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Intangible Assets Other Than Goodwill

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Abstract- An entity from which future economic benefits can be derived is known as an asset. Intangible assets are those entities that have no physical existence such as goodwill, patents, copyrights, customer database, software, business plans etc. In order to account for the transactions related to these intangible assets in the company's financial statements they take guidance from ASC 350 - Intangibles-Goodwill and others, IAS 36 – Impairment of Assets, and IAS 38 – Intangible assets. There are primarily two accounting systems to account for the transactions namely US GAAP and IFRS developed by Financial Accounting Standard Board (FASB) and International Accounting Standard Board (IASB) respectively. The two accounting systems are primarily different as US GAAP has a "rules –based approach" while IFRS has more of a " principles – based approach" while setting the guidelines. As the world is rapidly converting into a global village, many companies have multi-national transactions.

Introduction

An asset, which has no physical existence such as corporate intellectual properties (patents, trademarks, business methodologies and copyrights), trademarks, patents, software, goodwill and brand recognition are known to be an "Intangible asset". There are two major accounting systems to account for the Intangible assets namely International Financial Reporting Standards (IFRS) and U.S. GAAP. IFRS are a set of international accounting standards (IAS) that sets the guidelines regarding how the specific types of transactions and events should be accounted for in the financial statements of the companies. They are issued by the IASB specifying the accountants on the maintenance and reporting of their financial accounts. IFRS were primarily established to have a common accounting language for the businesses that could be understood globally ("IFRS - Home," n.d.). While the U.S. GAAP defines a set of accounting principles, procedures and standards that could be used by the organizations to prepare their financial statements. U.S. GAAP is a collection of diverse authoritative standards that are simple practices prevalent in the businesses for accounting, recording and reporting the financial information set by the policy boards ("FASB Home," n.d.).

Though both U.S. GAAP and IFRS take their primary guidance regarding the treatment of intangible assets from ASC350, IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets), they have some major difference in accounting for certain items. ASC 350 known as "Intangibles- Goodwill and Others" is developed by the FASB and is subdivided into five Subtopics namely Overall, Goodwill, Internal-Use Software, General Intangibles Other than Goodwill and Website Development Costs. IAS 36 i.e., Impairment of assets developed by IASB ensures that the assets are carried at their recoverable amount or less and defines how the recoverable amount should be determined. While the IAS 38 i.e., Intangible assets deals with the treatment of intangible assets that are not accounted for in other accounting standards. It states the recognition criteria regarding the Intangible assets, measurement of the carrying amount of intangible assets and disclosures required in respect to the intangible assets.

Purpose

There are many different kinds of accounting systems being used by the companies in different countries of the world. Every country has their own set of generally accepted practiced and rules regarding the recognition of the accounting standards. This allows the companies to prepare their financial statement in compliance with the generally accepted principles and practices in the country, which are more customized to them. However, as the world is rapidly converting into a global village and many companies have internal operations, the complication arises when the companies deals with the other international companies following a different set of principles and guidelines to prepare their financial statements. On what basis the investors determine the success of the company and how could the company's be compared based on the financials when they are prepared using a variety of different standards. How to deal with multiple set of standards and determine which ones are accurate? In order to address all these issues IASB developed a uniform set of principles and guidelines inline and with the mutual consent of major companies to be followed by all the companies.

Moving ahead, most of the companies have a tendency to center their attention on the impacts of transiting to IFRS from a general accepted accounting principles on recoding and accounting the transactions in the financial statements. Despite the efforts made by the IASB to make the transition process smooth, the process has a much greater impact than anticipated. The board has segregated the transition phase from reconciliation phase for a smooth transition as a first step in the process. The identification of differences and address only those i.e., a reconciliation approach can be effective only during the transition phase (less cost and less time). However, in the longer run this approach might not be effective as it can create number of unexpected difficulties as the proper tools and methodologies won't be in place to address the concerns.

