THE JUST EVALUATION OF NON-CURRENT INTANGIBLE ASSETS FOR FINANCIAL REPORTING

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ABSTRACT: Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as, scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trade-works (including brand names and publishing titles). Examples of items encompassed software, patents, copyrights motion picture films, customer lists, fishing licence import quotas franchises customer or supplier relationship, customer loyalty market shore and marketing rights.

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Introduction

For financial reporting at the just value of the non-current intangible assets and not only, an important role is held by the economic information which is essential for the decision making of the users of financial information (managers, investors, creditors etc.) . It can be said that the market for accounting information has an increasingly international quality because its users are more and more pretentious, and for the accounting profession this is a challenge.

The just value is a highly debated concept, being a consequence of a principle: true and fair value. No one has interpreted the just value as the faithful value, being translated into different languages as: just (juste) in French; real (reele) in Dutch; the value attributable (beizulengender zeitmert) in German; fair value without any translation in Italian.

According to the International Standards of Financial Reporting the just value is defined as being "the sum at which an asset can be transacted or a liability can be discounted,

willingly, between parts acquainted with the subject, in a transaction where the price is determined objectively" [1].

The just value contains the market value and is prone to cover all the values born out of the estimations based on economic calculations. It is opposed to the principle of prudence and of evaluation at the historic cost. The just value presents a series of qualities such as: comparability, restricted complexity and neutrality.

When there is not sufficient market information at the evaluation data as a result of the nonexistence of an active market, instead of the market value, for the assets outside exploitation a net replacement cost will be determined (NRC). For the estimation of the just value we consider we will be needing the aid of some informational sources such as:

a) IAS 38 – current intangible assets (Active necorporale);
b) IFRS 3 – entities' combination (Combinări de întreprinderi);
c) IAS 36 – depreciation of assets (Deprecierea activelor);
d) European Directives – in what measure the just value is accounted for;

e) IVS (International Valuation Standards) treatments recommended for the evaluation destined for financial reporting, especially GN 4-Evaluation of intangible assets.

The accounting treatment and the manner in which the financial information regarding non

current intangible assets is presented are included in IAS 38 „Intangible assets". A non-current intangible asset is defined as a non-monetary non-current asset without material substance.

According to IAS "Intangible assets", a non-current asset fulfills the criteria of identification from the definition of a non-current intangible asset when „it is separated, that is it can be separated or divided by the entity and sold, transferred, authorized, rented or exchanged, either individually or together with a contract , an asset or a correspondent liability; or it comes from contractual rights or of any other legal provenience, no matter if those rights are transferable or separable from the entity or from other rights or obligations"[1].

Evaluation of intangible assets

Economic entities frequently invest in resources or attract liabilities for the acquisition, development , maintenance or extinction of intangible resources such as scientific or technical knowledge, designing and implementing new technologies, licenses, intellectual property, software, patents, copyright, trademarks. But not all the elements previously enumerated satisfy the definition of a non-current intangible asset, respectively the recognizable qualities, the control over a resource and the existence of future benefits. If an element from an applicability area of this standard does not comply to the definition of the non-current intangible asset, then the expense for obtaining or internally generating it is recognised as cost in the moment of its occurence. If that certain element is obtained through a combination of entities, it represents a part of the commercial fund recognised at the date of the acquisition.

As about the recognition of the current intangible assets - it is made only when certain recognition criteria are fulfilled:

- they are likely to generate future economic benefit
- the cost of the current asset can be credibly evaluated.

Starting with the second financial exercise, current intangible assets can be evaluated separately in order to be recognised in financial situations presenting a series of particularities such as:

1. Determining the total value of the current intangible assets – residual extent
2. Determining the report between the value of the invested capital (VIC) and that of the invested net cash-flow (INCF)
3. The order of the evaluation of separate current intangible assets
4. The addition of the fiscal benefit resulting from the amortisation of separate current intangible assets
5. Other particularities
6. Recognised methods of evaluation

The fixing of the current intangible assets' residual extent's total value, typical of the acquisitions of entities, is made through the following series of calculus:

To the price paid for the acquisition of all current assets plus the overtaken short-term debts, we add the overtaken long-term loans and thus obtain the corrected acquisition price. Out of this price we substract the just value of all current assets found in the balance (except for that of current intangible assets), thus obtaining the total value of current intangible assets.

