Corporate reporting relies on the statutory rules and standards laid down by different statutory bodies all over the world. Every country has its own statutory body which issues mandatory rules and establishes certain standards from time to time, keeping in view its economic and legal environment. As mentioned earlier, the term ‘intangibles’ has not yet been given a globally accepted definition by the accounting authorities. Some authors define it as financial asset, whereas others think that intangibles are more of non-financial in nature. Most of the existing standards on intangibles define it as financial asset which limits their application in the financial statements. As a result, number of organizations and standard setting bodies are working on improving the present business reporting system so as to incorporate non-financial intangibles also along with financial intangibles. First of all, this chapter discusses in detail the existing standards along with its limitations and steps taken to improve the same. Then, the chapter discusses IAS-38 (an international standard on intangibles) along with their limitations and steps taken in this direction by International Accounting Standards Board (IASB) and some other prominent international organizations.

2.1 INDIAN STATUTORY RULES AND STANDARDS ON INTANGIBLES

In India, corporate reporting disclosure requirements consist of the accounting standards issued by the Institute of Chartered Accountants of India (ICAI); provisions laid down in the Indian Companies Act, 1956; and the listing requirements of Securities Exchange Board of India (SEBI).

ICAI is a national standard setting body in India. It regulates the corporate disclosure practices by issuing standards, statements and guidance notes containing various rules of accounting measurement and disclosure. So
far, ICAI have issued 28 standards of which Accounting Standard-26 (AS-26) deals with intangible assets which came into effect from April 2003. Earlier, accounting for intangible assets was governed by AS-10 which details out the criteria for recognition of purchased goodwill, patents and know-how, AS-6 on ‘depreciation accounting’ and AS-8 on ‘accounting for research & development’. All these standards stand withdrawn with the coming up of AS-26 on ‘intangible assets’.

The objective of AS-26 is to prescribe accounting treatment for intangible assets that are not dealt with specifically in any other accounting standard. The standard requires an enterprise to recognise an intangible asset if and only if certain criteria are met. Recognition of an intangible is guided by two sets of accounting rules (1) it shall satisfy the definition of an intangible asset (2) it shall fulfil the recognition criteria specified in the standard. The standards define intangible asset as an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Further, an intangible asset shall be recognized if and only if it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and the cost of the asset can be measured reliably (AS-26.20). As per the standard an intangible asset shall be measured initially at cost (AS-26.23). After the initial recognition an intangible asset shall be carried at cost less any amortization or impairment loss (AS-26.62). As per AS-26 internally generated goodwill should not be recognized as an asset (AS-26.35) but it sets out some recognition criteria for internally generated intangible assets. To assess that whether an internally generated intangible asset meets the criteria for recognition, an enterprise shall classify the generation of the asset into research phase and development phase. Only intangible asset arising from the development phase shall be recognized as an asset. If the recognition criterion is not met then the expenditure on generating an intangible asset should be expensed (AS-26.55). The standard states that the depreciable amount of an intangible asset shall be allocated on
a systematic basis over the best estimate of its useful life. This useful life of an intangible asset shall not exceed ten years from the date when the asset is available for use. The amortization method used shall reflect the pattern in which the assets economic benefits are consumed by the enterprise. If the pattern cannot be determined reliably, the straight-line method shall be used (AS-26.72). As per para 90 of the standard, the financial statements shall disclose the useful life, method, gross carrying amount and the accumulated amount relating to amortization for each class of intangible assets, distinguishing between internally generated intangible assets and other intangibles (AS-26.90). In addition, the financial statements shall also disclose an intangible asset which is amortized for more than ten years and the reasons for the same (AS-26.94). Regarding R&D expenditure the standard shall disclose the aggregate amount of R&D expenditure which is being expensed during the period (AS-26.96). Further, as per the standard the internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognized as intangible assets. These can be disclosed as a separate class/ group of intangibles (AS-26.91). The standard sets out some of the common items of intangibles. It includes computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licenses, import quotas, franchises, customer or supplier relationships, customer loyalty, market share, marketing rights and goodwill (AS-26.7). As per the standard not all the items mentioned above will meet the definition of an intangible asset (AS-26.8). It means that the standards do not cover all the intangibles existing in an enterprise, only those intangible assets are recognized which fulfil both the definition and the recognition criteria referred in the standards.

