

# MEASURING INTANGIBLE ASSETS ON THE FAIR VALUE IN THE KNOWLEDGE SOCIETY

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## ABSTRACT

*The current interest in the economics of intangibles is not surprising. It is now accepted that the concept of intellectual capital is having profound implication also for corporate accounting and reporting because more and more companies started producing reports which are different from the traditional or financially requirements.*

*The aim of this paper is to present the complex issues regarding the area of accounting for the faire value of intangibles and analysis the conditions to the recognition, measure in the traditional financial statements. A paradox of intangible assets is that the more incorporates, the more volatile is its valuation.*

*In other words, conventional financial statements and management reports presently provide insufficient information on the intellectual capital that really contributes to a company's success.*

**Key words:** *intangible assets, fair value, financial statements*

**JEL Classification:** *M41*

## INTRODUCTION

The essence of globalization is to ensure a social completeness of economy. The economy may be globalizing as an effect of commercial conventions through its specific agents, players of the global markets. According to their position on the international scene, this phenomenon shall be benefic for humanity. Along with the globalization of business comes globalization of the language of business: accounting.

Generally, globalization of accounting is a component of a total globalization package. Countries believe that embracing global accounting standards will open up capital markets and either attract, or restrict the loss of, foreign investment. Other countries have formally committed via Memoranda of Understanding with the IASB to converge their national GAAP with IFRS. In the new economy, the importance of informational, intangible assets derives from the benefits they bring, in a deeply competition society. Information becomes merchandise mainly due to its codification. Knowledge can be related to the human capital, but the two notions do not exactly overlap. As more and more work is done at the intellectual level, holding and manipulating information becomes an essential quality of each employee.

Moreover, it is visible that some of the models for evaluating intellectual capital are built on the same principles and use the same indicators, only their names being different. This fact proves that the area is in its first stages and no one wants to give up their own nomenclature by borrowing the results of the work of others, as long as no method is generally valid. Reasoning further, an important aspect for this research area is elaborating a common set of definitions and indicators which can be easily generalized.

Facing multiple challenges, like: striving towards conceptualizing the area; attempting to measuring the intangibles; establishing cause-effect relations; proving the truthfulness of some approximate variables, many companies with a system of managing the intellectual capital happen to use within it some individual indicators whose relevance is not fully justified. Thus, Goran Ross proved the fact that companies tend to use overextended lists of indicators, and the measuring systems they use tend as a consequence to be difficult and complex, being frequently loaded with useless indicators. Thus it is very important to determine and establish relevant indicators, to group them in specific categories (quantitative or qualitative, referring to individual aspects of the company's business - for example the employees - or to the macro aspects) and not simply put them together, while at the same time assigning to each category a specific weight in calculating the final result.

So, some specialists bring into question the understanding and application of existing national GAAP and historical cost accounting. While removal of global barriers makes a global accounting language appealing, differences between the economic, social, and political characteristics of each country raise questions concerning the ability of all countries to enforce an identical set of regulations.

## THE FAIR VALUE OF THE INTANGIBLE ASSETS

Using the existing definition of fair value in IFRS literature, fair value represents the amount for which an asset or liability could be exchanged in a current transaction. That amount compounds the expectations of market participants regarding the future net cash inflows to be generated by an asset or the future net cash outflows to be sacrificed in settling or extinguishing a liability.

Although it is not yet on the IASB's active agenda, accounting for intangible assets is one of the projects included on the Roadmap for Convergence. By 2008, the boards will have considered the result of the IASB research project on intangible assets and made a decision about the scope and timing of a potential agenda project.

In recent years the boards have spent some time considering the accounting for purchased intangible assets, including goodwill, in the context of their business combinations projects. In view of this, it is likely that the project listed on the Roadmap will focus on initial and subsequent accounting for internally generated intangible assets.

Most authors rather prefer simply counting the main parts of the whole, while the official accounting texts define the notion in very vague terms. Actually, the general definitions become very quickly useless because of their barely analytical nature, while the more precise definitions prove to be too focused on particular cases.

