Accounting and Reporting for Knowledge Assets with the Adoption of International Accounting Standard (IAS)

Dr. Vineet Chouhan
Lecturer, School of Management, Sir Padampat Singhania University, Udaipur
Dr. Anil. K. Bhatt
Assistant Professor, Shrinathji Institute of Management, Nathdwara
Dinesh Kumar Vyas
Research Scholar, University of Kota, Kota

Abstract

The value of a business increasingly lies not in the physical and the financial assets that are on the Balance Sheet, but in the intangible assets: Goodwill, copyright Trademark, brand, patents, franchises, software, research programmes, ideas, and expertise. Persistent competitive pressure induced by globalization of trade, deregulation and technological changes have forced the companies to rely on continuous innovations. One of the Innovations in turn is primarily achieved by investment in intangible assets.
They are often cited as a reason for performance which is surprisingly better or worse than expected. For example, no particular player on a sports team might be seen as a standout player, but as a group they might be able to defeat teams who are as superior in skill. Intangibles are often broken down into categories of abstract including ability to work as a team, dedication and effort, and so on. In the business world these are commonly referred to as intangible assets.

What are the Knowledge Assets?

It is generally defined as "an identifiable non-monetary asset without physical substance held for use in the production or supply of good or services, for rental to others, or for administrative purposes". So to be identified as an intangible asset, an asset should have the following characteristics:

" The concerned asset is a non-monetary asset.
" It should not have any physical substance.
" It has used in the operating activities or it is held for earning rent from others or it is held for administrative purposes.

Intangibles are qualities in a individual, especially those organized in an official group (e.g. a sports team or office) which affect performance but are not directly measurable.

It is an assets that promises future benefits and are not physical, like property, plant, equipment, stock and bonds.

Shahrokh M. Saudagaran defines intangible assets in a broad and a narrow sense. According to him in a broad sense, intangibles are non physical sources of probable future economic benefit to an entity that exist in addition to monetary and tangible assets. However, in a narrow sense, they are non-physical sources of probable future economic benefits to an entity that have been acquired in an exchange or developed internally from identifiable costs, having a finite life, market value and are owned or controlled by the entity.

Importance of Knowledge Assets

With the growth of the markets, the service sector and the level of mergers and acquisitions, intangible assets have become increasingly important. While assessing the total value of a company it is not only the tangible but also the intangibles assets that should be considered.

Assessing Value
Total Value = Tangible + Intangible

This is especially true since activities that create intangibles always lead to a set of tangible outcomes, over a period of time. For some companies, particularly those in new markets or in the service sector where processes tend to be labour rather than capital intensive, the book value of their tangible net worth are often a small fraction of their market value. The data on market capitalization and book value of the Sensex Companies are presented in Table 1.

Table 1 :
Differences between Market Capitalization and Book Value of the Sensex Companies

Name of the Companies	Market Capitalization (Rs. in crores)	Book Values (Rs. in crores)	Mkt. Cap-BV
1. ACC	25,662.00	10,196.37	15,465.63
2. Bajaj Auto	49,274.66	28,654.18	20,620.48
3. BHEL	39,161.60	44,693.18	5,531.58
4. BSES	30,322.60	25,126.41	5,196.19
5. Castrol Ind.	22,971.00	4,038.45	18,932.55
6. CIPLA	62,248.86	9,163.42	53,085.44
7. Colgate	17,950.68	2,393.42	15,557.26
8. Dr. Reddy's Labs	35,658.32	2,800.63	32,857.69
9. Glaxo Smith Pharma	27,706.56	5,608.34	22,098.22
10. Grasim Ind.	28,509.37	27,070.15	1,439.22
11. Gujarat Ambuja Cement	30,872.86	17,049.89	13,822.97
12. HCL Technologies	12,877.76	3,472.40	9,405.36
13. Hero Honda	12,141.76	1,369.94	10,771.82
14. Hindalco	54,700.24	49,635.68	5,064.56
15. Hindustan Lever	43,363.64	3,037.66	40,352.98
16. HPCL	90,601.11	64,879.90	25,721.21
17. ICICI Bank	30,630.04	58,549.65	27,919.61
18. Infosys Tech	119,752.71	10,400.19	109,352.52
19. ITC	151,228.61	34,725.65	116,502.96
20. Larsen & Toubro	43,016.45	39,609.95	3,406.50
21. MTNL	83,790.00	95,256.00	11,466.00
22. Nestle India	48,788.52	2,651.55	46,136.97
23. Ranbaxy Labs.	92,720.00	16,017.38	76,702.62
24. Reliance Industries	276,086.12	143,627.49	132,457.63
25. Reliance Patro	119,643.93	106,118.96	13,524.97
26. Satyam Computer	13,903.11	3,862.67	10,040.44
27. SBI	115,786.00	134,687.94	18,841.54
28. Tata Steel	41,233.92	47,492.64	6,258.72
29. TELCO	41,581.80	36,687.94	4,893.86
30. Zee Telefilms	4,950.00	4,092.00	858.00

A proper disclosure of intangible assets would potentially yield greater transparency, enabling the investment and lending communities to make better decisions.

