International Journal of Economics, Commerce and Management
United Kingdom Vol. IV, Issue 1, January 2016
http://ijecm.co.uk/ ISSN 2348 0386

EMERGING ISSUES IN ACCOUNTING FOR INTANGIBLE ASSETS

Babu Bakhsh Mansuri
Business Information Technology Department, Jeddah Community College,
King Abdulaziz University, Jeddah, Kingdom of Saudi Arabia
bbmansuri@yahoo.com

Abstract

Intangible assets viz., patent, copyright, brands, goodwill, trademark and intellectual property and license have own importance in business entity to achieve enterprise goal. The purpose of intangible assets is to determine whether such assets represent some benefit or privilege in the business as they are least liquid. These assets are recorded on the basis of consistent with generally accurate accounting principles. Hence, intangible assets should be valued at cost and should appear in the balance Sheet at cost less any amount written off from year to year to the profit and loss account. Against this background, the current study intends to explore emerging issues in accounting for intangible assets.

Keywords: Accounting, Intangible, Assets, Valuation, Financial statement

INTRODUCTION

Accounting for intangible assets has gained prominence in the past few decades due to changes in the business environment. The main objective of intangible assets accounting is to prescribe the accounting treatment that is not dealt with specifically in other accounting. The intangible assets accounting is to require an enterprise to recognize intangible assets if, certain criteria are met. It measures the carrying amount of intangible assets and also requires certain disclosures regarding intangible assets in financial statements.

International Accounting Standard (IAS)-38 published in 1998 and revised in 2008 defines intangible assets as non-monetary assets without physical substance. Accounting standard (AS) 26 issued by the Institute of Chartered Accountants of India deals with intangible assets. This standard should be applied by all enterprises in accounting for intangible assets, except intangible assets that are covered in another accounting standard, like financial asset, non re-generative resources, and asset arising in insurance enterprise from contract with policy holders, mineral rights and expenditure on the exploration or development and extraction of minerals, oil and natural gas.

Nature of Intangibles

An intangible asset defined as "a capital asset having to physical existence, its value being dependent on the rights that possession confers upon the owner"(Kohler,1957). Analyzing this definition, Professor Hendrickson (1965) states as "the defining of intangible assets as capital assets merely implies that they are non-current; otherwise, such items as prepaid insurance, prepaid rent, and franchise taxes paid in advance, would also be intangibles. Therefore, one common characteristic is that they are expected to benefit the firm beyond the current operating cycle of the business, and the invested capital represented by the assets will be available for reinvestment only gradually over several or many years."

As per AS-26, an intangible asset is an identifiable non-monetary asset, without physical substance held for use in the production or supply of goods of services, for rental to others, or for administrative purpose. Monetary assets are defined by AS-26 as money held and assets to be received in fixed on determinable amounts of money and non-monetary assets are assets other than monetary assts. It is an item covered by AS-26 does not meet the definition of intangible assets, expenditure to acquire it or generate it internally is recognized as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of goodwill recognized at the date of the amalgamation. Some intangible assets may be contained in a physical substance such as a compact disc in the case of computer software, legal documentation in case of a license or patent or film in case of pictures. Cost of the physical substance containing the intangible assets though tangible in nature is commonly treated as part of the intangible asset.

From the above definitions it is clear that intangibles are not basically different from other non-monetary assets as they are expected to benefit the owner beyond the current operating cycle of the business. But like other non-monetary assets, intangibles asset has no physical existence as land and building has which is a tangible asset. Thus, intangibles, as stated earlier, are assets which cannot be seen, touched and have no volume like tangibles but have right to future benefits. 'However' not all assets which lack physical substance are regarded as intangible assets; an account receivable, for example, or a short-term pre-payment, is of non-physical nature but is classified as a current asset and is not regarded as an intangible. In brief, intangible assets are non-current and non-physical" (Meigs,W.B. et al,1975).

Intangibles provide future benefits. But there is a high degree of uncertainty regaling the value of the future benefits to be received. In most cases, the possible values may range from zero to very large amounts.