On the whole, AS-26 discusses intangible assets from financial point of view leaving out many intangibles which are non-financial in nature. Sveiby (1997) argued that intangibles are essentially non-financial and we, therefore, need new, non-monetary proxies to measure them. In the Indian context, some of the non-financial indicators are being covered by the provisions of
Companies Act 1956 and the listing requirements of SEBI. As per provisions of the Act, a company should disclose in its ‘notes to accounts’, the details regarding contingent liabilities, expenditure on R&D, company’s business profile etc. Further, the listing requirements of SEBI require companies to disclose information on remuneration policy, plant locations, market price data, shareholding pattern etc. which are intangible in nature.

2.2 THE U.S. STATUTORY RULES AND STANDARDS

In the U.S., corporate reporting disclosure requirements consist of accounting standards issued by Financial Accounting Standards Board (FASB), and the guidelines laid down by Securities Exchange Commission (SEC).

The FASB has been the designated organisation in the private sector for establishing standards of financial accounting and reporting. Till date, FASB has issued 160 standards of which Statements of Financial Accounting Standards No.142 (SFAS-142) deals with goodwill and other intangibles. Though the concept of accounting for goodwill and other intangibles is not new to FASB but still realizing the increasing importance of intangibles in globalised economy, FASB issued a new statement on goodwill and other intangible assets in 2001. Prior to the issuance of this statement the provisions on accounting for goodwill and other intangible assets was provided by APB opinion no. 17, ‘intangible assets’ which the Accounting Principles Board (APB) issued in 1970.

The SFAS-142 addresses financial accounting and reporting on intangible assets acquired individually or with a group of other assets. As per the statement, an intangible asset acquired either individually or with a group of other assets shall be initially recognized or measured on its fair value (SFAS-142.9). The statement also applies to the costs of internally developing goodwill and other unidentifiable intangible assets with indeterminate lives (SFAS-142.5). Costs of such internally developing, maintaining or restoring
intangible assets shall be recognized as an expense when incurred (SFAS-142.10). Regarding accounting procedure, the statement mentions that an intangible asset with finite useful life should be amortized (SFAS-142.11), whereas other intangible assets should be tested for impairment on an annual basis or more frequently if events or changes in circumstances indicate that the asset might be impaired (SFAS-142.17). Further, goodwill shall be tested for impairment (SFAS-142.18). As a result, the enterprise shall disclose the total amount, any significant residual value and the weighted average amortization period assigned to any major intangible asset class which is subject to amortization (SFAS-142.44). Further, the enterprise shall disclose the gross carrying amount, the accumulated amortization value and the aggregated amortization expense for that period and for each of the five succeeding fiscal years of any major asset class which are subject to amortization (SFAS-142.45a). For intangible assets which are not subject to amortization, the enterprise shall disclose the total amount (SFAS-142.44b) and the total carrying amount assigned to that particular intangible class (SFAS-142.45b).

SFAS-142 does not change the accounting and reporting procedure prescribed by SFAS-2 on ‘Accounting for Research and Development Costs’ and SFAS-86 on ‘Accounting for Costs of Computer Software to be sold, leased or otherwise marketed’. As R&D and Software are the two important intangibles so their accounting and reporting procedure prescribed in the above mentioned statements is being discussed in the following section. As per SFAS-2 all R&D costs shall be charged to expense when incurred (SFAS-2.12) and the enterprise shall disclose this amount in its financial statements in each period for which an income statement is presented (SFAS-2.13). Further, SFAS-86 establishes standard of financial accounting and reporting for the costs of computer software to be sold, leased, or otherwise marketed as a separate product or as part of a product or process, whether internally developed and produced or purchased. It identifies that the costs incurred in the process of creating a software product shall be accounted and reported in
the same manner as SFAS-2 on ‘R&D costs’ provides. Further, the costs of producing software product shall be capitalized (SFAS-86.5) and then amortized on a product-by-product basis (SFAS-86.8). This capitalization of computer software costs shall cease when the product is available for general release to customers and it shall be charged to expense when related revenue is recognized or when those costs are incurred, whichever occurs first (SFAS-86.6) As a result, the enterprise shall disclose the unamortized computer software costs included in the balance-sheet and the total amount charged to expense in each income statement presented for amortization of capitalized computer software costs (SFAS-86.11).

