

VALUING THE INVISIBLE UNDER IAS 38: COMPLEXITY AND CONTROVERSY OF INTANGIBLE ASSETS

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Abstract

The research paper examines the ongoing theoretical and practical problems related to the recognition and valuation of intangible assets in accordance with IFRS, in particular IAS 38. The problem arises because intangible assets such as research and development, as well as brands, are crucial to corporate value but they have no physical content and active sales markets, and they depend on subjective decisions regarding future profitability. Based on a scientific literature review, the research found that while IAS requires recognition through identification, control and expected future benefits, companies predominantly use the cost model for subsequent measurement due to the absence of active markets. Theoretically, an income-based approach provides a good representation of fair value, they are rarely used due to their complexity, like their market price and the financial statements may not reflect the true economic benefit of the assets, and data requirements. The results show that the choice of valuation methods is primarily influenced by the characteristics of assets and the accessibility of data, despite that cost model is most useable one, the income approach is better suited for estimating fair value. However, it is limited by its complexity and resource requirements.

Keywords: future economic benefit, fair value, intellectual property, cost model, income approach.

Introduction

Over the years, intangible assets have become as one of the key factors in creating corporate value and competitive advantage. As the economy moves from traditional manufacturing to science-intensive industries, intangible assets such as intellectual property, brand capital, research and development, human capital, and digital innovation are becoming key components of corporate value. Despite their growing impact on business efficiency, the recognition and valuation of these assets remain one of the most complex and discussed issues under International Financial Reporting Standards (IFRS). Their non-physical nature, lack of active markets, and uncertainty about future returns make it difficult to assess reliability. Financial valuation methods, commonly referred to as intellectual capital valuation methods, are widely used in mergers and acquisitions, as well as in industry trials. However, they are often criticized for ignoring the broad strategic and innovative contributions of intangible assets and focusing solely on financial performance. International Accounting Standard 38 Intangible Assets (IAS 38) provides clear guidance on recognition criteria: identification, control and future economic benefits, however there is no consensus regarding the measurement of intangible assets, especially concerning the choice between cost, market and income approaches. This study contributes to this ongoing discussion by considering the conceptual framework of IAS 38, analyzing the recognition and valuation of intangible assets, and evaluating the application of various valuation methods. Synthesizing theoretical perspectives and practical considerations, the study covers both the problems associated with the assessment of intangible assets in the economy, based on modern knowledge, and the strategic consequences.

Research aim: to identify the theoretical and practical challenges in the recognition and valuation of intangible assets under IFRS.

The following **objectives** have been set to achieve the aim:

1. To analyse the conceptual framework of intangible assets under IAS 38 regulation;
2. To explore the recognition and measurements of intangible assets;
3. To evaluate the applicability of different valuation approaches for various types of intangible assets based on IFRS.

Research object and methods

The research object of this study are recognition and measurement of intangible assets in accordance with IFRS, with specifically IAS 38 "Intangible Assets". This study is based on a review of the scientific literature and IFRS standards. The method includes a comparative analysis of cost, income, and market value approaches, the analytical method to synthesize the results and assess the applicability of the different models. Data synthesis was used to structure and summarize the results.

Results and discussions

Conceptual framework of intangible assets under IFRS

Intangible assets (IA) are a complex but important aspect of financial reporting under IFRS, reflecting the growing importance of knowledge, innovation and intellectual property in the company's performance. IAS 38 identify intangible

assets as non-financial asset that lacks physical form, which are defined by their identification, control over resources and the possibility of future economic benefits. An analysis of scientific literature shows many interpretations share common characteristics and shown below in the Table 1.

Table 1. Definition of intangible assets.

Author	Definition
Kothari et al. (2013)	Intangible assets include assets that have no physical form and are not money. Their value lies in their intangible properties, they arise in the process of development or through efforts, and they can be identified as independent units.
Nichita (2019)	The category of long-term assets that do not have a physical substance but that have legal rights and benefits obtained through development and acquisition.
Petkov, Rossen (2020)	A resource that a company “controls” as a result of a “past transaction” which is expected to contribute to “future profits” with “reasonable probability”.

Source: according to M. Kothari et al. (2013), E.-M. Nichita (2019), R. Petkov (2020)

Those definitions highlight two key characteristics: the absence of physical form and the expectation of future economic benefits. Their value does not depend on their physical nature but arises from the rights and benefits they confer. The total cost of these intangible assets in the intangible assets section of balance sheet. One of the main advantages of intangible assets is that they are easy to transfer. According to IAS 38, intangible assets are defined by their identification, control over resources and the possibility of expected economic benefits. If something meets this standard but is not classified as an intangible asset, any costs associated with its acquisition or creation are recognized as an expense.

