CHAPTER 4

Intangibles – The Accounting Standards

➤ Introduction

➤ The International Accounting Standard: IAS 38 Intangible Assets and IAS 22

  Business Combination

➤ The UK Standard: FRS 10 Goodwill and Intangible Assets and SSAP 13

  Accounting for Research and Development

➤ The USA Standard: SFAS 142 Goodwill and Other Intangible Assets

➤ The Indian Standard: AS 26 Intangible Assets

➤ Accounting for Intangibles in Some Other countries

➤ Comparative Statement Showing Current Requirements Relating to Intangibles

  Accounting in Major Countries
Introduction

The accounting profession cannot afford to remain indifferent for long to the massive changes that are taking place in the international economy. After all, accounting is a social science. Its main objective is to provide investors and creditors with information required for their decision-making purposes. But the existing accounting system has been largely designed, as discussed in Chapter – 1, on the basis of an industry-based economy where physical assets dominate. Now the economy is increasingly becoming service- and knowledge-based where intangible assets act as main value drivers of an organization. The existing accounting system fails to capture the complex dimensions of these new kinds of assets. Moreover, in the absence of any guidelines, from the professional bodies of accountants, regarding accounting for intangible assets, many organizations have started structuring their accounting systems according to their convenience. The accounting profession needs to upgrade the accounting systems to respond to the international developments vis-a-vis intangible assets. Development of an effective accounting standard on intangibles has become imperative with a view to dealing with these assets most appropriately in accounts.

Realizing the importance of intangible assets in the new economy, the different accounting standard-setters of the world have begun to develop accounting standards on intangible assets, e.g., The International Accounting Standards Board (IASB) issued the International Accounting Standards (IAS) 38 (Intangible Assets) w.e.f. July 1, 1999. IAS 38 has been further revised by the IASB in March 2004 to make it more compatible with the new economy. The Financial Accounting Standards Board (FASB) of the USA issued the Statement of Financial Accounting Standards (SFAS) 142, (Goodwill and other Intangible Assets) w.e.f. the fiscal year after December 15, 2001. The Accounting Standards Board (ASB) of the UK issued the Financial Reporting Standard, (FRS) 10 (Goodwill and Intangibles) in December, 1997. The Accounting Standards Board (ASB) of India has also issued the Accounting Standard (AS) 26 (Intangible Assets) apart from the Accounting Standard (AS) 14, (Accounting for Amalgamation), which deals with the treatment of goodwill. This new standard on intangibles (i.e., AS 26) has become operative w.e.f. April 1, 2003 for those enterprises whose equity or debt securities are...
listed or are going to be listed, as evidenced by the board of directors’ resolution in this regard, on a recognised stock exchange in India and all other commercial, industrial and business reporting enterprises whose turnover for the accounting period exceeds Rs.50 crores. In respect of all other enterprises, AS 26 comes into effect during the accounting periods commencing on or after 1-4-2004.

In this chapter an attempt has been made to appreciate the effectiveness of these accounting standards vis-à-vis the problems associated with accounting for intangibles.

The International Accounting Standard: IAS 38 Intangible Assets and IAS 22 Business Combination

IAS 38 defines intangible assets as identifiable non-monetary assets without physical substance held for use in the production/supply of goods/services, for rental to others, or for administrative purposes. The salient features of IAS 38 have been given below.

1. Recognition and Initial Measurement
   An intangible asset should be recognized as an asset if and only if:
   (a) it is probable that future economic benefits, specifically attributable to the asset, will flow to the enterprise, and
   (b) the cost of the asset can be measured reliably.
   An intangible asset should initially be measured at cost.

2. Measurement subsequent to Initial Recognition
   Subsequent to initial recognition at cost, two measurement bases have been prescribed. One is benchmark treatment and the other one is allowed alternative treatment.
   The benchmark treatment is that the intangible should be carried at cost less accumulated amortization and any accumulated impairment losses.
   The allowed alternative is to revalue the intangible to its fair value and base subsequent amortization on that revalued figure. This allowed alternative treatment is only permissible if the conditions stated below are met.
   (a) The fair value must be capable of being measured reliably by reference to an active market. An active market, according to IAS38, is a market where the items traded
within it are homogeneous, willing buyers and sellers can normally be found at any
time, and prices are available to the public.

(b) All intangibles of the same class must be revalued.
(c) Revaluation must be made frequently enough to ensure that the carrying value at
each balance sheet date does not differ materially from the fair value.

IAS 38 specifically prohibits revaluation of brands, newspaper mastheads, music and
film publishing rights, patents and trademarks on the ground that no active market in
them can exist, as each such asset is unique.

If an intangible asset is revalued, any accumulated amortization at the date of
revaluation is either:

(d) restated proportionately with the change in the gross carrying amount of the asset
so that the carrying amount of the asset after revaluation equals its revalued
amount, or

(e) eliminated against the gross carrying amount of the asset and the net amount
restated to the revalued amount of the asset.

If an intangible asset's carrying amount is increased as a result of revaluation, the
increase should be credited directly to equity under the heading of revaluation surplus.
However, a revaluation increase should be recognized as income to the extent that it
reverses a revaluation decrease of the same asset and that revaluation decrease was
previously recognized as an expense.

If an asset’s carrying amount is decreased as a result of a revaluation, the decrease
should be recognized as an expense. However, a revaluation decrease should be
charged directly against related revaluation surplus, if any, to the extent the decrease
does not exceed the amount held in the revaluation surplus with respect to the same
asset.

