

ROLE OF INTANGIBLE ASSETS IN CREATING VALUE FOR THE COMPANY

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ABSTRACT

The need for a new conceptual framework for the modern economy remains supreme. This paper describes role and importance of intangible assets in the growth of organization and its importance in corporate success. It is widely accepted nowadays that since the end of the 20th century the economy has become significantly different from the industrial economy previous to the mid 20th century. This transition is the result of the vital role played by intangibles as a fundamental determinant of value creation in business world. There is a rapid growth of investment in intangible assets. In some cases this investment matches or exceeds investment in traditional capital such as machinery, equipment and buildings. This article discusses inclusion of intangible assets in financial statements and investment pattern in intangible assets of a company and problem of valuing intangibles for determining their value for future economic benefits of the organization and impairment of intangible assets. Intangibles are all around the business world.

KEYWORDS: *Intangible Assets, Impairment of Assets, Market Value.*

Introduction

Intangible assets are non-physical assets (such as trademarks, patents, copyrights goodwill and franchises) that grant the potential for certain rights and privileges as well as the possibility for economic benefits to the owner. The economic benefits may be fruitful or fleeting, depending on the nature of the intangible asset and the company exploiting it. Unlike physical or tangible assets, which one can see and touch, intangible assets cannot be physically distinguished. On the other hand, similar to tangible assets, in the appropriate circumstances an intangible asset can be exchanged, purchased, or licensed. For some companies intangible assets may have such a bearing on the business value that shareholders are willing to go great lengths and expend funds to define their intangible assets, monitor and manage them and protect them from infringement and damage. Nonetheless, an intangible asset's influence on business value may be simply ephemeral, subject to the gyrations of the stock market, consumer sentiments and inexorable competition.

So it is no surprise that companies in all industries are investing more in intangible assets than ever before – with trend values changing even higher. A clear “symptoms’ of this the fact that the gap between market values and book values of corporations has been constantly growing over the last few years. as a result, even companies of the ‘old industries’ possess today significant intangible assets (Gu/lev, 2001,p.12)- although they are not visible in their balance sheets or internal management accounts and reports, and that is the very problem; our enterprise management concepts and control instruments have failed to keep up with this development. They provide a much too narrow angle, and exclude the most important factors of production of our companies and economies of toady, which are increasingly knowledge-based and service-oriented; the intangible assets along with their intrinsic production forces and risks.

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Methodology

The article has been written on the basis of primary and secondary information. The primary data has been collected from chartered accountants with respect to intangible assets valuation and the secondary information is collected from published books, journals and research papers.

Objectives of the Study

- To have an insight of accounting for internally generated and self acquired intangible assets and inclusion in financial statement.
- To study importance of investment in intangible assets and its impairment.
- To understand the significance of intangible assets on the market value of the company

Internally Generated Intangible Assets

Intangible assets that are developed within the firm, the “internally-generated” intangibles, have caused recognition problems. These assets are developed, usually over a period of time, within the firm and have traditionally been ignored, that is, not recognized in the financial statements. Generally, the reason for the omission from the financial statement of these internally generated intangible assets has been due to a perceived lack of a relation between their costs and specific future revenue. In addition, the difficulties in ascertaining cost or valuation figures for intangibles and a focus on reliability over relevance when disclosing asset information have meant that self-generated intangibles have not usually been recognized. Most of these reasons constitute a “hang-over” from what some commentators have called the “old” economy in which the value creating assets were largely physical and the outputs were in a clearly tangible form. Although the presence of intangibles has long been known, they were not perceived as important in creation of value before the 1950’s. This might have been a reasonable view even up to 1980’s, from which time there is evidence that the significance of intangible assets has increased rapidly. That is, the value drivers of the firm became increasingly intangible with less of the market capitalization explained mainly by the tangible assets recognized in financial statements.

