

Qualitative Characteristic of Accounting Information in Reported Values of Goodwill and Intangible Assets (Case Study of the Stock Exchange of Iran)

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Abstract: Reliability and relevance are the most important qualitative characteristic of accounting information. Goodwill and intangible assets are among reported items in financial statements under title of fixed assets, which they have different nature from other assets or other items of financial statements. In this research, we study reliability and relevance of reported values of goodwill and intangible assets in financial statements. If accounting items have two characteristic of relevance and reliability, they should be used in decision-making and must affect market value. To do this research, a sample including 88 member companies in Tehran Stock Exchange for 5 years (2005-2010) was selected and studied. Also, to study reliability and relevance of goodwill and intangible assets of reported items in financial statements, correlation of these two factors with market value of companies was studied by regression. After fulfillment of this research and confirmation of research Hypothesis, it was found that there is a positive and significant relation between reported values of intangible assets and goodwill as independent variable and qualitative characteristic of information as dependent variable.

Key words: Intangible assets • Goodwill • Reliability • Relevance

INTRODUCTION

From the view of accounting information, the main goal of providing and submission of financial statements is succoring users of that information. Also, accounting information has special qualitative characteristic, among which there are reliability and relevance [1]. Among the most important and controversial accounting items are goodwill and intangible assets [2]. Despite of definition of goodwill and intangible assets, what was important in this research was study of reported values of reliability and relevance in financial statements [3].

If accounting items have two characteristic of reliability and relevance, they should be used for decision-making and affect on market values of a company [4]. Necessarily, correlation of reliability and relevance with market value must be measured to study their effects on financial statements [5].

Also, what was important and the basis of formation of this study was study of existence of reliability and relevance in financial statements [6].

This research helps users of accounting information by studying existence of information quality in reported values of goodwill and intangible assets.

Intangible asset is a non-monetary asset without an objective nature that:

- Is reserved to be used for production, supply of goods or services, renting, or administrative purposes by a commercial unit;
- Is obtained intending to be used for more than one financial period;
- Is identifiable [7].

In a comprehensive definition, relevance is suggested as follows:

“Goodwill may be a commercial index which enables companies to get excess profit than their normal investment return. Excess profit is a profit more than normal profit. Goodwill attracts more customers for companies [8].”

Goodwill basically depends on the following items:

- Good will of company's owners,
- Fame of products,
- Efficacy of advertising and propaganda,
- Exclusiveness of products,
- Lack of similar products [9].

Goodwill can exist in commercial affairs. Goodwill is the famous that a commercial activity can attract customers by it to increase its sell and profit. Thus, goodwill plays the role of an asset. Goodwill is as effective as an asset. Goodwill is obtained gradually and is invisible and insensible. Despite of these differences, goodwill is a valuable asset for a company. Sometimes a company may endeavor for goodwill more than a visible and sensible asset. Therefore, goodwill cannot be deemed as a chimerical asset [10].

Regarding the importance of this subject, this research studies relationship between reported items of intangible assets and goodwill with market value.

Goals of Research: The main goal of this research is if two the most important qualitative characteristic of accounting information, namely reliability and relevance, exist in intangible assets and goodwill.

Research History: Karami & Omrani (2010) in a research titled "Effects of company's life cycle on relevance of risk and performance" studied effects of life cycle on relevance of risk and performance. In this research, stock return was dependent variable and risk and performance were descriptive variables. At first, the statistical sample was separated to growing, mature and waning companies using sale growth variables. Then the Hypothesis were investigated by multi-variable regression equations and statistical test. The results of study of 518 companies from 2001 to 2007 showed that relevance of risk and performance criteria and also descriptive power of risk criteria in different stages of life cycle (growth, mature, waning) have significant differences. The results of Woung's statistical test showed that progressive descriptive power of risk criteria in growth stage is much and in mature stage is less [11].

