Accounting for Brands in France and Germany compared with IAS 38 (Intangible Assets)

An Illustration of the Difficulty of International Harmonization

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Key Words: Brands; International Accounting Standards; IASC; Intangible Assets; International Harmonization

Abstract: This paper compares the positions taken by IAS 38 over brands and the related treatments in France and Germany. Despite many points of convergence, the paper shows that these two countries, often to be found in the same cluster of national accounting systems (the "Continental European" model), have adopted very different solutions in relation to each other and to IAS 38. The results of the study highlight the difficulty of international harmonization. They also show that as far as the qualitative characteristics of accounting are concerned, the frequently made association between Anglo-American accounting philosophy and "relevance", and between Continental-European accounting philosophy and "reliability", may not apply when it comes to brand accounting. To resolve this international "disharmony", our paper militates in favor of disclosure of additional information.

List of abbreviations

CNC	Conseil national de la comptabilité	National Accounting Council
COB	Commission des Opérations de Bourse	French Securities and Exchange Commission
EEC	-	European Economic Community (now European Union)
HGB	Handelsgesetzbuch	Commercial Code
IAS	-	International Accounting Standard
IASC	-	International Accounting Standards Committee
MarkenG	Markengesetz	Brands Act
PCG	Plan comptable général	General Accounting Plan

INTRODUCTION

Intangibles have become an increasingly important factor in economic life and the success of corporate activities (Ochs 1996; Duizabo and Guillaume 1996). For the majority of companies, intangibles are essential for progress and a considerable part of the corporate value. One type of the very broad spectrum of corporate intangibles is brands. Brands can be defined as any word, tone, symbol or design to identify and distinguish one product or group of products from other products (Plasseraud, Plasseraud and Dehaut 1994). But brands are more than just the name or sign. In a broader sense, they create a unique image of the branded product or service, its quality and attributes as perceived by customers (Smith 1997, 38-44; Meffert and Burmann 1998, 81; see also Kapferer 1998). In the consumer product industry particularly, they are regarded as a key competitive factor influencing consumer preferences for a product, and therefore the corporate sales level[1].

Because of the importance of brands for the economic development of certain businesses, their accounting treatment has been a matter of debate and controversy in many countries, for example in Australia and the United Kingdom, where companies such as Grand Metropolitan and Rank Hovis McDougall decided in 1988 to include the value of brand names, either purchased or internally developed, in their consolidated balance sheets (among others see Barwise, Higson, Likierman and Marsh 1989; Power 1992). In France too, the consequence of accounting for intangible assets, including brands, is important for certain companies because of their potential relative significance in the presentation of the balance sheet. For example, in 1998, brands represented 22.8% of the balance sheet total for Rémy Cointreau and 11.9% for Danone (X 1999a). The most remarkable transaction concerning brands in Germany was the acquisition of the “Rolls-Royce” and “Bentley” brands by BMW and VW in 1998. For Beiersdorf there is an assumption that the “Nivea” brand is more valuable than the balance sheet total (Breit 1997).

Against this background, the International Accounting Standards Committee (IASC) issued its International Accounting Standard 38 in July 1998 (IAS 38 – “Intangible Assets” – see IASC 1998b; Gélard 1998), following the publication of two Exposure Drafts (E50, June 1995 – see IASC 1995; Gélard 1995; X 1995a and X 1995b and E60, August 1997 – see IASC 1997). The standard sets out proposals for the recognition, measurement, amortization and disclosure of intangible assets. Accounting treatment of brands is included in the scope of this text.

It is often stressed that the process and outcome of IASC standard-setting are very much influenced by the Anglo-American accounting approach, which theoretically emphasizes “relevance”. This is considered one of the major reasons why countries with other accounting approaches are clearly reluctant to adopt the international accounting standards. That is particularly true of countries belonging to the “Continental European conception” which is supposed to stress reliability, objectivity and prudence in income calculation. It is thus highly interesting to examine whether the treatment described in IAS 38 differs from accounting practice in Continental European countries, and to consider if the content of the standard could easily be adopted by enterprises in those countries. This is the main objective of our paper, which compares the positions taken by standard IAS 38 over brands with the related treatments[2] in two countries not often studied together: France and Germany.

The remainder of our paper proceeds as follows. The first section presents the recognition of brands as an asset, covering such fundamental problems as the definition of intangible assets, the principles governing the recognition of brands (acquired or self-generated) and initial measurement of brands. Section 2 describes the subsequent measurement (amortization, revaluation and value recovery) and section 3 suggests some limitations of our study and directions for future research. Section 4 presents the conclusions.

RECOGNITION OF BRANDS AS AN ASSET AND INITIAL MEASUREMENT

As brands are intangible items, their recognition on the balance sheet primarily depends on their compliance with the definition of intangible assets. The classification of intangibles as assets is therefore the preliminary step in our investigation.

Definition of Intangible Assets

IAS 38 (para. 7) defines an intangible asset as an “identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes". An asset "is a resource (a) controlled by an enterprise as a result of past events; and (b) from which future economic benefits are expected to flow to the enterprise". The standard indicates (IAS 38, para. 8) that "enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as ... trademarks (including brand names and publishing titles)". Not all intangibles items meet the characteristics of an intangible asset, that is, "identifiability, control over the resource and existence of future economic benefits" (IAS 38, para. 9).

