

## **Disclosure of intangible assets in the Financial Statements - Progress towards Sustainability**

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*Abstract—*

"What is essential is invisible to the Eye"

Intangible assets represent a major topic in the lively debate on modern company analysis. Non-financial Business Reporting is to emphasise its importance within the overall context of company reporting and promote better understanding by setting out disclosure criteria that will assist companies in meeting the expectations of investors. While on the one hand, Traditional Financial Report is a picture of decisions of the management in previous years, on the other hand the Intellectual capital Report plays a symmetric function.. it in fact allows the reader to anticipate possible developments to the company's balance sheet in future years, as it describes a company's competitive advantages. The article aims to put up the legal aspects of disclosures through current accounting standards, an overview of how to measure intangible assets of an organisation & how such a disclosure shall pave way for the progress of an organisation and its sustainability. Further it drives to generate a substantive dialogue between investors and company boards about the content and timing of non-financial business reporting.

MEANING

Intangible assets are non-physical assets (such as franchises, trademarks, patents, copyrights, and goodwill) that grant the potential for certain rights and privileges as well as the possibility for economic benefits to the owner. The economic benefits may be fruitful or fleeting, depending on the nature of the intangible asset and the company exploiting it. Nonetheless, an intangible asset's influence on business value may be simply ephemeral, subject to the gyrations of the stock market, consumer sentiment, and unrelenting competition.

There are two major categories of intangible assets:

- i) Legal
  - ii) Competitive:
- i) Legal intangible assets include intellectual property such as trademarks, copyrights, patents, trade secrets, domain names, and goodwill. Legal intangibles are known under the

generic term intellectual property. Legal Intangible generate legal property rights defensible in a court of law.

ii) Competitive intangibles include such things as institutional knowledge, distribution channels, or human capital. Often intangible assets can be far more valuable than physical assets — for example, the brand names of a major consumer product company.

Intellectual property (IP) is a legal concept which refers to creations of the mind for which exclusive rights are recognized. Under intellectual property law, owners are granted certain exclusive rights to a variety of intangible assets, such as musical, literary, and artistic works; discoveries and inventions; and words, phrases, symbols, and designs.

Intellectual property (“IP”) in general

3 broad categories:

- Research and development
- Patents, copyrights, brand names, trade secrets, trademarks, franchises, concessions, operating right or right of use
- Computer software (developed internally or acquired from a third party)

Intangible assets have become an integral part of value-creating process for any company. This necessitates its external communication to various interested parties like shareholders, investors etc. The dearth of literature on the subject in the Indian context and the ever increasing significance of intangible assets in the Indian corporate sector motivated the researchers to carry out this study. Accordingly, the objective of this study is to determine the disclosure requirement of intangible assets, methodology of identification of intangible assets and extent of intangible asset disclosure by Indian companies for the year 2011-12

#### OBJECTIVE

The growth of Indian economy from production to knowledge podium has lead to increasing investments in intangible assets by the companies. In such knowledge-driven global marketplace, intangible assets such as intellectual property, brands, goodwill, customer relationship, customer satisfaction and talent hold much more value than tangible 'visible' assets such as capital, land, buildings, machinery etc.

#### CONNECTION BETWEEN SUSTAINABLE DEVELOPMENT AND INTANGIBLE ASSETS

We see sustainability and intangible assets as two sides of the same coin: intangible assets require a focus on sustainability; whilst sustainability requires the propagation and use of intangible assets.

The intangible aspects as important for a sustainable development. In consequence, sustainable competitive advantage is a central point, if not to say the core of both the national and corporate strategy. It allows maintenance and improvement of the company's competitive position in the market and enables the business to survive competitors for a long period of time. Quantitative and qualitative fundamental change in competition requires organizational changes to an unprecedented level. Current sustainable competitive advantage must be built on the organizational capabilities and must be constantly reinvented.

People are key aspects for the evolution of value and co-creation of products and services that add value. Their distinctive capabilities are the basis of the competitive advantage. According to the new resource-based perspective of a company, competitive advantage is achieved by continuous developing existing resources and creating new resources and capabilities in response to constantly changing market conditions. Among these resources and capabilities in the new economy, knowledge is the most important value creation asset.

