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Intangible Assets as an Important Element of Business Entities Wealth

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Abstract: *Purpose* – presentation of the classification and evaluation of intangible assets showing a variety of approaches depending on the adopted legal solutions.
Methodology/approach – an overview of the national and world literature topic, analysis of current legislation acts.
Findings – discussion of the differences in defining and classifying the goodwill, presentation on selected examples of different ways of goodwill depending on methods of consolidation of units.
Originality/value – comparisons of intangible assets, an indication of the differences in the classification of goodwill as part of assets of the units (in the light of polish accounting law and tax law).

Keywords, intangible assets, goodwill, badwill

Introduction

In the technologically evolving global economy, the development of business entities and their market position are increasingly derived from their held assets . Especially all kinds of research and development, patents, know-how or software that has been known for years play an important role. Their value is also affected by the evaluation of the principles of the management that has been accepted.

In markets where servicization plays a significant role, the importance of the qualifications of staff providing specialized services, interpersonal relationships, processes and customer trust is rising. As noted by G. Urbanek, the value of knowledge assets is closely linked to the context of their use (Urbanek 2011: 141). Their positive reception is translated into balance on individual items and therefore, goodwill is generated.

It can, therefore, be concluded that at present, economic success is not derived only from traditional resources, but more often it is the intangible assets that are conducive to success.

The purpose of this article is to present the essence of what intangible assets do in the modern economy, against the background of the existing rules of their valuation and accounting – completed by an indication of their role in the reporting of insurance companies and consolidated groups. According to the authors, the correct valuation and recognition of

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intangible assets has a significant impact on the capital of the economic entity and – therefore – its market position.

Particular attention is paid to a certain category of intangible assets, which is goodwill. This asset brings about a lot of problems in enterprises because of its hardly tangible nature, and its various inclusions in balance sheets and tax regulations. To this end, an analysis of the existing legislation was performed, in the search for a definition and valuation of intangible assets, focusing on differences in their determination. Further, in this article, practical solutions for the recognition of goodwill according to two legal systems are presented.

1. Intangible assets and their valuation in the light of the Accounting Act and assets IAS, along with the Polish tax law

Regulations relating to intangible assets are included in the Polish Accounting Act (Accounting Act of 29 September 1994) and the International Accounting Standard (IAS) 38.

The Act, in Article 3, item 14 defines the elements which should be regarded as tangible and legal values. Acquired[1] fixed assets, such as property rights suitable for business use, with an expected useful life of over one year, intended for use by the Company are mentioned. Thus, copyrights, related rights, licenses, concessions, rights to inventions, patents, trademarks, utility and decorative designs and know-how are included here.

In addition, intangible and legal assets include goodwill, which is the difference between the lower purchase price of a particular entity or its organized part, and the fair value of the acquired net assets and development costs. As noted by D. Dobija (Dobija 2010: 58) econometric studies which refer to the market value of companies to the value of its investment in R&D, or indicators of market value to book value, indicate a statistically significant positive relationship between these values. This is probably the result of a situation where the development of the economy in the 21st century is demonstrated by knowledge and innovation (Bojewska 2013: 143) largely contributing to the creation of intangible assets.

It should also be noted that property rights arising from the possession of intangible assets can be put into use on the basis of lease agreements in order to acquire profit by the entity being their owner.

IAS 38 indicates that individuals often expend resources or incur liabilities for the acquisition, development, maintenance and improvement of intangible assets, which include scientific or technical knowledge, design and implementation of new processes or systems, licenses, intellectual property, market knowledge and trademarks (including brand names and publishing titles), including computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licenses, import quotas, franchises, relationships with customers or suppliers, customer loyalty, market share and marketing rights.

[1] Exceptions are the costs of completed research and development, which are generated in-house.

The recognition of an element as an intangible asset must include certain requirements defined in IAS 38, which include the ability to identify such a component, control it and future economic benefits[2].

The ability to be identified distinguishes the component of goodwill. Accordingly, the goodwill acquired in a business combination corresponds to the payment made by the acquirer in the anticipation of future economic benefits from assets that cannot be individually identified and separately recognized. At the same time it is indicated that future economic benefits may result from the synergy between identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements, but for which the acquirer is prepared to pay in a business combination.