3. Internally generated Intangibles
The standard specifically prohibits recognition of internally generated goodwill as an
asset. Similarly, internally generated brand, newspaper mastheads, publishing titles,
customer lists and other items similar in substance are specifically banned from being
recognized.
4. Research and Development Expenditure

IAS 38 requires that all research expenditure should be written off in the year of expenditure through the income statement. All development expenditure should be written off in the year of expenditure. However, the standard has allowed development expenditure to be recognized as intangible asset when the enterprise can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset,
(b) its intention to complete the intangible asset and use or sell it,
(c) its ability to use or sell the intangible asset,
(d) how the intangible asset will generate probable future economic benefits,
(e) the availability of adequate resources to complete the development and to use or sell the intangible asset, and
(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

5. Amortization

The depreciable amount of an intangible asset should be amortized over the best estimate of its useful life. It is assumed that the useful life of an intangible asset will not exceed twenty years. However, the standard acknowledges that, in rare cases, there may be persuasive evidence that the useful life of an asset is longer than twenty years. In such cases, the enterprise should

(a) amortize the intangible asset over the best estimate of its useful life.
(b) make impairment test, at least, annually to estimate the recoverable amount.
(c) disclose the reasons why the presumption (i.e., the useful life of the intangible asset will not exceed twenty years) does not hold good, stating the factors that play a significant role in determining the useful life of intangible assets.

The useful life of an intangible asset may be very long but will never be infinite.

The amortization method should reflect the pattern in which the asset’s economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used.
The period and the method of amortization should be reviewed, at least, at the end of each financial year. If the situation so warrants, the period and the method of amortization should be changed accordingly.

6. Residual Value
The residual value of an intangible asset should be assumed to be zero unless:
(a) there is a commitment by a third party to purchase the asset at the end of its useful life, or
(b) there is an active market for that type intangible asset, and:
   (1) residual value can be measured reliably by reference to that market, and
   (2) it is probable that such a market will exist at the end of the asset’s useful life.

6. Disclosure Requirement
IAS 38 requires that the financial statement should disclose the following for each class of intangible asset, distinguishing between internally generated intangible assets and other intangible assets:
(a) the useful lives or the amortization rates used,
(b) the amortization methods used,
(c) the gross carrying amount and the accumulated amortization at the beginning and the end of the period, and
(d) a reconciliation of the carrying amounts at the beginning and the end of the period showing:
   (1) additions,
   (2) retirements and disposal,
   (3) increases or decreases during the period resulting from revaluation and from impairment losses recognised or reversed directly in equity,
   (4) impairment losses recognised in the income statement during the period,
   (5) impairment losses reversed in the income statement during the period,
   (6) amortization recognized during the period, and
   (7) other movements.
The IASB has revised IAS 38 on 31 March 2004. The revised standard has classified intangible assets based on useful life. An intangible asset with a finite useful life should be amortised over that life. It should also be assessed for impairment in accordance with IAS 36. On the other hand an intangible asset with indefinite useful life should not be amortised. Annual impairment test is required for such asset.

Requirements of IAS 22 relating to Goodwill

IAS 22 Business Combination, requires goodwill, arising on an acquisition, to be capitalized and amortized over its useful life.

Goodwill has been defined in the standard as the difference between the value of a business as a whole and the aggregate of the fair value of its separable net assets. Separable net assets are those assets (and liabilities) which can be identified and sold off separately without necessarily disposing of the business as a whole. They include identifiable intangibles such as patents, licenses and trademarks.

Fair value is the amount at which an asset or liability could be exchanged in an arm’s length transaction between informed and willing parties, other than in a forced or liquidated sale. The standard has made a distinction between purchased and non-purchased goodwill. Purchased goodwill arises when one business acquires another business as a going concern. Goodwill also exists in any successful business. However, if the business has never changed hands this goodwill will not be recognized in the financial statements, as no event has occurred to identify its value. It can only be subjectively estimated. This is inherent goodwill.

It has been stated that purchased goodwill always has a limited life. As time passes the reputation of the business under its former owners ceases to have any value because potential customers begin to form a view of its performance under the present ownership. Purchased goodwill should, therefore, be amortized.

The standard has stated the following points relating to amortization:

(a) Purchased goodwill should not be revalued upwards.

(b) If there is impairment in the value of purchased goodwill, it should be written down immediately through the income statement to its estimated recoverable amount in accordance with IAS 36.
(c) Purchased goodwill, in so far as it has not been written-off, should be shown as a separate item under non-current assets in the balance sheet.

(d) The useful economic life as estimated at the time of acquisition should not include any allowance for the effects of subsequent expenditure or other circumstances subsequently affecting the enterprise which would have the effect of creating non-purchased goodwill.

(e) There is a rebuttable presumption that the useful life of goodwill will not exceed twenty years from initial recognition.

(f) The straight-line method should normally be used for writing off goodwill.

Negative goodwill
IAS 22 has stipulated that negative goodwill to the extent of expectation of future losses and expenses should be recognised as income in the income statement as the future losses and expenses occur. Any excess negative goodwill represents a gain to be recognised as income as the acquired assets are consumed in the business. In the case of monetary assets, the gain can be recognised as income immediately.

