Accounting Treatments for Identifiable Intangible Assets

Currently in Australia, there is no single accounting standard specifically handling the issue of accounting for identifiable intangible assets other than research and development costs. In 1989, the Australian Accounting Research Foundation (AARF) issued an exposure draft ED 49 Accounting for Identifiable Intangible Asset, covering a vast range of identifiable intangibles, which included, but was not restricted to, brand names, franchises, licence agreements, copyrights, intellectual property, mastheads, trademarks and patents. However, it was withdrawn in 1992 due to a lack of consensus (Belkaoui & Jones, 1996, p.484). Because of the absence of special standards, accounting treatments for these identifiable intangible assets could be selective and thus creative. It may be necessary to take further action to develop an accounting standard on this issue in Australia.

Although intangible assets are often referred to in the literature and in the financial reports of many entities, there seems to be not a unanimous definition for such assets. According to Henderson & Peirson, intangible assets can be defined as rights rather than objects (2002, p.370). However, International Accounting Standard (IAS) defines an intangible asset as an identifiable non-monetary asset without physical substance (IASB, 2002, online). The elusive definitions of identifiable intangible assets contribute to the inconsistency of accounting treatments for such assets. This essay sets out to discuss some arguments about the accounting treatments for identifiable intangible assets based on the analyses of three Australian publicly listed company cases, and analyse some possible recommendations for the new standard.

Case studies of three Australian publicly listed companies

As per IAS 38 Intangible Assets, examples of possible intangible assets include:

- computer software
- patents
- copyrights
- motion picture films
- customer lists
- mortgage servicing rights
- licences
- import quotas
- franchises
- customer and supplier relationships
- marketing rights (IASB, 2002, online).

As there is no separate standard for identifiable intangible assets apart from research and development costs, the accounting treatments for such assets should be subject to other related standards including AASB 1010 Recoverable Amount of Non-current Assets, AASB 1015 Acquisitions of Assets, AASB 1021 Depreciation and AASB 1041 Revaluation of Non-current Assets. AASB 1010 states that a non-current asset measured on cost basis should be written down to

its recoverable amount which is less than its carrying amount (Knapp & Kemp, 2003, p.227). AASB 1015 requires assets be recorded at the cost of acquisition (Knapp & Kemp, 2003, p.305). As per AASB 1021, non-current assets with limited useful lives should be depreciated over those useful lives (Knapp & Kemp, 2003, p.507). In AASB 1041, non-current assets are required to be measured at either cost or fair value (Knapp & Kemp, 2003, p.969).

The cases to be analysed below are Telstra Corporation Limited (TLS), Lend Lease Corporation (LLC) and Amalgamated Holdings Ltd (AHD), all of which are Australian publicly listed companies. For the purposes of this essay, the accounting treatments for identifiable intangible assets should involve the amortisation method, the useful lives of the assets and the treatment for their recoverable amounts. The following paragraphs will describe their accounting treatments for identifiable intangible assets, discuss the possible reasons for the treatments adopted by each of them and identify similarities and differences in the treatments across the three companies.

First of all, it can be seen from the financial report of Telstra that the dollar value of intangible assets was A$3,012 million at 30 June 2001. Excluding the goodwill of A$1,548 million, the identifiable intangible assets were A$1,464 million, which included patents, trademarks, licences, brand names, and customer bases (Appendix 1). According to note 1.20(b) to the financial statements, the costs of such assets were amortised using the straight-line method over their useful lives, which averaged 12 years for financial year 2001. The recoverable amounts were reviewed annually and the carrying amount was adjusted down and charged to the statement of financial performance when necessary. However, the research and development costs and the software assets developed for internal use were put under the item of other assets instead of intangible assets (note 1.21). On the other hand, note 1.1 states that its financial report was prepared in costs.

According to AASB 1021, the depreciation or amortisation method should be able to reflect the pattern where the entity consumes the future economic benefits of its assets (Knapp & Kemp, 2003, p.509). It may be because of the difficulty of estimating the pattern of consumption of economic benefits from aforenamed assets, which includes patents, trademarks, licences, brand names, customer bases, research and development costs and software, that they were amortised using the straight-line method in Telstra’s practice. Furthermore, the useful life of an asset should be estimated considering the factors of expected physical wear, obsolescence and legal or other limits on the use of the asset (Knapp & Kemp, 2003, p.509). Though the useful lives of some intangibles were not given individually, it can be believed that they were estimated on consideration of the legal limits of intangible assets. Besides, as required by AASB 1010, the intangible assets of Telstra are reviewed annually and reduced their values where applicable.

