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COMPARING OF U.S. ACCOUNTING STANDARDS FOR INTANGIBLES WITH INTERNATIONAL, CANADIAN, U.K., AND INDIAN STANDARDS

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THIS paper compares the U.S. accounting standards for intangible assets to International, U.S., Canadian, U.K. and Indian standards. The major problems posed by intangible assets relate to the issue of valuation and management. Overall, it appears that the standards for the four countries are only partly in harmonization with the international standards. The U.S. and Canadian standards are more in harmony with each other.

Introduction

Intangible assets make up about 80% of the market value of all public companies (Osterland 2001). As a result, intangible assets have become as valuable as, if not more valuable than, tangible assets. Intangible assets raise two questions in accrual accounting, as per Jennings and Thompson (1996), which are "(1) whether they should be recognized as assets and (2) assuming recognition, the basis on which they should be charged against subsequent revenues".

Harmonization of accounting standards related to valuation and management of intangible assets is increasingly becoming a problem. This paper will discuss the difficulties involved in valuing intangible assets, and move on to discuss U.S. accounting standards for recognizing intangibles. These standards will then be compared to the standards set by the International Accounting Standards Committee (IASC), as well as those set by Canada the United Kingdom, and India. When potential investors look at a company's financial statements, a company can appear to be less valuable than its actual worth, because intangibles may make up a large portion of the assets. Intangibles are only capitalized when one company buys another company, and/or when the rights to an intangible have been obtained legally otherwise intangibles are expensed (Jennings and Thompson 1996).

Intangibles and FASB

Unlike tangible assets, few intangibles can be traded in a market setting (Untangling 1992). This causes problems when intangibles are internally developed rather than purchased because accounting methods differ for the two. When one firm buys another firm those intangibles which can be separated and identified such as patents, copyrights, trademarks, franchises, and licenses are listed as such within that firm's financial statements. Otherwise all unidentifiable intangibles are lumped together and recorded as goodwill.

If an intangible is instead developed internally, FASB states that the intangible is to be recorded on the balance sheet as an expense[1] (Jennings and Thompson 1996). This puts some firms at a disadvantage, because if a firm's expense arises mostly from the development of intangibles then their financial statements are understated compared to other firms who instead buy their intangibles. The economic potential of those expenditures that relate to research and development goes undisclosed. FASB explains, "...a resource should

1 *The exception to this is in the development of computer software. According to FASB Summary of Statement No. 86 Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed (1985), August, when technological feasibility for the development of software has been established then the costs can be capitalized. Until completion of a program design or working model has been developed all costs are expensed.*

be recognized as an asset if it meets the definition of an asset (a probable future benefit) and has a relevant attribute that can be reliably measured," and a purchased intangible satisfies this requirement, whereas an internally developed intangible does not (Jennings and Thompson 1996). Intangibles are purchased using an arm's length transaction which subsequently implies future benefits are probable and that its cost is a reliable measure of its worth. Whereas internally developed intangibles do not ensure future benefit, making them risky to disclose as an asset on the balance sheet. Only when the contractual or legal rights (patents, licenses, copyrights) are obtained, can an internally developed intangible be recognized as an asset and not as an expenditure (Osterland 2001).

Global Standards

International: IASC

As markets become more and more globalized, there is an increasing need for countries to have similar accounting standards and guidelines to use, when preparing a firm's financial statements. The IASC was founded with the objective[2] to standardize accounting standards around the world (Street and Gray 1999). On the issue of intangibles, International Accounting Standard (IAS) 38: Intangible Assets[3] (July 1998) states that an intangible be recognized as an expense unless that asset can be distinguished, if future economic profit is probable, and if the cost of the asset can be measured accurately. If the intangible complies with these criteria, then the intangible can be capitalized. This applies to both purchased intangibles and to internally generated intangibles, but the Standard goes on to specifically state, even if the intangible meets the criteria, all goodwill, research, brands, and other similar items which have been internally generated are prohibited from being recognized as assets. Intangibles that are capitalized are subject to amortization over the useful life of the asset, not to exceed 20 years (IAS 38 1998; IAS 36[4] 1998). If the intangible asset's value is thought to exceed 20 years then a persuasive argument can be made to the IASC and the intangible can then be amortized over its useful life, subject to annual impairment tests. The IASC standard also does not allow the firm to assign an infinite life to the intangible. The IASC also allows for the recovery of the impairment loss when "…there has been a change in the estimates used to determine an asset's recoverable amount since the last impairment loss was recognized" (IAS 36 1998).