IAS 22 has been superseded by IFRS 3 in March 2004. Under IFRS 3, all business combinations must be accounted for using the purchase method. The use of the pooling of interests method is prohibited. The new standard requires that acquired intangibles must be recognised as assets separately from goodwill if they meet the definition of an asset, are either separable or arise from contractual or other legal rights and their fair value can be measured reliably. It also requires recognition of goodwill at the excess of the cost of the business combination over the net fair values of the assets and liabilities including contingent liabilities acquired. Unlike IAS 22, IFRS 3 prohibits amortisation of goodwill. Instead it requires annual impairment test or even more frequent impairment test if the circumstances so warrant. The new standard also prohibits recognition of negative goodwill. If the net fair value of the acquired net assets exceeds the cost of business combination, that excess (sometimes referred to as negative goodwill) must be recognised immediately in the income statement as a gain.
Conclusion

It was expected that the IASB would come out with a standard that would suitably address the complexities in accounting for internally generated intangibles. But it has simply avoided this issue in its standard on intangibles by stipulating some conditions for their recognition that are very difficult to meet in actual practice. Moreover by specifically excluding some important items of internally generated intangibles such as brand, customers list etc., from recognition, it has reduced the importance of the standard. So the accounting for internally generated intangibles, which are regarded as the most valuable assets particularly in knowledge-based companies, remains an unresolved issue. The IASB has of course taken a right step in dispensing with amortisation of goodwill and intangible assets with indefinite useful lives.

The British Standard: FRS 10 Goodwill and Intangible Assets and SSAP 13 Accounting for Research and Development

FRS 10 was issued by the Accounting Standard Board (ASB) UK, in December 1997 replacing SSAP 22 Accounting for Goodwill. Most commentators regarded SSAP 22 as unsatisfactory as it permitted a choice between two different accounting treatments. Naturally entities of the UK used to choose that accounting treatment which would give the most favourable view of earnings. The widely practised alternative, immediate elimination against reserve, was criticized for two main reasons:

- it gave the impression that the acquirer’s net worth had been depleted or eliminated
- the financial statements overstated the rate of return on acquired investments.

In addition, there was clearly the need for an accounting standard that dealt with other intangible fixed assets as well.

The objectives of FRS 10 are to ensure that:

- capitalized goodwill and intangible assets are charged in the profit and loss account in the periods in which they are depleted, and
• sufficient information is disclosed in the financial statements to enable users to determine the impact of goodwill and intangible assets on the financial position and performance of the reporting entity.

The salient features of FRS 10 are as follows:

1. **Goodwill**
   - Positive goodwill arising out of acquisition of business should be capitalized and classified as an intangible fixed asset in the balance sheet.
   - Internally generated goodwill should not be capitalized.

2. **Other intangible assets**
FRS 10 recognises that there are many types of intangible assets. Although some intangible assets are very similar to goodwill, some can be readily identified and reliably valued. Such intangible assets are to be treated as follows:
   - An intangible asset purchased separately from a business should be capitalised at its cost. Examples of such assets include copyrights, patents and licences.
   - An intangible asset acquired as part of the acquisition of a business should be capitalized separately from goodwill if its value can be measured reliably on initial recognition. It should initially be recorded at its fair value.
   - If its value cannot be measured reliably, an intangible asset purchased as part of the acquisition of a business should be subsumed within the amount of the purchase price attributable to goodwill.
   - An internally developed intangible asset may be capitalized only if it has a readily ascertainable market value.

3. **Amortization**
The standard has prescribed the following guidelines regarding amortization:
   - Where goodwill and intangible assets are regarded as having limited useful economic lives, they should be amortized on a systematic basis over those lives.
   - There is a rebuttable presumption that the useful economic lives of purchased goodwill and intangible assets are limited to 20 years or less.
   - A useful economic life may be regarded as longer than 20 years or indefinite if
a) the durability of the acquired business or intangible asset can be demonstrated and justifies estimating the useful economic life to exceed 20 years
b) the goodwill or intangible asset is capable of continued measurement (so that annual impairment reviews will be feasible).

- Where goodwill and intangible assets are regarded as having indefinite useful economic lives, they should not be amortized.
- A residual value may be assigned to an intangible asset only if the residual value can be measured reliably. No residual value may be assigned to goodwill.
- The straight line method of amortisation should normally be used unless another method can be demonstrated to be more appropriate.
- The useful economic lives of goodwill and intangible assets should be reviewed at the end of each reporting period and revised if necessary.

4. Impairment Reviews

- Where goodwill and intangible assets are amortized over 20 years or less, impairment reviews are required
  a) at the end of the first financial year following the acquisition, and
  b) in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

- Where goodwill and intangible assets are amortized over more than 20 years impairment reviews are required at the end of each reporting period.

5. Negative Goodwill

Negative goodwill arises where an entity is purchased for less than the total fair values of its identifiable net assets. FRS 10 has prescribed the following guidelines for the accounting of negative goodwill:

- Negative goodwill should be recognised and separately disclosed on the face of the balance sheet, immediately below the goodwill heading and followed by a subtotal showing the net amount of the positive and negative goodwill.
- Negative goodwill up to the fair values of the non-monetary assets (e.g. fixed assets and inventory) acquired should be recognised in the profit and loss account in the...
periods in which the non-monetary assets are recovered, whether through
depreciation or sale.

• Any negative goodwill in excess of the fair values of the non-monetary assets
acquired should be recognised in the profit and loss account in the periods where the
benefit is expected to be felt.

