

THE GRANTING OF LETTERS PATENT FROM THE POINT OF VIEW OF THE INTERNATIONAL STANDARDS OF FINANCIAL REPORTING

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ABSTRACT: *The development of the competitiveness hasn't been a priority for Romanian companies until the moment of the economical crisis. The difference can be seen in quality, services, innovation, image, knowledge, the approach to information, culture, etc. The companies that manage to differentiate from the others will resist in time and the economic advantage is made through intangible assets. The assessment of the intangible assets is the real description of the company wealth which is very well known to all balance sheet users, because it contains their fair value. Result of the Knowledge Revolution, the intangible assets started to be the most important component in the balance sheets of the companies starting with the post industrial and post modernist period we live in. Being means of production of the highest qualitative level, made through scientific research, creativity and intellectual effort, they have really high values and help the companies to achieve high performances in all their areas of activity: processes quality, products and services, productivity, efficiency, economic profitability, global efficiency.*

KEY WORDS: *patent; assessment; reassessment; recognition; balance sheets.*

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1. LEGAL ASPECTS REGARDING THE LETTERS PATENT

Originality and creativity are the most important features that favoured human differentiation during his evolution from all the other beings. The ability to transform

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these features into something useful is very important for the economic structures and human society. The survival of each human being, of each company, organisation and even of a nation depends on the ability of keeping in touch with the development and progress at all levels.

The creations that are subject of protection of industrial property are like all the other creations that benefit of protection under the name of „intellectual property” products of human creative activity, the result of human intelligence, knowledge, and rational activity, the result of man’s ability to invent and to approach concepts, to operate with abstract concepts. Unlike the copyright and the similar rights, which protect the form of creation and the fund, inside the „intellectual property” is protected the fund of the intellectual creations which is applicable in industry and which is called “commercial creations”.

The industrial property was recognized and used especially by industrialised countries and represents an important instrument of the technological, economic and social development. To protect the benefits of the industrial property, most countries have established laws that are based on two reasons: the first one is the necessity to express statutory the patrimonial and moral rights of the creators over their creations, and the other reason is the necessity to promote a deliberate act of the government policy, the creativity, its dissemination and the applicability of its results, but also to encourage the fair trade, which contributes to the social and economic.

The industrial property includes all the rights over the creations of the human genius related to: *inventions*, utility models, designs or industrial models, *trademarks or service marks*, *topographies of integrated circuits*, varieties of plants and animals, *commercial names*, *indications of sources or names of origin*, protection against unfair competition.

The letters patent, the most important branch of the right of industrial property, is the protection title of the invention according to Law no 64/1991 republished and completed, law that regulates the legal regime of the letters patent. According to art. 7 from law no 64/1991 the patent is granted only for an invention that brings something new compared to the known status of technique, at the moment of registering the application for the letters patent, it is based on an innovative activity of its author and it is susceptible of industrial application, if its object can be made or used in at least one of the industrial areas including agriculture.

Patents rights issues, according to art. 3-5 in Law no 64/1991 can be:

- The inventor or his successor in rights;
- The co-author if the invention was created together with other inventors;
- The employee inventor, for the inventions made at job in absence of contrary clauses from the agreement;
- The company where the inventor is employed, for the inventions made by the employee at his job in order to exercise his individual employment contract;
- The institution which ordered the research, for the inventions that result from a research contract, in absence of a contrary clause.

The letters patent is granted by the State Office for Inventions and Trademarks (SOIT) and the patenting procedure follow the following steps:

- 1) The constituting of the national legal filling, this means presenting an application form to SOIT for a letters patent, accompanied by a description of the invention;
- 2) The evaluation of the conditions from the registry application, the application is evaluated by an evaluation committee from SOIT;
- 3) The issue of the letters patent, the issue date is the date to which the statement of the issue is published in the Industrial Property Official Gazette.

The protection period of letters patent is 20 years starting with the date of constituting the national legal filling and cannot be extended.