In order to further explain the significance of the differences between the two systems let's consider a American Express residing in United States using U.S. GAAP and another Aigo operating in China using IFRS. The US GAAP is considered to be a more of a "rules based" system for accounting the transactions while the IFRS is a "principles based" approach for accounting system. In the US GAAP, research is primarily focused around the literature while in case of the IFRS the recognition of facts and assumptions pattern is more rigorous. The US is also expected to adopt the IFRS by 2015. Under the US GAAP, an asset is defined as a body from which future economic benefits can be derived while according to US GAAP an asset is a resource through which economic benefit is expected to flow. According to the US GAAP, American express will record the acquired intangible assets such as Advertisement cost and Research & Development at the fair value of asset. However, the Aigo following the IFRS would recognize the asset only in the scenarios where the future economic benefits from the intangible asset are probable and can be measured reliably. Moreover, under the IFRS it is permissible for the companies to account for on a historical basis or revaluation while in U.S. GAAP no subsequent revaluations are permitted.

In order to comply with the IFRS, American express would address the concerns regarding the long-term transactions with the IFRS perspective. If American express has to enter into any joint venture arrangement in the longer run, it should take account of the potential IFRS accounting so as to prevent the unexpected results at the moment of the transition into IFRS system of accounting. The American based can influence on the merging process by executing new procurements as soon as possible and primarily those which are positioned to be converged with IFRS like SFAS 141 (R) addressing the business combinations and SFAS 160 addressing the issue of accounting for the non-controlling interest. Moreover, in order to train the staff for the transition, American express should put in place a detailed training program plan on IFRS guidelines and principles.

The difference in both companies accounting system would play a major role if they have a parent-subsidiary relationship, if one company is going to merge or acquire the other company or even if they have significant frequent transactions. For example during the consolidation of financial statements by the parent at year end how to account for the intangible items recorded by the subsidiary in different accounting system. Are the assumptions regarding the life, recognition, revaluation and impairment also holding true for the parent/acquirer company? If the company has recognized a significant item in the financial statement which is allowable under IFRS but not U.S GAAP or vice versa that the acquirer might end up paying a significant premium in acquiring the company. The companies might also face a conflict while agreeing on which accounting system to use while deterring the potential price of the target.

Moving ahead, despite the nature of the industry the company is operating in, identifying the intangible assets of the business and developing the skills to measure and evaluate them are crucial in modern day for the achievement of greater business value. Due to increased competitive environment in the recent times, the companies are increasingly putting efforts to achieve competitive advantage that makes them stand out in the market place. Moreover, the technological revolution in the recent era made it clear to the organizations that only those organizations can thrive in longer run which have superior technology ("Intangible assets and Competitive advantage, 27/04/11, Ayham's blog," n.d.).

Trends towards the adoption of IFRS and U.S. GAAP

The transition of businesses towards a global economy has precipitated the demand to adopt global accounting standards. The latest decisions made by the United States Securities and Exchange Commission (SEC), had significant implications on the matter of converging International accounting standards and US GAAP. The recent ruling of the American commission to allow the international companies to inculpate IFRS for financial reporting purposes without any reconciliation with U.S. GAAP on investors, multinational organizations, and global financial reporting has core implications (Ahmed, A. S., Neel, M., & Wang, D. (2013)). Moving ahead, it is both timely and need of the hour to converge and integrate the U.S. GAAP and IFRS into one single set of principles and guidelines as Global Accounting Standards. The ultimate result of this is an increasingly stabilized and prosperous global economy that will be helpful to resolve a number of the global financial reporting issues (Daske, H., Hail, L., Leuz, C., & Verdi, R. (2013). The FASB is undertaking significant initiatives since 1999 in order to address the issue of integrating the US GAAP with the IFRS. Some of these steps are:

1) Conducting joint projects with the International Accounting Standard Board such as financial statement presentation, Revenue recognition projects, conceptual framework projects and finally the business combination projects.
2) Near term Convergence projects
3) FASB monitoring of the projects taken by the IASB
4) Various convergence projects

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5) Liaison between the IASB members with the FASB offices on site
6) Explicit analysis of the merging potential in the Board agenda decisions.