6. Disclosure

Recognition and Measurement

• Describe the method used to value intangible assets.
• Disclose the following information separately for positive goodwill, negative
goodwill and each class of intangible asset reported on the balance asset:
  a) cost or revalued amount at the beginning of the financial period and at the balance
     sheet date
  b) the cumulative amount of provisions for amortisation and impairment at the
     beginning of the financial period and as at the balance sheet date
  c) a reconciliation of the movements
  d) the carrying amount at the balance sheet date

Amortisation

• Disclose methods and periods of amortisation of goodwill and other intangible assets
  and reasons for choosing those periods.
• Disclose details of changes in amortisation period and method.
• Disclose grounds for amortisation of goodwill or intangible assets over a period that
  exceeds 20 years.

Negative goodwill

• disclose the periods in which negative goodwill is being written back in the profit and
  loss account.
• Where negative goodwill exceeds the fair values of the non-monetary assets, the
  amount and source of the ‘excess’ negative goodwill and the periods in which it is
  being written back should be explained.
COMMENTS

FRS 10 has been criticised for more than one reason. Firstly intangible assets have been given less consideration than they deserve by being included in the standard along with goodwill. The standard has permitted purchased intangibles to be capitalized, but only if they can be reliably measured. It does not give direct guidance on how this can be done. If the intangible asset’s value can be reliably measured, it should be initially recorded at its fair value. According to FRS 7, *Fair Values in Acquisition Accounting*, fair value means replacement cost. Arriving at fair value is an extremely difficult task. This is particularly true for assets such as brands and publishing titles for which the existence of active market is a remote possibility. So these intangibles are virtually subsumed within goodwill. The condition of ‘readily ascertainable market value’ for recognition of internally generated intangibles is also very difficult to fulfil. Most of the intangibles are unique in nature and do not have readily ascertainable market value. So valuation of internally generated intangibles really becomes a myth.

The critics are also doubtful about the veracity of impairment reviews of goodwill and intangible assets. FRS 11 issued by the ASB, UK deals with impairment reviews. An asset is said to have been impaired when its carrying value is more than its recoverable amount, which is the higher of net realisable value and value in use. As most intangibles are not traded in the active market it is very difficult to ascertain the net realisable value. In finding out value in use, apart from the obvious difficulties in forecasting cash flows, there is great subjectivity in selecting the appropriate discount rate. The process of progressively writing down the value of goodwill, intangibles and then fixed assets in the income generating unit by the amount of impairment loss is something much more oblique. It is also very difficult to segment the business into different income generating units.

The process of elimination of negative goodwill as prescribed in the standard is also criticised for its lack of symmetry with positive goodwill. Moreover the ‘dangling credit’ approach to negative goodwill in its disclosure has not been favoured (*Paterson, Accountancy, Feb. 1998*).
SSAP 13 Accounting for Research and Development

The ASB, UK has issued the above separate standard for dealing with research and development expenditure. The requirements of this standard are as follows:

Expenditure on pure and applied research should be written off in the year of expenditure through the profit and loss account.

Development expenditure should be written off in the year of expenditure, except in the following circumstances, when it may be deferred to future periods:

- there is a clearly defined project
- the related expenditure is separately identifiable
- the outcome of the project has been separately assessed with reasonable certainty as to its technical feasibility and its ultimate commercial viability
- the aggregate of the deferred development costs, any further development costs, and related production, selling and administration costs is reasonably expected to be exceeded by related future sales and other revenues
- adequate resources exist, or are reasonably expected to be available, to enable the project to be completed and to provide any consequential increases in working capital.

In the foregoing circumstances, development expenditure may be deferred to the extent that its recovery can reasonably be regarded as assured.

The USA STANDARD: SFAS 142 Goodwill and other intangible assets

This statement issued by the FASB, USA, addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognised in the financial statements.

The main features of this standard are as follows:

1. Initial Recognition and Measurement of Intangibles Assets

An intangible asset that is acquired either individually or with a group of other assets shall be initially recognised and measured based on its fair value. The fair value of an
asset has been defined in the standard as the amount at which that asset can be bought or sold in a current transaction between willing parties.

2. **Internally Developed Intangible Assets**

Costs of internally developing, maintaining, or restoring intangible assets including goodwill that are not specifically identifiable, that have indeterminate lives, or that are inherent in a continuing business and related to an entity as a whole, shall be recognised as an expense when incurred.

3. **Amortization**

A recognised intangible asset shall be amortised over its useful life to the reporting entity unless that life is determined to be indefinite. If an intangible asset has a finite useful life, but the precise length of that life is not known, that intangible asset shall be amortised over the best estimate of its useful life. The method of amortisation should reflect the pattern in which the economic benefits of the intangible asset are consumed. If that pattern can not be reliably determined, a straight-line amortisation method shall be used.

An intangible asset shall not be written down or written off in the period of acquisition unless it becomes impaired during that period.

An entity shall evaluate the remaining useful life of an intangible asset that is being amortised in each reporting period to determine whether events and circumstances warrant a revision of the remaining period of amortization. If the estimate of the remaining useful life of the asset is changed, the remaining carrying amount of the intangible asset shall be amortised prospectively over that revised useful life.

An intangible asset that is subject to amortisation shall be reviewed for impairment. An impairment loss will be recognised if the carrying amount is found exceeding the fair value. After an impairment loss is recognised, the adjusted carrying amount of the intangible shall be its new accounting basis. Subsequent reversal of a previously recognised impairment loss is prohibited.