2. THE RECOGNITION AND THE ASSESSMENT OF THE LETTERS PATENT FROM THE INTERNATIONAL ACCOUNTING REFERENTIAL PERSPECTIVE

The international accounting standard IAS 38 “Intangible assets” controls the treatment of letters patent and presents rules regarding the recognition and the assessment of the intangible assets.

2.1. The initial recognition of the letters patent

The international accounting rules define the assets or the intangible assets as *non-monetary identifiable assets without a physical substance* (IFRS 2009:1992)

IAS 38 standard (IFRS 2009:1986) specifies that in order to be included in the balance sheet, the patent should meet the identification criteria from the definition of intangible assets when:

- a) it is separable (capable of being separated and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract), with an asset or a debt; or
- b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations

The initial assessment of the intangible assets is based on their **cost**, which is calculated according to their source of origin as follows: separate acquisition, internally generated assets, acquisition under a government grant, acquisition in exchange for other assets, and acquisition as part of a business combination.

2.2. The separate acquisition of a patent

IAS 38 specifies that the price an entity pays to acquire separately an intangible asset should reflect the probability that the expected future economic benefits will flow to the entity. The recognition criterion is always considered to be satisfied for intangible assets acquired separately. Also, the cost of the intangible asset

acquired separately can be measured reliably. The cost comprises the purchasing price to which the following costs are added: the direct costs assigned to the purchased asset, wage costs for making the asset functional, professional fees, testing costs. The advertising costs, the general costs and the losses from initial exploit are not included.

Application no. 1

ALFA Company bought from a patent holder from another country a letters patent for a new product for the price of 10.000 lei. The seller of the patent applied a 5% discount to the price of the patent. The customs duty for the import of the patent was 1.000 lei. The evaluation cost of this patent was 6.00 lei. The patent will be accounted at the initial registration in the balance sheet to the following cost:

$$10.000 - (10.000 * 5\%) + 1.000 + 600 = 11.100 \text{ lei}$$

The reflection in Romanian financial accounting according to OMFP 3055/2009 for the approval of accounting regulations in accordance with the European directives, of the intangible assets inclusion by acquisition from providers implies the following action:

2051	=	404	11.100
” Concessions, patents, licences, commercial trademarks and other similar rights and values”		”Assets’ providers”	lei

2.3. Internally generated assets

IAS 38 specifies that sometimes is difficult to say whether an intangible asset meets the necessary conditions to enter into the accounting system or not. For the recognition of an intangible asset that results from the developing stage, supplementary conditions for their recognition were established. The internally generated letters patent is evaluated to the prime cost, represented by direct expenses carried out only after the date when the developing costs are recognized to produce an intangible asset. The direct costs, the staple and services costs, the personnel costs and the costs for registering the intangible asset. The explanation for this accounting treatment is that the only intangible assets internally generated that are recognized as intangible assets are those resulting from a developing project or from the evolution phase of a research-development project provided that the technical and financial feasibility of the project is demonstrated, as well as the existence of technical and financial resources for its completion. It is also explicitly specified that all the research costs should be billed under the direct costs section.

Application no. 2

ALFA Company started a project of research-development for a patent for a new product. The date for finalizing the research-development project is 30.12.2009.

The costs associated to this research and development project were the following:

- 3000 lei, costs for general research between 01.01.2008 and 30.06.2008;

- 4000 lei research costs associated with the research project between 01.07.2008 and 30.12.2008;
- 40.000 development costs, between 01.01.2009 and 31.12.2009 out of which 31.000 lei after the date when the meeting of the simultaneous recognition criteria was demonstrated;
- 3000 lei costs of patenting.

The application of the patent started on 01.01.2010.

The cost of the patent , to which it will be registered in the balance sheet will be 31.000 lei (including the development costs starting with the date when the company can demonstrate the meeting of the 6 simultaneous criteria provided in IAS 38) + 3000 (costs of patenting) = 34000.

