed costs** — once expensed, cannot be revived later (Para 58).



## DISCLOSURE

### Key disclosures required

- Useful life or amortisation rate used
- Amortisation method used
- Gross carrying amount and accumulated amortisation at period-end
- Reconciliation — beginning, additions, disposals, amortisation, impairment, end
- Reasons for amortising over > 10 years (if applicable)
- Aggregate R&D expenditure recognised as expense
- Restrictions on title / assets pledged as security

# Key Takeaways

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## 01

Three simultaneous tests — identifiability, control, future benefits. Missing any one = not an intangible asset under AS 26.

## 02

Internally generated goodwill, brands, mastheads and customer lists CANNOT be capitalised — no matter how valuable.

## 03

Research phase expenditure is always expensed. Development capitalisation requires all six Para 44 conditions satisfied.

## 04

Once expensed, never reinstated. Past period expenses do NOT come back as intangibles when criteria are later met.

## 05

The 10-year useful-life presumption is rebuttable — but requires persuasive evidence, not just managerial optimism.

## 06

Annual AS 28 impairment test is MANDATORY for intangibles not yet in use or amortised over > 10 years.

*Discussion & Questions*

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*Thank You*

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