4. **Intangible Assets Not Subject to Amortization**

If an intangible asset is determined to have an indefinite useful life, it shall not be amortised until its useful life is determined to be no longer indefinite. An entity shall evaluate the remaining useful life of an intangible asset that is not being amortised in each reporting period to determine whether events and circumstances continue to support...
an indefinite useful life. If an intangible asset that is not being amortised is subsequently determined to have a finite useful life, the asset shall be tested for impairment. That intangible asset shall then be amortized prospectively over its estimated remaining useful life and accounted for in the same manner as other intangible assets that are subject to amortization.

An intangible asset that is not subject to amortization shall be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset may be impaired. The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognised of an amount equal to that excess. After an impairment loss is recognised, the adjusted carrying amount of the intangible shall be its new basis of accounting. Under no circumstances the previously recognised impairment loss shall be written back.

**Accounting for Goodwill**

Goodwill shall not be amortised. Goodwill shall be tested for impairment for each reporting unit of the entity separately. Goodwill is supposed to have been impaired when its carrying amount exceeds its implied fair value. The standard has prescribed the following two steps for conducting impairment test.

The first step is to compare the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, thus obviating the necessity of the second step.

The second step of goodwill impairment test compares the implied fair value of the reporting unit’s goodwill with the carrying amount of goodwill. If the carrying amount of the reporting unit’s goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognised of an amount equal to that excess. For determining the fair value of goodwill, the entity shall allocate the fair value of a reporting unit to all the assets and liabilities of that reporting entity including any unrecognised intangible assets as if the reporting unit has been acquired in a business combination and the fair value of the reporting unit is the price paid to acquire the reporting unit. The excess of the
fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill.

When the reporting unit is the company as a whole, the current stock price will represent the company’s fair value. When the reporting unit is a particular segment of the company, other valuation models such as discounted cash flow model or multiples of earning model may be used.

Goodwill of a reporting unit shall be tested for impairment on an annual basis. However if some event occurs causing probable reduction in the fair value of the reporting unit below its carrying amount, impairment test will be done instantly.

Disclosures

1) The following information shall be disclosed in the notes to the financial statements in the period of acquisition:

a) For intangible assets subject to amortisation: (1) the total amount assigned and the amount assigned to any major intangible asset class, (2) the amount of any residual value, in total and by major intangible class, (3) The weighted average amortisation period, in total and by major intangible class.

b) For intangible assets not subject to amortisation, the total amount assigned and the amount assigned to any major asset class.

c) The amount of research and development assets acquired and written off in the period.

2) The following information shall be disclosed in the financial statements or the notes to the financial statements for each period for which a statement of financial position is presented:

a) For intangible assets subject to amortisation: (1) the gross carrying amount and accumulated amortisation, in total and by major intangible asset class, (2) the aggregate amortisation expense for the period, (3) the estimated aggregate amortisation expense for each of the five succeeding fiscal years.

b) For intangible assets not subject to amortisation, the total carrying amount and the carrying amount for each major intangible asset class.

c) The changes in the carrying amount of goodwill during the period including: (1) the aggregate amount of goodwill acquired (2) the aggregate amount of impairment
losses recognised (3) the amount of goodwill included in the gain or loss on disposal of all or a portion of a reporting unit.

Comments on the SFAS 142

SFAS 142 was introduced by superseding APB Opinion No. 17 where goodwill and other intangibles were required to be amortised within the maximum period of 40 years regardless of their actual lives. Financial analysts are of the opinion that this system of arbitrary amortisation would cause an unnecessary drag on earnings after acquisition. Thus acquisitions that were likely to dilute earnings per share were often scrapped even though there was a strong rationale for the deal. The new standard on intangibles and goodwill in the USA has done away with that eventuality. Analysts believe that impairment testing of goodwill will provide more transparency. Me Connell, senior managing director at Bear, Stearns & Company, Inc., says, “if properly applied and enforced it (impairment test) will give users of financial statements more insight than the current system of arbitrary amortization, which tells little or nothing. A goodwill impairment charge may be an important signal of a decline in a business for reasons not obvious to financial statement users” (Moehrlie and others, Journal of Accountancy, September 2001).

Some other experts have, however, pointed out that the impairment test instead of periodic amortisation will lead to volatility in the reported earnings of the companies. They also argue that due to the end of the practice of goodwill amortisation “one of the great defenses against hostile offers has been eliminated.” It is reported that hostile deals are soaring in the USA particularly in the technology sector built on human capital where the difference between a company’s assets value and market value is significantly high. Indeed 62% of hostile bids in 2001 involved the technology sector up from 24% of hostile deals just a year earlier (Business Week, January 14, 2002). But this argument is not very sound. The truth should not be kept hidden on the pretext of volatility in earnings or corporate predation.

Although the standard has taken a very realistic approach towards goodwill accounting, it has failed to address the problem of accounting for internally generated intangibles. It has
simply avoided the issue by requiring the companies to expense away the costs incurred for intangibles when they are incurred.