The criterion of the traceability of a particular item of intangible assets is met if the asset can be identified (excluded or separated from the unit) and sold, transferred, licensed, rented or exchanged for use to third parties. It may be implemented separately or together with a related contract, asset or liability. The condition is also satisfied if it arises from contractual or other legal rights, regardless of whether they are transferable or separable from the entity or from other titles or liabilities (IAS 38 2012: par. 9–12).

In accordance with IAS 38, (IAS 38 2012, par. 13–16) an important criterion for the recognition of intangible assets is the ability to control them. Thanks to exercising control, an entity may restrict or prevent access to a particular asset (such as technical know-how) to third parties so that they reach this and thus will not acquire economic benefits thereof.

An asset can also be considered intangible if it contributes to its disposer's acquiring of future economic benefits and – therefore – specific revenue, cost savings or other benefits resulting from its use (IAS 38 2012, par. 17).

According to the Polish Corporate Tax Act (The Corporate Income Tax Act of 15 February 1992: art. 28 item 8) and IAS 38, the first evaluation of an intangible asset in the books takes place according to its acquisition price or production cost. During the evaluation, one should also take into account received rebates and discounts which reduce the value of the considered asset. Where payment is deferred as a component for a long time (usually more than one year), then the purchase price is considered to be the amount that should be paid in cash, while the difference is recognized as profit or loss (as a financial cost resulting from interest).

The use of intangible assets is subject to depreciation procedures and ones regarding impairment of a loss, if such a circumstance arises.

Depreciation charges operating expenses, while where a particular property right loses its economic usefulness, is followed by impairment. It is charged to the other operating costs[3]. The value of intangible assets is recognized at the end of the year, at the purchase

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[2] If the component being the subject of this standard does not meet the definition criteria of an intangible asset, expenditures for its purchase or generation by the entity is recognized in profit or loss when incurred. If an asset was acquired in a business combination, it forms part of goodwill as of the acquisition date (IAS 38 paragraph 68).

[3] The operating expenses include the amortization of goodwill.

price, minus the value of the accumulated depreciation and impaired losses. There is also the possibility of fair value evaluation based on information from the active market, provided that it exists.

The adoption of an asset for use in accordance with the requirements of the Act requires the establishment of the planned period of its use. The determination of this period results in determining depreciation rates for individual intangible assets for the whole period of its depreciation before it is recorded.

Intangible assets subject to amortization include those that must comply with the following conditions: they are owned, jointly owned by the taxpayer, or are used under finance leases,

- are used by the taxpayer for the purpose related to the business, put into use under license, sublicense, lease, rent or lease,
- the period of their use is longer than a year.

In accordance with the provisions regarding depreciation it is carried out systematically over set periods, which affects the adoption of specific rates[4]:

- 24 month license (sublicense) for computer software and copyright,
- 24 months after the license to show films and for the emission of radio and television programs[5].
- 12 months from the incurred costs from completed development work,
- 60 months in case of the remaining intangible assets.

It follows that the Act provides only for the possibility of a specific time of economic usefulness of the intangible asset. However, the regulations of IAS 38 introduce different rules from the Accounting Act for entities that apply IAS. In assessing the period of the useful life of an intangible asset, one may assume a definite or indefinite period, which is essential for the conduct of further records of this component. According to the IAS 38, intangible assets with:

- finite lives are amortized,
- definite useful lives are tested for impairment.

In the latter case, it is necessary to regularly test an intangible asset for impairment. These tests should be performed, in accordance with IAS 36 Impairment of Assets, annually or whenever there are indications of impairment in their value. In such a situation, the business entity should document the rationale and conduct tests to check when such conditions take place.

According to the IFRS, the starting point for the correct recognition of intangible assets should be a reliable and well-documented policy of testing for the impairment of

[4] Only for cooperative ownership rights to housing, the right to cooperative premises, and the right to a detached house in a housing cooperative the legislature includes no minimum depreciation period, but an annual depreciation rate of 2.5 per cent, and if the initial value of the above rights is determined using the simplified method (Article 22g item 10 if the Act- i.e., as a product of the space and the amount of PLN 988), the rate is 1.5 percent per year.