In order to achieve the uniformity in the accounting guidelines the IASB is working viciously towards the adoption of IFRS by more and more countries. The trend towards the common globalized accounting standard has been rapidly increasing as IFRS is used in many regions of the world such as European Union, Hong Kong, Singapore, Australia, and Russia among the other countries. As of April 2011, more than 120 countries have adopted the IFRS as basis for the preparation of their financial statements. More and more countries are shifting from their own generally accepted guidelines to IFRS. Canada officially adopted IFRS standard during the January 2011. However, the United States has yet to officially accept the IFRS and still operates under the U.S. GAAP (Fosbre, A. B., Kraft, E. M., & Fosbre, P. B. (2009)).

Types of Intangible assets and their recognition

In contrast to Facebook, Twitter allows its users to "Tweet" Intangible assets of the business are either acquired through a business combination or are developed internally. In most of the cases if the asset is acquired through an acquisition or a merger than it is recorded at its fair value while if the assets is generated internally than it is accounted for according to the amount of the costs incurred during the development phase of the asset. In regard to the accounting of internally manufactured intangible assets there are two types of costs 1) Research phase and 2) Development phase. The research phase comprises of accumulative costs incurred on the intangible asset before it became commercially viable, whereas the development costs includes all the costs and activities incurred after the asset becomes commercially feasible. The costs relating to the research phase of the intangible asset are expensed out in the statement of profit and loss in the duration they are incurred while the costs regarding the development phase of the intangible assets are capitalized and recorded as a separate line item under Non-current assets in the statement of financial position. There are many types of intangible assets ("What are examples of intangible assets? - Questions & Answers - AccountingTools," n.d.), some of the major examples are explained below:

Goodwill and Brand recognition

Goodwill is a form of intangible asset, which is accounted for when an entity acquires another entity. It is the additional cost or the premium paid by the acquiring company above the fair value of the company's identified assets or the market value of the shares of the business ("Cheng, M. Y., Lin, J. Y., Hsiao, T. Y., & Lin, T. W." (2010)). For example, Acacia Ltd. Acquired the Beta Ltd. for a lump sum amount of $ 100 million. The fair value of Beta Ltd. net assets is $75 million at the time of acquisition. The difference or the premium paid by the Acacia Ltd. above the $75 million fair value of the Beta's assets can be distributed to the goodwill or brand recognition, which in this scenario is $25 million. Goodwill or brand reputation of $ 25 million is the intangible asset and represents the Beta's business reputation.

Copyrights

Copyrights grant a business the sole proprietorship rights and authority to produce and sale an intellectual property such as software, magazine, book and a journal etc. Copyright protection is available to the persons or organizations that produce original works of authorship in any kind of tangible medium of expression. It means that a person who seeks the copyright protection must be the original writer and has to write record or publish the concept in such a way that it can be reproduced.

In order to better understand let's consider Company Alpha produces artistic works such as novels, poems, lyrics of songs, photographs, movies, musical compositions, plans for constructing the buildings and sound recordings. Similarly, a company beta deals in IT industry and makes computer software applications, computer software codes for the websites, software codes for managing the database and codes for software applications and programming tools. Moreover, the database, architectural plans, the complete writings of business plans and marketing plans, annual reports, business proposals, letter or email correspondence of the company with the client and lastly the manual guides of operation of equipment or machinery used in the daily operations of the both organizations are subject to the copy right protection.

Patents

Patents protect the rights of a manufacturing and research company by giving the company control over the production, use, and sale of a particular drug, particular design in manufacturing process, a code, etc. There are three main types of the patents namely utility patent, design patent and plant patent which the inventor can use as a protection ("Cohen, W. M., Nelson, R. R., & Walsh, J. P.", (2000). The three types are further explained below :

Utility patent: A utility patent is issued by entities to the companies for any new or useful manufacturing, processes, machines, and compositions of matter or any new and beneficial advances and developments thereof.