**The Indian Scene: AS 26 Intangible Assets and AS 14 Accounting for Amalgamation**

The Accounting standard (AS) 26 *Intangible Assets* issued by the Council of the Institute of Chartered Accountants of India has been drafted in the same line as IAS 38, *Intangible Assets*, issued by the International Accounting Standards Board (IASB) barring the requirement relating to measurement subsequent to initial recognition and amortisation period. Unlike IAS 38 which has offered a choice between two treatments subsequent to initial recognition namely (a) benchmark treatment and (b) allowed alternative treatment, AS 26 has prescribed only the benchmark treatment i.e., an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment loss. The other area where the two standards differ is the amortisation period. The Indian standard has considered that there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use while the international standard has considered the period as twenty years.

Difference in the amortisation period can also be found with respect to the treatment of goodwill arising out of amalgamation of business. AS14, *Accounting for Amalgamation* has prescribed a period of five years for amortisation of goodwill arising on amalgamation of businesses unless a somewhat longer period seems justified, while IAS 22, *Business Combination* has considered twenty years for amortisation of this item.

It is, therefore, noted that Indian standards have adopted a more conservative approach towards accounting for goodwill and intangible assets.
Accounting for Intangibles in Some Other Countries

The requirements for accounting for intangibles in some other significant countries are discussed in brief.

Germany

In Germany intangible fixed assets which are purchased are required to be capitalised and amortised. Capitalisation of purchased goodwill is optional. Capitalisation should always be done at the cost of acquisition cost. Internally generated intangibles including internally generated development expenditure should not be recognised. Goodwill arising on consolidation must be amortized through the profit and loss account. The law has mentioned a period of four years for goodwill amortisation. Intangible assets are to be amortised over their estimated useful life using the straight-line method.

France

French GAAP requires capitalization of purchased intangibles including goodwill at their acquisition costs. As regarding capitalization of internally developed intangibles the following guidelines are prescribed:

Patents: Patent development cost can be capitalized if the capitalization criteria are met.

Goodwill: Their capitalization is prohibited.

Start-up costs: They may be capitalized as intangible assets.

R&D Expenditure: Applied R&D expenditure may be capitalized as intangible assets. Pure research is never reported as an asset.

The GAPP has also permitted recognition of some items such as software development costs, advertising costs, training costs and portfolio of customers as assets.

The French GAAP has not set any specific period for amortisation of purchased goodwill. Goodwill can be retained in the balance sheet as a permanent asset where it is seen as having an enduring value. It can be amortised through the profit and loss account over its useful economic life if that is determinable. Immediate write-off is also permitted by the 1986 Decree, but with imprecise conditions. Other purchased intangibles may be subject to systematic amortisation if their value is associated with a specific period of legal protection (such as patent). When the value of a category of intangible assets e.g.,
The Netherlands

Dutch companies are allowed to capitalise purchased intangibles only if future benefits are assured and in excess of future depreciation. Internally generated intangible assets other than goodwill may be capitalised based on costs incurred and a reasonable amount of indirect costs. R&D costs can be capitalised only if the following conditions are met:

1. A detailed description has been made of the product and process, and costs to be allocated are determinable.
2. Proof exists of the technical feasibility of the product or process.
3. The new product or process will be introduced in the market.
4. There is clear market potential or other beneficial use.
5. The development process can be completed (i.e., is financially feasible)

The accounting regulation leaves several options for the after recording treatment of purchased goodwill. It can be treated as an asset with systematic amortisation over its useful life. Amortisation over a period extending five years requires explanation. Immediate write-off against reserves is also permitted. The third option available to Dutch companies is to write-off goodwill against current income, but this option is rarely availed of.

Intangible assets, except R&D and issue costs and goodwill, must be depreciated over their useful lives. R&D and bond issue costs must be amortised over a period not exceeding 5 years.
Australia

The Australian GAAP requires the recording of purchased intangibles, including goodwill, at cost. Internally developed intangibles excluding goodwill may be recorded as assets at cost or at fair values if:

1. They are material.
2. They can be clearly identified as contributing to the revenue earnings capability of the business in the future.
3. It is reasonably expected that the future revenue will be sufficient to carry the expense forward, or the expenditure has given rise to an asset that may be reasonably expected to realise at least its book value.

The Accounting Standard of the Australian Accounting Standard Board (AASB)1011, Accounting for Research and Development Costs states that R&D costs should be expensed as they are incurred.

According to AASB 1013, Accounting for goodwill, purchased goodwill is amortised, by systematic charge against income, over the useful life not exceeding 20 years. There are no definite rules regarding amortization of other identifiable intangible assets like patents, tradenames, brand names etc. There is no annual impairment test requirement. So only in few cases these are amortised over their expected useful lives. In most of the cases these assets are not amortised as it is argued that they have indefinite lives. But the AISC has not favoured this practice. It notes that ‘it is extremely unlikely that AISC will accept a claim that the life of an intangible asset is unlimited, nor would it accept a claim that the life should be regarded as unlimited because a precise estimate of useful life can not be made’. So it has asked a number of companies to review and revise their accounting for intangibles (Roberts, Weetman and Gordon, 2002).

China

The Chinese GAAP requires similar treatment for all intangible assets including patents, non-patented technology, trademarks, copyrights, and rights to use sights and positive goodwill. All purchased intangibles must be initially recorded at costs. Similarly all self-generated intangibles should be recorded at costs. Thus as regards accounting for internally generated intangibles there is significant departure from the international
practice. Once the initial costs have been recorded, they must then be amortised over the periods expected to generate benefit. If the useful lives of intangibles cannot be ascertained, they must be amortised over a period of not less than ten years.