[5] If the contract specifies a period shorter than 24 months from the effect of film licenses, radio and television programs, taxpayers can depreciate the assets during the period resulting from the contract.

non-financial assets. It is believed that the current market volatility is increased by the growing likelihood of tests being required more frequently than once a year, as in the case of goodwill and intangible assets with an indefinite period of use. (*Aktualności MSSF* 2013)

The tax law approaches the issue of intangible assets from a pragmatic angle, describing them only through the prism of depreciable categories. Thus, Article 16b. of the Corporate Income Tax Act (The Corporate Income Tax Act of 15 February 1992) specifies cooperative ownership rights to housing, utility space, or a detached house in a housing cooperative, as well as copyright or related proprietary rights, licenses and rights specified in the Act on industrial property and know-how with an expected period longer than one year used by a taxpayer for the needs of their business activities or rendered by them for use under a license, lease or similar agreement are subject to amortization if they had been acquired and are suitable for economic use on the day of being accepted. In addition, it is specified that, regardless of the expected period of use, goodwill (subject to the conditions set out in the remainder of this study) and development costs are subject to amortization, if they have been satisfactorily completed and the assets do not constitute to the property of the taxpayer if they are pursuant to depreciation.

Intangible assets are measured according to the method of their acquisition. Thus, the initial value is the purchase price, while the cost of generating or market price is estimated according to the conditions laid down in Article 16g of the Corporate Income Tax Act.

2. Goodwill, its quantification and meaning in reporting of capital groups

Goodwill is a highly specific asset presented in the context of intangible assets. It is hidden, as often claimed, in the business entity[6] and can only be determined at the time of acquisition of the business entity or its organized part, and only the difference between these values can be the basis of its evaluation. As pointed out by R. Patterson, goodwill value is the excess of the price of acquisition of the economic entity over the fair value of the acquired net assets and liabilities at the date of the transaction's effect (Patterson 2002). A similar approach is presented in IFRS 3 *Business Combinations*, which indicates that goodwill acquired in a business combination corresponds to the payment made by the acquirer in anticipation of future economic benefits from assets that cannot be individually identified and separately recognized. As noted by D. Wędzki, goodwill arises in each case of the acquisition of a subsidiary, associate or jointly controlled entity (Wędzki 2009: 180). It should also be noted that the value of the company, although it has characteristics of commercial value, is not a standalone asset – as goods or materials – and cannot exist without the company; you can be bought only with all the assets of the entity (Cieciura 2012: 18). In contrast to the

[6] The issue of establishment and meaning of goodwill are widely discussed by Berett Zanoni (Berett Zanoni 2009).

provisions of the Polish Corporate Tax Act, IFRS does not anticipate any negative goodwill (Accounting Act: art. 33 item 4).

According to the IFRS 3, goodwill acquired in a business merger is recognized as an asset and represents the excess of the sum of the payment transferred for the acquisition of any amount of non-controlling interest in the acquiree and the fair value at the acquisition date of the share capital of the acquired, held by the acquirer before obtaining control over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities of the acquired subsidiary. The value resulting from the acquisition of a subsidiary is recognized as intangible assets and measured at an initial value minus accumulated losses resulting from loss of value.

The following is a numerical representation of the issue in question (*Połączenie jednostek gospodarczych i zmiany struktury własnościowej. Przewodnik po znowelizowanych standardach MSS F3 i MSR 27, 2013: 62–67*).

The investor acquired 80% of Irma's shares, paying PLN 75,000. At the time of the acquisition (the acquisition date), the fair value of the net assets of the acquired company was PLN 80,000. The remaining 20% of the shares were retained by the existing shareholder, who evaluated the company's net assets at the time of purchase at PLN 100,000.

Table 1

Proportional goodwill model

	Dt	Ct
Irma company net assets	80,000	
Investor shares in Irma 80%		75,000
Goodwill (acquired)	11,000*	
Minority shareholders' interest (non-controlling)		**16,000****
	91,000	91,000

* Goodwill 75,000 – (80% × 80,000) = 11,000.

** Non-controlling interest 80,000 × 20%16,000 lub 91,000 – 75,000 = 16,000.

Source: own development.

In the present case, goodwill is attributably proportionate to the shares of the investor is 11,000. In this situation, it was assumed (the concept of the parent entity) that the value of the company is commensurate to the interests held by the dominant investor in the fair value of the net assets of the acquired company (subsidiary).

Goodwill full in terms analyzed was 15,000, as it also contained a proportional value attributable to non-controlling interests (4,000). The concept of a business entity (as a whole) was used and goodwill was recognized as the total value of the company as a whole (including the rights to minority shareholders).

It should also be noted that with the passage of time, depreciation of goodwill is not considered, which introduces a substantial difference between IFRS (including US GAAP, which also does not provide for depreciation) (Stickney and others 2010: 437, Hubental, 2003: 6–13) and the Polish Act, and in return, the acquirer tests it annually for impairment, or more frequently, if events or changes in circumstances indicate that impairment of its value might have taken place (MSSF 3, MSR 38 2012).