There is also an Income Statement

If it is difficult to get a summary value number from the balance sheet, is accounting information hopeless for inferring the value of intangible assets/ No; there is also an income statement. Even though intangible assets are missing from the balance sheet, earnings from intangible assets flow through the income statements. Value can be established by measuring the asset value directly but also by capitalizing the earning from the market price of the buildings (a stock valuation) or from the rents that the business yields. When one account determines a stock valuation (a balance sheet valuation), one turns to the flow (an income statement Valuation). There is another important point in turning to the income statement. While the balance sheet cannot yield a summary number that the balance sheet cannot yield a summary number that reports the value of using assets jointly, the income statement does (at least in principle): earning is the accounting measure of value added from employing tangible assets along with entrepreneurship, brands, knowledge, organizational capital, and so on. This is the brilliance of accounting; rendering a performance measure from organizing assets under a business plan. With this summary measure, there is no need to identify intangible assets (or even to ask if they exist); one just observes earnings generated by the business plant. The point that earnings give the value of intangible assets is implicitly acknowledged in statements of those who claim the existence of intangible assets. Speculators in the 1990s pointed to price-to-book ratios, but writers on intangible assets often point to earnings performance to infer those assets.

A recent article on “organization capital” by Lev, Radhakrishnan, and Zhang (2009) is an example. In this paper “organization capital” is attributed to Wal-mart, Microsoft, Southwest Airlines, Intel, Dell and others because these firms have had very good earning performance. Indeed, the paper estimates the value of “organization capital” from sales and expensed in the income statement. One of course seeks to understand the source of good performance, but attributing earnings performance to ‘organization capital’ is by fact, without cause and effect demonstrated; one is simply observing firm performance as reported in earning, whatever the cause and calling it something else.

Importance of Investment In Intangible Assets

The integration of the world economy has emphasized the need for firms to exploit Intangible Assets on a global scale. As highlighted by Griliches, 1994; Lev, 2001; Firer and William, 2003; Boujelben and Fedhila, 2011, the basis of economic development and wealth of the economy lies no

longer in the investment in Tangible Assets but in the creation and use of Intangible Assets. This increased importance of Intangible Assets in the economic value creation is also attested by the increasing gap between the firms' accounting Book Value and their Market Value (Gu and Lev, 2001). There are variety of reasons that lure the companies to invest in Intangible Assets. Intangible Assets play an increasingly important role in facilitating productivity and efficiency for the companies (OECD, 2008). These assets also help the companies in competing with their competitors and in enhancing their market value (Canibano et al.1999, Mishra and Jhunjhunwala, 2009). These also provide a firm with improved customer attainment and preservation by building customer loyalty as well as brand image (OECD, 2008). Specifically mentioning the relevance of some of these assets, Goodwill is given due consideration at the time of mergers and acquisitions (PWC, 2014). A higher value is paid by a company with the intention to take advantage of the existing technology, knowledge and other Intangible Assets (Canibano et al. 1999; Gu and Lev, 2001; PWC, 2014). Investment in R&D, patents, copyrights etc. give monopoly to the firms for producing innovative products (Pradhan, 2003). Advertising and Customer Relationship Management (CRM), other Intangible Assets are documented as a generator of high profits for the companies as the advertised products are easily recallable and identifiable and the chances of confusion are minimized (Sahay and Pillai, 2009). Last but not the least, investment in Human Assets builds the intellectual capital of companies and helps them in earning high profits as the companies take advantage of the skills and abilities of its workforce to outperform their rivals (Arrighetti et al.2014).