Second, according to its financial report, Land Lease had intangibles of $2.6 million other than goodwill on 30 June 2001, which consisted of a patent $ 4.2 million that was being amortised over 3 years. The basis of amortisation was the straight-line method. Moreover, the costs of IT systems and mortgage servicing rights were put under the name of other assets instead of recording in intangible assets. The notes also states that the financial statements had been prepared on historical cost and did not take into account fair values of non-current assets.

Land Lease is a real estate investment manager company. Due to its range of services, it may be believed that its intangible assets were recorded on cost basis because it was assumed to be more reliable. The use of a straight-line basis may attribute to the difficulty of estimating the pattern of consumption of economic benefits from its intangible assets. The various useful lives, however, could be determined relying on the length for which Land Lease was going to use them.

The third company to be analysed is Amalgamated Holdings Ltd (AHD). The financial statements show that it possessed $11,437 thousand intangible assets, the identifiable intangible asset among which is a liquor licence of $82 thousand at 30 June 2001. It can be seen from note 17 that the liquor licence was not amortised during the financial year 2001. Research and development expenditure was expensed as incurred and thus not included in intangible assets. The financial statements had been prepared on the historical costs basis, not concerning the fair values. The carrying amount of identifiable intangibles was reviewed at balance date, the excess amount of which over the recoverable amount, if any, would be written off as an expense.

As described above, Amalgamated Holdings recorded its intangible assets at costs instead of fair values probably due to the belief that the former may be more reliable. The treatment of carrying amount is subject to the requirements of AASB 1010. However, the possible reason for not amortising the liquor licence could be the belief that it has an indefinite useful life.

In summary, comparing and contrasting these treatments adopted by the three companies above, there are both similarities and differences in the treatments. On the one hand, they all prepared their financial reports on a historical costs basis, and reviewed the carrying amounts of their identifiable intangible assets and write them down when they were greater than the recoverable amounts. Moreover, any of the three companies did not recognise the research and development costs as identifiable intangibles. On the other hand, both of Telstra and Land Lease amortised their identifiable intangible assets on a straight-line basis over their useful lives, while Amalgamated Holdings did not perform this amortisation for financial year 2001. Also, there is a slight difference between the useful lives determined by Telstra and Land Lease. The former amortised its intangible assets over the period of expected benefit based mainly on their legal lives, while the latter amortised its patent over 3 years, which was much shorter than its legal life.

Arguments about these accounting treatments in companies' reports

In the next part, both positive and negative sides of the arguments with respect to the recognition and subsequent amortisation of identifiable intangible assets in these three companies' annual reports are to be discussed. Analyses would be undertaken regarding to two sections: recognition and amortisation of identifiable intangible assets.

Firstly, an asset is recognised in the statement of financial position when and only when it meets the recognition criteria (Greaves et al. 2003, p.3-7). As per ED 49, an identifiable intangible asset is to be brought to account where (a) the future benefits of the identifiable intangible asset are probably to eventuate, and (b) it possesses a cost or other value that can be measured reliably (Alfredson, 2001, p.13). By and large, existing financial statements often recognise only those assets that are acquired externally. Arguments encompass the extent of the recognition and the value recognised of identifiable intangible assets.

To some extent, internally developed intangible assets will often not be easy to measure reliably because they may not be able to associate directly with transactions of the entity (Alfredson, 2001, p.13). IAS 38 issued by the International Accounting Standards Committee (IASC) puts some restrictions on the recognition of internally generated intangible assets. Paragraph 45 states that internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets (Leo, 1999, p.30). However, opponents of IAS 38 argue that these rules for recognition are inconsistent because identifiable intangible assets are treated differently from other non-monetary assets (the Group of 100, 2000, online). For instance, internally generated intangibles such as brands, mastheads and publishing titles may satisfy the definition of an "asset" but are not permitted to be recognised as separate assets according to IAS 38. In the case of Telstra, assets like brand names and customer bases were recorded as intangibles although they have been developed internally by the company.

As for the measurement of intangible assets, paragraph 22 of IAS 38 requires an intangible asset be measured initially at cost (IASB, 2002, online). In Australia, the principles for accounting for acquired assets, including intangibles, are stated in AASB 1015 that acquired assets should be recorded at the cost of acquisition (Knapp & Kemp, 2003, p.305). Arguments against this rule suggest that the initial recognition rule should be at cost or value (Leo, 1999, p.31). In Australian practice, however, intangible assets are generally measured at cost concerning the requirements of the accounting standard. Examples are given as the adoption of above three companies.