IAS 38 requires an intangible asset to be "identifiable to distinguish it clearly from goodwill" (para. 10), which is the case "if the asset is separable" (para. 11). Separability exists "if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity" (para. 11). But it may also be possible to prove the identifiability of an asset in some other way (see IAS 38, para. 12). IAS 38 assumes that "an enterprise controls an asset" if it "has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits" (para. 13). Future economic benefits may "include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise" (para. 17).

The definition and explanations given by IAS 38 are much more detailed than German and (particularly) French texts on the subject. In Germany, intangible assets, like tangible assets, are not legally defined. The general definition of an asset, derived in German accounting tradition from the "principles of proper accounting" (*Grundsätze ordnungsmäßiger Buchführung*, GoB) and the purposes of financial accounting, in fact applies to tangibles as well as intangibles. Thus, intangible assets are all items which correspond to the general asset definition, and are fixed but not tangible (i.e. without physical substance) or financial (Haller 1998, 564). The major formal difference compared to the IASC definition is that the German definition does not explicitly stress the characteristic of a "future economic benefit". It speaks about an "economic value" inherent to an item, and this generally but not necessarily implicitly incorporates the idea of a future economic benefit (Moxter 1986, 246-247; Hommel 1997, 352). The two predominant components of the German asset definition are quite similar to the IASC approach, in that an asset must be identifiable and independently and reliably measurable (Haller 1998, 575; Hommel 1997; Baetge 1996, 148-155). Identifiability means that the item can be separated from the business and its economic benefits can be disposed of separately in any form. So in terms of separability of the item from the enterprise, and its independent and reliable measurability, the definition of intangible assets in Germany is quite similar to that given by the IASC (Haller 1998, 575; Hommel 1997, 363).

In France, however, the General Accounting Plan (*Plan comptable général - PCG*) 1982 (CNC 1986, I.33; Orsini, Gould, Mc Allister, and Parikh 1998) defines intangible assets as being fixed assets other than tangible or financial assets, with a fixed asset being defined as an asset acquired for long term use in the operation of the business. The general definition of an asset is "... an element of net worth which has a positive economic value for the firm". (The concepts of "identifiability" and "separability" are not dealt with). Therefore, intangible assets are recognized only by comparison with tangible assets, which correspond to real rights over tangible objects. The new version of the General Accounting Plan, dating from 29 April 1999 (X 1999c), no longer provides a definition of intangible assets. However, the general opinion is that the definition given in 1982 is still valid.

It could therefore be claimed that the German and French definitions of intangible assets are not in contradiction with the IAS 38, but are simply less specific. Nevertheless, they are not totally comparable because of the differences in the general asset definition regarding the characteristic of "future economic benefits" (see table 1).

Insert Table 1 About Here

Principles for Recognition of Brands

In IAS 38 (brands are mentioned on several occasions, most importantly in the overall definition of intangible assets), and also the accounting rules in France and Germany, brands are regarded as a type of intangible item whose recognition could become possible or even necessary.

IAS 38 has made a considerable effort to clarify matters by indicating (para. 18) that an intangible item should be recognized as an asset if it "meets the definition of an intangible asset" mentioned above, plus two additional "recognition criteria set out in the Standard":

(a) "it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

(b) "the cost of the asset to the enterprise can be measured reliably" (para. 19).

Before looking into the possibilities for recognizing brands in France and Germany, we should remember that articles 9 and 10 of the Fourth Directive, n° 78/660/EEC of 25 July 1978, stipulate that, in order to be included in balance sheet assets, brands should be:

- either “acquired for valuable consideration and need not be shown under goodwill”;
- or “created by the undertaking itself, in so far as national law permits their being shown as assets” (EEC 1978, art. 9 C.).

This European Directive lacks precision and therefore leaves European Union countries considerable scope for initiative. In France and Germany, this part of the Directive was turned into a simple rule concerning the format of the balance sheet. While France goes so far as to cite brands in the balance sheet headings for intangible assets, they are not explicitly mentioned in the corresponding balance sheet position under German rules (HGB para. 266 [2]), but they are covered as they belong to the term “*gewerbliche Schutzrechte*” (industrial property rights), which are mentioned in the national rule.

Looking at the conditions of recognition in more detail, differences between the three regarded sets of rules become obvious.

Probability of Future Economic Benefits

According to IAS 38 (para. 20), “an enterprise should assess the probability of future economic benefits by using reasonable and supportable assumptions that represent management’s best estimate of the set of economic conditions that will exist over the useful life of the asset”. In Germany, as already mentioned, future economic benefits are not explicitly referred to in the intangible asset definition. In France, the same applies for individual financial statements. However, the new regulation on consolidated accounts (X 1999b, para. 2111) includes the requirement of future economic benefits.

Reliable Measurement of Cost

Brand value, as a key management responsibility, should be assessed, monitored, maintained and enhanced, for the following reasons: (1) maximization of shareholder value through maximization of brand value, (2) estimation of the value of a company in the context of mergers and acquisitions, (3) determination of royalties for brands and (4) for accounting purposes. While many companies include brands on balance sheets, many also charge subsidiaries for access to and use of brands (e.g. Nestlé), and many companies are acquired as much for their brands as for their tangible assets (e.g. Nabisco, Jaguar). Brands must also be valued because they are increasingly the subject of litigation. The more valuable they are perceived, the more companies are prepared to spend to defend their values. One role of assessing the value of brands is to convince the courts of the gravity of the offence and to help the court assess the damage in settlement.