Bottlenecks in Investing in Intangible Assets

Intangible Assets are not free from bottlenecks. Despite the growing importance of Intangible Assets, it is strange that these are not fully recorded in companies' Balance Sheets perhaps because these are complex to define and difficult to measure (Goldfinger, 1997; Sveiby, 1998; Lonnqvist, 2004; Gu and Wang, 2005; Lev, 2005; Austin, 2007; Corrado et al. 2012). Infact, they lack both consistent data and uniform definition (Toubal, 2009). Also these assets are difficult to identify separately and thus fail to match the fundamental requirements for accounting recognition (Canibano et al.1999). Intangibles are non physical in nature and do not follow the same pattern of depreciation as tangible assets (Canibano et al.1999). Also, the future benefits derived from Intangible Assets are uncertain (Holland, 2001). As a result economic rents, growth opportunities, and other factors associated with Intangible Assets are not fully captured in the accounting system

Impairment of Intangible Assets

AS 36, Impairment of Assets (the standard) sets out the requirements to account for and report impairment of most non-financial assets. IAS 36 specifies when an entity needs to perform an impairment test, how to perform it, the recognition of any impairment losses and the related disclosures. Having said that, the application of IAS 36 is wide and its requirements may be open to interpretation. The recent economic uncertainty has thrown a spotlight on impairment. As such, many entities have decided to reassess their impairment testing processes, models and assumptions. In this introductory publication, we provide an overview of the key requirements of IAS 36 - an introduction for those who have not performed impairment test in accordance with IAS 36 and a refresher for existing IFRS preparers. We point out areas where IAS 36 differs from US GAAP and also highlight some of the practical considerations for first-time adopters of IFRS. Impairment principle and key requirements IAS 36 deals with impairment testing for all tangible and intangible assets, except for assets that are covered by other IFRS. IAS 36 requires that assets be carried at no more than their recoverable amount. To meet this objective, the standard requires entities to test all assets that are within its scope for potential impairment when indicators of impairment exist or, at least, annually for goodwill and intangible assets with indefinite.

Hypothesis 1

- H₀:** The inclusion of financial statement is independent of type of intangible asset (acquired / self generated)
- H₁:** The inclusion of financial statement is dependent of type of intangible asset (acquired / self generated)

Case Processing Summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
Type of IA * Inclusion In Financial Statement	80	100.0%	0	0.0%	80	100.0%

Type of IA * Inclusion in Financial Statement Cross tabulation

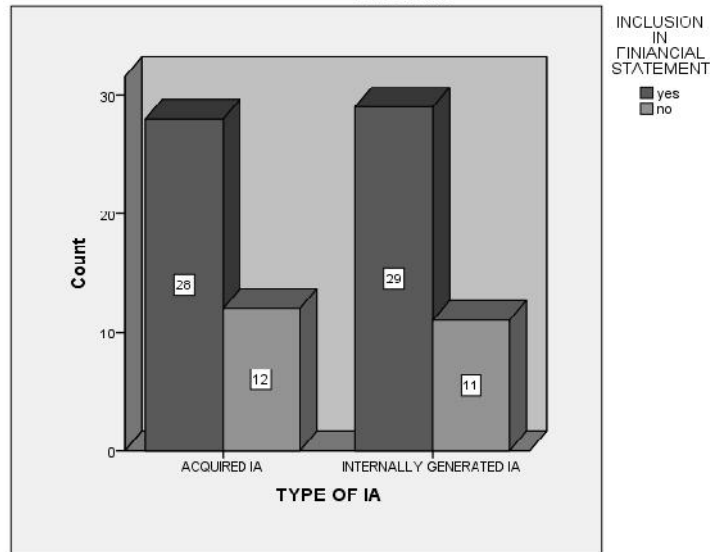
			Inclusion in Financial Statement		Total
			Yes	No	
Type OF IA	Acquired IA	Count	28	12	40
		Expected Count	28.5	11.5	40.0
		% within type of ia	70.0%	30.0%	100.0%
		% within inclusion in financial statement	49.1%	52.2%	50.0%
		% of total	35.0%	15.0%	50.0%
	Internally Generated IA	count	29	11	40
		expected count	28.5	11.5	40.0
		% within type of ia	72.5%	27.5%	100.0%
		% within inclusion in financial statement	50.9%	47.8%	50.0%
		% of total	36.2%	13.8%	50.0%
Total		count	57	23	80
		expected count	57.0	23.0	80.0
		% within type of ia	71.2%	28.8%	100.0%
		% within inclusion in financial statement	100.0%	100.0%	100.0%
		% of Total	71.2%	28.8%	100.0%

