ACCOUNTING TREATMENT OF BRAND AS AN INTANGIBLE ASSET OF ENTERPRISES

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Abstract: *The modern economy is qualified as an economy dominated by knowledge, creativity, high technology, or intangible assets. Intangible assets are a key determinant in the creation of value and cash flows of an enterprise. The brand plays a significant role in positioning the company, as intangible assets that have not yet been adequately formalized in financial accounting. A brand is a composite of intangible items such as copyright, patents, customer relationships, know-how, quality, company image. Accounting treatment for brand as an intangible asset is an attractive field of study, where the interests of contemporary researchers gravitate towards finding an adequate accounting treatment model. Accordingly, the main objective of this paper is to consider the accounting treatment of a brand as an intangible asset.*
Key words: *brand, intangible assets, accounting treatment*

INTRODUCTION

In the new knowledge economy, enterprises are significantly enriched with knowledge-intensive intangible assets such as sophisticated technology and knowledge and established software systems in enterprises, enthusiasm, creativity, and competence of the workforce and strong reputation (Upton, 2001, p. 6). The definition of an intangible asset is interpreted in international accounting conventions as non-monetary identifiable assets without physical substance (IAS 38, paragraph 8). The treatment of intangible assets through accounting conventions is partial, covering only that portion that meets the criteria for recognition. By treatment, we mean the qualification or recognition of an intangible asset, its measurement, and disclosure in the reports. As a result, numerous alternative treatment models have emerged (Pastor et al., 2017, p. 391).

The brand, as a fascinating category of intangible assets of a company, largely dictates the market value of the company. Brand valuation is becoming a significant topic in academic accounting, marketing, and financial professionals. The process of brand operationalization in accounting opens a wide field of discussion on how to treat this part of the intangible assets of the company. Given that brand

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value strongly reinforces the disparity between the book value and the market value of an entity, its inclusion in the financial statements is an indispensable need.

This paper examines the importance of a brand in a company and its valuation as an intangible asset in financial statements. Brand accounting treatment could be considered in two ways, first is brand recognition as an intangible asset, and brand as intangible asset that is recognized in business combinations within goodwill or separated from goodwill. The normative basis thet interprets accounting treatment of intangible assets is mainly defined, according to situation, in *International Accounting Standard IAS 38 - Intangible Assets* and in *International Financial Reporting Standard, IFRS 3 - Business Combinations*. These standards also represent a relevant accounting approach to this issue.

In accordance with the set goal and the subject of the research, the paper is structured as follows. Following the introductory considerations, attention will be paid to the importance of the brand as an intangible asset of the company. Next, the method of accounting for the brand as an intangible asset will be descriptively analyzed in ways that we previously mentioned. The concluding considerations will synthesize the key findings of the research.

1. BRAND AS AN INTANGIBLE ASSETS OF THE COMPANY

Intangible assets have been analyzed in the scientific literature within the innovation economy. Technological change is defined through a trilogy made up of invention (research that leads to the generation of new ideas), innovation (implementation of new products) and diffusion (the spread of products through the market). Innovation is a fundamental source of wealth, and in this respect, businesses need to allocate their resources to R&D in order to gain a higher level of knowledge and improvement, which in turn increases their competitive advantage. Investments within the internal R&D sector, investments in software, people, design, marketing, create positive improvements to products and processes, it also increase the reputation of the firm itself (Canibano et al., 2000, p. 103). In developed economies, investments in intangible assets are strongly tangible to the interest of lenders and investors. Within intangible assets, there is usually a distinction made in the literature between identifiable intangible assets and non-identifiable assets (Cohen, 2011, p. 9-22).

Identifiable intangible assets include intellectual property, such as patents, copyrights, trade secrets, and trademarks. There are also intangible assets that exists, but in most cases, accounting conventions do not providefull accounting treatment for them in financial statements as assets, such as brand, design, partner relationships and software code (Cohen, 2011, p. 9-22).