In the words of Jorboe (2005; p.1), “While a framework exists for the recognition of intangibles under U.S. Financial Accounting Standards Board (FASB), SFAS 141 and 142, this framework is incomplete in both its scope (i.e., only those assets acquired from outside the company must be recognized) and its coverage (i.e., certain intangibles such as R&D and workforce, are specifically excluded)”. According to him, a review of various studies and discussions reveals three points: (i) there is continued lack of clarity about what should be included; (ii) there are areas that have been clearly excluded from SFAS 141 and 142 which need to be addressed; and (iii) the different treatment of acquired intangible assets and those generated internally. As a result, FASB decided to reconsider how intangible assets are amortized, including determination of the useful life, under SFAS 142. Further, FASB launched a project namely, the Business Reporting Research Project-Improving Business Reporting, in 2001. The FASB report on the same recommends a new comprehensive reporting model which includes non-financial metrics also along with financial metrics. It organizes the information into the following categories: (i) Business data (for example, high-level operating data and performance measurements that management uses to manage the business); (ii) Management’s analysis of business data (for example, reasons for changes in the operating and performance-related data, and the identity and past effect of key trends); (iii) Forward-looking information
(for example, opportunities and risks including those resulting from key trends; management’s plans, including critical success factors; and comparison of actual business performance to previously disclosed opportunities, risks, and management’s plans); (iv) Information about management and shareholders (for example, directors, management, compensation, major shareholders, and transactions and relationships among related parties); (v) Background about the company (for example, broad objectives and strategies, scope and description of business and properties, and impact of industry structure on the company); and (vi) Information about intangible assets that have not been recognized in the financial statements. In October 2005, Enhanced Business Reporting Consortium (Project of the AICPA’s special Committee) released a disclosure framework draft that intends to promote greater transparency on corporate strategy and performance. On the same lines SEC which has statutory authority to establish financial accounting and reporting standards for publicly held companies has played an active role in the development of disclosure principles on non-financial metrics. Recently, it has issued guidance for the ‘Management Discussion and Analysis’ statement required as a part of annual corporate filings. The guidance specifically mentions the types of metrics that would be permissible. It includes the items mentioned in FASB report discussed earlier and some other items being mentioned in the footnote of the report includes manufacturing plant capacity and utilization, backlog, employee turnover rates, customer satisfaction, time-to-market, product development, market demand, customer relations, employee retention, business strategy, changes in the managerial approach or structure etc.

2.3 JAPANESE STATUTORY RULES AND STANDARDS

In Japan, corporate reporting disclosure requirements consist of accounting standards issued by Accounting Standards Board of Japan (ASBJ), Corporation Law of Japan, and Securities and Exchange Law (SEL).
Until 2001, the Business Accounting Deliberation Council (BADC), an advisory body to Japan’s Ministry of Finance, held the prime responsibility for issuing standards. In 2001, BADC was replaced by Financial Accounting Standards Foundation (FASF) which organizes Accounting Standard Board of Japan (ASBJ) as an independent private sector entity to develop accounting standards in Japan. Since its inception, the ASBJ has issued many accounting standards and guidelines but regarding goodwill and other intangible assets the ASBJ has indicated that they will carry out a preliminary study project on ‘accounting for intangibles’ as a part of the convergence process (JICPA, 2006). As a result, till date in Japan, no accounting standard specifically deal with intangibles but it has a standard for Research and Development costs issued in 1998 by BADC. As per this standard, the total amount of R&D costs shall be charged to expense as and when incurred and this amount shall be noted to the financial statements. The standard also talks about the accounting and disclosure requirements on software costs for internal use. As per the standard, the software costs for internal use shall be capitalized as an asset and this amount shall be disclosed as an intangible fixed asset in the balance-sheet (www2g.biglobe.ne.jp). Regarding goodwill, some of the regulations are being discussed in standard for ‘business combinations’. As per this standard, goodwill is defined as the “excess of the acquisition cost of an acquired company or business over the net amounts assigned to assets acquired and liabilities assumed” (Nakamura, 2006). For accounting, the standard provides that goodwill should be amortized by applying the straight-line method over periods not exceeding 20 years (JICPA, 2006).

Though the Commercial Law of Japan sets forth limited number of accounting disclosure requirements but it does talk about goodwill. The new Commercial Law of Japan which came into effect from 1st May, 2006 did not provide any definition of goodwill rather it specifies different cases in which recognition of goodwill is allowed. Further, the law specifies that assets should
be amortized when amortization is necessary for such accounts (Nakamura, 2006).

Disclosure requirements under the SEL which are aimed to protect the general interests of the investors deal with non-financial indicators as it requires that corporations should disclose about the nature of the business, an analysis of the financial position, outline of the corporate governance structure etc. (JICPA, 2006). Further, in 2004, the Japanese Ministry of Trade and Industry compiled a 'pilot model of patent/technical information disclosure' in which they issued reference guidelines for intellectual property information disclosure. The guidelines consist of below specified ten items, the details of these items are given in the annexure.

