# MAKING THE INVISIBLE VISIBLE: THE INTANGIBLE ASSETS RECOGNITION, THE VALUATION AND REPORTING IN ROMANIA

**NICOLETA RADNEANTU** *

**ABSTRACT:** *The emergence of knowledge-based companies increased the importance of intangible assets, assets that were considered the most competitive advantages of companies. So, in this paper I tried to answer the following question: Which is the Romanian accounting reality about the intangible assets recognition, evaluation and reporting? What can we do that traditional financial statements do not become mostly useless for their end users?*

**KEY WORDS:** *intangible assets, knowledge based organizations, recognition, valuation, reporting*

## 1. INTRODUCTION

Throughout time, accountancy in Romania has been oriented moreover on providing financial information to the state and fiscal authorities. The evolution of the Romanian accounting regulations is closely related to the changes of the economic, social and political environment [1]. Currently Romania applies OMF (Order of the Ministry of Finance) No. 1752/2005 regarding the financial statements of commercial companies. This accounting regulation implements the 4$^{th}$ Directive as well as the 7$^{th}$ Directive of the European Economic Community.

The 4$^{th}$ Directive of the European Economic Community establishes the form and contents of annual financial statements, accounting principles and evaluation rules, as well as regulations regarding the preparation, approval, auditing and publication of financial statements; meanwhile the 7$^{th}$ Directive of the European Economic Community establishes and regulates the form and contents of annual financial consolidated statements, as well as the rules to be respected when creating, approving, auditing and publishing annual consolidated financial statements.

* *Assist.Prof., Romanian-American University of Bucharest, Romania,* nicoleta.radneantu@yahoo.com

## 2. THE INTANGIBLE ASSETS RECOGNITION, EVALUATION AND REPOTTING IN ROMANIA

Further, on we shall try to identify the accounting treatment for intangible assets based on different types of financial statements commercial companies must prepare - enclosed in table 1.

**Table 1. Regulations regarding the recognition, evaluation and reporting of intangible assets in Romania**

| | |
|---|---|
| OMF no. 1752/2005 | Regulates the treatment for the accounting recognition of intangible assets in individual financial statements of companies in Romania. |
| IAS 38 – Intangible assets | Regulates the accounting treatment of recognition of intangible assets in financial statements |
| IFRS 3 – Mergers | Prescribes the accounting treatment for intangible assets that can be segregated and have their origin in contractual rights or other legal rights, as well as intangible assets that meet the segregation character of the definition. |
| GN 4 – Evaluation of intangible assets | Concentrates on explaining the approaches, principles and different values that should be taken into consideration when evaluating intangible assets. |

*Source: The author of the paper*

According to OMF No. 1752/2005, intangible assets are in fact identifiable non-monetary assets that have no material support, utilized in production or supply of goods and services that can be rented to third parties or used in administrative purposes. The present classification [6] used in Romania is based on the conception that the assets of a company consist of tangible and intangible assets. You will find further classification of intangible assets in Romanian legislation enclosed in table 2. The International Accounting Standards Committee (IASC) proposes as solution for the controversial issue of intangible assets evaluation the regulations under the International Standard of Evaluation Practice GN4 - The evaluation of intangible goods. IASC provides accountants with recommendations and counseling regarding evaluation; it seeks to coordinate its standards and programs or disciplines related to accounting as well as cooperate with international organisms to elaborate and promulgate new standards.

In order to have a match between IASC standards - International Evaluation Standards, International Standards of Applying Evaluation, International Standards of Practice in Evaluation; Financial Reporting Standards (IAS/IFRS), IASC cooperates with The International Accounting Standards Board (IASB) as well as with independent standard committees of the International Federation of Accountants (IFAC) - The Committee for Accounting Standards for the Public Sector and the International Committee for Audit and Insurance. International Evaluation Standards are considered the permanent grounds for the other. These are IVSC 1(market value - Type of value), IVSC 2 (Types of Values other than market value), and IVSC 3 (reporting evaluation). The International Standards for Applying Evaluation describe the means of evaluating assets so as to further use them in financial reports or taking decisions of granting loans, while International Standards of Practice in Evaluation give instructions on specific problems that appear during the evaluation process and the means of applying standards in different situations or particular domains.