Besides the need to identify the asset, the key issue in brand valuation is the selection of an appropriate valuation method, which is based on a subjective process emphasizing economic benefits. Various valuation methods are discussed and proposed in literature and used in practice. In general, these methods can be divided into three approaches: the cost approach (historical cost method or replacement cost method), the income approach (namely the royalty-relief method, and all types of discounted cash-flow and earnings methods) and the market approach (comparison with other transactions) (see among others Barwise, Higson, Likierman and Marsh 1989, 53-76; Medus 1990; Viale 1991; Nussenbaum 1991; Roeb 1994, 80-133; Sattler 1995; Haigh and Perrier 1997; La Villeguérin 1997; Kahn 1997; Smith 1997; Reilly and Schweihs 1998, 426-433).

In practice, the accounting policy followed for brand recognition and, in particular, the choice of a valuation method, depends on the way the brands have been obtained by the enterprise: separate acquisition (including acquisition without charge or by exchange), acquisition as part of a business combination (mergers or acquisition of subsidiaries), or internal generation.

Separate Acquisition

According to IAS 38 (para. 23), “if an intangible asset is acquired separately”, its cost “can usually be measured reliably. This is particularly so when the purchase consideration is in form of cash or other monetary assets”. When a brand is acquired by exchange (or as part of an exchange) with another asset (tangible or intangible), it must be measured at its fair value, “which is equivalent to the fair value of the asset given up adjusted by the amount of any cash or cash equivalents transferred” (IAS 38, para. 34).

In France, brands acquired for a consideration are treated as intangible fixed assets and as such are recorded under the heading “*Concessions et droits similaires, brevets, licences, marques, procédés, logiciels, droits et valeurs similaires*” (Concessions and similar rights, patents, licenses, brands, processes, software, rights and similar assets). Like all other assets, the value recorded is the acquisition cost paid (Viale and Lafay 1990; La Villeguérin 1997). An asset acquired by way of an exchange should be recognized at its market value, which is the price that would have been paid under normal market conditions (i.e. in an arm’s length relationship). Measurement of acquired brands is therefore similar under IAS 38 and French rules. Furthermore, the National Accounting Council (*Conseil national de la comptabilité – CNC)*, the standard-setting body attached to the Ministry of Economy and Finance, set up a committee to work on brands in 1990-1991. This committee issued a report (CNC 1992) in April 1992: it refers to acquired brands without discussing their recognition and measurement.

In Germany, until the adoption of the *Markengesetz* (MarkenG, Brands Act of October 25, 1994), it was not possible to sell a brand separately, but only with the whole enterprise or with the business of an enterprise possessing the brand. Today, a brand itself can be sold separately without any connection to the sale of the whole enterprise or parts of it (MarkenG, para. 27). As reliable cost measurement is the predominant requirement for recognition of an intangible asset, recognition depends on the acquisition being for a consideration, which gives a reliable indication for measurement. Therefore a brand, like all other intangible assets, must be recognized at acquisition cost if it has been acquired for a consideration (Keitz 1997, 66-68; Coenenberg 1996, 83). Brands acquired by way of exchange can be initially measured either at the fair value of the asset given up or at its carrying amount (Knop and Küting 1995, 1047-1048).

In the event of separate acquisition of a brand, IAS 38 and both French and German accounting rules require initial measurement of the brand to be based on the acquisition cost, and so only the historical cost approach is appropriate. The definition of acquisition cost is similar in the three sets of rules. It comprises purchase price, including any import duties and non-refundable purchase taxes, and any directly attributable expenditure on preparing the asset for its intended use. There is only one difference, relating to the treatment of professional fees and legal charges, which are not included in France. With regards to brands acquired by way of exchange, the three sets of rules are similar.

Acquisition as Part of a Business Combination (Merger or Consolidated Financial Statements)

IAS 38 (para. 27-32) covers the treatment of intangibles acquired as part of a business combination as defined in IAS 22 (IASC 1998a). In this context, the cost of an intangible asset "is based on its fair value at the date of acquisition" (IAS 38, para. 27). Judgement is needed to determine whether the fair value of the intangible asset can be ascertained with sufficient reliability. In such cases, IAS 38 (para. 28) states that, "quoted market prices in an active market provide the most reliable measurement of fair value". "If no active market exists for an asset, its cost reflects the amount that the enterprise would have paid, at the date of the acquisition, for the asset in an arm's length transaction between knowledgeable, and willing parties, based on the best information available" (para. 29). IAS 38 also cites several other methods to estimate the fair value, e. g. multiplicators or discounted cash flows (IAS 38, para. 30), and concludes, "if the cost (i.e. fair value) of an intangible asset … cannot be measured reliably, that asset is not recognized as a separate intangible asset but is included in goodwill (IAS 38, para. 31-b)."

As it is usually difficult to arrive at separate evaluations of brands acquired as part of a business combination, then as we understand IAS 38, the first consolidation will only seldom lead to separate recognition of a brand, because of the lack of sufficient reliability in measurement (see also Harding 1995, 9). IAS 38 actually leaves companies the option of whether to separate the brand or to include it in goodwill. Additionally, the Basis for Conclusions for IAS 38, para. 37-b (IASC 1998c), a separate document prepared by the IASC Staff giving their reasons for supporting or rejecting alternatives on certain specific issues, does not explicitly require an active market for an intangible asset to be separated from goodwill in a business combination and measured at fair value. In the final analysis, as the treatment of goodwill is consistent with that of intangible assets, separate recognition of brands is only a question of disclosure and additional information and has no material impact on net income (at least as long as amortization is the same for goodwill and brands) (IASC 1998c, para. 57-59).