Non-identifiable intangible assets are included in goodwill, as a residual that is created when one enterprise purchases another enterprise at a higher cost than fair value of identifiable net assets (Cohen, 2011, p. 9-22). So these, unecognizable assets, remain hidden, at least in accounting terms, until some transaction (for example, an acquisition) indicates the existence of goodwill.

The word brand is derived from the old Nordic language from the word brand, which meansburn. According to the American Marketing Association (AMA), a brand is "a name, meaning, symbol or design, or a combination thereof, to identify the products and services of one seller or group of sellers and differentiate themselves from competitors." When market participant creates a name, logo or symbol for a new product, he created the brand in a technical sense (Keller et al., 2011, p. 31).

The success of a modern company is largely driven by branding. A brand is an intangible asset in the form of a reputation that an enterprise has with its customers. Brand as part of a company's capital determines its market value (Ognjanovic, 2017, p. 70). The brand gives the company a personality that helps consumers to create certain expectations about the quality of the company (Wasserman, 2015, p. 12). The brand can significantly affect the value of the product and its market position, especially in industries such as pharmaceutical or cosmetic (See more: Sharma & Dharni, 2017). Such a claim actually provides us with evidence that the brand generates economic benefits, as well as other assets, which makes it necessary to value and recognize it.

Production processes and design can be copied, but the impressions of individuals and organizations over the years of marketing activity and product experience cannot be easily created. In this sense, branding can have a strong influence on ensuring competitive advantage (Keller et al., 2011, p. 35).

An indispensable topic that speaks to a brand is its value. In the marketing and finance literature, there is a strong differentiation between brand equity and brand value. Brand equity is based on the specific perception of a particular brand by consumers, which, thanks to the brand name, creates a differentiated effect expressed through marketing results as opposed to results that would result if the product did not have that name (Starčević, 2013, p. 68). In simpler terms, brand equity represents the added value that the brand name gives to the product, because of the company's marketing activities (Starčević, 2013, p. 68). Brand value is a financial category, which is defined by reducing it to the present value of cash flows based on the monetary benefits that a given product carries in the future. The two concepts are in a causal consequence. The financial value of the brand is the monetary value of the brand and at the same time the outcome of managing brand equity. Consumers use strong brands as a tool to reduce risk and uncertainty and reap social and emotional benefits from their choices (Datta et al., 2017, p. 4).

Beginning in the 1980s during the massive emergence of mergers and acquisitions, analysts were fascinated by the discrepancy between the market value and the book value of individual companies when buying or merging. This problem has been recognized in the context of the need for brand valuation, as an asset that plays an extremely important role in shaping the overall value of a business. Today, brands are largely positioning global entities on the marketing platform. The following table shows the brand value within individual companies today.

Table 1.: The most valuable brands in the world, 2018.

Company name	Brend value (in bilions of dollars)
Apple	214,480
Google	155,506
Amazon	100,764
Microsoft	92,715
Coca-Cola	66,341
Samsung	59,890
Toyota	53,404
Mercedes-Benz	48,601
Facebook	45,168

Source: http://interbrand.com/best-brands/best-global-brands/2018/ranking/

Table 1 illustrates the value brands of specific global leaders. However, these figures are not included in the financial statements of these companies.

2. THE BRAND IMPORTANCE FOR FINANCIAL REPORTING

Given that the financial statements of the company do not indicate the value of the brand, there is a myopia of users of accounting information. In this regard, the necessity of adjusting accounting mechanisms and reducing the discrepancy between the value of an entity recorded in the financial statements and the value manifested in the market.

Symptoms of decadence within the normative accounting treatment of intangible assets have led to a stronger gravity of researchers' interest in creating certain alternative accounting mechanisms in the treatment of intangible assets. The volume of literature has grown exponentially within the scope that covers intangible asset disclosure procedures (Castilla-Polo & Gallardo-Vázquez, 2016, p. 330).