The evaluation of separate current intangible assets is made in a certain order, and the main criterium is the credibility degree of the evaluation hypothesis:

1. Computer programmes
2. Internally applied intervention patents
3. Products' marks
4. Instructed labour force
5. Licenses

6. Unpatented technology
7. Unfinished research-development projects
8. Commercial fund

The evaluation of current intangible assets is made at their just value which, according to IFRS 2007, is a concept similar with that of market value. An intangible element, reported as a current expenditure, cannot be later on recognised as a part of a current intangible asset's cost. Following expenditures, performed with a current intangible asset, will increase the cost of that current intangible asset only when those expenditures allow the current intangible asset to generate future economic benefits that surpass the initially predicted performance and if they can be credibly evaluated. We must mention that set-up costs, professional development costs, publicity and promotion costs, moving or activity reorganising costs and internally generated commercial funds are not admitted as separate current intangible assets.

IFRS insists that, in case of entity combination, the owner should recognise as many separate current intangible assets as possible so as to ensure a more precise reflection of the entities' patrimony. Experts should especially pay attention to the current intangible asset called **"instructed labour force"** which cannot be admitted as a separate current intangible asset yet it is separately evaluated so as to ensure the accuracy of the evaluation techniques of the other separate current intangible assets. The explanation is that, due to the entities' incapacity of controlling the benefits brought about by such a current intangible asset, the value of the instructed labour force is included in the commercial fund when transposed in the accounting balance.

Identifiable current intangible assets, bought as a part of entities' combination, is registered at the just value of the acquisition date provided it fulfills the recognition criteria. The most credible estimation of a current intangible asset's just value is the acquisition price of other similar or identical current intangible assets from an active market. IAS 38 also mentions the possibility of estimating the current intangible assets' just value , current intangible assets that were obtained as a result of entities' combination, through indirect estimation techniques, which consist of

a) either some multiplying coefficients used on some forms of income
b) either the use of net due economic actualisation method
c) either the actualisation of the following net cash-flow that might be generated by a current intangible asset.

As about the evaluation methods used for the current intangible assets, they present a series of particularities, such as:

- In case the current intangible asset is evaluated with respect to its costs (for instance a computer programme), we must take into account the amount we save when the profit tax is levied (fiscal benefit)
- When two or three landings to value are used, the result is that obtained from the most credible landing, without making the arithmetical mean.
- If two procedures of the same evaluation method are used and we obtain two different but close values, we may suggest as a final value the arithmetical mean of the two results
- The result that relies on information collected directly from the market is always the most credible one.

The landings in the evaluation of current intangible assets are:

a) Landing through sales' comparison
b) Landing through income
c) Landing through cost.

Landing through sales' comparison

The determination of a current intangible asset's just / market value through this approach refers to:

- transaction prices of identical or similar current intangible assets, or
- through "evaluation multiples" implied in the transaction price of identical or similar current intangible assets.

An “evaluation multiple” is a multiplying coefficient computed as a report between the transaction price of a current intangible asset and a financial indicator such as the business figure generated by the current intangible asset, the profit generated by the current intangible asset after the deduction of the expenditures related to the use of the current intangible asset. These indicators may be from this year, the previous or the following one. The evaluation multiple is then applied to the financial indicator of the evaluated current intangible asset.

The market current intangible assets are transacted on may be:

1. **an** extremely small **active market** [2]**;** in IAS 38, fishing and cab licenses are called non-current intangible assets. In this particular case, when current intangible assets are identical, their transaction prices may be adjusted only so as to reflect the type of transaction and the shifting of prices between the moment of the identical current intangible assets’ transaction and that of the evaluation of the current intangible assets.