Another researcher considers that instead of a universal definition or some lists stating which expense can be seen as an investment, it is more relevant to specify the features of immaterial investment, which are, according to him, the following:

- ⇒ appears in an important amount before the production process, in the research and development stage for technologies, and in the market expansion stage for retail investment;
- ⇒ is usually irreversible;
- ⇒ generate specific assets which are difficult to be sold on the market, their value being usually determined by the organization which incorporates them.

The immaterial are a combination between expenses and investment, saying about them that they are not common expenses for which the aim is only their management and decrease, but rather a strategic managerial decision of the company; nor are they common investment because their effects are indirect and are qualitative in nature, while their profitability is only financial.

IAS 38 Intangible Assets contains very restrictive conditions for the recognition of internally developed intangible assets. Indeed, it specifically prohibits the recognition of internally generated brands, mastheads, publishing titles, customer lists and items similar in substance.

IAS 38 also contains very restrictive conditions for revaluing intangible assets to fair value, requiring there to be an active market for the intangible asset in question. The end result of these restrictions is that, absent business combinations, very few internally developed intangible assets are recognized in financial statements and even fewer are ever revalued. Many commentators see this outcome as evidencing a major deficiency in the existing accounting model, particularly in view of the fact that internally generated intangible assets increasingly constitute significant resources in modern corporations. They point to business combination accounting, where these assets are recognized and are measured at their fair value, and ask why two such contradictory accounting models co-exist.

The challenge facing the boards in developing an improved accounting standard for internally developed intangible assets is that the conventional cost-based accounting model seems unsuited for the task - at least for initial recognition. These assets typically arise over time, often over long periods, without a specific recognition event occurring. Cost accumulation models do not work very well when you do not know whether you have an asset for which costs should be accumulated. Then when you do believe an asset exists, it is often extremely difficult if not impossible to trace the specific past costs that may have been associated with the creation of the asset. A fair value model, on the other hand, can provide an accounting measure for these assets, both at initial recognition and subsequently - the amount for which the asset could be exchanged in a current transaction. Notwithstanding the off-expressed concerns about the reliability of such fair value measures in the absence of market evidence, fair values of internally developed intangible assets are determined and reported in the financial statements whenever business combinations take place.

Although I expect the Board to commence a project in accounting for internally developed intangible assets, I do not anticipate a broader review of the Standard in the foreseeable future. For example, we see no prospect of the Board giving serious consideration to replacing the cost model for subsequent measurement of intangible assets with a fair value model. Likewise, I do not see the Board removing the fair value option, although it may be that its work on identifiable intangible assets will lead to reconsideration of the existing restrictions on using the option.

Some analysts have proposed finding fair values of intangibles and equity by analyzing capitalized value based on current share prices. This defeats the purpose of accounting. The purpose of accounting is to help investors make bid and ask prices in the stock market and to provide risk information to creditors and investors. Using share prices to set accounting values puts the cart before the horse. The accounting horse is supposed to pull the cart; the cart is not supposed to pull the horse.

Another problem of intangibles valuation is that such values are often extremely unstable. A new discovery may destroy huge components of patent, skilled labor and other knowledge capital intangibles.

## CONCLUSIONS

Fair value is here to stay. It is already deeply embedded in IASB and FASB literature and there are growing calls from the user community to increase its use in financial reporting. Conceptual support for fair value is demonstrable and will be further underpinned in the revised conceptual framework. Users, preparers, auditors and regulators will become more comfortable with the use of fair value as time passes. On top of that, the current lack of investment in intellectual capital has several consequences. If we can develop a better way to account for such investments, we will achieve a more efficient allocation of resources and benefits will accrue to the economy. As a result it is some problems of credibility and meaningfulness vis-à-vis these new reports. Also the intangibles phenomena represented by the date which can be in conflict with their reliability.

In economist dreams, the net value of assets minus the net value of liabilities with fair value adjustments is equal to the current value of the equity if that equity is sold in the open market. However, this will be an evolutionary rather than revolutionary process and will involve targeting areas in need of improvement. It will also involve extensive consultation with constituents.

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