(i) Core Technologies and Business Models
(ii) R&D Segment and Business Strategy Orientation
(iii) R&D Segment and Intellectual Property Overview
(iv) Analysis of Marketability and Market Advantages of Technologies
(v) R&D and Intellectual Property Organizational Chart, R&D Alliances
(vi) Intellectual Property Acquisition and Management, Trade Secret Management, Policies on Technology Leakage Prevention (Including Guideline Implementation)
(vii) Significance of the Licensing Activities to the Company’s Business
(viii) Significance of the Patent Portfolio to the Company’s Business
(ix) Policies on Intellectual Property Portfolio
(x) Information on Risk Countermeasures.

2.4 SOME NOTABLE EFFORTS AT INTERNATIONAL LEVEL

International Accounting Standards Committee (IASC) now known as International Accounting Standards Board (IASB) has addressed the issue of
expanding the borders of what could be regarded as intangible assets on the balance-sheet by issuing International Accounting Standard–38 ‘Intangible Assets’ in 1998. The standard sets out examples of possible intangible assets, which includes computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, licenses, import quotas, franchises, customer and supplier relationships and marketing rights. It also includes intangibles acquired by separate purchase, as a part of combination, by a government grant, by exchange of assets and by self-creation. The standard requires that an enterprise shall recognise an intangible asset if and only if it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably (IAS 38.19). As per the standard intangible assets are initially measured at cost (IAS 38.22), whereas the subsequent expenditure shall be recognized as an expense when it is incurred unless the above mentioned criteria is met (IAS 38.60). Further, the standard requires that an intangible asset shall be amortized over the best estimate of its useful life (IAS 38.79) which shall not exceed 20 years from the date when the asset is available for use. Regarding disclosure requirements, the standard requires that an enterprise shall disclose for each class of intangible asset, the useful life, the amortization method, the gross carrying value, the accumulated amortized value and a reconciliation statement of carrying amount at the beginning and the end of the period (IAS 38.107). Further, an enterprise shall disclose an explanation about any intangible being amortized over longer than 20 years. An enterprise shall disclose the intangible acquired by way of government grants and the commitments to acquire intangible assets. The standard has been considered highly controversial as it delimits rather than extends the opportunities to capitalize intangibles (Grojer and Johnson, 1999). The standard codifies the traditional accounting approach which defines an asset in such a way to exclude ‘assets’ that cannot be directly linked to a revenue stream (Zambon, 2003). In particular, IAS-38 does not allow the recognition of assets arising from research or the recognition of internally generated brands.
publishing titles, customer lists and items similar in substance (IASB, 2007). Also, the study undertaken by Stolowy and Jeny (2001) indicates that IAS-38 has failed to bring international accounting harmonization as no conceptual framework is commonly accepted and there is a considerable lack of consistency both inter-country and intra-country. Efforts are being made to cover up the limitations of IAS-38. In December 2002, the IASB issued an Exposure Draft (ED) of proposed amendments to IAS-38 which amends the definition of an intangible asset. Further, in October 2005 IASB launched an initiative about whether it should promote a Management Discussion and Analysis "MD&A type" reporting framework known as Management Commentary (MC).

Organization for Economic Cooperation and Development (OECD) organized an international symposium on intellectual capital in 1999 where need for a better information on intellectual capital was evidenced. It was emphasized that the improvements in reporting should be made to inform employees, suppliers and customers better. Further, in 2006 OECD released a report on 'Intellectual Assets and Value Creation: Implications for Corporate Reporting' in which they concluded that competition is encouraging companies to improve their reporting and managerial practices with respect to intellectual assets. Moreover, they emphasized that the suitable framework for this improved reporting is narrative reports in which companies voluntarily disclose their key performance indicators. According to the report improved disclosure on intangibles should remain voluntary.

European Commission (EC) has launched series of studies and projects which aim to better understand the knowledge economy and the importance of intangible assets. One of the major projects named MERITUM (Measuring Intangibles to Understand and Improve Management) initiated in 1998 gave some important suggestions on reporting of intangibles. They suggested guidelines for the measurement and disclosure of intangibles, details of which are being attached in the annexure A(v). This project is being
followed by E*know-net which aims to exploit and make more visible the results obtained in MERITUM. Some other notable projects are MAGIC, PRISM, NORDIKA and FRAME.

A number of other institutions and governments are working in the area of intangibles. For example, Brookings Institution releases reports on two projects, namely, ‘unseen wealth’ and ‘intangibles management, measurement and reporting’. Danish Agency for development of trade and industry published a study of intellectual capital accounts, and the Netherlands Ministry of Economic Affairs published ‘Intangible Assets, Balancing Accounts with Knowledge’.