Bayazidi & Jabbarzadeh Kangarluyi (2009) fulfilled a research titled "study and compare of descriptive power of economical added-value, residual income and abnormal growth of profit to determine value of stocks market of companies accepted in Tehran Stock Exchange". Residual income evaluation model knows a company's market value a function of profit and book value of rights of stockholders in global accounting and abnormal profit growth knows market value a function of abnormal profit in each period. Meanwhile, added-vale model calculated a company's value upon net operational profit after deduction of financial supply costs (through debt or rights of stockholders). In this research, 115 companies accepted in Tehran Stock Exchange were studies for

2003-2007 period. Integrative data was used to test Hypothesis. The results show that there is no significant difference between descriptive power of these models to determine values of companies [12]. Nearly, in all cases, residual income evaluation model has higher descriptive power than economical added-value model and economical added-value model has higher descriptive power than abnormal profit growth to determine companies values [13].

Saeidi & Ghaderi (2007) in a research titled "study of relevance of accounting profit, book value, operational cash flow and investment in price-based evaluation models" studied anticipating power of book value, net profit, operational cash flow and investment as representative of accounting information to evaluate market values of companies. Their findings shows that book value and accounting profit are more relevant and inclusion of operational cash flow and investment will not increase descriptive power of models significantly [14].

Holthausena & Watts (2009) in a research titled "Relationship between value and reliability of intangible assets before and after IFRS" studied reported values of intangible assets before and after IFRS in 2001-2008 in Australian companies. They found that reported values of intangible assets of many companies were changed after approval of accounting standards. Also, reliability of intangible assets had a significant effect on reported values [15].

Thompson and Dennis (2003) fulfilled a research titled "evidences about relevance of promissory items with cash flows: deprivation". To find evidences to confirm this subject, they compared interpretation power of calculated profit according to promissory accounting of properties, machinery and equipments and calculated profit according cash accounting of properties, machinery and equipments to know which one could interpret future profits of a large set of productive companies. They found that calculated profit can describe less portion of deviations of stocks price by deposition of investment costs to the account of period cost and descriptive power of calculated profit is more in deprivation method [16]. This is also true for those companies that use a yearly regular pattern for their investment costs [17].

Hypothesis of Research

Main Hypothesis: There is a direct relation between reported values of goodwill and intangible assets with qualitative characteristic of accounting information (reliability and relevance).

Table 1: Normality test

		Market value	Intangible assets	Goodwill
Normal parameters	Data number	88	88	83
	Average	8852219.49	10297.36	7709.60
	Standard deviation	5540312.558	3320.434	3063.872
Deviations	Absolute	0.087	0.053	0.064
	Positive	0.087	0.053	0.047
	Negative	-0.071	-0.047	-0.064
	Significance level of K-S Test	0.818	0.500	0.586
	Bilateral significance level	0.515	0.964	0.882

Sub-main Hypothesis:

- There is a direct relation between reported values of goodwill and a company's market value.
- There is a direct relation between reported values of intangible assets and a company's market value.

Statistical Society and Sample: Because of quality and accessibility of information of companies accepted in Tehran Stock Exchange, these companies are the statistical society of this research. Also, size of the sample is enough large to have a precise statistical deduction.

The selected companies were selected by the following conditions for the 5 years period (early of fiscal year of 2005-end of fiscal year of 2010):

- The company was a member of Bourse before 2005.
- The company has submitted its financial statements to Bourse for the period.
- The company had no interruption more than 6 months in its transactions.
- The company's financial statements were ended to March 20.
- The company has not changed its fiscal year.

The sampling method was a "complete" one including all members of the statistical society, unless those companies with either inaccessible information or impossible calculation of variables. Therefore, all companies member of Tehran Stock Exchange were selected as the statistical society. After examination of their financial statements, 88 companies were finally selected for the sample of research.

Research Method: The method of this research is inductive and post-event (using past data) and sectional correlation, that is study of relations between variables by regression.