**Table 2. Classification of Intangible Assets regulated by nowadays laws in Romania**

| | |
|---|---|
| **OMF no. 1752/2005**<br>- Foundation expenses<br>- Development expenditure<br>- Concessions, patents, licenses, trademarks, rights and similar assets, if they were acquired for consideration<br>- Goodwill, since it was acquired for consideration<br>- Other intangible assets<br>- Advances and intangible assets in progress | **IFRS 3**<br>- Intangible assets related to marketing<br>- Customer related intangible assets<br>- Intangible assets from the artistic field<br>- Intangible assets such as contractual<br>- Intangible assets such as technological |
| **GN 4**<br>1. Rights :<br>- Lease contracts<br>- Distribution agreements<br>- Employment contracts<br>- Conventions<br>- Financing agreements<br>- Supply contracts<br>- Licenses / permits /authorizations<br>- Certificates / attestations<br>- Franchise agreements<br>2. Relations<br>- Trained workforce<br>- Relationships with consumers and dealers<br>3. Intangible assets grouped (goodwill)<br>4. Intellectual property<br>- Inventions<br>- Copyright<br>- Trademarks<br>- Used Technology (formulas, recipes, specifications, databases, trade secrets, know-how, customer lists, etc.)<br>- Research projects - ongoing development | **IAS 38**<br>- Software<br>- Patents<br>- Copyright<br>- Movies<br>- Client Lists<br>- Rights regarding mortgage<br>- Licenses<br>- Import quotas<br>- Franchise<br>- Relations with customers and suppliers<br>- Market share<br>- Marketing Rights |

*Source: The author of the paper*

The International Standards of Practice in Evaluation GN4 address the problem of measuring intangible goods using different approaches, principles, methods and evaluation procedures in concordance with the market reality. Intangible goods have no physical substance; they grant rights and privileges to their owner and usually produce income for their owners [5]. GN 4 Standard [7] provides the following approaches regarding the evaluation of intangible assets: the market approach (the comparison of sales), the capitalization of income and the cost approach.

*The market approach* determines the market value of an intangible asset by referring to: either the traded prices of identical or similar intangible assets on an active market, or by the multiple evaluation involved in the transaction prices of some intangible identical or similar assets on an active market. Market multiples represent a way of standardizing the analysis of comparable elements. These are evaluation elements that represent the multiples of some elements which are usually accounting concepts (turnover, current gross profit - EBIT, gross operating profit before deducting depreciation - EBITDA) [2].When about market approach there must be a reasonable basis for the comparison of similar intangible assets. The latter must function in the same field or in a field that responds to the same economic variables as those of the evaluated element [7].

*The capitalization of income approach* refers tot the estimation of the value of an intangible asset or ownership rights over it by calculating the present value of anticipated benefice [2]. The two common methods within this approach are the direct capitalization of income, the discounted cash flow analysis (DCF). Direct Capitalization of income is calculated as a ratio between a representative level of income and a rate of capitalization; or a multiple between of the representative level of income and an income multiple (a capitalization factor). The discounted cash flow analysis presupposes the estimation of future cash receipts. These receipts are converted into value by applying a discount rate. The present value of cash flow for a certain period projected into the future can be found out by using the following formula: $PV = C_1 / 1+r_1$ , where: PV - Present Value, $C_1$ – Cash flow during the first period, $r_1$ – The discount rate during the first period. The most popular methods of determining the discount rate are: the Capital Asset Pricing Model (CAPM), the arbitrage pricing theory – APT, the Fama-Fench Three Factor Evaluation Model.

*The cost wise approach* presupposes the estimation of cost for each element involved in the creation of assets, including profit promoter, using in our evaluation data we hold at the present

## 3. CONCLUSIONS AND SUGGESTIONS

Challenges brought by the new knowledge economy have led to a higher awareness when about the necessity and importance of information in the process of the survival, performance and continuity of knowledge based companies. The difficulty to asses what are the operations generated by the continuous development of companies determined the reconsideration of the financial information systems and further generated the use of terms such as: intensive knowledge-based company, intellectual capital, structural capital, organizational capital [4]. In our vision the most appropriate definition of intangible assets fitted to nowadays social, financial and political environment in Romania would sound like this: intangible assets are economic goods that have no material substance, a lifetime longer than one year, generate both future benefices for the company in its relationship with the stakeholders, as well as resources the company generates for internal use.

We consider the notion of intellectual capital is not synonymous to that of intangible assets, as it can be considered a subcategory of the latter, because elements such as foundation expenses, licenses, and research and development costs cannot be treated as intellectual capital. This perception is also reflected in the research of economists and such as Bontis, Black, Carns, Richardson, and Epingard. We believe the structure of the balance sheet presented in table 3 is the best response to the demands of this kind of companies.