The reflection in the Romanian financial accounting of the amortization of the intangible assets implies the following:

6811	=	2805	2.200 lei
” Revenue expenditures regarding the assets amortisation”		” The amortization of the concessions, patents, licences, commercial trademarks and other similar rights and values”	

2.4. Acquisition as part of a business combination

According to IFRS 3 Business Combinations, if an intangible asset is acquired in a business combination, the cost of intangible asset is its fair value at the acquisition date. The fair value of an intangible asset represents the market expectations that future economic benefits will flow to the entity. The entity estimates to obtain the economic benefits even if the time or the value of the benefits is uncertain. The fair value can be determined easily when for the analyzed good there is an active market.

An active market is that where the traded items are homogeneous and willing buyers and sellers can normally be found at any time and prices are available to the public. In the absence of an active market, the intangible asset should be evaluated to the sum that the entity should pay for this at the acquisition date, when there is a transaction between well-informed parties that act under conditions of normal competition. To determine this amount, the company must take into account the result of the most recent transaction for similar assets (Feleaga & Malciu, 2004, p.181).

2.5. The acquisition of the letters patent in exchange of other assets

The intangible assets are assessed at their fair value excepting the case when or the exchange transaction doesn't have a commercial character or the fair value of the assets that are traded cannot be reliably quantified. In these conditions, the purchased intangible asset is registered at the accounted value of the transferred asset.

3. THE SUBSEQUENT ASSESSMENT OF THE INITIAL ACCOUNTING OF THE LETTERS PATENT

After the initial recognition, an intangible asset should be accounted for to the input value impaired with the cumulated amortisation and the possible cumulated losses of value.

3.1. The amortisation of the letters patent

According to IAS standard after the initial accounting, an intangible asset should be accounted for at its value, impaired with the amortisations and the possible cumulated losses of value. The amortisable amount of an intangible asset should be divided methodically on the estimated time. There is a critical supposition according to which the useful life of an intangible asset cannot be longer than 20 years.

Application no. 3

ALFA Company registered in accounting on 31.12.2009 the acquisition of a patent for a purchasing price of 11.100 lei. The company estimates that the patent will have an useful life of 5 years.

The annual amortisation will be: 11.100 lei: 5 ani = 2.220 lei

The reflection in Romanian financial accounting of the intangible assets implies the following action:

6811	=	2805	2.200 lei
”Revenue expenditures related to the amortisation of the assets”		” The amortisation of the concessions, patents, licences, commercial trademarks and other rights and similar values”	

3.2. Impairment losses

To determine whether there is an impairment loss of the letters patent, the IAS 36 standard must be applied. This standard specifies that a society should estimate, at least at the end of each fiscal year, the recoverable amount of the intangible assets, even if there is no indication that the asset lost impairment. If there is such an indication, the society should calculate the recoverable amount of the intangible asset. IAS 38 requires an annual depreciation test, even if there is or not, an indication of the depreciation for the intangible assets with indefinite useful life and for those that were not used yet, the good will resulted from a business combination.

Application no. 4

A letters patent is included in a cash generating unit and should be tested for impairment in order to determine the recoverable amount of the patent.

The Assets from the cash generating unity are:

Assets of the cash generating unity	Accounting values 31.12.2005 (lei)
Letters patent	100000
Buildings	1200000
Good will	80000

Other necessary information

- The useful life estimated for a cash generating unity is of 8 years.
- The residual value of the cash generating unity at the end of the 8 years in zero.
- The prevision of the cash flow before the tax was effectuated in two stages:
 - On the basis of the best evaluation of the unity management owner of the cash generating unity, of the cash flow before the tax, for the first 4 years (2006-2009)
 - On the basis of extrapolation the cash flow before the tax, from the previous year, using decreases rates, for the last 4 years (2010-2013)
- The discount rate after the tax, taken from the similar assets market, is 12.6%
- The corporate tax rate is 16%

