ABHINAV
International Monthly Refereed Journal of Research In Management & Technology
ISSN – 2320-0073 Volume II, February'13

VALUATION OF INTELLECTUAL PROPERTY RIGHTS: AN ACCOUNTING PERSPECTIVE

Sarbajit Paul

Assistant Professor, Vijaygarh Jyotish Ray College, Kolkata, India
Email: paulsarbajit06@gmail.com

ABSTRACT

Now a days, some new concepts have emerged in the field of trade industry and commerce. Intellectual Property (IP) assets are one of them. IP assets are simply innovative and creative in nature and the rights which are enjoyed by the inventor of IP assets are called Intellectual Property Rights (IPRs). Today success of an organization depends not only on tangible assets but also on IP assets. Even in case of many organizations the very survival depends largely on IP assets. All these assets must be properly reflected and posted into the organization's profit and loss account and balance sheet. Measurement, valuation and reporting of such assets are now very essential. Present study highlights the various valuation models of IP assets, accounting framework and its interpretations.

Keywords: IP assets, IPRs, Tangible assets

INTRODUCTION

In the international trade and commerce sector, some new concepts have been evolved in the process of rapid improvement and transition. Today most of the organizations are not entirely dependent on their tangible assets to make their profit and growth rather they depend more on intangible assets. Intangible assets have wide concept Intellectual property (IP) assets are one of the major sub-sets of intangible assets structure. The rights which are enjoyed by the inventor of intellectual assets are called intellectual property rights (IPRs).

IPRs are extremely creative in nature and at present, recognized globally. Organizations are gaining their competitive advantages by utilizing their IPRs. Indeed, no organization can deny the importance of IP assets today. Moreover, in some organizations, the worth of IP assets is higher than that of tangible assets they own. There exist some organizations in the world like consultancy concerns which entirely organize their job by their intellect and they use minor tangible assets or tools like calculator, computer, website etc. to give shape to their mental phenomena into reality. That is why; it is high-time to probe methods of measurement and reporting of IP assets.

Different Forms of IPRS & Their Protection

"Intellectual assets are knowledgeable creation of human resources on which the organization can assert ownership". (Sullivan, Patrick H., 1994). In the broader sense, IP assets include patent, copyright, trademark, design, trade secrets and other different types of creative processes. More or less, all the organizations use intellectual assets for their betterment. Recently we notice the extensive use of IP assets in IT as well as pharmaceutical, Agricultural, Bio-technological and other innovative sectors. The World Trade Organization

(WTO) enacted Trade Related aspects of Intellectual Property Rights (TRIPS) Agreement on 1st January 1995 from among 120 countries of the world. Another remarkable step was taken by the WTO in this regard to protect all the IPRs and their modification or addition. Thereafter significance of the IP assets has been steadily increasing. In the recent years almost all the countries are enthusiastic about gaining and utilizing these assets. Now it is the time for formulating regulations for utilization of IP assets and different organizations in each country should devise proper measurement and reporting techniques of the new assets.

PURPOSE OF THIS PAPER

In this paper a modest effort has been made to highlight the position of current accounting system viz-a-viz accounting standard about the recognition, measurement and reporting of IP assets and specially the methodology on which experiments have been made for valuing such assets.

Why Should We Go in For Valuation of IP Assets?

The question may arise why should we go in for such valuation. The answer is very simple. Alike other cases we notice that there are some social factors as well as economic reasons for the existence of which we have no other alternative than to pay attention to these aspects. In fact, IP assets have the great impact on a firm's profitability, growth and its stability. Apart from it, survival of some organizations are entirely dependent on IP assets. Similarly there are so many other reasons for valuing and interpreting IP assets and these are:

- Intellectual Assets Management including Sale or Purchase.
- Business Acquisitions, Extentions or Disposals.
- Performance Evaluation with Consequences.
- Prudent Financial Accounting & Reporting.
- Facilities in Tax and Duty.
- Rationalisation of Old system.
- Preparations for Switching over to Improved Techniques.

Social Factors

- Bringing up intellectual individuals
- Develop Employment Possibilities.
- Induce more Entrepreneurship
- Derive Benefits of Globalisation.

IP Assets in Accounting Sense

IP is an asset; we find in it all the features or characters of traditional assets. The only difference between these two types of assets lies in the fact that IP assets are intangible and invisible but we feel these assets. Assets mean economic resources from which the concern may get certain benefit either at present or on recurring basis. As per the accountant's view, if an item renders economic resource, it is identified as an asset but if it is not possible to ascertain its objective value, the item can never be regarded as an asset. An asset has the

ISSN – 2320-0073 Volume II, February'13

following characteristics: (a) Emergent by the introducer, (b) Potent to yield prospective benefit and (c) Under control of the claimant concern. Today all organizations realize that they get a lot of economic benefits by use of IP assets which they own. The higher authority of almost all the countries also realize that by proper use of IP assets the society is highly benefited. So there is no doubt about it whether IP is an asset or not. Now the question arises, how the IP assets can be recognized? IP assets have all the characteristics of an asset but its main deficiency is that IP assets are difficult to be recognized individually and measure quantitative terms. Though the purchased or acquired IP assets be recognized and given an imposed value but the internally generated IP assets can hardly be properly recognized and measured.