Chi-Square Tests

	Value	Df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	.061 ^a	1	.805		
Continuity Correction ^b	.000	1	1.000		
Likelihood Ratio	.061	1	.805		
Fisher's Exact Test				1.000	.500
Linear-by-Linear Association	.060	1	.806		
N of Valid Cases	80				

a. 0 cells (0.0%) have expected count less than 5. The minimum expected count is 11.50.
 b. Computed only for a 2x2 table

Bar Chart



From the descriptive statistics it is evident that 70% of respondents have the opinion that the acquired IA has to be included in the financial statement whereas in case of self generated IA it is 72.5%. From the chi-square table it is evident that the Pvalue(0.61) is less than 0.05. therefore null hypothesis is rejected and alternative hypothesis is accepted. We can conclude that the inclusion of financial statement is dependent of type of intangible asset (acquired / self generated)

Hypothesis 2

H₀: There is significant difference in measurement of intangible asset with regard to types IA

H₁: There is no significant difference in measurement of intangible asset with regard to types IA

ANOVA

Type of IA

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	4.891	3	1.630	8.201	.000
Within Groups	15.109	76	.199		
Total	20.000	79			

From the ANOVA table it is evident that P -value is less than 0.05. Therefore null hypothesis is rejected and therefore we can conclude that there is significant difference in There is significant difference in measurement of intangible asset with regard to types IA.

Hypothesis 3

H₀: There is significant difference in market value of company with regard to IA

H₁: There is no significant difference in market value of company with regard to IA

One-Sample Test

	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Effect of IA on market value of the company	8.408	39	.000	.97500	.7405	1.2095

From the t test table it is evident that the P value is less than 0.05 therefore null hypothesis is rejected and we can conclude that there is significant different in market value of the company with regard to intangible asset.

Hypothesis 4

H₀: There is no association between subsection of impairment test with regard to type of IA

H₁: There is association between subsection of impairment test with regard to type of IA

Case Processing Summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
type of IA * subsection to impairment test	80	100.0%	0	0.0%	80	100.0%

Type of IA * Subjection to Impairment Test Cross tabulation

		Subjection to Impairment Test				Total	
		Strongly agree	Agree	Disagree	Strongly disagree		
Type of IA	Acquired IA	Count	12	21	7	0	40
		Expected Count	7.5	25.0	7.0	.5	40.0
	internally generated IA	Count	3	29	7	1	40
		Expected Count	7.5	25.0	7.0	.5	40.0
Total		Count	15	50	14	1	80
		Expected Count	15.0	50.0	14.0	1.0	80.0

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	7.680 ^a	3	.053
Likelihood Ratio	8.454	3	.038
Linear-by-Linear Association	1.852	1	.174
N of Valid Cases	80		

a. 2 cells (25.0%) have expected count less than 5. The minimum expected count is .50.

From the chi-square table it is evident that the Pvalue(7.6) is greater than than 0.05. Therefore null hypothesis is accepted and alternative hypothesis is rejected. We can conclude that There is no association between subsection of impairment test with regard to type of IA.

Findings

- The study has proved that intangible assets inclusion in financial statements provide more accurate information.
- It is observed the intangible assets gradually shown an significant impact on the market value of the company
- All assets are subject to impairment test and impairment loss as per IAS 36

Conclusion

Intangible assets cannot be seen and physically measured but have immense value for the business. Although yet there are a number of intangible assets but a few are very popular in the parley of intangible assets such patents, copyright trademark and trade names, franchise licenses, government licenses and goodwill. The present study an insight of accounting for internally generated and self acquired intangible assets and inclusion in financial statement, how the intangible assets are impaired and the significance of intangible assets on the market value of the company.

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