The Fourth (EEC 1978) and Seventh European Directives (EEC 1983) do not include any explicit advice on how to treat intangible assets acquired through a merger or with a subsidiary. Implicitly, however, it can be concluded that such assets - if identifiable - should be recognized and measured separately.

The position taken by the IASC differs slightly from French rules and practice. In France, when an enterprise is first included in consolidated accounts, brands may be capitalized in recording the difference between the cost of acquiring a company and the proportion of the net assets acquired, including profits for the accounting year to date. This difference comprises two elements: firstly, the positive or negative valuation differences on certain identifiable assets when restated at fair value, and secondly, a remainder, which cannot be allocated, called the "acquisition difference" (goodwill). With respect to valuation differences, the National Accounting Council specifies, in an Opinion dated January 15, 1990 (CNC 1990), that "among these identifiable elements should be included intangible assets, which have not been included in the individual company accounts: commercial networks, market shares, databases, etc". The

CNC opinion does not mention brands specifically, but commentators (and French companies) made two remarks following the publication of the Opinion:

- logically, it is possible to argue that brands are more easily identifiable than market shares, which are explicitly mentioned in the Opinion;
- the presence of the "etc" at the end of the sentence leaves the list open to additional items.

Consequently, in practice a certain number of French companies allocate a part of the difference on first consolidation to brands. In fact, according to the annual review by a group of accounting firms of published annual reports for 1998 (X 1999a), 48 of the hundred groups reviewed allocate a part of the consolidation difference to brands, and in some cases the brands concerned amount to more than 20% of the balance sheet total.

To confirm the analysis of the 1990 Opinion by commentators, the new regulation on consolidated financial statements (X 1999b, para. 2111) explicitly quotes brands in the list of identifiable intangible assets, thus clearly saying that brands can be recognized as assets within the context of a business combination.

As far as the valuation of brands is concerned, several methods exist side by side, as presented in literature and more particularly in the National Accounting Council report (CNC 1992). Methods based on the capacity to generate future cash flows (or profitability methods) can be used to value a brand in the context of a merger or the first consolidation of an acquisition, in order to separate the valuation difference into identifiable components. The royalty-relief-method is the most standard approach and, if applicable, the most often used for brand valuation in France (La Villeguérin 1997).

In Germany, if the acquisition cost is higher than the proportional net asset value of the acquired subsidiary, the difference on first consolidation must be allocated between the various assets, or offset against certain liabilities of the acquired company (HGB, para. 301 al. 1, s. 3). The portion of the consolidation difference which cannot be allocated to specific assets has to be treated as goodwill ("*Geschäfts- und Firmenwert*") (HGB, para. 268 al. 2) and recorded under the balance sheet heading of intangible assets.

Under the generally accepted principles, there is certainly no option on separate recognition of brands, since it is either obligatory (HGB, para. 246, al. 1) or forbidden (HGB, para. 248 al. 2). If the purchased company possesses (internally generated) brands, the acquiring company must recognize the brand in its balance sheet if there is a reliable basis of measurement (Stein and Ortmann 1996, 788; Rohnke 1992). Because of the difficulties mentioned above in determining identifiable intangibles, and measuring them reliably, the majority of German companies include the vague amount corresponding to intangibles acquired with a subsidiary in goodwill. Nevertheless, some authors refer to a possible price arrangement for specific items in the contract of sale or in the underlying valuations which might be a value indication (Richter 1990, 23), while some also list several of the above-mentioned methods for brand valuation and give practical advice for their use (Rohnke 1992).

While France believes that measurement of brands is sufficiently reliable, the IASC and Germany have concluded otherwise. How can this difference be explained? One answer could be France's long tradition and a great amount of literature dealing with the valuation of brands. Therefore the reliability argument is not considered an obstacle to putting "relevance" first. Another reason relates to the fact, already referred to, that separability is not a specific characteristic in the French definition of an asset. Therefore, there is no need to comply with a "separability" or "identifiability" requirement in recognizing a brand. A more practical reason for the transfer from goodwill to brands of part of the difference on first consolidation could be the positive effect on income for French companies, as brands are regarded as non amortizable[3] (see below, section 3).

Internal Generation

As IAS 38 (para. 39) points out, "it is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition". The standard indicates that, with regard to intangible assets "arising from development (or from the development phase of an internal project)", special conditions which give more concrete guidance for recognition must be met (para. 45, a-f). They are "the technical feasibility of completing the intangible asset so that it will be available for use or sale", the "intention to complete the intangible asset and use or sell it", "the ability to use or sell the intangible asset", the demonstration of probable future economic benefits, "the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset" and the "ability of the enterprise to measure the expenditure attributable to the intangible asset during its development reliably".

Most surprisingly - without taking into account whether the concrete conditions are fulfilled or not - IAS 38 (para. 51) states specifically that "internally generated brands … should not be recognized as intangible assets". This is because the IASC believes "that expenditure on internally generated brands ... cannot be distinguished from the cost of developing the business as a whole" (IAS 38, para. 52). With this concrete prohibition, the IASC is taking a very prudent point of view which stresses reliability.