Table 2 presents the same case, but seen from the perspective of goodwill.

Table 2

Full goodwill model

	Dt	Ct
Irma company net assets	80,000	
Investor shares in Irma 80%		75,000
Company value	**15,000***	
Minority shareholders' interest (non-controlling)		**20,000****
	95,000	95,000

* Total goodwill 75,000 + (100,000 × 20%) – 80,000 = 15,000.
** Non-controlling interest 100,000 × 20% = 20,000.

Source: own development.

When quantifying goodwill, business entities should consider the differences between their accounting solutions, since it is the correct selection and use that will have a significant impact on the values that are often presented in financial statements.

3. Goodwill in the Polish tax law

The Corporate Income Tax Act does not define "goodwill," although the concept is used there. The Act defines the initial value of the company as the positive difference between the purchase price of the enterprise, its organized part, or nominal value of shares issued, in exchange for a contribution in kind and the market value of the assets included in the purchased components, adopted for paid use or incorporating into the entity (Act of Corporate Income Tax 1992: art. 16b). It is worth noting the fact that the tax law defines only positive goodwill, but there is a clear possibility of a reverse situation. The existence of negative goodwill, however, is recognized as the initial value of the acquired tangible and intangible assets in the event of acquisition by purchase or acceptance for paid use of an enterprise or its organized part. The Act uses the following wording: in the event of a positive market value, the initial value is the sum of the market values – in the case of the non-occurrence of a positive value, the initial value is the difference between the purchase price of the enterprise or its organized part and the value of assets other than fixed assets or intangible assets (Act of Corporate Income Tax 1992: art. 16g item 10). It is not negative goodwill in the classical sense, since a possible negative difference corrects the initial value of fixed assets and intangible assets (Cebrowska 2005). Rather, it is – using the language of the law – "a lack of positive goodwill".

In accordance with the tax law, goodwill is depreciable if established by purchase, acceptance for payment when the depreciation charges are made by the beneficiary, or acceptance to the company under the provisions of commercialization and privatization procedures (Act of Corporate Income Tax 1992: art. 16b item 2). This means that if the goodwill is the result of e.g. contribution in kind of an enterprise or an organized part of a commercial company or partnership, it is not subject to depreciation (Pfaff 2007: 47). Similarly, in the case of a merger or acquiring an asset free of charge by inheritance or donation.

Goodwill is depreciated only linearly, within a period of no less than five years (Act of Corporate Income Tax 1992: art. 16m) while, as noted by I. Olchowicz, under the straight-line method of depreciation it is possible to apply a one-time security if goodwill does not exceed the amount of PLN 3,500 (Olchowicz 2009: 367). In accordance with the tax law, the depreciation rate cannot be changed during the entire period and must be fixed before amortization.

Conclusions

Intangible assets, although they have represented an element in the enterprise wealth from time immemorial, continue to raise many problems with the ways of their identification, valuation and depreciation. These problems arise not only between the balance sheet law and tax law (which would be understandable, since these legal systems have different objectives and use different methods), but also between regulations for accounting – the Accounting Act and the International Accounting Standards.

The perspective of goodwill discussed in this article clearly shows that there is a need for further work to unify – or at least approach – solutions, so that the enterprise could reasonably dispose of its assets and effectively plan its activities.

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AKTYWA NIEMATERIALNE JAKO ISTOTNY ELEMENT KSZTAŁTUJĄCY MAJĄTEK PODMIOTÓW GOSPODARCZYCH

Streszczenie: *Cel* – prezentacja bilansowego i podatkowego ujęcia wartości niematerialnych i prawnych na przykładzie wartości firmy.
Metodologia – przegląd krajowej i światowej literatury tematu, analiza obowiązujących aktów prawnych.
Wyniki – omówienie różnic w definiowaniu i klasyfikowaniu wartości firmy, prezentacja na wybranych przykładach różne sposoby powstawania wartości firmy w zależności od sposobu konsolidacji jednostek.
Oryginalność/wartość – porównanie ujęć wartości niematerialnych i prawnych, wskazanie różnic w klasyfikacji wartości firmy jako elementu majątku.

Słowa kluczowe: wartości niematerialne i prawne, goodwill**,** badwill, dodatnia wartość firmy, ujemna wartość firmy

Cytation

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