Some intangibles relate to the development and manufacture of a product, while others relate to the creation and maintenance of the demand for the product. Patents arid copyrights reflect primarily their former while trademarks and trade names reflect primarily the latter. Goodwill may represent either of both. However, represent valuations that are highly uncertain and difficult to relate to specific revenues or to specific periods (Hendrickson,1965).

Key aspects of Intangible Assets Accounting

A business entity is required to consider key aspects in accounting for intangible asset like how should the acquisition cost he determined, how should the disposal of the asset be treated and how should the cost of future accounting period be allocated. However, intangible assets are recorded and reported at the acquisition cost. If an intangible asset is acquired by purchase, it is recorded at purchase price. If an intangible asset is developed within an enterprise, it is recorded at the cost of labour and material consumed in the production, plus the legal cost incurred in securing and defending the exclusive rights for the asset.

As general practice, the expenditure incurred in developing intangible assets is usually not recognized as asset and only intangible asset acquired through market exchange from other firms is recognized as an asset. Further, the process of allocating the cost of an intangible asset over its life with a view to match the cost against the revenues produced by the asset is called amortization. The life of an intangible asset is its economically useful life or its legal life, whichever is less.

Valuation of Intangible Assets

Intangible a assets viz., patent, copyright, brands, goodwill, trademark and intellectual property and license have own importance in any business to achieve enterprise goal. In view of this proper valuation of intangible asset is must be to know the true value of' intangible asset and disclosure of information regarding intangible asset in financial statement. However, the valuation of intangible asset is a unique and challenging engagement. Because, the valuator requires sound knowledge to assess the nature of intangible assets and understand how intangible assets contribute to the value of an entity requires special knowledge and experience. There are three approaches to measure the value of intangible assets viz. cost, market and income discussed below:

Cost Approach

It is one of the vital methods, which is based on the economic principles of substitution and utility. In other words the cost approach is based on the premise that a willing buyer would pay no more for an intangible asset than the cost to produce. The cost approach typically involves two types' of costs, i.e. reproduction cost and replacement cost. Reproduction cost is the cost, which concerns with the cost to actually reproduce an exact replica of the intangible assets, without considering changes over time that may affect the cost. Replacement cost is the cost, which refers examination of what it would take to build the asset using current knowledge. However, cost has to be adjusted for obsolescence in order to estimate value. The common type of obsolescence is physical deterioration, functional obsolescence, technical obsolescence and external obsolescence.

Income Approach

Income approach is a most fitting fur valuation of intangible asset because; it considers present value of future economic income stream. This approach has two methods for valuation of intangible asset, i.e., direct capitalization and yield capitalization method. The direct capitalization method is used when an intangible asset is expected to generate a normal income, charging at a constant rate over time. On other hand, yield capitalization method is used when an intangible asset is expected to generate uneven income over discrete period of time. Because, many sports franchises do not earn positive accounting income, cash flow based measures of economic income are commonly used. However, the value of intangible asset calculated by multiplying projection of periodic income amounts by a corresponding series of present value discount rates. The present value of discount rates is a function of two factors such as market expected rate of return on investment and the expected duration of income generation.

Market Approach

According to this approach the intangible asset is valued on the basis of sales or licensing of comparable asset. In other words market approach is based on sales of discrete intangible assets. However, for measuring the value of intangible asset according to this method the data are extracted from the market place and analyzed to conclude cash equivalent prices for the intangible sales or licenses. The market approach considers both tangible asset sales and licenses and it examines market derived licenses fees, royalties, profit-split percentages, and other intangible asset transfer prices. Since intangible assets are typically highly specialized hence, finding good market comparable is often, difficult, particularly financial details of sales or licenses transactions are rarely disclosed.

However, intangible assets should he valued at cost. An intangible asset should be shown in the balance sheet only if a cost has been incurred to acquire or develop it. An intangible asset cannot be physically verified because it has no physical substance. It makes accounting for an intangible asset difficult because value put on it becomes debatable and the length of its useful life becomes questionable. In view of this, the basis of valuation adopted for intangible assets is cost. In this connection, the AICPA(1961) has rightly stated in Accounting Research Bulletin, No. 43 "The initial amount assigned to all types of intangibles should be cost. In the case of non-cash acquisitions, as, for example, where intangibles are acquired in exchange for securities, cost maybe considered as being either the fair value of the consideration given or the fair value of the property or right acquired, whichever is the more evident".