In principle, the French viewpoint is opposed to the IAS, but in practice, it conforms to it. The General Accounting Plan (PCG) even includes a specific balance sheet heading to record "expenses incurred to obtain the benefit that comes from the protection afforded (...) to the beneficiary of the operating rights (...) to a brand" (CNC 1986, I.25; X 1999c, para. 441). Based on a broad interpretation of this heading, enterprises could include self-generated brands in their balance sheets. However, in practice, French companies do not recognize internally generated brands as assets. The major arguments against it are the high degree of uncertainty as to the nature of expenses that can be capitalized, and the impact on taxable income, given the close interdependence of financial accounting and taxation in France.

The first of these arguments against recognition is highly debatable, especially as the CNC report (CNC 1992) states that an intangible item developed internally by an enterprise should be included in the balance sheet fixed assets if:

- it is possible to demonstrate, with reasonable probability, that the item is capable of generating future economic benefits in favor of the enterprise;
- it is intended to be used durably in the enterprise;
- and its cost can be calculated in a reliable way, with the help of a specific individual project.

The CNC report, modeled on the measures adopted in the CNC opinion on computer software (CNC 1987), undertakes an in-depth study of the process of brand creation and proposes step-by-step solutions for recording a brand as an asset, based on the different stages of this process. All the reasoning is based on the concept of a "project", where the following seven criteria must be met to record the output (brand) as an asset:

1. Specification of the output (brand) (answer to the question: what?)
2. Identification of the process to develop this output (brand) (answer to the question: how?)
3. Allocation of human, financial, commercial... means (resources) to the project (answer to the question: with what resources?)
4. Implementation of management tools to control the process, in order to (a) measure the cost of the brand created, (b) match the expenses to the different steps of the project, (c) evaluate, at each step, the probability of commercial success or failure (answer to the question: with what control tools?)
5. Explicit commitment to produce the output (use the brand) whose development is in process.

6. Reasonable probability of generating future advantages (commercial profitability).
7. Long-term use of the output produced (brand created).

If criteria 1 to 5 are satisfied, we have a real “project”. If criteria 1 to 5 plus 6 and 7 are satisfied, the output (brand) can be capitalized. The report goes on to describe the different phases of development of a brand and explains when (at which phase) the brand can be recorded as an asset.

For determining the production cost of a brand produced by the enterprise for its own use, current accounting discussion in France has concluded that this method is:

- reliable, through use of the project concept applied to the brand creation process (see above);
- relevant, according to the CNC (1992), particularly for valuing a recent brand with a serious chance of commercial profitability but which has not yet attained its full maturity.

This production cost method leads to separate valuation of the brand, and the result is relatively objective in the way it is determined (project) and consistent with the standard accounting measurement approach based on costs. Unfortunately, the CNC report has never been turned into a standard, probably because of the taxation effect already mentioned.

We have not discovered any official indications in Germany of a similar reflection to that undertaken in France concerning the recognition of self-generated brands. On the contrary, in Germany, the recognition of internally generated non-current intangible assets is illegal because of the lack of sufficient reliability of measurement (HGB, para. 248, al. 2; Adler, Düring and Schmaltz 1995, No. 23 to HGB, para. 248). Without any doubt, brands are covered by this ban.

The ideas contained in the CNC report are very interesting and show that, contrary to what is affirmed in IAS 38, solutions exist to calculate the cost of internally generated brands. It may seem surprising to find a method that is considered both reliable and relevant in France, while the IASC and Germany believe that reliability is impossible in the field of internally generated brands, especially given that the criteria (steps one to seven) proposed by the CNC are quite close to the requirements indicated in IAS 38 (para. 45). We do not think that the French proposal is less rigorous than systems applied elsewhere, or that French “specialists” are somehow “cleverer”. We believe that the cultural weight of “reliability” is very important elsewhere and that the French proposal still includes assumptions that leave it open to criticism and discourage other countries from following its lead.

MEASUREMENT AFTER INITIAL RECOGNITION

When brands are recognized separately, their value must be examined at the balance sheet date. This may result in (1) amortization, (2) revaluation or (3) a possible write down or write-up.

General Reflections On Brand Amortization

There is considerable discussion about whether a brand should be subject to amortization at all, and how to determine its useful life. The main arguments against a definite useful life, and therefore against amortization of brands, are as follows:

- In many countries the legal protection of brands is unlimited, or at least renewable indefinitely (e.g. for Community Trademarks within the European Union, in France, Germany, and the USA). Hence from a legal point of view, the use of a brand is not limited for its owner.

- Some brands are very old, sometimes reaching 150 years in certain sectors: in France, for instance, 150 years for champagnes such as "Moët", or cognacs like "Martell" and "Rémy Martin"; 100 to 150 years for mineral water ("Evian", "Vittel", "Badoit"...); 50 to 100 years for spaghetti ("Lustucru"), chocolate ("Lanvin") and Pastis ("Ricard") (CNC 1992). Other examples of "old" brand names are "The Times", "Coca-Cola" and "Walt Disney". Although the useful life cannot be known with certainty, particularly in advance, age is an *ex post facto* proof of a long economic life.

- Some authors argue that the value of a brand is maintained or even increased by huge advertising expenses, which are recognized as expenses and do not therefore justify amortization or a limitation of the useful life. In a similar situation, the useful life of tangible assets would be estimated based on the assumption of regular maintenance. In addition to this, amortization of the brand would result in double impact on the profit margins (amortization and maintenance) (Harding 1997, 81-84; Pizzey 1991, 26).