Design patent: A design patent is issued to an organization or any person who has designed or invented a brand new or non-obvious ornamental design to manufacture an article.

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Plant patent: As implied by its name, a plant patent issued by the entities to organizations that have designed, innovated, discovered and asexually produced and created any different and new class and variety of a plant.

At the end of the 20th century there were two main standards followed by the companies namely US GAAP and IFRS. Both the standard setter bodies i.e., IASB and FASB had initiated a convergence assignment even before many countries in world had adopted the IFRS. Going ahead, as the United States is clearly shifting towards adopting the IFRS as can be seen from the recent proposal of the US Securities and Exchange Commission. We have discussed the potential impacts of recording the transactions in both the accounting systems and the affect of their differences on the financial statements.

Internally developed Intangible assets

Internally developed intangible assets include the internal research and development costs and trade names. Under the US GAAP the costs that are incurred to develop, maintain and restore the intangible assets are expensed out in the income statement as they incur. The exceptions to this rule includes the costs regarding the computer software development that is intended to be sold in the future, computer software developed for internal usage and website development. However, under IFRS the internally developed intangible assets are reported on the financial statements only if 1) it is probable that the expected future economic benefits attributable to the asset will flow to the entity and 2) the cost attributable to the asset can be measured reliably. For example, the Alpha Company following US GAAP would be expensing out the costs regarding the intangible assets while the Beta Company operating in China and reporting according to IFRS would only recognize the costs regarding the internally developed assets if they fulfill a certain criteria ("Is IFRS That Different From U.S. GAAP?," n.d.).

Advertising costs

Moving ahead, another major difference in the recognition of the intangible assets between the two accounting systems is regarding the advertisement costs. In the US GAAP the advertising costs are either expensed out as incurred or expensed as a whole as soon as advertising takes place. The standard allows some exceptions such as 1) direct response advertising and 2) expenditures for the advertisement costs that incur after the revenues attributable to such costs (e.g., cooperative advertising) are recognized. While in IFRS, the advertising costs are expensed out as they incur unless the expense is attributable to the payment made prior to the entity obtaining a right to access goods or receive services.

Extent of impairment testing for the goodwill

Under the US GAAP, the intangible asset is tested for the impairment up to the smallest reporting unit i.e., either an operating segment or a level below that. While in case of IFRS, the intangibles assets are tested for the impairment up to the smallest cash generating unit i.e., the smallest level at which the goodwill is observed for the internal management purposes which cannot be larger than a one operating segment ("Goodwill and other intangible assets — Key differences between U.S. GAAP and IFRSs," n.d.).

Impairment testing of indefinite lived intangible assets

In order to test for the impairment of indefinite lived intangible asset in the US GAAP, the entity needs to apply the optional qualitative impairment first (Shoaf, V., & Zaldivar, I. P. (2005)). If the results of the initial qualitative impairment assessment suggest that the indefinite lived asset is impaired than the entity is required to compute the fair value of the intangible asset for an impairment assessment. In impairment assessment, the fair value of the intangible asset is compared with the carrying amount of asset in the books. If the carrying value of the intangible asset exceeds its fair value than the difference is recorded as an impairment loss. The reversal of an impairment loss is not permitted under US GAAP.

In comparison, according to the IFRS the recoverable value of the intangible asset is computed as the higher of 1) fair value less cost to sell and 2) higher of value in use and the carrying amount of the intangible asset. The impairment loss is recorded as the difference between the carrying value and the recoverable amount. Although reversal of the impairment loss is permitted under the IFRS under certain conditions if they are met.

Benefits of Intangible assets

Intangible assets form a major proportion of the modern businesses and are a primary area of discussion during the modern company analysis. Brand name, employee and management skills, Research and Development activities, IT systems, stakeholder relations are significant factors to determine any country's success. The major factors such as customer satisfaction, continuous innovation, Product and service quality as well as the financial profitability and ability to leverage the opportunities present in the market depend upon these intangible assets. To summarize, the company's future capacity for the growth and sustainability depends upon the intangible assets ("Intangible Assets - benefits, expenses," n.d.).