2. **an inactive market** on which similar current intangible assets are transacted. In this case either transaction price or evaluation multiples’ adjustments are required.

As a result of the reduced number of transactions with current intangible assets on an inactive market, the adjustments of the similar current intangible assets’ prices or multiples is extremely hard to justify and as a result the setting of the just/market values through this landing is quite rare. We notice the IAR 38’s firm position, stating that the current intangible assets’ reevaluation is only allowed for those which appear on an active market.

Landing through income

The value of a current intangible asset using this landing equals the updated value of the profit, of the cash-flow or of the savings that could be obtained by the participants in the market, owners of these current intangible assets. The income flow that may be attributed to a current intangible asset could come from several sources, from all the owner of the entity’s activity areas.

There are three methods used for the landing through income of a current intangible asset:

a) Economy method / due exemption method – primary method used for the evaluation of products’ marks, invention patents, franchises, licenses and technical documentations. Its credibility degree is high as it relies on due rates found on the market for similar current intangible assets.

b) Supplementary profit method (economic profit) – consists of the estimation and update or capitalization of the profit or of the supplementary cash-flow that may be obtained by the participants in the market that use a current intangible asset, besides those obtainable without the use of that current intangible asset.

c) Net profit method / exceeding periodical net cash-flow method is constructed on the prevision of the net cash-flow from that entity’s exploitation who uses a current intangible asset, out of which we substract the cash-flow allocated to ensuring the profitableness demanded by the other current assets that contribute to generating the entity’s net total cash-flow.

Landing through replacement cost

The essence of this landing consists of determining the cost of an identical or potentially similar current intangible asset: either by identifying the replacement price of an identical or similar current intangible asset, or by determining the internal generation cost of a similar or identical current asset. The evaluated current intangible asset needs to be transactionable at a price that is equal with its replacement cost in order for the result of this method to reflect the just/market value. The landing through net replacement cost is the only method registered through landing through cost just as the International Standard of Evaluation GH8 demands (the net replacement cost for financial reporting).

Landing through cost has greatest relevance for the evaluation of:

- instructed labour force
- computer programmes
- distribution system

However, several prestigious authors also sustain the possibility of applying the cost landing for the evaluation of other current intangible assets such as marks, invention patents, technological documents.

In order to highlight the relevance of this approach we propose a case study regarding a separately acquired invention patent.

Case study

An economical entity has bought from a foreign invention patent owner a patent for a procedure, for 200,000 Euro. The seller made a discount of 5% of the selling price of the invention patent. Customs duties rise to 20,000 Euro. You are asked to determine the cost at which the patent will be accounted in the initial accounting balance.

Solution: the cost of the patent = 200,000 – (5%*200,000) + 20,000 + 5,000 = 165,000 Euro, and this value will be initially written in the balance.

The values determined from the just evaluation are economical values found through expertise and diagnostic by professionals in the field.

The dependency between the stock exchange and the reevaluation reserves has been proven to take place by studies performed in the domain of evaluation through tests baring statistical significance on efficient markets. This dependency appears as a result of the use of the just value for the reevaluation of non-current assets.

The quality of the accounting information depends on the way the just value is estimated through the credibility and neutrality criteria. Professional experts have a significant role in the process of estimation of the just value, when evaluating the current assets. One of the requirements of some useful services is the proper knowledge and interpretation of the International Evaluation Standards (IVS), and of those of accounting (IFRS), as well as national accounting norms.

References

1. [1] IAS 38 – "Non-current Intangible Assets", (Imobilizări necorporale), CECCAR Printing House, Bucharest, 2001; IFRS , CECCAR Printing House, Bucharest, 2007
2. [2] An active market is a market that fulfills three conditions:

a) homogonous transaction elements

b) the permanent existence on the market of a considerable number of interested buyers and sellers

c) the availability of prices to the public.