

# Analysis, Valuation, and Disclosure of Intangible Value

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## INTRODUCTION

The “information gap” between the data provided by the traditional corporate reporting, with its focus on tangible assets, and the information used to determine corporate value, has long been recognized. The missing information is about the nucleus of the modern corporate capitalization and the substantial foundation of modern corporation: the intangible items, the intangible value and the earnings-capacity of the firm.

What do we mean by intangible value? Intangible items? Intellectual capital? How can we identify and value those items?

These apparently simple questions have been at the heart of accounting for a century or so. These questions are also integrative ones to other managerial sciences even when formulated for instance as: “How do we assess organizational performance?”

Moreover, if what is counted usually counts, the “calculation self” (Miller, 1992) is central to the aspiration to act upon that relies at the heart of our organizations; the identification and valuation of intangible items is a central question to the management of modern organizations: accountability is a vivification device.

In this short article, we highlight the main lines of an integrated framework of analysis, valuation and disclosure of intangible value. The framework proposed, promoting the extension of the traditional accounting framework of analysis in a dual way, gives expression to a managerial point of view of the strategic goals and positions of the firm and leads up to an auditable going concern statement, disclosing the relevant score of performance.

## BACKGROUND

Perhaps the answer to the above questions seems now quite obvious. In fact, a quite impressive amount of techniques have been proposed: taxonomic and valuation devices. For an overview, see Zambon (2003).

Nonetheless, those proposals seems unable to provide intervening devices and at the same time an integrative framework for accountability, that is a selective visibility of organizational actions and outcomes as an integrative part of the accounting framework of analysis. In fact, the proposals relying mostly on the items, as in the capital intellectual statements, do not offer methods for reaching a reliable measurement system for them, and even the holistic approaches do not provide integrative frameworks, as they disregard the traditional accounting framework of analysis. In the valuation side of the puzzle, in general, the valuation models fail to fully account for the intangible items as such, as they do not generate cash flows on their own. Many of them are only “contributing parts,” that is, they allow a company to charge higher prices for its products and generate more in cash flows. Others are only real options. In both cases, they only exist as parts of the whole.

We might use any valuation approach to assess firm value. But, a dual way of analysis and disclosure requires a dual model of valuation of the whole, as in the residual income framework, and of the parts (market opinion, internal opinion), as follows.

## MAIN FOCUS OF THE ARTICLE

### What are Intangible Items?

What in the world are intangible items? Intangible assets?

The intangible items we are concerned with are not the “intangibles almost tangible” of the IASB/FASB standards (see IASC, 1998). In fact, the recognised intangible assets are summations of costs with no physical substance, that is, assets with some degree of constructed “tangibility.”

The intangible items we are concerned with are those out of the balance sheet. They have been identified as knowledge assets, capabilities, competencies, strategic

assets, and assets with a high degree of specificity. But none of these delimitations provide an “intervening device.”

a. Let us assert (mostly) with the early writers that:

1. The intangible items have the nature of a differential advantage (they are “chiefly of the nature of a differential advantage of a given business man, or a given concern, as against another” Veblen, 1908).
2. They are not costs (“an intangible property value is one which originates without direct cost” Paton, 1962, p. 312), they are the residuum (“the excess, if any, of the value of the enterprise as a going concern over the sum of the more specific and independent assets listed individually” Paton, 1934, p. 295); the contributing parts to that residuum and the materialization of it. “These assets come forth, grow great, and decay, according to the advantage or decline of the strategic advantage achieved by given individuals or business concerns” (Veblen, 1908).
3. They are opinion assets: lying in the routines of the organization (cannot be bought or sold separately), their identification and valuation cannot be based on the market (in one of the markets in which the firm participates). Instead, the identification and valuation vectors of those items may fruitfully be assumed to be an expression of the strategic purpose of management and, in that sense, they are opinion assets.
4. They have a fuzzy and complex nature in fuzzy logic sense (see, namely, Zadeh, 1965, and Bojadziev & Bojadziev, 1997). The boundaries and essence of an intangible item are fuzzy, its service potential is a fuzzy and complex concept, full of ambiguity and intrinsic imprecision, and besides that they are opinion assets.

b. Following Veblen (1908), the intellectual capital must be seen as an internal equity, the excess if any of the enterprise value, as a going concern, over the claims of the equity providers, that is, as the monetary expression of the aggregate intangible value.

## The Founding Steps

With this in mind, we can build an integrative framework to provide accountability, shaping accounting as an enmeshed mirror of organizational reality. Let us enumerate the founding steps:

1. The specification of a way of seeing the firm is an integrative part of accounting, as in the entity theory tradition of the American school or in the *economia aziendale* tradition of the Italian school.
2. To the traditional accounting framework of analysis, the firm is a price mechanism, or a nexus of contracts. The assets are seen as in a buy-sell process and performance is basically a question of matching in a timely manner the costs with the revenues, the realized ones.
3. But, the firm is also and basically a producer of his own resources. And as that, each firm is unique. Relying in its base of resources, that is, in the intangibles in a proper sense, the resources that cannot be bought or sold, both their idiosyncratic nature and the source of the differential advantage.
4. So, asserting that the firm is the center or the area of attention we may draw the main lines of a dual model of analysis, that is, a comprehensive entity approach, overlying to the firm as a link between markets the concept that it is also a producer of its own resources (for a full description see in Canadas, 2004, “Towards an approximation to an accounting theory of the firm”).
5. This vectorial space of analysis, a simplified expression of “an onion model of reality” (Mattessich, 2003), contains the building basis of the dual model of analysis, valuation and disclosure we propose. In fact, this dual space of analysis makes pertinent the partition of the set of resources of the firm in two groups, one resulting from market transactions (the assets of the traditional framework of analysis), the other, the intangible items in a proper sense, lying in the routines of the organization.
6. The above partition is also the starting point to select both the relevant unit in accounting measurement, since we must value the intangible items as parts of a generating value unit, that is, by their contribution to the whole, their “mem-

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