D. Pastor et al. (2019), A. Milijić (2020), A. Georgiou (2024) agreed on three critical attributes of intangible assets:

1. Identifiability. Identification is the main criterion for determining intangible assets, as it allows them to be separated from goodwill. Identifiability is established where an asset meets the following criteria:

- It may be separate (through a sale or purchase), was created independently (within the company's internal structure) or was transferred, licensed, obtained via government grant, leased or transferred individually or collectively as part of a business combination.
- An asset is considered to be derived from contractual or legal rights, even if it is not possible to transfer or separate such rights from the subject or related obligations.

2. Control. The second criterion focuses on whether the subject has the right to access and profit from the economic value arising from the asset and to prevent third parties from benefiting from it. The control criterion is considered to be met if the resource is provided with legally enforceable rights. An organization can protect its technical knowledge through legal documents, including patents and copyrights, which are sufficient in court. Nevertheless, the control criterion can still be satisfied through exchange transactions involving identical or comparable assets, even when no legal rights are attached to source. Exchange transactions of this nature demonstrate the entities control over the assets expected economic benefits.

3. Future economic benefits. As a result of the use of an intangible asset, an organization can receive economic benefits in various forms. Such profits include income from the sale of goods and services, cost reduction, or other economic benefits related to the use of an asset. In particular, the use of intellectual property in production activities makes it possible to achieve economic efficiency not by increasing future profits, but by reducing production costs. However, expected economic benefits are not allocated to pseudo-profit centers. This means that an organization cannot obtain future economic benefits by allocating costs or benefits between other divisions.

The five major categories of intangible assets have been recognized by researchers M. Bănuță and M. Gădoiș (2023), A. Milijić (2020) (see Figure 1).

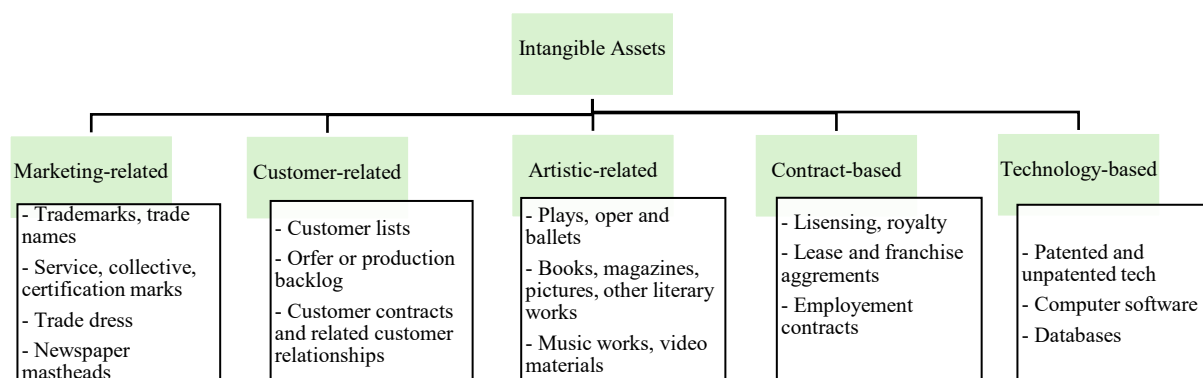


Fig 1. Classification of Intangible Assets

Source: according to M. Bănuță and M. Gădoiș (2023) and A. Milijić (2020)

The figure shows that intangible assets based on their nature and economic function. These assets are grouped into five main types which reflects the diversity of intangible assets and how different forms of intellectual property and contractual rights contribute to an organization's value and competitive advantage.