Future financial performance is a consequence of excellence in leveraging these underlying strengths – thus, many investment analysts view these intangibles as leading indicators of market value. Certain companies are able to create sustainable value over the long run because of intangible strengths such as vision, creativity, and dedication, which do not appear on financial statements. In the words of Collins and Porras<sup>1</sup>, they are “*built to last*”. It is important, that the quality of intangibles is driven primarily by excellence in staff functions – in a sense, intangibles are the “products” of staff performance.

#### Intangibles, sustainable growth and well-being :

Role of intangible assets in the context of corporate social responsibility (including economic, environmental, social aspects of sustainability). Role of intangible assets for developing ‘green’ innovations and business models, and for promoting environmentally friendly consumption

Role of intangible assets as a source for increasing well-being at individual and societal levels for socially sustainable growth.

Intangible assets could also play an important role for sustainable growth if they contribute to ‘green innovation’, new and environmental friendly business models and consumption patterns, welfare services, and cross-disciplinary capabilities. The development of intangible assets such as design, work-life and management practices, human, social and cultural capital, can also be considered as investments in wellbeing and socially sustainable growth.

### **Accounting Standard**

Intangible asset accounting is coming to the forefront of the corporate agenda in most of the countries including India. The Ministry of Corporate Affairs, in collaboration with The Institute of Chartered Accountants of India has been able to incorporate very specific and focused disclosure for intangible assets in the Revised Schedule VI of the Companies Act 1956 which is effective for all the balance sheets being prepared as on 31.03.2012.

Accounting Standard (AS) 26 specifically deals with accounting treatment of intangible assets with respect to recognition, measurement and disclosure in varying business situations.

### **Accounting Standard (AS) 26**

#### **Objective:**

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard.

#### **Intangible Assets – Disclosure**

The Ministry of Corporate Affairs (MCA) has issued revised Schedule VI which lays down a new format for preparation and presentation of financial statements by Indian companies for financial years commencing on or after 1 April 2011. The pre-revised Schedule VI had been in existence for almost five decades without any major structural overhaul. In view of the drastic changes during this long period in economic philosophy and environment coupled with advancements in accounting principles and in global practices

relating to corporate financial reporting, a major overhaul of the Schedule was overdue. The revised Schedule VI introduces some significant conceptual changes with respect to disclosure of intangible assets. While the revised Schedule does not adopt the international standard on disclosures in financial statements fully, it brings corporate disclosures closer to international practices

#### **Revised Schedule VI**

Section 211(1) of the Companies Act, 1956 requires all companies to draw up the Balance Sheet and Statement of Profit and Loss account as per the form set out in Schedule VI.

As per Revised Schedule VI, the disclosure for fixed assets is to be segregated into:

- (a) Tangible assets;
- (b) Intangible assets;
- (c) Capital work-in-progress; and
- (d) Intangible assets under development

#### **Other Disclosures pertaining to intangible assets:**

The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

- the useful lives or the amortisation rates used;
- the amortisation methods used;
- the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;
- a reconciliation of the carrying amount at the beginning and end of the period showing:
- additions, indicating separately those from internal development and through amalgamation;
- retirements and disposals;
- impairment losses recognised in the statement of profit and loss during the period (if any);
- impairment losses reversed in the statement of profit and loss during the period (if any);
- amortisation recognised during the period; and
- other changes in the carrying amount during the period.

## IMPORTANCE OF DISCLOSURE OF INTANGIBLE ASSETS

The growth of Indian economy from production to knowledge podium and the growing software & IT, financial services, business outsourcing, media, healthcare, pharmaceutical industries etc. have lead to increasing investments in intangible assets by the companies.

- **Influencing Decisions**

Although intangible benefits are hard to define, they can influence business decisions. For instance, the Amway Corp. in September 2011 announced a sponsorship deal to be the official nutritional supplement supplier to the Detroit Red Wings professional hockey team, and to have the Amway logo appear on tickets, other paraphernalia and throughout the team’s home arena. Amway said it acted in part to gain the intangible benefits of being associated with a popular sports franchise.