United States: FASB

While many countries are committed to developing accounting standards that are universal and in accordance with the international standards, many accounting boards set standards that are not in accordance with those set by the IASC. The United States is one example of a country that has recently passed standards that diverge from those by the IASC. When FASB passed statements No. 141 and No. 142[5], the U.S. changed, how it accounted for acquired intangibles and goodwill. The U.S., by eliminating amortization for indefinite intangibles went against the standards by the IASC. This could potentially give U.S. firms an unfair advantage in the global market because, its adopted accounting standards will make reported profits higher than for those countries who amortize intangible assets and goodwill. Otherwise the handling of intangibles is similar to the international standards. In both sets of standards, internally developed assets are expensed. They both call for research to be expensed, but the U.S. also calls for development (except in the case of computer software) to be expensed, whereas if it meets international standards development could be capitalized[6], thus appearing on the balance sheet as an asset, not an expense (Street and Gray 1999).

2 *The IASC has two objectives which are "(1) to formulate and publish in the public interest accounting standards…and to promote their worldwide acceptance…and (2) to work for the harmonization of regulations, accounting standards, and procedures relating to the presentation of financial statements" (Street and Gray 1999).*

3 *IAS 38 was issued in July 1998, and that same year was amended.*

4 *IAS 36 was issued April 1998 and amended April 2000.*

5 *Refer to footnotes 2 and 3 respectively for other items the Statements covered.*

6 *For an intangible asset to be capitalized in the development stage it has to meet the following criteria: it has to be technologically feasible, there has to be the intention and ability of completing and then selling/using the item, there has to be a market for the item, a firm has to already have the resources to complete the item and sell it, and there has to be a way to measure its costs during development (Cearns 1999).*

Canada: AcSB

Canada is another example of a country that differs with the accounting standards for intangibles and goodwill set internationally , but which are similar to U.S. standards. The United States and Canada worked together to harmonize the recent announcement of accounting standards that dealt with intangibles, which include Canadian sections: 1581 Business Combinations, 3061 Property, Plant, and Equipment, and 3062 Goodwill and Other Intangible Assets (Andre 2001). These standards eliminate amortization on indefinite intangibles making them subject to annual impairment tests[7]. Canada's standard of amortizing intangibles with a definite life is in accordance with both FASB and IASC standards. Where Canada differs from those standards, in that Canada does not require assets that are acquired, which deal with research and development to be expensed (Andre 2001).

United Kingdom: ASB

In the United Kingdom, the Accounting Standards Board passed Financial Reporting Standard (FRS) 10: Goodwill and Intangible Assets[8] (1997), to assist British accountants in the handling of these items. The U.K., as stated in FRS 10 doesn't consider goodwill as an asset in the general terms that define an asset, but instead considers it to be a bridge. The standard goes on to state that "…it forms a bridge between the cost of an investment shown as an asset in the acquirer's own financial statements and the values attributed to the acquired assets and liabilities in the consolidated financial statements" (FRS 10, amended 1998). Purchased goodwill is shown among the assets on the balance sheet, but it is considered to be "…part of a larger asset, the investment…" (FRS 10, amended 1998). The U.K. standard, FRS 10, in summary, states that goodwill resulting from the purchase of a company is capitalized, while goodwill that is internally developed[9] is not. The standard states that goodwill, if amortized, has a maximum life of 20 years, but if the goodwill has an estimated life that is more than 20 years or is indefinite, then goodwill whether it is amortized or not has to undergo annual impairment reviews. Impairment reviews are required at the end of "…the first full year after initial recognition [of goodwill]…," and whenever circumstances indicate the value may be impaired (Waxman 2001).

The standard differs from that of the U.S., in that it specifies a maximum amortization period of 20 years, which is in agreement with the IASC standard. It differs from the IASC standards, in that it allows for goodwill and other intangibles to be considered indefinite. It is similar to U.S. standards, in that some intangibles and goodwill that either have an indefinite life, or an estimated life over 20 years, do not have to be amortized, but are instead subject to annual impairment reviews. The international standard while stating impairment reviews will have to be undertaken and, also require that the intangibles and goodwill still be amortized. (Waxman 2001)

India: Accounting Standards Board (ASB)

In India, the Accounting Standards Board has issued Accounting Standard 26: Intangible Assets (2002), effective from January 4, 2003, to account for the disclosure of intangibles on financial statements. An intangible will only be recognized, if there is probable future economic benefits, and the cost of the asset can be reliably measured (AS 26 2002). All internally developed intangibles, if they meet these criterion, can be disclosed as assets on financial statements. The exceptions are research and goodwill. Each of these activities if internally generated, are expensed in the period incurred. With internally generated goodwill, India's ASB determined, there was no reliable measure of cost, therefore its disclosure is similar to that of an expense. Furthermore, the Standard states that intangibles will be amortized over their useful life, not to exceed 10 years. If a case can be made, that the useful life exceeds 10 years or has an indefinite life, the intangible is amortized over the useful life of the product/ service and will be subject to annual impairment tests. (AS 26 2002).