Spouse and Monitz (1962) also recommend that intangibles should be valued at cost even though they prefer valuation of other assets at current values. They state.... "these items are notoriously difficult to evaluate and, therefore, should probably be carried at acquisition cost in the absence of compelling evidence that their value is markedly different."

Amortization of Intangibles

Amortization refers to the systematic write off of cost of an intangible asset over the period of its economic usefulness. The amount written off every accounting period is debited to Amortization Account like depreciation on fixed assets debited to Depreciation Account and credited to the Intangible Asset Account. Balance in Amortization Account is treated as an expense and is transferred to Profit and Loss Account every accounting period like other expenses.

Some accountants are of the view that certain intangibles are not normally subject to amortization because they are assumed to have an unlimited useful life. Examples are trademarks, trade names, secret formula and good will. Such assets should not be amortized and should be carried indefinitely at cost if there is no reason to believe that their useful lives will terminate so long as the business continues to be a going concern. However, the Accounting Principles Board, New York (1970) rightly concluded that "the value of intangible assets at any one date eventually disappears" and recommended that all intangibles must be amortized over their useful lives (AICPA, 1970).

It is difficult to estimate the useful life of an intangible asset such as goodwill. However, cost of such asset should be amortized during the years in which it may be helpful in producing revenue.

The Accounting Principles Board, New York has suggested that the period of amortization should not exceed 40 years(AICPA,1970). In case of intangibles, the straight line method (i.e. fixed installment method) of amortization is generally used.

Disclosures regarding Intangible Assets

The main aim of accounting is to record, measure and to disclose the true value of assets in financial statement. In view of this the business organizations are required to disclose various information regarding intangible assets like useful life of asset, amortization rate, amortization method, gross carrying amount, accumulated amortization and impairment losses, certain special disclosures about intangible assets acquired by way of government grants information about intangible assets whose title is restricted, etc.

CONCLUSIONS

A business entity is required to spend lot of money for acquisition development, maintenance, or enhancement of intangible sources like patent, copyright, technical knowledge, design, and implementation of new process; licenses, intellectual property, trade mark, brand; franchising and goodwill. In view of this the business organization is needed to record, measure ‘and disclose the true value of intangible assets in the financial statement However, the management and measurement of intangible assets is a difficult task, because, intangible assets do ‘not have any physical existence, difficulties relating to sale of intangible assets and it is difficult to determine the correct value of intangible assets. In spite of these problems, there is much scope to measure, manage and disclosure of desired information about intangible assets through sound accounting practices and possible further studies especially empirical one may be conducted in this area.

REFERENCES

Anthony, R.N. and J.S. Reece (1979). Accounting Principles (6th Ed), Richard Irwin Inc.

AICPA(1970). Accounting Research and Terminology Bulletins, p. 38.

Donald E. Kieso, Jerry J. Weygandt and Terry D. Warfield(2010). *Intermediate Accounting* (13thEd.), John Wiley & Sons.

Hendrickson, Eldon S(1965). Accounting Theory, Richard D. Irwin, pp. 336-37.

Jain, S.P. and K.L.Narang(2015). Advanced Accountancy, Kalyani Publishers.

Kohler, Eric L.(1957). A Dictionary for Accountants, Prentice-Hall, p. 260.

Meigs, Walter B., Mosich, AN. and Megis Robert F.(1975). Financial Accounting, McGraw-Hill Book Company, p. 421.

Shukla, M.C. and T.S. Grewal(2014). Advanced Accounts, S.Chand &Co.

Spouse, Robert. T. and Monitz. Maurice (1962). “A Tentative Set of Board Accounting Principles for Business Enterprise,” Accounting Research Study No. 3, American institute of Certified Public Accountants, p. 37.