Japan

In Japan, purchased intangibles including goodwill are recorded at cost. Internally generated intangibles are also recorded at cost, but internally generated goodwill is not allowed to be recognised as an asset. The Stock Exchange Act in Japan has also prohibited recognition of internally generated brand as an asset in the balance sheet.

In 1998 the Business Accounting Deliberation Council (BADC) issued a standard that required both research costs and development costs to be charged as expenses when incurred (Global Financial Reporting, John Flower, 2002). They should be disclosed in footnotes.

Acquired goodwill, which is to be capitalised, must be amortised within five years after its acquisition. Intangible assets are amortised over their estimated useful lives usually following the straight-line method.

Belgium

The Belgian GAAP has permitted companies to record purchased intangibles at acquisition costs. It has also permitted capitalisation of internally generated intangibles at costs incurred. However, the costs at which intangibles will be capitalised must not exceed their “prudently estimated usage value or future return” for the enterprise.

The Belgian GAAP is very much liberal towards treatments of changes in value of intangibles. Intangibles with limited useful lives are subject to amortization. The selection of the method and rate of amortization are left to the judgement of firm’s board of directors. Complementary or exceptional, amortization is required if, as a result of changes in economic or technological circumstances, the book value of intangible assets exceeds its usage value. Intangible assets with unlimited useful lives are subject to reduction in book value only if permanent loss in value has occurred.
Italy
The accounting regulation in Italy has allowed recording of purchased intangibles. However, purchased goodwill can be capitalised subject to the permission from the collegio sindacale. The GAAP is very selective in allowing capitalisation of internally generated intangibles. It has prohibited capitalisation of internally generated goodwill and also brand. In rare cases advertising expenses, research and development costs are capitalised.

Intangibles and deferred charges are required to be amortised over the expected period of benefit, which should never exceed 5 years. The NCA recommends that goodwill be amortised within 5 years or more than 5 years but the period should never exceed 10 years. The NCA has recommended a specific amortization policy. As an alternative it suggests amortization over the expected period of benefit.

Sweden
If an entity has acquired a business for a consideration that exceeds the value of the acquired assets, the difference may be recognised as an intangible asset to the extent that it represents goodwill.

Expenditures for technical assistance, research and development, trial runs, market research and similar activities may be recognised as intangible assets, provided that the expenditures will benefit the entity during future years. The Swedish GAAP requires goodwill to be amortised over its useful life, which should normally not exceed 10 years. A maximum of 20 years is permissible.

Norway
The Norway GAAP permits capitalisation of intangible expenditure as fixed assets provided they will benefit the entity during future years. Such assets should be amortised by an appropriate amount, generally at least 20 percent annually. However, if it is clear that the value of intangible assets will last for a longer period, amortization at lower rate is permissible.
Trademarks are amortised over their economic life. Goodwill is subject to annual amortization of 20 percent on the straight-line basis. Amortization of goodwill can be based on a longer period subject to a maximum of 20 years (5 percent).

**Switzerland**

Purchased intangibles may be carried on a Swiss balance sheet at values not exceeding their realizable value to the company. In other words, they are to be shown at the lower of cost or market value.

According to Accounting and Reporting Recommendations (ARR) 9 issued by the Fachkommission für Empfehlungen zur Rechnungslegung (FER, Foundation of Accounting and Reporting Recommendations), the Swiss accounting standards body, internally generated intangibles may be recognised as assets when the following criteria are satisfied:

- the intangible item can be separately identified;
- it will generate future economic benefits over several years;
- its costs can be reliably measured;
- adequate resources exist, or are reasonably certain to be available to complete the item and to market or use it.

Research costs can not be capitalised. Development costs can be capitalised provided the above recognition criteria, as applicable for other intangibles, are fulfilled.

According to ARR 9, intangible assets should be amortised on a systematic basis (generally straight-line method) over their useful lives. When the useful life of an intangible can not be reliably measured, the amortization period should not exceed 5 years. However, if a longer life of an intangible can be established, the amortization period can be extended subject to a maximum of 20 years. In any event, intangible assets related to human resources should not be amortised over more than 5 years.

**Canada**

In Canada companies can record goodwill as asset in the balance sheet only when it is purchased. Research costs are required to be expensed as they are incurred. The same is
generally true for development costs, but deferral is required if all the following criteria are met:

1. The product or process is clearly identified and the costs attributable thereto can be identified.
2. The technical feasibility of the product or process has been established.
3. The management of the enterprise has indicated its intention to produce and market or use the product or process.
4. The future market for the product or process is clearly defined, or if it is to be used internally rather than sold, its usefulness to the enterprise has been established.
5. Adequate resources exist, or are expected to be available, to complete the project.

The Canadian GAAP, like US GAAP, abolished amortisation of goodwill and other intangibles over 40 years and replaced it by annual impairment test.