Table 1. The determination of the patent depreciation

Years	Impairment rate	Cash flow before the tax	Discount rate 15%	Discounted cash flow
2006		180,000	0.869	156,420
2007		220,000	0.756	166,320
2008		240,000	0.657	157,680
2009		260,000	0.572	148,720
2010	-10%	234,000	0.497	116,298
2011	-12%	205,920	0.432	88,957
2012	-15%	175,032	0.376	65,812
2013	-20%	140,026	0.327	45,789
Value in use				945,996

- The value in use of the cash generating unity = 945.996 lei
- The recoverable value of the cash generating unity = 945.996 lei
- The accounting value of the cash generating unity = 1.380.000 lei
- The loss of value of the cash generating unity = 434.004 lei (1.380.000 lei – 945.996 lei)

The allocation of the loss of value (impairment) on the three assets of the cash generating unity is the following:

- 80.000 for the good will
- 326.772,92 lei for buildings (92,31% \times (434.004 lei-80.000 lei))
- 27.231,08 lei for the letters patent(7,69% \times (434.004 lei-80.000 lei))

The book value of the patent after the impairment loss of value will be:

$$100.000 \text{ lei} - 27.231,08 \text{ lei} = 72.768,92 \text{ lei}$$

The reflection in financial Romanian accounting involves the following action according to OMFP 3055/2009 “The intangible and tangible assets registered in accounting, found to be impaired, are evaluated at their actual value, determined by their useful value and the market price. The amendment of the accounting value of the tangible and intangible assets and their adjustment to the inventory value is made according to the type of impairment by registering an additional amortization if there is an irreversible impairment or by supplementing the adjustments for impairment if there is a reversible impairment.

6813	=	2905	27.231,08 lei
” Revenue expenditures regarding the provisions for assets impairment		” Provisions for concessions, patents, licences , commercial trademarks and other rights or similar values”	

3.3. The reassessment of the Letters patent

IAS 38 accepts, as an authorized alternative treatment the reassessment of the intangible assets. The reassessed value is the fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

The fair value should be calculated by reference to an active market. IAS specifies that for trademarks there is no active market because each trademark is unique. The price paid for an asset does not always provide enough information to determine the fair value of another asset. The letters patent should meet two important conditions (Stan, et al., 2006):

- To have an important contribution in generating economic benefits for the unity
- This contribution can be isolated by the impact of other tangible or intangible assets.

The value of a letters patent is:

- Directly proportional with the contribution of the patent in generating the economic benefits for the unity or with the amount of the paid royalties.
- Directly proportional with their technical-technological advance compared to the competition
- Inversely proportional with their age
- Directly proportional with the nature of the invention and with the force of claiming the patent
- Directly proportional with the area of applicability of the patent

The most common evaluation methods are:

- The Profits method
- The Royalty Exemption Method
- The economy of expenditures method
- The Residual method

4. CONCLUSIONS

The matter of recognition and assessment of patents, for which we tried to spot several characteristic elements, is continuously rising controversies all the more so as, in a society marked by competition and change, the estimation of the future benefits generated by these, depends less on their material or immaterial condition and more on the market characteristics inside of which they operate (the degree of competition, the speed of technological changes). For the moment, the accounting regulations encourage (without forcing) the companies to present in their explanatory notes the categories of investments that have an impact upon the performance for a long term but which are still recognised as assets (according to IAS) in the balance sheet.

While the International Accounting Standard IAS „Impairment of assets” recommends that the recoverable value of an intangible asset be assessed at each reporting date whether there is any indication that an asset may be impaired, the accounting regulations from Romania assess the intangible assets only at the end of each financial year when according to the law, the process of general evaluation takes place whether there is an indication indications of impairment or not.

From a legal point of view we consider that the issue of intellectual property rights is very well regulated, but, as regards their accounting, things are far of being regulated. Therefore, it would be necessary a model of explanatory notes to the balance sheets which would have to contain all the information that a potential investor would be able to use or would help him in consolidating his decisions.

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