- **Direct Value**

Intangible assets, unlike intangible benefits, can have a value assigned to them for accounting purposes, similar to valuing buildings and equipment. Intangible assets can have a direct dollar value if they are purchased from another entity, such as buying a well-established brand name. Intangible assets with limited useful life, such as with a copyright, can be depreciated over time. Intangible assets also can have indefinite life, such as with a trademark or perpetual franchise

- **Merger and Acquisition**

Intangible assets also play an important role in Mergers and acquisitions. In large M&A transactions, the share represented by intangible assets has gotten progressively larger. The rules on recognition methods and accounting treatment for intangible assets will have a major impact on the future expression of operating results by post-M&A enterprises, and the importance of intangible assets in those results will continue to grow.

- **Future Benefit**

Tangible asset provide information on Company’s performance from yesterday until today. Once can measure companys doing well or not, according to the asset it has accumulated until today. But this accumulation of tangible assets does not give any information on how the comapny will perform in the future. Where as, But this accumulation of tangible assets does not give any information on how the comapny will perform in the future.

- **Corporate Community**

Intangible Asset in Todays Corporate Community is very important to understand and that’s the reason intangible assets are so important today for the stock markets analysts and the Banking and finance community.Funds and private equity firms focused on intangible assets, IP, changing senior management views.

### Does Intangible Asset makes Impact on the financial statement

#### Case Study:

Most Inspiring and famous personality, co-founder of facebook – Mark Zuckerberg, had a deep interest in computer and writing computer software with the result and outcome of which “Facebook” was developed. It was his intellectual knowledge for computer software made him generate most poular social networking website Facebook. For the purpose of making it legal and not to getting duplicated with any other person, facebook has regeistered their copyright. Significance of registration if so huge that Mark Zuckerberg is a millionaire due to his creation of facebook.

### Intangible Asset Disclosure in Pharma Industry

**Fact** - Despite the significance of its communication externally, only Alembic Ltd. from pharmaceutical industry have disclosed their brand valuation information in their annual reports for the years 2003-04 and 2007-08 respectively. Low disclosures regarding brand valuation in annual reports could be inferred from the fact that companies yet do not realize the significance of brand value in determining its true overall value. The other reason could be that the companies might be reluctant to share this information with their stakeholders because of their brand value being low.

**Figures** - The mean disclosure score of drugs and pharmaceutical industry has increased from 22.64% in the year 2003-04 to 31.30% in year 2007-08. This industry occupies second highest mean disclosure score for both years of the study. A slight increase in variations and range is also noticed for this industry in the year 2007-08 as compared to 2003-04.

**Motivation:** The high mean disclosure score for Drugs and pharmaceutical industry could be motivated by the need to recognize the research activities and patents in this industry.

### CONCLUSION

Based on the above discussions on intangible assets, the following conclusions can be drawn:

- One cannot disagree over the fact that intangible assets have become far more important than its tangible counterparts especially in the service industry. Conventional methods of enterprise value such as market capitalization, profit margin, sales growth etc. have become somewhat obsolete since they do not portray the exact financial position of the firm where nearly 80 % of the assets are intangible
- AS 26 specifically defines the accounting meaning of intangible assets and brings out distinction between accounting of intangible assets based on type and business transaction thereby helping the accounting community in true and fair treatment of intangible assets in the books of accounts of the Company
- Recognising the significance of intangible assets, the revised Schedule VI requires them to be presented separately from tangible fixed assets with further sub-classification in the notes to accounts. This Schedule makes it compulsory to disclose Intangible assets subject to meeting the guidelines prescribed by AS 26. This information on intangibles would certainly improve the quality of numerous business decisions
- Although Indian Accounting Standards do not recognize the value of internally generated brands, customer relationships, customer satisfaction and talent, valuation of these attributes is very important in understanding the value of the company from the financial perspective. Indian Accounting needs to evolve and capture these attributes so as to provide information that is useful to present and potential investors and creditors and other users in making rational investment.

- Intangible Assets certainly represent major value of modern companies. There is no doubt that brands R&D, innovation etc are crucial for companies success. In short a company’s capacity for growth and sustainability. In this respect more ore systematic and better organised disclosure of company intangible resources greatly helps financial analysts develop their judgement: for example, information on the quality, seniority of resources, and output of an R&D department can provide support to forecasts on companies growth and success.

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