Secondly, there are also pro and con arguments with respect to the necessity of amortising intangible assets. On one hand, amortisation is generally mandatory according to accounting standards. Intangible assets are required in paragraph 79

of IAS 38 to be amortised over the best estimate of its useful life (IASB, 2002, online). The halted ED 49 proposed that identifiable intangible assets with finite lives should consequently be amortised over the period of time during which benefits from the assets are expected to arise (Alfredson, 2001, p.13). As given above, amortisation is adopted by Telstra and Land Lease following the rules in AASB 1021.

On the other hand, however, some commentators argue that the amortisation requirement should not be compulsory. The Group of 100 believes that identifiable intangible assets that have indefinite lives should not be subject to mandatory amortisation, but that an annual impairment test should be applied to ensure the carrying amount of the asset is recoverable (2000, online). In practices, according to a survey of Australian company reporting involving the top 150 Australian holding companies reporting over the years 1993 to 1996 by Tibbits, a number of companies stated their intentions not to amortise their intangible assets (Leo. 1999, pp.675-677). In the case of Amalgamated Holdings, no amortisation was provided on the liquor licence possessed by the company.

Recommendations to the new standards

The current absence of single accounting standard that specially deals with the issue of accounting for identifiable intangible assets leads to the somewhat flexible accounting practices in Australia in a certain extent. For instance, the results of a company or an economic entity could be reported more favorably merely by classifying a greater portion of the cost of identifiable intangible assets with an assumed indefinite life because intangible assets with indefinite lives are believed acceptably not to require amortisation. The release of IAS 38 indicates the international tendency of reducing such flexibility by revising accounting standards for treating intangible assets. However, the need has existed in Australia for a new standard regarding to the topic of accounting for identifiable intangible assets.

First of all, considering the difficulty of recognizing identifiable intangible assets without a satisfactory definition, a standard relating to the definition and essential characteristics of an “identifiable intangible” asset should be proposed. The Intangibles Research Center at New York University offers a possible definition: Narrow Definition¯ Intangibles are nonphysical sources of probable future economic benefits to an entity that have been acquired in an exchange or developed internally from identifiable costs, have a finite life, have market value apart from the entity, and are owned or controlled by the entity (Upton, 2001, p.57).
As per SAC 4, identifiable intangible assets should be recognised when they meet the recognition criteria as well as the definition. In order to establish an acceptable and reasonable practicing system for treating identifiable intangible assets, it could be essential to consummate the accounting theory.

Furthermore, identifiable intangible assets should be measured at either cost or allowed alternative values. The Group of 100 recommends recognising identifiable intangible assets at cost of acquisition or at valuation (2000, online). However, in the CPA Australia monograph, identifiable intangible assets are suggested to measure at cost or at discounted recoverable amount (Parker & Soukseun, 1998, online). Choice of measurement basis can be made depending on the source and nature of the assets.

In addition, the term "Amortisation" should be replaced with the term "depreciation" and all assets which have determinable useful lives should be depreciated in accordance with AASB 1021 "Depreciation" (Parker & Soukseun, 1998, online). The term "amortisation" is described in AASB 1021 paragraph 5.5.1 as having "the same meaning" as "depreciation" but is used in relation to non-current assets which do not have physical substance (Knapp & Kemp, 2003, p.509). Moreover, as indicated in APB Opinion 17, there should be no sensible distinction that can be made between assets on the ground of physical substance (cited in Leo, Hoggett & Radford, 1995, p.90). Therefore the two different terms should be unified in all accounting standards.

Conclusion

In conclusion, the importance of intangible assets is the distinguishing feature of the new economy. Given the analyses of the three Australian publicly listed companies here, accounting treatments that have been adopted for the identifiable intangible assets are various. Controversial arguments about this issue are also continuous during the recent decade. It is necessary for AASB to speed up the process of developing an accounting standard on this issue.

However, establishing a standard on accounting for identifiable intangibles is never going to be an easy task for Australian standard-setters. Flexible practices have become well established and any proposed restrictions to those practices were inevitably going to give rise to controversy. Alternatively, the AASB could seek to convince the IASB and other national standard-setters that a less restrictive approach is preferable. Meanwhile, academics could well play a role by conducting relevant empirical studies. But, above all, the AASB must have the resolve to finalize the task.

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