Accounting treatment of intangible assets is normatively defined in professional regulative in form of conceptual framework and standards which are published by *International Accounting Standard Board - IASB*. Particular standard which determine the treatment of intangible assets is Internatioanl Accounting Standard 38 – *Intangible Assets*. Accounting treatment of intangible assets include recognizing, evaluating and reporting particular intangible asset in financial statements. According to this standard, assets are generally interpreted as assets controlled by an entity arising from past events and on the basis of which it is expected that future economic benefits will flow to the entity. Intangible assets as a sub-category of assets are defined as non-monetary assets that can be identified without physical substance. The synthesis of these definitions reveals the essential criteria of an intangible asset that are manifested in IAS 38 in order to implement accounting treatment. Criteria that qualify intangible asset for accounting treatment are folowing: it can be identified, controled by an entity, and entity expects inflow of future economic benefits on the basis of those assets.

For an intangible asset to be identifiable, it must be separable and come from contractual or legal rights, whether those rights are transferable or separable from the entity or other rights or obligations. The separability criterion is a crucial element that explains the ability to identify an intangible asset in an enterprise. Intangible assets that cannot be separated from an entity and sold, transferred, licensed, leased or exchanged with or without a related contract do not adhere to the recognition criteria (Ernst & Young, 2019, p.1218; Cohen, 2011, p. 49). Control as criteria for accounting treatment of brand means the exclusive right for entity to obtain future economic benefits and to restrict others for obtaining such benefits. This ability arises from legal rights that entity has (IAS 38, paragraph 13). In that sense, it is difficult to prove the existence of such control. For example, a firm may have partial control over the intangible assets of employees. Engaging employees in other entities will result in an overflow of economic benefits from that intangible asset to another entity, thereby impairing the accounting control clause. The pursuit of future economic benefits relates not only to future revenues but also to cost savings or other benefits that result in the use of the intangible asset in the entity. Thus, using intellectual property production process may reduce future production costs (IAS 38, paragraph 17).

IAS 38 in paragraph 21 confirms that, an asset that complies with the above criteria for qualifying an intangible asset qualifies for recognition if, upon initial acquisition, its cost can be measured reliably, with expected future economic benefits arising from that intangible asset. Such accounting treatment of recognition in accounting books can be easily manifested in the separate acquisition of an intangible asset or its acquisition in business combinations. However, the recognition problem becomes more intense in the case of internally generated intangible assets such as software, patents or intangible assets created as a result of research and development. According to IAS 38, since the recognition and measurement criteria (cost can be reliably determined) are respected, the entity begins the decomposition of the intangible asset generation into the research and development phases. Once such internally generated intangible assets have reached the development stage, the costs incurred during that stage can be capitalized. When development phase is reached, it provides evidence that internally generated intangible assets enable the entity to hold future economic benefits (Zéghal & Maaloul, 2011, p. 264). On the other way, a brand is difficult to even define because it covers intangible assets such as copyrights, patents, customer relationships, know-how, quality, company image (Cohen, 2011, p. 21). It is clear that some internally generated items of intangible assets can be recognized, while for some it is not possible, such as goodwill and brand. Accounting argues that it is impossible to separate the cost of such intangible assets from the usual costs of running and developing a business so that these intangible assets cannot be measured reliably.

Paragraph 20, IAS 38, takes the view that subsequent expenditure on trademarks (trademarks), impressions, titles, customer lists, and items similar in content (whether internally generated or externally acquired) is always recognized in income statement when they arise, because such expenditures do not differ from the development costs of a single enterprise.

3. BRAND ACCOUNTING

The mechanism of brand coverage in financial accounting is defined by the fact that it is segmented into a portion that is deferred through goodwill and a portion that is contained in intangible assets that can be recognized. There is also a portion of intangible assets that are recognized under business combinations but separately from goodwill. Considering this, brand accounting can be analyzed through: treatment of the brand as an intangible (identifiable) asset and treatment of the brand in business combinations within and separated from goodwill.