It is noted from the above discussion that requirements relating to accounting for intangible assets differ from country to country. However, from the accounting periods beginning on and from 1st January 2005, all listed companies in the countries belonging to the European Union will be required to issue financial statements based on IASs of the IASB. The Financial Reporting Council of Australia has also decided to adopt IAS in Australia from 1st January 2005 (Accountancy, August 2002). This decision is in the right direction towards attainment of harmonization of accounting practices all over the world. Anyway, the present requirements relating to intangibles accounting in the countries stated above are presented in a comparative form in the Table 13. The presentation is a highly condensed one, focusing only on some key aspects of intangibles accounting. The areas of intangibles accounting in respect of which international comparison is made are:

1. recognition of internally generated goodwill, (2) recognition of purchased goodwill and other intangibles, (3) recognition of internally generated intangibles (other than goodwill), (4) requirement relating to amortisation, (5) retention of purchased goodwill and intangibles as permanent assets, (6) immediate elimination against reserve, (7) requirement of impairment test, (8) treatment of negative goodwill (9) capitalization of research costs and (10) capitalization of development costs.
<table>
<thead>
<tr>
<th>Requirement</th>
<th>UK</th>
<th>USA</th>
<th>India</th>
<th>Germany</th>
<th>France</th>
<th>The Netherlands</th>
<th>Austria</th>
<th>Japan</th>
<th>China</th>
<th>Belgium</th>
<th>Italy</th>
<th>Sweden</th>
<th>Norway</th>
<th>Switzerland</th>
<th>Canada</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognition of Inherent Goodwill</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
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<tr>
<td>Recognition of Purchased Goodwill and other Intangibles</td>
<td>Allowed</td>
<td>Allowed</td>
<td>Allowed</td>
<td>Allowed</td>
<td>Allowed</td>
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<tr>
<td>Recognition of Internally-Generated Intangibles</td>
<td>Allowed if it is likely to generate future economic benefits and its costs can be reliably measured. Brand and some other intangibles can not be recognised.</td>
<td>Allowed if it has readily ascertainable market.</td>
<td>Same as IASB</td>
<td>Allowed except Brand</td>
<td>Allowed</td>
<td>Allowed</td>
<td>Allowed</td>
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<tr>
<td>Amortisation of other Intangibles</td>
<td>Allowed</td>
<td>Allowed</td>
<td>Allowed</td>
<td>Allowed</td>
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<td>Allowed</td>
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<tr>
<td>IASB</td>
<td>UK</td>
<td>USA</td>
<td>India</td>
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<tr>
<td><strong>Maximum Period of Amortisation</strong></td>
<td>Not applicable for G and I with indefinite useful life; for other I over useful life</td>
<td>Over useful life with rebuttable presumption that it will not exceed 20 years</td>
<td>Not applicable for G and I with indefinite life; for other I over useful life</td>
<td>5 years for G and for I over estimated useful life</td>
<td>4 years for G and for I over estimated useful life</td>
<td>5 years for R and G and for I over useful lives</td>
<td>5 years for G and for I over useful lives</td>
<td>5 years for G and for I over useful lives</td>
<td>Over useful life for I; For G over 5 years</td>
<td>Over useful life</td>
<td>5 years for I; R &amp; G; For G, 10 years for G and in some cases</td>
<td>5 years for I &amp; R; 20 years for G;</td>
<td>Same as USA</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Retention as permanent assets</strong></td>
<td>Allowed</td>
<td>Allowed for G and I</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
<td>Allowed for G and Brand</td>
<td>Not Allowed</td>
<td>Allowed</td>
<td>Not Allowed</td>
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<tr>
<td><strong>Immediate elimination of goodwill against reserve</strong></td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Allowed with impaired condition</td>
<td>Allowed</td>
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<tr>
<td><strong>Impairment test</strong></td>
<td>Required</td>
<td>Required at the end of first year and at the end of each reporting period if amortisation exceeds 20 years for G &amp; I</td>
<td>Required at the end of each reporting period</td>
<td>Required if amortisation period exceeds 10 years</td>
<td>Not Required</td>
<td>Amortisation over period exceeding 5 years requires explanation</td>
<td>Not Required</td>
<td>Not Required</td>
<td>Not Required</td>
<td>Not Required</td>
<td>Not Required</td>
<td>Not Required</td>
<td>Not Required</td>
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<td>Not Required</td>
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<tr>
<td><strong>Treatment of Negative Goodwill</strong></td>
<td>To be credited in the P/L</td>
<td>Utilised to reduce proportionately the fair value</td>
<td>Credited to the Reserve</td>
<td>Data not available</td>
<td>Credited to the Owners' Equity</td>
<td>Data not available</td>
<td>Credited to Revaluation Reserve</td>
<td>Data not available</td>
<td>Data not available</td>
<td>Data not available</td>
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<tr>
<td>IASB</td>
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<tr>
<td>A. C. as immediate gain</td>
<td>if it is treated as income in P/L, A.C. according to their consumption. Any balance is treated as deferred income credited to the years benefitted.</td>
<td>Allowed for I</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
<td>Not Allowed</td>
<td>Allowed for I</td>
<td>Not Allowed</td>
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<tr>
<td>Revaluation (increase in value)</td>
<td>Allowed for I</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Allowed for applied research</td>
<td>Allowed in restricted cases</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Allowed in some cases</td>
<td>Allowed in some cases</td>
<td>Not allowed</td>
<td>Not allowed</td>
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<tr>
<td>Capitalization of research costs</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Allowed for applied research</td>
<td>Allowed in restricted cases</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Not allowed</td>
<td>Allowed in some cases</td>
<td>Allowed in some cases</td>
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<tr>
<td>Development Costs</td>
<td>Allowed in restricted cases</td>
<td>Not allowed</td>
<td>Allowed in restricted cases</td>
<td>Not allowed</td>
<td>Allowed in restricted cases</td>
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</table>

I = Other intangible assets; R = R&D costs; G = Goodwill

Sources: