

COMMERCIAL FUND, RECOGNITION AND ASSESSMENT

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ABSTRACT: *The importance of the immaterial investments within companies nowadays urges the specialists in accounting to find the ways to present more in the elements. In their studies researchers face the controversy reinvestments, as an asset in the balance sheet or an expense in the profit or loss account. The main goal of this paper is to analyze the difficulties in commercial fund. In the first part we will analyze various definitions of the problems concerning the commercial fund's recognition and assessment. The paper also suggests that investments are really social and economic problems.*

KEY WORDS: *immaterial investments; commercial fund; commercial fund's recognition; clusters*

JEL CLASSIFICATION: M41

1. INTRODUCTION

In the last decades a significant change has been manifesting as a result of increased importance of immaterial investments. Technology development, and especially of the technologies regarding information transfer and communication, reducing time for the technological cycle and the increased competition are only a few of the elements that attract the enterprises attention upon the ways to remain competitive.

If in the past, an enterprise's development depended on the effectual organization of the material assets, with physical existence, today we can't analyse the enterprise and its future without bringing up the immaterial. The potential of an enterprise regarding knowledge, information, technical progress, intelligence and the

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way it administrates them are essential elements that distinguish it from its competitors. The essence of a person's, an enterprise's or an entire society's capacity to produce opulence consists firstly in the specific knowledge that it possesses.

The ideas mentioned above induce the fact that we have transited from an industrial society, where the main position was seized by material assets, to an informational society, where the leading part is played by human capital. The essential difference between enterprises is given by people and not as much as building and equipments.

It is noticeable that, besides the already existent elements (work, tangible assets), the new elements are beginning to appear more and more in an enterprise's life, *such as:*

- *intelligence ;*
- *technical progress ;*
- *information ;*
- *knowledge.*

We are wondering now how will accounting, used to a representation system only for the concrete and verifiable, that is based on a proof, a property document, surprise the essence of abstract elements in an enterprise, such as immaterial investments.

Although intangible elements have become more and more important in the modern economy, financial accounting produces insufficient information about it, as a result the investors are uninformed and the managers lead based on assumptions.

Along with its co-workers (Lev, 2002), has brought strong arguments, showing the this development of the economy asks that these intangible elements to be recognised in financial situations: "we use a system to make decisions old for over 500 years in a complex business environment, in which the essential actives that create value have fundamentally changed".

The absence of reliable information about intangible assets represents a social and economic problem nowadays (for example: if investors would have had more reliable information regarding intangible assets of the companies from the internet, it would have been easier to estimate their real value). But the difficulties don't appear only concerning financial communication regarding intangible elements, but they start from defining, classifying, recognizing and evaluating them.

Accounting practices relating to immaterial investments are based on theoretical fundaments and equivocal typologies, in the centre of the equivocal typologies, which it is hard to border, we find the commercial fund (Malciu, 2002).

The controversies about the commercial fund are mainly about its recognition and its assessment.

2. COMMERCIAL FUND: THEORETICAL APPROACH

One of the first articles that refer to commercial fund was published in 1884, although this concept is a lot older. Leake (1948, quoted by Bloom, 2006) presents a discussion from 1571 which uses the expression "good will..." But also his states that the firs reference of the term good will belong to CRUTWELL V. LYE 1810, in a

lecture about which Lord Eldon commented upon:” commercial fund which was the topic of the sale is nothing more than the possibility that the old customers return at the same place”, thus referring to one of the components of the commercial fund: clients’ fidelity.

Since then, many articles and books have been written referring to commercial fund, same as generations of fixers have confronted with this problem.

Internationally, commercial fund is debated both in the *rules on intangible assets* and in those *referring to clusters*. Through the issuance by FASB in 2001 of the standards SFAS 141 *Clusters* and SFAS 142 *Commercial fund and other intangible assets*, there have been essential changes by acceptance as a single method of registering clusters of the acquisition method and especially by changing the scheme of the commercial fund further evaluation, passing from the depreciation system to the application system impairment test.

The international accounting standardization body in the convergence project with the American referential renounces at standard IAS 22 *Clusters* and it adopts in 2004 the International Financial Reporting Standard (IFRS) 3 *Combinations (groups) of enterprises*, which requires the same treatment as American standards. Also, in the same convergence project on clusters it has been reviewed the standard IAS 38 *Intangible assets* in 2004.

The project’s objective was to improve quality and to obtain international convergence in clusters’ accounting and of subsequent accounting regarding commercial funds and intangible assets obtained due to clusters.

By revising IAS 38 *Intangible assets* it wasn’t followed the reestablishment off all the requirements of the standard. The changes made to the standard are basically related to clarifying the notion of “feature identification” in terms of intangible assets, life length of life and depreciation of intangible assets and accounting of research and development projects obtained by clusters.

IAS 38 *Intangible assets* specify that commercial fund is treated by International Financial Reporting Standard (IFRS) 3 *Clusters*, representing the unidentifiable part of the payment made by the buyer due to clusters.

According to IFRS 3, the commercial fund obtained in clusters is determined as a difference between the acquisition cost of securities and the share that the purchaser recurs in fair value of assets, liabilities and the possible identifiable purchased liabilities of the entity.

Commercial fund is an anticipated payment made by the purchaser on account of future economic benefits that can result from the synergy of the purchased identifiable assets of from the assets that, analyzed individually, don’t meet the recognition criteria in individual cases, but for which the purchaser is willing to make a payment in the acquisition (Feleagă, Malciu, 2004).

Measuring commercial fund as a residual value is consistent with the approach “from top to base”, according to which commercial fund is considered a component of the investment that relies on the purchaser’s expectations regarding future economic benefits arising from clusters. The investment is considered an active (expanded active, for example the entire company), then it is divided into its component parts, and after

the different purchased items are registered as assets what remains represents the commercial fund.

In contrast, “the base to top approach” refers to the fact that when the cost of acquisition exceeds the fair value of the purchased net assets of the entity, probably some resources were obtained by the purchaser. This point of view focused more on the commercial fund’s components, rather than on it measuring (Johnson and Petrone, 1998).

The approach of commercial fund as a residual proportion is widely recognized by the most representative referenced (international, American, British, Australian, European VII directive).

Commercial fund is determined in term of accounting as a residue, as a difference between the *global value of the enterprise* (its real value as a unit) and the *reference value* (fair value of the identifiable assets) (Bloom, 2006).

This *method is a subtractive one* preferred in accounting, but which has the inconvenience that it doesn’t explain the component elements of the immaterial capital. Commercial fund can also be determined through an *additive way*, starting form a direct valuation of its components (patents, licences, brands, distribution networks etc.).

However, this method is rarely used because it doesn’t take into consideration the independence of the active’s component elements and their effects (Feleagă, Malciu, 2004).

3. IS COMMERCIAL FUND AN ASSET OR ISN’T IT?

In order to establish the in favour and against arguments for recognition of the commercial fund as an asset, we will analyse in detail the **definition** of intangible assets established by international accounting standardization body and the problems encountered in identifying the intangible assets.

The previous version of IAS 38 defined intangible asset as an identifiable non-monetary asset without a physical substance held for use in the production or supply of goods or services, for rental or administrative purposes.

The definition of the revised standard eliminates the requirement for asset to be held for use in production or supply of goods or services for rental or administrative services. The council noted that intangible assets have the following essential characteristics: they are resources controlled by the enterprise from which future economic benefits are expected to be obtain by the entity, they have no physical substance and are identifiable.

Thus, it’s concluded that the purpose for which an entity has an element with these characteristics is not relevant to its classification as an intangible asset and that all these elements should enter into the scope of this standard. Hereby, an intangible asset is an identifiable non-monetary mobilization without physical substance.

Accounting for an item in the category of intangible assets requires a firm to demonstrate that the item meets the definition of intangible asset and criteria for recognizing asset (*the company is likely to obtain future economic benefits attributable to the asset and whether the cost of the asset size can be measured reliably*).

For an intangible element to meet the definition of intangible assets, it must have the following characteristics:

- *identifiable character;*
- *control of a resource;*
- *the existence of future economic benefits.*

A non-monetary item without physical substance must be identifiable in order to satisfy the definition for intangible assets. The previous version of IAS 38 did not define the "*identifying characteristic*", but it claimed that an intangible asset can be clearly distinguished from goodwill if it is separable, meaning it can be separated or divided from the entity and sold, licensed, rented or exchanged, but the fact that this is separable isn't a necessary condition for its identification. The revised standard considers that an asset meets the criterion of identification when:

- *it is separable*, meaning it can be separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a contract, a corresponding asset or a liability;

Or

- *it arises from contractual rights or other legal nature*, whether those rights are transferable or separable from the entity or other rights and obligations.

The *first argument* arises *against the recognition of commercial fund as an asset*, caused by failure of the definition of *intangible assets: commercial fund is not separable* and can not be sold separately from the purchased company, being identifiable only as a residual size.

Entities often spend resources or attract their debt for the acquisition, development, maintenance or extension of intangible resources such as:

- scientific or technical knowledge,
- design and implement new systems and processes,
- licensing,
- intellectual property,
- market and trademarks knowledge.

The International Standard IAS 38 *Intangible assets* specifies some examples of intangible items acquired or developed by businesses: software, patents, copyrights, film, customer lists, mortgage rights, fishing licenses, relationships between customers and suppliers, customer loyalty, marketing rights, market share. Also, it highlights that not all assets of this type will satisfy the definition of a separately identifiable intangible asset.

Items that do not meet this definition will be registered in the accounts of expenditure being considered components of the commercial fund created by the entity, unless they are part of what the commercial fund that appears to acquisition, in which case they will be treated as part of it.

Therefore, it is ascertained that in our analysis we have to take account the manner in which the commercial fund was generated: a commercial fund created by the enterprise is a commercial fund obtained as part of a cluster?