Accounting for Intangibles

The accounting for intangible assets must be considered in the context of the objective of the financial statement as a whole. One of the objectives is to provide the users of the financial statements with useful and reliable information to facilitate their decision making process.

Accounting for Intangible Assets has gained prominence in the past few decades due to changes in the way the business world operates. In the last couple of the year, new instrument & method of measuring, valuing & managing different forms of intangible assets have been proposed. The various proposals on how accounting for Intangible could more closely achieve the underlying objective of providing relevant & reliable information to users in a comparable & understandable manner.

National Practices

The treatment of certain intangible assets had to be construed from the various accounting standard till the Institute of Chartered Accountants of India (ICAI) came out with the Accounting Standard 26 on "Intangible Assets" in 2002. But with the adoption of International Accounting Standard now the International Practices will be useful and our companies have to adopt the International Accounting Standard (IAS).

International Accounting Practices

The International Accounting Standard (IAS) No. 38 "Intangible Assets" specifies the criteria under which an outlay can be treated as an intangible assets or must be written off as an expanses in the income statement. The rule of the initial recognition and measurement of intangibles comes in two parts:

1. It is probable that any future economic benefits associated with the team will flow to or from the enterprise and
2. The team has a cost or value that can be measured with reliability. This rule precludes the recognition of internally generated intangibles as assets.

IAS No. 38 has included advertising, training, start-up, and research and development (R&D) activities as intangibles. It does not apply to financial assets, insurance contracts, mineral rights and the exploration for and extraction of minerals and similar non-regenerative resources. IAS No. 38 permits two possible treatments for intangibles after they meet the initial recognition criteria. The preferred treatment is to carry the intangible assets at cost less any reduction due to amortization or impairment. The allowed alternative treatment is to revalue the intangible assets as it fair value less any subsequent amortization or impairment. Revaluation is only permitted if there is an active market from which to determine the fair value of the assets. IAS No. 38 also presumes that the useful life of the intangible assets is 20 years or less.

The Financial Accounting Standard Board (FASB) Concepts Statements provide similar fundamental criteria for recognition and measurement of intangibles as IAS. Which are:

1. "It embodies a probable future benefit that involves a capacity, single or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
2. A particular entity can obtain the benefit and control other's access to it, and
3. The transaction or other event giving rise to the entity's right to or control of the benefit has already occurred" (FASB Statement of Financial Accounting Concepts, No.6)

Further, the asset also must be measurable and provide information that is relevant and reliable (FASB Statement of Financial Accounting Concepts, No.5). The Statement also say that, to be reliable, the information must be "sufficiently free of error and bias to be useful" to the users.

Difficulties in Accounting for Intangibles

The valuation of intangibles is difficult due to the following reasons:

1. Companies have less control over intangibles, which causes higher risk.
2. If a company fails, its intangible assets cannot be sold off easily like the tangible assets.
3. There are no markets for intangibles and a market provides a value to tangible assets.
4. Management has no incentive to share the information about intangibles. Not only they can be held liable for error, but also sharing the

information would further complicate investors relations.

5. Intangible assets essentially represent the secret of a business enterprise. If the company shares those secrets with investors (and with competitors),it could hasten the erosion of those very intangibles.

In words of Bob Williams, an accounting expert at Lehman Brothers, "Accounting for intangible introduced so much more uncertainty and judgment into the accounting process and for a profession that likes its assets hard and well defined that is a problem".

Reporting For Knowledge Assets

Knowledge Assets are both large and important. They have increased in recent years both in significance and value. They require now much attention from managers, investors and financial analysts. While Knowledge assets have become so important today for managers, who are seeking to increase value and for both shareholders and other stakeholders of their companies and for investors, who are trying to optimize their investment portfolios and want to make more wiser investment decision, the standard for external corporate reporting (which should enable investor to assess a company's value creation potential for the future) and for internal management reporting and controlling (Which should enable managers to make more appropriate resource allocation and internal investment decision in an efforts to improve performance and increase corporate value) have not kept pace with the rises of intangibles. Accounting rules did not allow companies investment in intangibles and to report on them like on other assets, and this is the major reason for the growing disconnection between market values and financial information. Financial statements are insufficient to assess properly. The performance and the value generation potential of today's companies, where intangible assets are the major drivers of corporate value. Intangible assets can be reported with the help of the Model given in Table 2.