Data Gathering Method: Data was gathered by the following methods:

- Referring to Tehran Stock Exchange and using financial statements of those companies in its library.
- Using financial reports published by Securities Bourse.
- Using software packages of Dena Sahm, Tadbir Pardaz and Pars Portfolio companies.
- Variables of research

The variables are market value as dependent variable and reported amount of goodwill and intangible assets as independent variables. Other variables such as movements, financial levers, industry type and inflation rate were considered and control variables in this research.

Statistical method of research

Kulmogruv-Smirnov Normality Test: Kulmogruv-Smirnov Test is used to test normality. If probability of this test is greater than 0.05, then we can confirm normality of remainders by 95%.

Regarding to the Significance Level (0.88, 0.96, 0.51), the Research Variables Are Normal.

Regression Model: Regression model is used to test Hypothesis. In regression, we seek an arithmetic relation to find the relationship between variables. In this model, we assume the dependent variable (market value) is a function of independent variables (reported values of goodwill and intangible assets). If there is a linear relation between the dependent variable and the independent variable, then it is expected the observed changes in the dependent variable are described by the independent variable. Otherwise, we conclude that there is no linear relation between dependent and independent variables [18].

F Statistic of Regression: In spite of t statistic, F statistic examines significance of the estimated coefficients. Naturally, the more the F statistic, the more descriptive the model.

Mean Square Error (MSE): Since irregular changes in the time series indicated undefined and unpredictable vibrations in data, therefore we should expect errors in our anticipation. There are many indices to determine anticipation error. The most important index is Mean Square Error (MSE), which is obtained by division of squares of errors by freedom degree. Naturally, the less the index, the more the descriptive power [19].

- Examination of correlation coefficient between dependent and independent variables and study of significance level of coefficients [20].

In this step, we calculate Pierson Correlation Coefficient between dependent and independent variables. By the sign of correlation coefficient, we indicate the kind of relation (direct or reverse). Also, significance level is indicated by its probability value, which a value less than 0.05 indicated a significant relation.

- Examination of type and severity of relation by dispersion charts

In this step, we draw dispersion charts between dependent and independent variables. If the pile of observations is around the first-third bisector, we conclude a direct relation. If the pile of observations is around the second-fourth bisector, we conclude a reverse relation. In addition, the coefficient to determine the simple regression line indicates percentage of changes of dependent variables by which independent variable can be described.

To test the research Hypothesis, we examine the linear regression.

Statistical Model of Sub-main Hypothesis 1:

$$Mv_{i,t} = \alpha + \beta (GW_{i,t})$$

in which,

$Mv_{i,t}$ = Market value of i-th company in year t, which is calculated by number and price of stocks at end of period.

$GW_{i,t}$ = (GW)¹ reported goodwill in financial statements of i-th company in fiscal period t.

Statistical Model of Sub-main Hypothesis 2:

$$MV_{i,t} = \alpha + \beta (IIA_{i,t})$$

in which,

Table 2: Descriptive statistics of dependent variable (in Rials)

Dependent variable	Market value
Number of observations	88
Average	8,852,219.4
Median	8,391,549
Domain	23,853,319
Standard deviation	5,540,312.5
Skewness	0.358
Extension	-0.715

Table 3: Descriptive statistics of independent variables

Dependent variable	Reported value of intangible asset	Reported value of goodwill
Number of observations	88	83
Average	10,297.36	7,709.6
Median	10,552.5	8,005
Domain	21,201	11,784
Standard deviation	3,320.43	3,063.87
Skewness	0.228	-0.328
Extension	0.508	-0.505

Table 4: Frequency distribution of market value of company

Frequency	
31%	< 5,000
51%	5 001 to 15,000
18%	> 15,000

Table 5: Frequency distribution of reported value of goodwill

Frequency	
17%	< 5,000
59%	5,001 to 10,000
18%	> 10,000

Table 6: Frequency distribution of reported value of intangible asset

Frequency	
3%	< 5,000
66%	5,001 to 12,000
31%	> 12,000

$IIA_{i,t} = (IIA)^2$ Reported intangible assets in financial statements of i-th company in fiscal period t. The dependent variable is market value, which is obtained from number of current stocks of company multiplied by the price of each stock 10 days after legal 4-month opportunity to close accounts and constitution of meeting. In this research, regression model is used to examine the relations between variables.