Recognition and measurement of intangible assets under IAS 38

In accordance with the IAS 38, the initial valuation of an intangible asset is carried out at its actual cost. M. Jankowska et al., (2019) points out in her work that organizations have a choice between two post-recognition measurement models for intangible assets: the cost model and the revaluation model. The revaluation model provides an opportunity to value intangible assets at their fair value, which can be beneficial. However, this model has a number of strict rules that may make it difficult to apply in practice. For example, revaluation is allowed only in cases where there is an active market for this type of intangible asset. Also, if a company chooses this approach, it must consistently apply it to all assets in the same category to ensure uniformity and comparability of its financial statements. It is also noted that the revaluation method can't be used for intangible assets that were initially recognized at values other than cost, except in cases where assets are obtained through government grants and recorded at a nominal amount. In these situations, the change in fair value at the revaluation date will determine the new revalued amount. Meanwhile, accumulated amortization is either adjusted proportionally to the change in the asset's gross carrying amount or eliminated against the asset's carrying amount before restatement, ensuring that the net carrying value accurately reflects the revalued amount. When there isn't an active market, which is often the case for intangible assets like proprietary technology, internally developed software, or customer relationships, companies can't use the revaluation model. Instead, entities apply the impairment claim under IAS 36 "Impairment Assets" of the impairment of assets to ensure that the book value of the intangible asset does not exceed its recoverable amount.

R. Moro Visconti (2019) emphasizes that estimating the fair value of intangible assets is difficult due to the lack of a developed market. Many important business resources, such as patents and brands, are immediately written off as expenses and are not reflected in assets, so companies that actively invest in such resources look less profitable, while the performance of weakened companies may be artificially inflated. The problem is reinforced by a different accounting approach, that is, internally created intangible assets are written off, and acquired ones are capitalized. This makes it more difficult to compare companies with different approaches to innovation. In addition, data on intangible expenses are not disclosed in sufficient detail.

R. Petković et al., (2020) indicate that acquired intangible assets can either be written off as expenses or capitalized. The latter is acceptable only if it is possible to separate the asset and evaluate it reliably. According to IAS 38, intangible assets created within a company are classified as research and development (R&D). Research expenses are always recognized in the income statement, as their future effectiveness is not guaranteed. In contrast, development costs are subject to capitalization if several conditions are met technical feasibility, intent and feasibility of use or sale, expectation of economic benefits, availability of sufficient resources and reliable indicators.

Applicability of valuation approaches for intangible assets

Scientific discussions on valuation emphasize that there is no single method used for all types of intangible assets. Studies by various scientists compares cost, income and market approaches and assess their applicability to different types of assets (Table 2).

Table 2. Relevance of the valuation methods for intangible asset.

Relevance of the method/Intangible asset	Good	Satisfactory	Weak
Intellectual properties, patents	Income	Market	Cost
Trademarks and product name	Income	Market	Cost
Copyright	Income	Market	Cost
Assembled workforce	Cost	Income	Market
Managerial information systems	Cost	Market	Income
Software programs	Cost	Market	Income
Distribution networks	Cost	Income	Market
Franchise rights	Income	Market	Cost
Internal practices and processes	Cost	Income	Market

Source: according to M. Jankowska et al. (2019); L. Gutsalenko and A. Beldiy (2020); M. Bănuță and M. Gădoi. (2023)

Based on collected information, income-based methods are generally more relevant for intangible assets that generate income, such as patents and brands, while cost-based approaches are often used for internally developed assets whose economic potential is unknown.

Moreover, there are two more approaches: the royalty savings method which based on income, is frequently used to value trademarks and licensed technologies (Jankowska et al., 2019). This method values the asset as the present value of hypothetical royalties that could be saved by owning the asset instead of licensing it. And the last one, the discounted cash flow (DCF) method estimates the net present value of expected future cash flows attributable to the asset over its useful life (Kothari et al., 2013).

Although after initial recognition IAS 38 permits the application of either the cost model or the revaluation model for measurement, scientific literature analyses in more detail the main valuation approaches - cost, income and market. The study by A. Banociova and R. Bajus (2023) provides a structured comparison of these approaches, highlighting their applicability, data requirements and conceptual validity (Table 3).

Table 3. Advantages and disadvantages of valuation approaches.

Approach	Advantages	Disadvantages
Cost	- Simple to calculate - Suitable when the benefit from an IA is unclear - Identifying amount of IA immediately	- Market value cannot be directly established because there is no clear link between the asset's value and the costs incurred in its creation. - Future income is not taken into account in the calculation. - The potential benefits of the asset are not reflected. - A detailed analysis is required, including the underlying basis and relevant technical parameters.
Income	- Applicable to most types of IA - Tradable in the form of license agreements - Related cash flow is predictable	- The valuation is based on assumptions regarding future development and associated risks. - The prediction of future cash flows alone is insufficient; the estimation of an appropriate discount rate is also required. - The non-market approach does not determine market value, as the nature of intangible assets and their heterogeneity are not taken into consideration.
Market (comparative)	- Provides a practical and easily understandable approach to assessment; - Uses assessment method that can be applied without difficulty; - Enables evaluation without the need for advanced calculations; - Applicable for wide range of intangible types.	- The market for the trading of intangible assets is limited. - An accurate assessment requires in-depth knowledge of the relevant market. - Key data and resources are often unavailable or insufficient. - Comparability is constrained by the distinctive nature of intangible assets.