Table 2: Reporting for Knowledge Assets

Classification	**Definition and Measurement**			**Recognition**	
	Primary input intangible expenditures		Secondary input intangible assets	Intangible asset (Contract or legal rights)	Intangible expense (No/weak control rights)
	Acquired Cost $	Internal Cost $	Valuation $	$	$
Information System Infrastructure Information system planning and development, Commercial enterprise system, Software, Database, Other Computer Services, Registered patents, Trademarks, Designs, Licenses					
Production and Technology Product & process R&D, Product design, engineering and development, Process design, engineering and development, Technology adoption, Quality control systems, proprietary technology, patents, trademarks, designs, Licenses					

Human Resources Recruitment and selection, Incentive systems, Staff development and training, Staff goal planning and evaluation, Information and knowledge database development, programs for health and motivation of workforce (e.g: labour relations, health care, fitness)					
Organization & Administration Organization design and management technique, Corporate governance structures, Networks and strategic alliances, Administration structure and systems, Finance systems, Accounting systems.					
Procurement and External Distribution Distribution and market research systems, Advertising, Trademarks, Brands, Customer list, subscribers' list, potential customer list, Product certification, quality certificates.					
Total Information Infrastructure					
Total Production and Technology					
Total Human Resources					
Total Organization and Administration					
Total Procurement and distribution					
Total					

Conclusion

We would like to sum up by posting a key question: How we accomplish the main objective that has presented in the paper i.e., accounting and reporting for intangible assets in the best way? In our opinion the best solution for accounting if Intangible assets could be a combination of both approaches and recognition of Intangible assets in Financial Statements include the ones that have not been acquired but created in house (to enable investors to better assess the past performance of the companies) and in addition to the financial statement a supplement report which is reporting on the potential available and in creation to enable for future performance (each of them measure against financial result in future).

In traditional accounting system financial statements are missing all Knowledge capital which may be contributing 60% to 80% of the value of Knowledge-based enterprise and hence the system is not verify as informative. The proposed accounting system will report value of intangible and will make the balance sheet considerably richer.

References

Baruch, Lev. "Intangibles: Management. Measurement and Reporting", http:/// w w w . k n o w l e d g e .

Wharton.upenn.edu.com

Ghosh, T.P. (2001), "Accounting Standards and Corporate Accountmg Practices", Taxmann Allied Services (P) Ltd.

Saudagaran, M. Shahrokh (2001), "International Accounting", Thomson Asia Pte Ltd., Singapore.

IAS No. 38 on "Intangible Assets" From http:///1www.iasc.org.uk

Accounting Standard 26 on "Intangible Assets", The Chartered Accountant, Vol. 50, No. 8, February 2002.

Baruch, Lev, "Intangibles: Management, Measurement and Reporting", Http:///www.wharton.upenn.edu.com.

Ghosh, T. P.(2001), "Accounting standard and corporate accounting Practices", Taxmann Allied services(P) Ltd., PP 200

Sisodia, Amit S.(2001), "Accounting For Intangibles", Charted financial Analyst, October, PP 44-46

ABDEL-KHALIK, A.R. (1975), "Advertising Effectiveness and Accounting Policy," The Accounting Review, pp 657-670.

ABOODY, D., BARTH, M. E., AND R. KASZNIK. (1999), "Revaluations of Fixed Assets and Future Firm Performance: Evidence from the U.K." Journal of Accounting and Economics, pp149-178.

AMIR, E. AND B. LEV. (1996), "Value-Relevance of Non financial Information: The Wireless Communications Industry," Journal of Accounting and Economics, pp 3-30.

BARTH, M. E., W.H. BEAVER, AND W.R. LANDSMAN. (1998), "Relative Valuation Roles of Equity Book Value and Net Income as a Function of Financial Health.", Journal of Accounting and Economics, pp 1-34.

BHUSHAN, R(1989),"Firm Characteristics and Analyst Following", Journal of Accounting and Economics, pp 255-274.

BOTOSAN, C.A. (1997), "Disclosure Level and the Cost of Equity Capital." The Accounting Review, pp323-349.

BRENNAN, M., AND P. HUGHES. (1991), "Stock Prices and the Supply of Information", The Journal of Finance, pp 1665-1691.