**Table 3. The balance sheet of a knowledge-based company**

<table>
<tr><th colspan="2">Assets</th><th>Equity + Debt</th></tr>
<tr><td>Current assets</td><td>• Stocks<br>• Claims<br>• Cash<br>• Cash Equivalents</td><td rowspan="3">Financing resources for tangible and intangible assets included in annual financial statements</td></tr>
<tr><td>Immobilized assets</td><td>• Land and land arrangements<br>• Construction<br>• Plant and machinery<br>• Other plant, machinery and furniture<br>• Advances and tangible assets in progress<br>• Formation expenses</td></tr>
<tr><td rowspan="2">Intangible assets</td><td>Intangible assets recognized in financial statements and registered in annual financial statements (intangible assets)<br>• Formation expenses<br>• Patents, licenses, trademarks and other commercial rights<br>• Concessions<br>• Expenditure on Research Development<br>• Commercial Fund<br>• Other intangible assets</td></tr>
<tr><td>Intangible assets unacknowledged and unregistered in annual financial statements<br>• Knowledge and skills of employees<br>• Experience of staff<br>• Skills<br>• Customer Loyalty<br>• Alliances<br>• Company image<br>• Emotional Intelligence<br>• Formal relations<br>• Informal relations<br>• Social networks<br>• Partnerships, etc</td><td>Financing resources for intangible unacknowledged intangible assets not included in annual financial statements</td></tr>
</table>

*Source: The author of the paper*

Given the characteristics of knowledge based companies (innovation, increasing importance of intangible assets inside companies, investment in training and workforce, continuous learning, protection and exploitation of intellectual capital, development of an open culture, internal development of a knowledge data base and continuous growth of network of clients, suppliers and external human resources, externalization of activities that are not essential to the company, strategic development of the company based on the depth or solidity of the company's knowledge force. etc.) we consider that their financial situations must comprise the following elements that generate added value: knowledge and skills of employees, employee experience, skills, clients 'loyalty, alliances, company image, emotional intelligence, formal relationships, informal relationships, social networks, formal processes, informal/ tacit routines, management process, partnerships.

The emergence of knowledge-based companies increased the importance of intangible assets, assets that were considered the most competitive advantages of companies, which lead to situations where the market value of companies became much higher than their accounting value. This tendency will amplify in the near future and there is great danger that traditional financial statements become mostly useless for their end users. The problem of revising accounting regulations regarding the evaluation of intangible assets had been emphasized by the international authority that regulates accounting standards – IASB ever since with 2007. The context of convergence between IFRS and US GAAP, offers the opportunity of substantial improvement regarding the recognition, evaluation and reporting of intangible assets in concordance with the demands of the present economy. Due to a lack of resources, IASB decided that the project should not be included on the active debate agenda [8].

Therefore, this paper is trying to make a first step in recognizing intangible assets generated by the knowledge-based organizations. In order to achieve a considerable improvement of the accounting information, an important volume of work will be necessary for the construction of concepts and methods of intangible assets recognition, evaluation and reporting. We really took a step forward in understanding the place of information in the life of enterprises by making a revision of traditional approaches concerning accounting and by accepting that a change in the principles and accounting practices of intangible assets must be made.

## REFERENCES:

**[1]. Bertoni, M.; Cristea, S.; De Rosa, B.** - *Provocări în procesul de armonizare din România și Italia*, Revista Contabiliatea, Expertiza și Auditul Afacerilor, nr.3, Editura CECCAR, Martie 2007, p.36

**[2]. Cohen, J.A.** - *Imobilizări necorporale. Evaluare și beneficii economice*, Editura Irecson, 2008, p.140

**[3]. Felega, N.; Manciu, L.** - *Provocarile contabilității internaționale la cumpana dintre milenii*, Ed. Economică, București, 2004, p.130

**[4]. Potecea, O.; Gabroveanu, E.; Radneantu, N.** - *Accounting Information - Power Instrument for Advanced Management. In: Knowledge Based Organizations"*, The Journal of the Faculty of Economics - Economic Science Series, vol.III, tom XVII, 2008, pp.1463-1469

**[5]. Stan, S.V**. - *Evaluarea activelor necorporale. Ghid de interpretare și aplicare a GN 4*, Editura IROVAL, 2008, p.21

**[6].** *** - OMF nr. 1752/2005 și modificările prin OMF nr. 2001/2006 publicat în M. Of. Nr. 994 din 13.12.2006, OMF nr. 2374/2007 publicat în O. Mf. Nr. 25 din 14.01.2008

**[7].** *** - Standarde Internaționale de Evaluare GN 4, Paragraful 3.14, p.204, Paragraful 58121, p.209, Editura IROVAL, 2007

**[8].** www.iasb.org, accessed on 5.sept.2009