- There are no doubts about the possibility of a brand value declining, but there are doubts about the regularity of the decline. Consequently, brands should be subject to write-downs if necessary but not to regular amortization (Wild and Scicluna 1997, 94-96; Smith 1997, 104-123).

Those in favor of amortization and a limited useful life for brands put forward the following responses to these arguments:

- For the purposes of financial accounting, the economic approach is more relevant than a legal point of view (Barth and Kneisel 1997, 474). Although the legal right to use a brand might last indefinitely, the ability to achieve future economic benefits from this brand is what settles the question of amortization and useful life. It is not the legal aspect of a brand which creates future economic benefits but the higher sales of products, the stabilized connections between customers and the branded products, and the savings on advertising expenses (Gold 1998, 958; Stein and Ortmann 1996, 790; Meffert and Burmann 1998, 87; Barwise, Higson, Likierman and Marsh 1989, 29-32). Brands are closely connected with the product sold under the brand. But products, their technology, customer expectations and market conditions change constantly. So if the brand is not supported by management action to anticipate or oppose these changes, the value of the brand diminishes quickly (this conclusion has been reached from several different perspectives, see Meffert and Burmann 1998; Barwise, Higson, Likierman and Marsh 1989, 32-38). The question raised by this argumentation is whether, from this point of view, the brand is still an identifiable and separable asset, or whether it is in fact too closely connected to the products or services to allow separate recognition.

- The expenses incurred to maintain a brand, e.g. advertising costs, are not an argument in favor of an indefinite life. The value of a brand is a certain customer connection which leads to higher sales. With time this connection loses strength, then advertising creates new customer connections. So even when sales levels are constant, they are in fact different in substance from the original sales. This line of thought thus concludes that the purchased brand is eventually replaced by an internally generated brand, which should not be recognized as an asset (Barth and Kneisel 1997, 476-477; Boorberg, Strüngmann and Wendelin 1998, 1115).

- Just as there seem to be examples of brands always keeping their value, there are also brands which have vanished, like “Steinhäger” (spirit), “Simca” and “Triumph” (cars) (Harding 1997, 82; Stein and Ortmann 1996, 791).

In the end, the debate over brand amortization is based on how we understand the function of amortization. If amortization should reflect current value, there seem to be more objections than reasons for its application; if amortization is to distribute the recognized amount over a limited time, there are more arguments in favor of regular amortization (Barth and Kneisel 1997, 474). The rules of the IASC, France and Germany clearly reflect this discrepancy.

Amortization of Brands under IAS, French and German Accounting Rules

According to IAS 38 (para. 63), “after initial recognition, an intangible asset should be carried at its cost less any accumulated amortization and any accumulated impairment losses”. Later, the standard states (para. 79) that “the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life” and that “there is a rebuttable presumption that the useful life of an intangible asset will not exceed twenty years”. In the case of control “achieved through legal rights that have been granted for a finite period”, the standard adds that “the useful life of the intangible asset should not exceed the period of the legal rights unless: (a) the legal rights are renewable; and (b) renewal is virtually certain” (para. 85). However, because of the existence of economic factors, “the useful life is the shorter of the periods determined by” economic and legal “factors” (para. 86).

Moreover, “in rare cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than twenty years. In these cases, the presumption that the useful life generally does not exceed twenty years is rebutted and the enterprise (a) amortizes the intangible asset over the best estimate of its useful life; (b) estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss (…); and (c) discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the asset” (para. 83).

The idea that the asset may never be amortized is explicitly mentioned, as the standard adds that “the useful life of an intangible asset may be very long but it is always finite” (para. 84).

Article 35 of the Fourth European Directive of 1978 (para. 1. b) stipulates that “the purchase price or production cost of fixed assets with limited useful economic lives must be reduced by value adjustments calculated to write off the value of such assets systematically over their useful economic lives”. This article gives a general definition of depreciation. However, the Directive does not provide any special guidance for brands, in contrast to formation expenses (article 34) and costs of research and development (article 37, para. 2). Once again, member states enjoy the widest latitude in dealing with brand amortization.

In France, the depreciable nature of brands was the subject of considerable debate in the report on brands mentioned above (CNC 1992), due to a lack of clarity in the General Accounting

Plan. The Plan seems (implicitly) to exclude amortization of acquired brands, because they are not mentioned in the asset sub-heading “Amortization of concessions, patents...” whereas they are included in the asset heading “Concessions, patents... brands...”. At the same time, a write down expense is allowed, if necessary: the asset sub-heading “Write down (provision) expense for intangible assets: concessions...” includes brands explicitly. Considering matters from a conceptual point of view, the CNC report added that there is no irreversible amortization of a brand, and so it concluded that a brand (acquired or internally generated) should not be amortized. Instead, a regular test of impairment should be implemented.

In Germany, recognized intangible assets – with the exception of the acquired goodwill - have to be amortized over their useful life. In this country recent discussions dealt with the question of whether a brand has a determined useful life and, if so, what the appropriate period is for financial accounting purposes. In 1996 the federal court for tax affairs (*Bundesfinanzhof*) ruled that there is no reliable estimation for a specific limitation of the useful life and amortization of brands: therefore brands should not be subject to amortization. In reaction, the ministry of finance took a contrary position in 1998, declaring that it generally supposes a useful life for brands to be 15 years (the same as for goodwill) if the owner cannot justify a shorter period. Since accounting for tax purposes and financial accounting are closely connected in Germany (see Haller 1992), these statements are in fact relevant for financial accounting, too.