3.1. Accounting treatment of a brand as identifiable intangible asset

The role of accounting is also reflected in the coverage of all brand-related items. For monitoring of brand value from the point of view of accounting, it is necessary (Brlečić Valčić & Hodžić, 2016, p. 136):

1. to define a brand structure that includes parts of intangible assets that can be easily captured in accounting,
2. to establish a link between the brand structure and the general ledger accounts,
3. to approve brand structure accounting by managers,
4. to account brand-related business changes.

Defining the parts of a brand structure that can be accounted for involves defining all the business changes that are associated with the brand. If a company produces several different products that are closely related to brand equity and fall into different product categories (food, beverage), the first step is to define the business segments in which they arise. Once defined, the brand structure is linked to the general ledger accounts, thereby creating an information base forreporting in management accounting (Brlečić Valčić & Hodžić, 2016, p. 136). Based on the financial and management accounting information, the company management analyzes the profitability of further investment in the brand and the development of such capital.

Table 2 shows an example of accounting the purchase of promotional material for brand development from Supplier 22, according to the defined brand structure, in the amount of RSD 3,500.00. The example shows us that all business changes are linked to brand structure analytics so that they can be analyzed later. The code S001 under the item "Segment" represents the segment of business within which the brand is produced, while under the item "Brand structure" the code 01 represents the brand code and 03 in the structure represents the number of the work process for the development of the brand (procurement of promotional material that connects with brand development, in this example).

For determining fair value of intangible assets in business combinations, number of approaches are used, which can be grouped into three basic groups (Spasić, 2012, p. 149-151): the market approach, income approach, and the cost approach.

Table 2.: Example of posting by defined brand structure

Account	Business Partner	Debt	Claims	Segment	Brand Structure
Promotional material	22	3.500,00		S001	0103
Liabilities to suppliers	22		3.500,00	S001	0103

Source: Brlečić Valčić, S. B., & Hodžić, D. (2016). Računovodstvo Brenda u funkciji očuvanja vrijednosti poduzeća. Ekonomska Misao i Praksa, 25(1), p. 137.

The market approach, as the highest level in the hierarchy of procedures for determining the fair value of assets and liabilities, consists of methods based on the use of market data for a given asset or liability. The most reliable measurement of a particular item of intangible assets could be made if it were traded on the market, if the price on the day of the business combination reflected the amount that could have been reached at that moment in the exchange of the asset, between the notified willing parties in an independent transaction. If a particular item is not traded on the market, the alternative is to use active market prices that were obtained in a similar transaction for the same or approximately the same intangible asset item. This approach involves the use of the method of comparison, that is, the method of analogy (Spasić, 2012, p. 149). However, it is very difficult to identify this part of identifiable intangible assets, as there are almost no transactions on the market for it. The reason is that most often such assets are created according to the specifics of the entities.

Income approach methods are based on determining the present value of income (or profit), cash-flow, or cost savings that can actually or hypothetically be incurred by a market participant owning a given asset. The known methods are (Spasić, 2012, p. 150): the royalties savings method, the surplus yield method, and the incremental cash flow method.

The royalties saving method implies that the intangible assets are in the possession of the entity, thus avoiding the payment of the licensing costs of the asset. The estimated value of an item is equal to the present value of the expected savings from non-payment of the license fee (royalties) plus *tax amorrtization benefit - TAB*. The application of this method is possible for valuation of a trademark, patents, existing technology, software, etc. (Spasić, 2012, p. 150).

The surplus yield or residual value method determines the present value of the net cash flow that can be attributed to a given asset, after excluding the net cash flow contributed by assets within the entity to which the intangible asset belongs. Depending on the period of use of the asset, the method may be separately applied for a period of one year (single-period excess earnings method) or multiple accounting periods (multi-period excess earnings method) (Spasić, 2012, p. 150).