Description of Statistical Data: In the following table, we calculated central and dispersion indices for the research variables. Average is the most important central index and deviation, skewness and extension are the most important dispersion indices. Deviation indicated dispersion of data, skewness indicates symmetry of data and extension indicated height of data.

¹Goodwil

²Identifiable Intangible Assets

Table 7: Results of SPSS test for the sub- Hypothesis 1

Durbin-Watson	Sig	F	R ²	Freedom degree	Confidence level	Result
2.023	0.00	24.215	0.230	1	95%	Confirmation of Hypothesis

Table 8: Analysis of sub- Hypothesis 1

	Non-standard coeff.		Standard coeff.	T	Sig.
	β	Error			
Fixed, intercept	2,458,675.67	1,456,186.144		1.688	0.095
Intangible asset	864.515	175.671	0.480	4.921	0.000

Table 9: Results of SPSS test for the sub- Hypothesis 2

Durbin-Watson	Sig	F	R ²	Freedom degree	Confidence level	Result
1.813	0.00	69.728	0.448	1	95%	Confirmation of Hypothesis

Table 10: Analysis of sub- Hypothesis 2

	Non-standard coeff.		Standard coeff.	T	Sig.
	β	Error			
Fixed, intercept	2,644,790.5	1,445,873.568		-1.829	0.071
Intangible asset	1,116.500	133.708	0.669	8.350	0.000

Regarding to the above table, we see that average, adjusted average and median are nearly equal and skewness is nearly zero. Thus, we say dependent variable, that is market values of sample companies, is distributed normally. However, skewness of the research variable is relatively high and this indicates more extension of distribution of this variable than normal distribution.

Similar to the dependent variable, we see the average, adjusted average and median are nearly equal and skewness is nearly zero for independent variables, too. Thus, we say independent variables are distributed normally. Skewness of the research variable is relatively high and this indicates more extension of distribution of this variable than normal distribution.

In continue, we see value descriptions of the research variables.

Market Value of Company

Reported Value of Goodwill

Reported Value of Intangible Asset

Test of Hypothesis and Data Analysis

Sub-Hypothesis 1: There is a direct relation between reported values of goodwill and a company's market value.

$$H_0: \rho_{(x,y)} = 0$$

$$H_1: \rho_{(x,y)} \neq 0$$

In which, x is the independent variable (reported value of goodwill) and y is the dependent variable (market value).

To examine significance level of this Hypothesis, we used linear single-variable regression. Probability value

(significance level) is equal to 0.00. Since this is less than 0.05. It means coefficients of this regression model are significant and linear. So, a significant relation between the reported value of goodwill and market value is confirmed by 95% of confidence level.

Determination coefficient or R² is 0.23. This means nearly 23% of changes of the dependent variable (market value) are described by the independent variable (reported value of goodwill).

If t is located in the rejection area, then Hypothesis zero is rejected. Since t for slope is equal to 4.921 and t for intercept is 1.688, which is significant for the independent variable coefficient and is insignificant for intercept of regression line, then the model is written as:

$$MV_{it} = 2,458,675 + 864.515 GW_{it}$$

Examination of type and rate of regression line for sub-Hypothesis 1 upon dispersion charts