Since the decision of 1996, several comments have been published in literature (see among others Barth and Kneisel 1997; Boorberg, Strüngmann and Wendelin 1998). Nearly all authors criticize the decision of the federal court; in doing so they put forward a range of arguments (most of them included in the list above), and recommend amortization of brands (exception: Fick 1997). Even the presumption of 15 years is considered too long. Instead, a useful life of between three and five years is proposed. This shorter period is justified by the prudence principle as there is no reliable measurement, or by reference to life cycles (Meffert and Burmann 1998, 96-118; Stein and Ortmann 1996). For extremely strong brands only, a longer useful life may be applied (Boorberg, Strüngmann and Wendelin 1998, 1114-1116). These arguments correspond to the general opinion before the 1996 court ruling (Richter 1990). Because of the range of opinions, the question of applying amortization remains unclear for both financial and tax accounting purposes.

A brand acquired in an acquisition of a whole enterprise (in a merger or other business combination) and which is not reliably separately identifiable is - as mentioned above - included in goodwill. This goodwill (and therefore the brand, being part of it) can, in Germany, be either amortized over a maximum of four years or a longer useful life, or treated directly as an expense. If the company opts to amortize intangible assets over more than four years, a useful life of 15 years is usually applied in the financial accounts due to a corresponding fiscal regulation. Goodwill arising from a business combination can additionally be set off against reserves. The considerable number of options in the treatment of goodwill arising from a business combination shows that in Germany, it is significant whether a brand is separated from the goodwill and recognized as an identifiable asset or incorporated in the goodwill. While in the first case it must be amortized over its useful life, in the second it can be amortized over a period of up to four years, amortized over the useful life of the goodwill, directly expensed or set off against reserves. This means it really matters how a brand acquired in a business combination is recorded.

And so a general divergence emerges between the German and French accounting conceptions regarding the amortization of brands, resulting - as already seen - from different perceptions of the function of depreciation. According to HGB, para. 253, al. 2, s. 2 the dominant objective of normal depreciation in Germany is not to take account of a fall in value but to spread the cost over the useful life (Döring 1995, 926-928; Coenenberg 1996, 130; Moxter 1996, 215-217). The same reasoning is followed by the IASC (1998c, para. 46). The purpose of amortization is therefore clearly defined under IAS and German rules, whilst in the French General Accounting Plan amortization "hesitates between the objective of assessing depreciation and that of spreading costs" (Klee 1992, 50).

There are thus important differences between Germany and France with respect to both the concept and the period of brand amortization. Whilst in Germany brands are treated as amortizable assets with relatively short lives, in France, brands are non amortizable intangible fixed assets. IAS 38, with its rebuttable presumption of a useful life no longer than 20 years, lies somewhere in between these positions, albeit closer to the German position (see table 2).

Insert Table 2 About Here

Revaluation

For the valuation of intangible assets at the end of the financial year, IAS 38 defines a benchmark treatment and an allowed alternative treatment (para. 63-64). The benchmark treatment is based on the initial measurement minus accumulated amortization and accumulated impairment losses, as explained above. Under the allowed alternative treatment, "an intangible asset should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization and any subsequent accumulated impairment losses. (…) Fair value should be estimated by reference to an active market" (para. 64). But as IAS 38, para. 67 specifies, "an active market cannot exist for brands" - as is the case for other intangible assets, like newspapers, mastheads, publishing rights etc. - because "the transactions are relatively infrequent". Therefore, the prices for recent transactions do "not provide sufficient evidence of the fair value" of other brands. Due to this lack of a reliable measurement basis, IAS 38 appears not to allow revaluation of brands.

The situation is absolutely clear in Germany and France. There, in accordance with the Fourth European Directive (article 33, para. 1), the revaluation of intangible assets is generally not allowed. In Germany, due to the strong principle of prudence, revaluation is not allowed for any asset. In France, the general revaluation option is limited (as it is in art. 33 para. 1 of the Fourth Directive) to tangible fixed and financial assets.

In practice, the positions taken by IAS 38 and the French and German laws lead to the same result: revaluation of brands is forbidden.

Recovery of the Carrying Amount

Brands may be subject to a write-down because of extraordinary conditions that lead to an unexpected decline in value. Examples of such circumstances are a loss of customer confidence because of an event such as the "Elch-Test" for Daimler-Benz or a loss of image such as "Brent Spar" was for Shell (Meffert and Burmann 1998, 118-119).

To determine whether or not an intangible asset is impaired, an enterprise applies IAS 36 ("Impairment of Assets"). In addition to the requirement included in this standard, IAS 38 adds that "an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end, even if there is no indication that the asset is impaired:

(a) an intangible asset that is not yet available for use; and
(b) an intangible asset that is amortized over a period exceeding twenty years from the date when the asset is available for use" (para. 99).

This mandatory write-down, in the case of impairment, is a direct consequence of the worldwide-applied principle of "lower of cost or market". Therefore it is compatible with the French and German rules.