The incremental cash flow method is defined by comparing the expected cash flows or other benefits that would be made at defined level of business doing, with the same level of business doingbut without that particular intangible asset. The difference between these two flows of cash and benefits is then reduced to the present value with discounting rate, aiming to obtain the estimated value of the intangible asset (Spasić, 2012, p. 150).

The cost approach of valuation of intangible assets can be used in the case of procurement or production of the same asset. It is a method of determining the fair value of an asset that uses the „re-procurement cost method" in the case of the „exact copy" of a given intangible asset, while the „cost of production method" is used in the case of the production of a functionally the same asset (Spasić, 2012, p. 151).

Although proper accounting treatment of a brand as an internally created and developed asset would provide numerous benefits to the enterprise (for example, greater borrowing power), financial accounting did not find a satisfactory form of balancing it (Brlečić Valčić & Hodžić, 2016, p. 129). The brand, therefore, is not included in the balance sheets or in any financial statements, which is problematic for investors, creditors and other external users (Wasserman, 2015, p. 15). In addition, brand as an intangible asset raises the problem of determining its useful life, since it is not known for what period the economic benefits will flow to the entity. This also raises the issue of depreciation of such a portion of the property. Recognizing a brand as an internally acquired intangible asset would greatly increase the value of the property, thereby creating situation for more progressive taxation by the country in which the company is resident. How complicated this really is, tells us the dilemma whether to include brand equity or brand value within the balance sheet. (Wasserman, 2015, p. 23).

Brand value is interpretation of financial significance of brand, but when we consider brand equity it includes a premium value that entity obtain from assets and liabilities that makes brand visible. Brand equity is more complex and it means a value in customers eyes. According to data, Apple still has the highest brand value. (https://www.forbes.com/powerful-brands/list/#tab:rank) while brand equity is measured respecting the type of products or service that companies provide. For example, according to data from 2019, in audio streaming service Apple Music holds fist place, when we consider digital paying and receiving service PayPal is on the first place, considering luxury auto industry Lexus holds first, BMW second and Mercedes-Benz third place (https://theharrispoll.com/equitrend-ranking-page/) .

Brand as intangible asset includes intangibles that can be reported in financial statements, and intangibles that cannot be reported, because they don`t meet criteria for financial accounting treatment. For example product design is not object of accounting treatment, relations that entity has with partners and expertise of human reasources also. We are sure that investors, creditors and other external subjects are willing to pay for this intangibles, so these unidentifiable intangibles have value.The main symptom which represent this is a huge gap that today occurs between book value and market value of business entities (https://www.multpl.com/s-p-500-price-to-book). Considering this, brand is composit of identifiable and unidentifiable intangibles and could be accounted partially in financial accounting. Hovewer, when one entity purchases another entity as a whole, this business combination includes transfer of identifiable an unidentifiable intangible assets.Unidentifiable intangible assets are embodied in goodwill. Intepretation of Goodwill was defined in *International Financial Reporting Standard, IFRS-3 - Business Combinations*. So, we can say that brand in true sense cannot be separately sold, transferred, licensed etc.

Current accounting professional conventions also defines intangible assets that can be recognized separately from goodwill and which have not previously been recognized. IFRS 3 recognizes customer relationships, that is, the portfolio of customers as intangible assets, but in a business combination and separately from goodwill. This view is justified by the fact that the acquirer can expect that due to the business entity's efforts in customer relations, customers will continue to do business with the entity (Anselmsson & Bondesson, 2015, p. 58-70). Intangible assets, which can be recognized separately from goodwill, are mainly but not all based on recognition in the contract that defines this item. Intangible assets are thus materialized by contract providing information to assess the future benefits of such an item. The objective of recognizing intangible items separately from goodwill is to determine more precisely the synergistic effect of a business combination (Spasić, 2012, p. 142, 146).