7 *An annual impairment test could be avoided if (1) the reporting unit has not changed significantly, (2) the fair value is substantially greater than the carrying value and (3) there have been no circumstances or events that would have caused the fair value to fall below the carrying amount (CIAC Section 3062 2001 and Statement of Financial…2001).*

8 *FRS 10 was issued in December 1997, and amended in July – December of 1998.*

9 *According to FRS 10: Goodwill and Intangible Assets (1998 amended), internally developed intangibles can be capitalized only when market value can be easily determined.*

A Comparative Summary

A summary of the comparisons across the four countries is provided in Table 1.

Table 1: Country Comparisons

	Intangible Assets:		**Amortization:**		**Goodwill:**	
	Internally Developed	**External**	**Definite Life**	**Indefinite Life**	**Internally Generated**	**Bought**
U.S.	Expensed including R&D	Capitalized at cost	Over useful life	No amortization. Annual Impairment Tests	Expensed	Capitalized
Canada	Expensed including R&D	Capitalized at cost, including R&D	Over useful life	No amortization. Annual Impairment Tests	Expensed	Capitalized
U.K.	Expensed	Capitalized	Over useful life - 20 years maximum	Can or can not be amortized and subject to annual impairment tests	Expensed	Capitalized
India	Expensed, including Research	Capitalized at Cost	Over useful life - 10 years maximum	Over useful life, subject to annual impairment reviews		
International	Expensed	Capitalized	Over useful life	No indefinite - 20 years maximum life. If proven useful life longer then amortized over useful life & subject to annual impairment tests	Expensed life status	Capitalized

Conclusion

Disclosure of intangibles and harmonization of accounting standards is becoming increasingly important in our global society. In a global society where markets from other countries are interwoven among each other, having differences in accounting standards can unfairly give some firms, depending on where they are based, unfair advantages. These advantages can come in the form of higher net incomes, and larger asset bases, while the disadvantages are just the opposite because the intangibles that are reported as expenditures can incorrectly skew the financial statements, when potential investors study them. Harmonizing international accounting standards with the various countries' accounting standards boards will, not only make financial statements easier to prepare, but will also make those statements easier for investors to understand.

In the end, if full disclosure of intangibles takes place either in the financial statements, if possible, or in the notes of the statements and standards between countries become similar, everyone will benefit. The problem with full disclosure of intangibles, is that, unless they are bought from another firm, intangibles are hard to value. It is hard to put a value on employee intellect that is reliable, when those key employees could leave at any time, and the other internally developed intangibles are just as difficult to value. But just because it is difficult doesn't mean it can't be done.

When firms go to banks for loans[10], some sort of value has to be placed on the intangibles, before a loan is granted and the appraisal method could possibly be adapted in some form, where firms could disclose the values of the intangibles, if not in their financial statements, then in an annual report (King and Henry 1999). FASB is currently considering a project proposal, Disclosure of Information about Intangible, Assets Not Recognized in Financial Statements[11] (2001), that would establish standards for disclosing intangibles that are not shown on the financial statements. The project, as stated by the FASB proposal, if undertaken, would improve the information provided to investors in the financial statements, as well as, being a movement in the direction of getting firms to fully disclose in their financial statements all of their intangibles – purchased or internally developed. If these two problems – full disclosure of intangibles, and standardized global accounting standards – can be overcome, then investors will become better, if not fully informed about a firm, before investing, and also all companies will be put on an even footing, so that they all can fairly compete for capital.

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10 *In an article by King and James (1999), they discuss disclosing the value of intangibles through the use of appraisals, indicating that banks give firms loans using intangibles as collateral. They go on to discuss the three methods appraisers use to determine value – the cost approach, the market comparable approach, and the income approach. The article suggests that since banks give loans based on appraiser information then this should also be good enough for investors.*

11 *The FASB Proposal requested comments about making this a project from August 2001 to September 2001. On October 24, 2001 FASB directed staff to further study the proposed project, and to report their findings by December 2001. If the project is undertaken FASB states that the principle issues would be "…determining what intangible assets [would be]…covered…,"and determining whether additional statements need to be issued to discuss the handling of intangible assets "…that would have been recognized had they been acquired from others, [and the]…in process research and development assets [that are] written off after acquisition" (FASB Proposal 2001).*

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