In France, the *Commission des Opérations de Bourse* (COB - French equivalent of the Securities and Exchange Commission) also indicates that management is responsible for determining the objective and verifiable numeric criteria upon which the value of elements of intangible assets may be based year by year (1991, 10; X 1991).

German rules regarding write-downs differentiate between state-owned corporations and private companies, current and non-current assets and whether the decline in value is expected to last for a longer or shorter period. In the standard case of a state-owned company whose brands are classified as non-current assets, the brand must be written down to its fair value if an event has decreased the value of the brand for quite a long time. If there is a recovery of value later, the company must restate the brand at the lower of cost or market (HGB, para. 280).

LIMITATIONS AND DIRECTIONS FOR FUTURE RESEARCH

The topic of brand valuation has not been developed further here, because it represents a separate topic in itself. The reliability and relevance of each of the methods in either Germany or France or within the context of IASC standards is open to discussion. It would also be interesting to address the following questions:

- How do industry norms for tradable assets (e.g., landing slots, franchise rights) differ in France and Germany?
- What are the limits of market valuation?
- How do companies deal with the following problems encountered in the use of royalty-relief methods: selection and determination of royalty rates, discount rates, protection/renewal and length of brand life, and calculation of discounted value on the basis of a terminal value or to perpetuity?

Harmonization efforts are long-run and evolutionary in nature, with the market ultimately determining which of the existing alternatives will prevail. Harmonization also requires countries to change their domestic practices at some point – at least for multinational reporting. In this context, our conclusions on the difficulty of harmonization may by limited by the fact that any assessment as to whether harmonization initiatives have worked or are working is difficult on a spot basis.

CONCLUSION

The Fourth and Seventh European Directives allow wide latitude for the treatment of brands, in relation to their capitalization, their valuation and amortization, and the treatment of the difference arising on first consolidation. This partly explains the emergence of accounting solutions that may be divergent or even contradictory in different European countries, as in the examples studied, France and Germany. Table 3 presents the major differences between the three sets of rules.

Insert Table 3 About Here

Firstly, it becomes obvious that with regard to self generated brands German standards have more in common with the IASC opinion than with leading accounting assumptions in France. In consolidated financial statements, as far as brands are concerned, France clearly has no hesitation in breaking away from the focus on the prudence principle and moving towards a more economic approach to accounting. Most surprisingly, the IASC stresses the reliability aspect ("separability", "identifiability" and "reliable measurement of cost") over the relevance aspect in connection with brands. Finally, regarding the concept and period of amortization of brands, the IASC's position is closer to Germany than France.

Brand accounting is the focus point of the conflicting relationship between the major characteristics of accounting data, "relevance" and "reliability". This research shows that the frequently stated association between the Anglo-American accounting philosophy and "relevance", and between the Continental-European philosophy and "reliability", may not apply when it comes to brand accounting (see table 3). It also questions the research concept of clustering national accounting systems, because France and Germany, two countries often found together in the "Continental-European cluster" (Choi, Frost and Meek 1999, 37), have adopted very different solutions for brand accounting in relation to each other and to the IASC.

Although we worked on a spot basis (see above), this paper seems to be a good illustration of the difficulty of international accounting harmonization. It could be worthwhile to think about other ways of making accounting comparable in the meantime, in order to avoid fundamental opposition (we find it difficult to imagine French companies starting to depreciate brands, even over twenty years), for example by providing additional information in the notes. One idea could be the disclosure of an additional statement of the breakdown, changes and values for the most important groups of intangible assets in a corporation (Haller 1998, 583-591). This should show to what extent the corporate value is made up of different sorts of intangibles. Such a statement would have to be accompanied by additional information e.g. explaining the brand(s) and its (their) valuation. Our reflections demonstrate that brands in particular and intangibles in general are set to remain a major accounting challenge in the future.

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List of tables

Table 1. Definition of intangible assets

IAS 38	France	Germany
Identifiable, non-monetary assets without physical substance	Fixed assets other than tangible or financial	No legal definition In practice: Fixed assets other than tangible or financial

Table 2. Amortization of brands

IAS 38	France	Germany
◆ Amortization required over the useful life ◆ 20 years normally the maximum (rebuttable presumption) ◆ Disclosure if the amortization period exceeds 20 years ◆ Impairment test if amortization period > 20 years	No amortization Impairment possible	Amortization required Generally over 3-5 years, limited possibility over 20 years

Table 3. Fundamental differences

	IAS 38	**France**	**Germany**
Capitalization of internally generated brands	Impossible	Might be possible	Impossible
	Reliability	*Relevance*	*Reliability*
Allocation to brands of the difference arising on first consolidation	Possible in theory Difficult in practice	Possible and widely practiced	Possible in theory Difficult in practice
	Reliability	*Relevance*	*Reliability*
Amortization	20 years	No amortization	Short amortization
	Reliability/Relevance	*Relevance*	*Reliability*

NOTES

[1] An empirical study (sample of 400 companies) carried out in Germany indicates that more than 80% of managers are convinced that the importance of brands has increased considerably during the last few years. At the same time, taking all industries together, brand values represent on average 56% of the market values of German companies (Wermelkirchen 1999).
[2] The notion of "treatments" comprises accounting rules, principles, and company practices.
[3] This reasoning is in conformity with the experience of the UK before FRS 10 (ASB 1997) was adopted. The treatment of brands was in practice affected by considerations concerning its effect not on taxable income but on critical accounting ratios (Muller III 1999).