The major benefits derived from the intangible assets are discussed below:

- **Enhance value of business:** Intangible assets play a significant role in enhancing the value of the business. Consumer perception and reputation of the company in the market are the core elements for the success of any company. As the world is largely converting into a global village the importance of the intangible assets like intellectual property, knowledge and business relationships etc are increasing. Intangible assets are becoming a greater percentage of most of businesses in the recent times as compared to the large space occupying and unnecessary cost incurring intangible assets. However, this concept is relatively new and most of the new businesses on the smaller scale don't account for these . They don't have the adequate understanding of how the company's reputation or customer base could be beneficial for the company and how to account them properly in the books. Moreover, the more efficiently the intangible assets are managed over the life of the business, the higher the premium earned upon selling the business.

- **A great Investment:** Efficiently managing and accounting for the intangible assets is a form of investment in the business as compared to developing a strong tangible asset base. The company earns a significant premium as compared to the costs incurred in order to acquire, develop or maintain them. For example, for the tangible asset the company would have to incur the buying / manufacturing cost, storage and maintenance cost, depreciation expense, obsolescence costs etc. While no such costs are born by the company for the intangible assets other than costs which the business has to incur in any case in order to remain in the longer run in the race. By merely putting all the efforts in enhancing the bottom line of the organization leads to overlooking several other areas of significance. In order to successfully stand out against the competitors in the industry, the company needs to recognize the intangible assets as unique elements.

Drawbacks of Intangible assets

Going forward, although a strong intangible asset base provides organizations a competitive edge, they also have their drawbacks as well which are explained below:

- **Complex task:** Intangible assets valuation is a complex process and needs core understanding of the various methodologies, approaches and exercises (Ambler, T., & Banvise, P. (1998)). Often entrepreneurs and booming business don't have the skills, knowledge and resources to carry out these activities and need expert services from and analyst or accountant. These experts may charge high fees that the company might not be able to bear at the initial phases.
- **Fraud:** Intangible assets can significantly increase the value of a company. There recognition is relatively a newer concept and requires significant developments and rectifications. The management of the company may use creative accounting and window dressing to fraudulently increase the value of the business and earn significant premium on its disposal.
- **Taxes:** Goodwill is reported on the balance sheet under the non-current assets, which is amortized over a time period of no more than 40 years in order to comply with the accounting principles ("Intangible Assets - benefits, expenses," n.d.). The company charges amortization on this goodwill periodically on the income statement that reduces the company's profitability. Moreover, according to the recent tax regulations the amortization of goodwill is not deductible in the calculation of tax expense payable for the year.

Conclusion

The adaptation of businesses towards a global economy has triggered the need to adopt global accounting standards. Moreover, it is both timely and need of the hour to converge and integrate the U.S. GAAP and IFRS into one single set of principles and guidelines as Global Accounting Standards. IFRS were primarily established to have a common accounting language for the businesses, which could be understood globally. The ultimate result of this is an increasingly stabilized and prosperous global economy that will be helpful to resolve a number of the global financial reporting issues. Though the companies operating in United States use GAAP and IFRS are not incorporated widely yet for SEC filling purposes, they are still largely impacted by it in the scenarios such as the merger and acquisitions globally, during the dealings with the non- US subsidiaries and non-US stakeholders such as shareholders, suppliers, customers etc. In these scenarios the company's residing in the United States have to prepare their financial statements again in accordance with the IFRS standards. The impending transition from the US GAAP to the IFRS would always be a challenging goal for several US companies to achieve.

Going ahead, despite the nature of the industry the company is operating in, identifying the intangible assets of the business and developing the skills to measure and evaluate them are crucial in modern day for the achievement of greater business value.

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