An entity controls an asset if the entity has the ability to obtain future economic benefits from resource and to restrict the access of others to those benefits. *An entity's ability to control the future economic benefits of an intangible asset is*

normally separated of the legal rights that apply into a court. In the absence of legal rights, keeping control is more difficult to prove, but there are other ways in which the entity can control the future economic benefits without legal application of law.

For example, in the absence of legal rights that protect the relations with the consumers, the exchange transactions for the same non-contractual relationship with the consumer or to a similar one (other than as part of a cluster) provides evidence that the entity is still able to control the future economic benefits arising from relationships with consumers. Because such exchange transactions also provide evidence that customer relationships are separable, those customer relationships meet the definition of intangible assets.

International Standard IAS 38 also provides examples of intangible elements that generate future economic benefits, but for which problems arise with regard to complete control of such resources or to prevent others from control:

- *technical and market knowledge* (the entity can control the economic benefits generated by them if, for example, that knowledge is protected by legal rights such as copyright, limiting trade agreement or restriction of legal coercion of employees to retain confidentiality);
- *qualified personnel* (the entity can not normally control sufficiently the future economic benefits generated by a team of professionals and training programs, so it is unlikely that technical or management skills to meet the definition of intangible assets, unless they are protected by the legal rights to use and obtain the expected future economic benefits);
- *a portfolio of customers or a market share* (although the entity can predict that because of his efforts to build business relationships and loyalty with consumers, consumers will continue to appeal to it, however, without legal rights that protect or other methods to control customer relationships and loyalty, the entity has insufficient control over future economic benefits with consumers for the immaterial elements such as customer portfolio, market shares, customer relationships or their fidelity to meet the definition of intangible assets).

Consequently, the second argument against the recognition of goodwill as an asset is the fact that not in all cases the enterprise is able to exercise control over the economic resources, although it will obtain future economic benefits by using resources.

Future economic benefits resulting from an intangible asset may include revenue from the sale of products or services, savings or other benefits resulting from the use of assets by the entity (the use of intellectual property in a production process). Obviously, commercial fund generates future economic benefits as a result of a past transaction (clusters), because it's able to create together with other assets, cash flows, the entity controlling these advantages (Feleagă, Malciu, 2004).

Accounting specialists must exercise professional reasoning in assessing the safety degree associated to the flow of future economic benefits towards the enterprise” (Epstein, Ali Mirza, 2005).

One of the most difficult criteria to satisfy is the reliable measure of the cost. This criterion should be respected by all assets.

Thus, it highlights *a third argument against the recognition* of commercial fund as an asset and this consists that fact that commercial fund can't be measured reliably, other than the commercial fund acquired by parties by enterprises.

4. CONCLUSIONS

Commercial fund is conventionally divided into two categories:

- ***internally generated commercial fund***, which is developed by processes and unspecific expenses And the entity that includes items such as advertising, product development, personnel recruiting and training, etc., bearing in mind that not all of these costs create commercial fund, and
- ***purchased commercial fund***, which is more easily defined and identified, being registered at any time, one entity acquires another entity and to requit the excess over what is justified by the fair value of purchased identifiable assets and liabilities (Bloom, 2006).

By amending IAS 38 Intangible Assets, IASB has tried to remove the limits of traditional accounting system and to adapt to the changing realities, where the role of intangibles is becoming stronger. The provisions of the new standard are a step toward achieving the convergence agreement between the International body and the American body. Apparently, the difficult problem of capturing in the balance sheet or other format of value creating intangible elements could not be resolved. The recognition criteria of intangible assets offered by IAS 38 are quite restrictive, and businesses will ascertain that many of the expenses made in order to purchase, or to create an intangible asset will not pass the capitalization test. Given the inability to assess separately the acquired intangible elements and their classification in the category of goodwill acquired, but especially by failing to recognize the goodwill created internally, the reported financial information is not complete and the users are misinformed.

Another step in achieving convergence is adopting the financial reporting standard IFRS 3 Combinations (groups) of enterprises. One of the most important provisions of the standard relates to disclaiming goodwill amortization and subjecting it to an impairment test each year. The presence of a goodwill impairment expense may signal an unfavorable situation in the entity. However, it seems that controversy also may appear in the case of the impairment test, related to the moment when it is made, the impairment indexes, the cash-generating unit or the selected reporting unit, and the depreciation effect on the financial statements.

Following the review of international accounting rules, some intangible elements originally incorporated in goodwill will be accounted separately: research and development projects underway, customer relationships in certain circumstances, for the first ones the conditions for recognition are met, but the last category it is more difficult to control. However, it remains to be clarified the recognition of some intangible elements such as employment contracts of key people, legal unprotected databases, additional skills of a qualified team due to training expenses, special talents in management, administrative and technical areas, etc.. IASB and FASB have in their long-term common agenda a project for accounting intangibles.

The conclusion is that commercial fund meets the criteria to be recognized as asset at the acquisition of a company, but not after this operation (Feleagă, Malciu, 2004).

Internally created commercial fund is not an identifiable resource controlled by the enterprise and it can't be measured reliably.

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