Source: according to A. Banociova and R. Bajus (2023)

Based to that, IFRS oriented valuation literature identifies the income approach as the preferred method for determining the fair value of intangible assets. The cost method remains a conservative and practical option, while the market approach plays a supporting role in confirming the valuation when reliable market data is available. Thus, each approach has its advantages, the applicability of each approach depends on the specific features of the asset, the availability of data, and the objective of the valuation.

The applicability of different valuation approaches for intangible assets based on IAS 38 is explored with highlighting their usefulness, limitations, and practicality in industries where intangible assets are of primary importance.

P. Zammit (2022) explores the accounting of intangible assets in the online gaming industry, focusing on assets such as gaming platforms, licenses, brands, and customer relationships, as well as their metrics. A review of the current situation in the IGaming industry demonstrates that intangible assets are of great importance for generating value. Platforms, recognizable brands, valid licenses, and strong customer relationships are considered key factors contributing to making a profit. Among all these assets, gaming platforms occupy a leading position, since "the success of many companies is almost entirely determined by their software." When assessing intangible assets according to IAS 38, most organizations, despite their strategic importance, prefer a cost model. A sample of 14 industry experts showed that 11 of those present use an exceptionally cost method or use it in combination with other approaches. The advantages of the cost model are its efficiency, verifiability and reliability. However, its inability to adequately reflect economic value is widely recognized, especially in relation to self-created assets. The revaluation model is rarely used. Its application is limited by the requirements of IAS 38 for an active market, which is rare for intangible assets such as software or brands. In addition, respondents noted practical difficulties, like reassessment is difficult, can be unstable, and increases the workload of auditors. Subjectivity in determining fair value also creates a risk of manipulation. The fair value assessment is an integral part of the business combination process. The research showed that most common is income approach that relies on the discounting of future cash flows, which requires significant professional judgment in estimating free cash flows and weighted average cost of capital. The market approach is usually used as supportive, providing comparative data, while the cost method is rarely used, only when replacement costs can be reliably estimated. The study shows that despite the fact that the revaluation model theoretically better reflects the economic reality within the framework of IFRS, its practical application is limited due to difficulties with objective assessment, comparability and the lack of developed markets. Therefore, companies tend to use the cost accounting model, even realizing that it does not fully disclose the true value of assets. In this regard, participants support that fair value increases accuracy, but is an expensive and complex process, and comparability depends on methods (Zammit, 2022).

Conclusions

1. Intangible assets are non-monetary assets without physical form and are defined by their identifiability, control over resources and ability to generate future economic benefits. These criteria form the basis of the conceptual framework of IAS 38 and distinguish intangible assets from goodwill and other costs that are recognised as expenses. In general, the literature draws attention to the diversity of intangible assets and their increasing importance within a knowledge, innovation and intellectual property, driven economy.

2. The recognition and measurement under IAS 38 of intangible assets remains problematic for many companies. The main reasons lie in the lack of developed markets for such assets, which makes the assessment of their fair value extremely subjective. As a result, most organizations choose the cost model, rarely using the revaluation model. Even more strict requirements are imposed on assets created internally generated intangible assets, particularly those arising from research and development. Research costs are generally expensed as incurred, and capitalization of development costs is only possible if strict criteria are met. These issues contribute to the possibility of comparing the innovative activities and effectiveness of companies, transparency and their accurate reflection in the financial statements, therefore, in such cases, professional judgments and wide disclosure of information are required.

3. The results show that the valuation of intangible assets is determined by the characteristics inherent in assets, and their economic significance has contributed to the development of income, costs and market methods. The income method corresponds to assets with predictable cash flows, such as patents and brands, the cost approach applies to internally developed assets with uncertain potential, and the market approach provides additional data when there are reliable market comparisons. Although revaluation models can theoretically more accurately reflect the economic value of an asset, most gaming companies adhere to a cost model. This is easy to verify and compare at different stages, but it often reduces the real value of core assets such as platforms, brands, and customer relationships. In practice, accounting decisions are based on practicality and reliability, as well as on what best reflects economic reality, which leads to a gap between the reported numbers and the true value of intangible assets.

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