3.2. Brand accounting treatment within goodwill

Goodwill occurs when an entity purchase another and it represents high portion of the gap between purchase price and book value of purchased entity. Goodwill is an intangible asset and an expression of the future economic benefits that accrue from assets acquired in a business combination that cannot be individually identified and separately recognized. The difference between the cost of acquisition and the acquired fair market value of all identifiable and unidentifiable net assets is the goodwill acquired in the business combination.

Etymologically, goodwill is a word of English origin that means goodwill, friendship and reputation. The connotation of the term from the accounting-economic point of view has undergone certain changes over time. They define the first definitions of goodwill as a business advantage that results from a good relationship with customers (Budimir, 2014, p. 71). Goodwill represents the difference between the purchase price of a company and the sum of the book value of its net assets (Starčević, 2013, p. 65). In the contemporary definition framework, it is expressed as a form of intangible asset, represents a value above the fair value of net assets realized within the business combination (acquisition, merger or participation in the equity determined by the acquirer) or when purchasing the company (Stanić, 2014, p. 562). Buyers of a subsidiary recognize the value of internally acquired unrecognizable intangible assets that can bring them synergetic economic benefits. When purchasing a subsidiary, internally acquired intangible assets are converted to goodwill (Cohen, 2011, p. 59). After identifying intangible assets in a business combination according to IFRS-3, intangible asset shoul be recognised if it will cause inflow of future economic benefits and the cost of the asset can be measured realiably. The costs of intangible asset is its fair value on aquisition day.

When it comes to brand valuation, we can say that companies that often make acquisitions in their business are at an advantage. They are able to recognize a portion of the brand's value in the form of goodwill, in the course of an acquisition or merger process. For example, when Disney merged with Marvel and Pixar, it was able to gauge the value of both companies. Marvel's acquisition is estimated at $ 4 billion and Pixar at $ 7.4 billion. Both companies are included in the company’s financial statements. However, a brand created within Disney along with divisions is not recognized as an asset because it is internally created and does not appear to be sold (Wasserman, 2015, p. 17). Here we note another task of accounting regulation, which is the process of codifying a brand as a consolidated value of the parent company and its divisions. Take Apple, for example, which has separate brand lines that are separately identified. iPhone, Ipad, iPod, and Apple Watch are brands that add value to Apple. Johnson & Johnson owns the following brands: Tylenol, Neutrogena, Aveeno, Band-Aid, and Listerine. Johnson & Johnson does not add as much value to the brands it produces. There is also an example in the domestic market, in 2004 Agrokor from Croatia bought the Idea company, which was owned by Mercator. At the time of purchase, the Idea had a negative equity of -50,000 EUR. On the other hand, Agrokor paid 7 mEUR for the company. The reason for the purchase is explained in Agrokor's annual report: „Goodwill stated includes customer relationships, ie. intangible assets in the form of contracts with customers.“ (http://mcb.rs/recnik/equity-kapital/)

CONCLUSION

Intangible assets in companies are divided into identifiable and unidentifiable according to accountint treatment criteria. The vitality and strength of business entities largely depend on the configuration of their identifiable intangible assets in the financial statements. However, intangible assets that have not yet been adequately accounted in financial accounting have a decisive role in positioning the company.

An example of such intangible asses is brand. The first and main difficulty that accounting is facing is the separation of a brand item from other intangible assets. A brand is actually a composite of intangible items such as copyrights, patents, customers relationships, partners relationships know-how, quality, company image. Some of these items that meet the accounting treatment criteria under IAS 38 may be internally recognized, while others may not. That means that brand has partial accounting treatment in entity. Intangible items that cannot be recognized as internally generated can be recognized through business combinations, in the godwill value. Goodwill is substantial part of brand. The normative basis for goodwill accounting treatment is defined by IFRS 3.

Based on the above, we can conclude that the accounting profession needs to improve the existing brand reporting mechanism created internally. One way is to adopt international accounting standards in conjunction with marketing professionals or to create alternative mechanisms for brand involvement through supplementation with financial statements. In the case of business combinations, recognition of goodwill and items of intangible assets separately from goodwill results in significant improvements in accounting.

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