Measurement of IP Assets

It is an extremely difficult task, because in many cases concerned assets are not identifiable or separable from the other assets. The measurement of IP asset depends on the process by which such measurement is done. To measure the value of IP assets as a whole, the value of the firm is ascertained first and the total value of identifiable tangible and intangible assets are deducted from it. The difference is taken as the value of unidentifiable intangibles like internally generated goodwill or any other incorporeal items. But there arises another question, how to value the IP assets individually? The alternative route is that IP assets have only their acquisition values i.e. the amount paid for procurement of the rights. More while, this amount is called cost price or purchase price otherwise it is very difficult to measure IP assets. Though there are only a handful of possible approaches like market Approach, Revenue Approach, Cost-saving Approach for measurement and reporting of IP assets which are discussed later.

Accounting for IPRs under Historical Cost Framework

Historical cost simply means the cost which is ascertained after it has been incurred i.e. the past cost. In the accounting literature it means also something more. Under historical cost system an item (tangible assets) is valued and recorded in the books at their acquisition price or the exchange price on the acquisition date, less depreciation, regardless of their present market value or true value. In case of IP assets which are valued and recorded at purchase price and amortised according to their usual life. Under this method if the organization owns an asset without any financial sacrifice, it is not reflected in the accounts. Similarly, internally generated intangible assets like goodwill or any kind of IP assets developed by research process etc. do not appear in the balance sheet as an asset. However acquired IP assets are recorded at their costs i.e. the price paid or to be paid to acquire them wholly or some unamortised portion of it and then presented in financial statement even when their real prices are substantially high, in general, the valuation of internally generated intangible assets or IP assets rests primarily on the proper allocation of capital expenditure associated with the assets and secondarily on prudent assessment of the future prospects of utilization of the assets. The process is very intricate and baffling. Here lies the main limitation of historical cost system. It does not recognize the true or fair value of assets to be shown in the balance sheet. So under the historical cost framework it is not possible to record the value of IP assets in the balance sheet as they are purely volatile in nature irrespective of the IP assets which are licensed or sold. Similarly assets like human resources, managerial efficiency, good market demand, healthy supirior-subordinate relationship, market potential etc. have the great impact on a firm's stability and prosperity but they are not shown in the balance sheet as they don't have any cost or acquired price. These so-called assets can't be represented in the basic accounting framework consisting of Journal, Ledger, Cash book, Trial balance and ultimate Balance Sheet. That is why; historical cost valuation based balance sheet becomes irrelevant for decision-making of the users as it does not reflect the true value of the business concern. Till now all organizations of the world are maintaining their accounting system under historical cost-based valuation as it is objectively determined and secure the uniformity of valuation among the various organizations. Now it is the time for change over to new methods of valuation, recording and reporting of the (identified and unidentified) IP assets so that the balance sheet can reflect the true and fair view of the financial condition of an organization.

Attempts to Make Valuation of IPRS

Some useful attempts have been made to make the valuation of IP assets rather realistic. Financial professional, accountants and businessmen agree on some common models like cost based valuation, market based valuation and income based valuation. According to the valuation process and proper usefulness of such assets we have to identify them under the above three categories. Cost based approach indicates the costs incurred for developing of an IP asset. Market based valuation method focuses on the value of an IP asset in the market place and income based valuation model estimates the future revenues generated by an IP asset.

Besides these some other measures may be contemplated. Valuation based on cost saving by installation of new IP assets (saving approach), rules of the thumb i.e. assuming 20% of income generated by IP assets to restore the uniformity among the organization.

Market approach means that the value of IP assets is determined on the basis of exchange price which is the result of a particular transaction in the market. In other words, the fair value of an IP asset can be determined in comparison of the market price of other IP assets of similar category. This is easy but there is a problem that all IP assets are not homogeneous. Sometimes again market prices are very much variable.

Revenue approach is the most logical approach of valuing IP assets as it counts on the future economic benefit that can be derived by use of these IP assets. The total present value of expected future cash inflows in the life-time of a particular IP asset is sometimes taken as its value. This approach is not free from the limitation that there is always a high degree of uncertainty in estimating incremental future returns. Apart from this many IP assets generate benefits along-with other assets and it is difficult to segregate the benefits that arise from particular IP assets alone. (Ghosh, 2002-03)

Cost approach indicates the actual expenses incurred in the procurement of IP assets. Again, when the IP assets acquired by purchase or the hire charges for taking license from the respective authority, that purchase price or sum total of hire charges taken as the value of IP assets. But the actual problem is that the expenditure incurred in developing such an asset can hardly be ascertained." Most of the cost of patents, trademarks and trade names are joint costs. Many patents may emerge from joint research and development expenditures and several trademarks and trade names may be advertised jointly"(Hendriksen, 1984).

Technical, economical and functional obsolescence sometimes requires the adoptation or installation of new IP assets. In most cases new-fangled assets lead to the prosperity of

ISSN – 2320-0073 Volume II, February'13

an organization by cost-saving processes. The sum total of such cost saving items constitute the value of IP assets. Although it is difficult to ascertain the value of each cost-saving item severally.