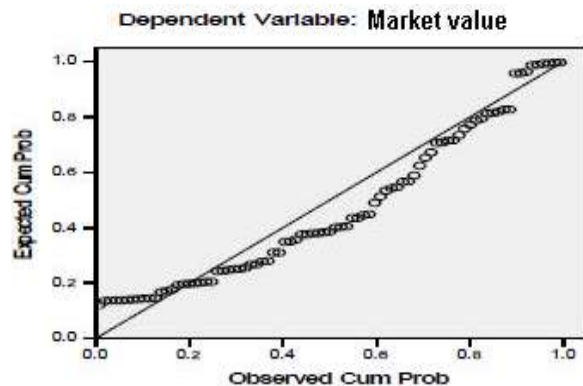


Chart 1: Dispersion chart for sub- Hypothesis 1

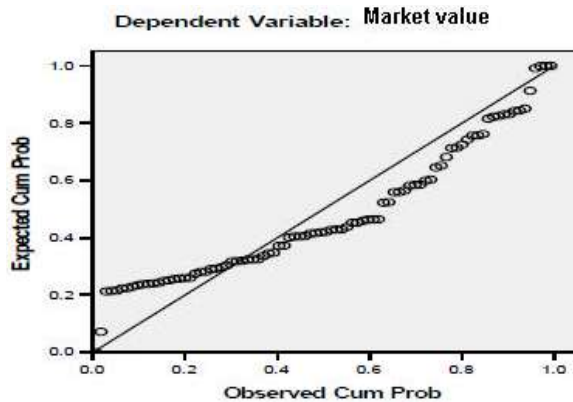


Chart 2: Dispersion chart for sub- Hypothesis 2

In this step, dispersion charts for dependent and independent variables are drawn. As you see, the pile of observations is around the first-third bisector, which a direct relationship is concluded.

8.2.Sub-Hypothesis 2: There is a direct relation between reported values of intangible assets and a company's market value.

$$H_0 : \rho_{(x, y)} = 0$$

$$H_1 : \rho_{(x, y)} \neq 0$$

In which, x is the independent variable (reported value of intangible assets) and y is the dependent variable (market value).

To examine significance level of this Hypothesis, we used linear single-variable regression. Probability value (significance level) is equal to 0.00. Since this is less than 0.05. It means coefficients of this regression model are significant and linear. So, a significant relation between the reported value of goodwill and market value is confirmed by 95% of confidence level.

Determination coefficient or R^2 is 0.448. This means nearly 45% of changes of the dependent variable (market value) are described by the independent variable (reported value of intangible assets).

If t is located in the rejection area, then Hypothesis zero is rejected. Since t for slope is equal to 8.350 and t for intercept is -1.829, which Hypothesis zero is rejected in both cases. Then the model is written as:

$$Mv_{it} = 2,644,790 + 1,116 IIA_{it}$$

Examination of type and rate of regression line for sub-Hypothesis 2 upon dispersion charts

In this step, dispersion charts for dependent and independent variables are drawn. As you see, the pile of observations is around the first-third bisector, which a direct relationship is concluded.

CONCLUSION

In the main Hypothesis it was suggested that reported items of goodwill and intangible assets are reliable and relevant in accounting system. After dividing this Hypothesis to partial Hypothesis and examination of confirmation of these sub-Hypothesis, we can discuss about conclusion of the main Hypothesis.

According to the analysis and acceptance of the sub-Hypothesis 1, we can suggest that there is a direct and significant relation between the reported items of goodwill and market value of a company. In other words, there is a direct correlation between the reported values of goodwill and market value of company as a criterion for relevance of this item in financial statements.

Also, regarding to acceptance of the sub-Hypothesis 2, we can suggest that there is a direct and significant relation between the reported items of intangible assets and market value of a company. In other words, there is a direct correlation between the reported values of intangible assets and market value of company as a criterion for relevance of this item in financial statements. According to the results, we can conclude rightness of the main Hypothesis, that is, the reported values of goodwill and intangible assets in accounting system are reliable and relevant. In other words, in the statistical society of this research (member companies in Tehran Stock Exchange), intangible assets and goodwill items in financial statements are reliable and relevant. Thus, it can be suggested that accounting systems of Bourse can offer reliable and relevant information useful for decision-making by users.

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