Another view in this regards is that rules of the thumb. Generally most of the organizations assume the value of IP assets at 20% to 25% of their present value of future earnings that is to be created by the IP assets. The main reason of that type of valuation is maintenance of uniformity among the organisation which use the same type of IP assets.

Inspite of some difficulties the above mentioned methods are easy for valuation of IP assets. These methods of valuation are in vogue at the national and international spheres although they have their limitations. However, they are much more improved and advanced than the traditional methods.

Position of Current Accounting Standard Relating To IPRs

Both the Indian and International Accounting standard has not yet provided any concrete direction how IP assets can be channelized through the traditional accounting system. Indian Accounting standard 26 and International Accounting Standard 38 have given some guidelines relating to recognition; valuation and reporting process for intangible assets though these are not adequate. This can be primarily followed as guidelines or auxiliary systems. International Financial Reporting Standards (IFRS) 13 has also given some ideas about the fair value accounting which could be the good guidance in this respect.

REMARKS ON CONCLUSION

There have been very many experiments at national and international stages concerning recognition, measurement and reporting of IP assets. It is a matter of shame that lack of organized, systematic and transparent accounting concept about the recognition, measurement and reporting of IP assets often misled the decision maker and for that very reason almost all the organizations are losing their financial, economical and social importance. As these are essential aspects for the development of the economy as a whole, all great thinkers of different part of the society should immediately come forward. To cope with the problem, we should go in for change over the definition of the assets, finding out the appropriate measurement process, appropriate valuation rules and lastly the suitable reporting methods.

We believe that accounting standard-setters, academicians, scholars and researchers should extend their hands of co-operation and combine their efforts which can only mitigate the problems. In fact, the IPRs have posed a great challenge before the accounting community. We have a firm faith that it's a challenge before us and this challenge has to be accepted. Otherwise, the future progress of the discipline may be in jeopardy on account of its own deficiency.

REFERENCES

1. Anthony, Robert N. and Reece, James S.(1987), Accounting Principles,All India Traveller Book Seller,Delhi, pp.180-183
2. Arthur Anderson & Co. (1992), The Valuation of Intangible Assets—Special Report No. P254 The Economist Intelligence Unit- London.

3. Banerjee, D.(1997), Accounting Theory, Book Syndicate Private Ltd.,Calcutta
4. Chandra, A. and Kumar, S.(1999), Intellectual Property Rights : Issues,Status and Strategies , Yojana, Vol.43,No. 10, October, pp.14-19
5. Fitzsimmons.C and Jones, T. (2002), Managing Intellectual Property, Capstone Publishing,U.K.
6. Gangopadhyay,P.L. and Halder, R.(2003), Entrepreneurship Development & Business Communication, Dey Book Concern, Kolkata
7. Ghosh, J. (2002-03), Studies in Accounting Theory, Book India, Kolkata
8. Gupta, Dinesh K. (1997), Valuation of Intellectual Assets and Human Resource Accounting, The Management Accountant, Vol.32, No.3, March, pp. 206-207
9. Hendriksen, E. S. (1984), Accounting Theory, Khosla Publishing House, New Delhi
10. Jagannathan, D. (1997), WTO-General Agreement on Trade in Services (GATS): Implications for Accounting Sector, The Management Accountant, Vol.32 No. 12, December, pp.900-901 and 905
11. Pan, T.K. and Karmakar, M. (2004), Samakalin Udog Unnayan o Babosayik Yogayog, New Central Book Agency Pvt. Ltd. Kolkata
12. Paul.Sarbajit.(2012), Intellectual Property Right for Micro, Small and Medium Enterprises: A Study of a Small Industry in the District of Howrah, West Bengal, accepted in Indian Streams Research Journal, 2012, Solapur,Maharashtra
13. Poltorak, Alexander I. and Lerner, Paul J. (2002), Essentials of Intellectual Property, John Wiley & Sons . Inc. New York
14. Rakshit, P. (2002), Students Guide to Accounting Standards & Guidance Notes, Tee Dee Publications, Kolkata.
15. Simensky. M, Bryer, Lanning G. (1994), The new role of intellectual property in commercial transactions, John Wiley & Sons. Inc. , New York
16. Smith, Gordon V. and Russel L. Parr (1989), Valuation of Intellectual Property and Intangible Assets, John Wiley & Sons. Inc. New York
17. Sullivan, Patrick H. (1994), Extracting Value from Intellectual Property, (Berkeley : Law & Economics Consulting Group), p.5

Websites referred:

1. www.wipo.int/sme/en/documents/value_ip-intangible-assets.htm
2. http://www.cogentvaluation.com/con_services_ValIPRights.cfm
3. http://www.wipo.int/sme/en/documents/ip_standards.htm
4. http://www.investopedia.com/terms/i/intellectualproperty.asp#axzz2HJ0sxdJu
5. http://www.iveybusinessjournal.com/topics/strategy/leveraging-the-power-and-value-of-intellectual-property#.UOrxiq6Zk_4