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A86045 Accounting and Financial Reporting (2017/2018)

Session 8

Non-current Assets - Intangible Assets

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SESSION 8 OVERVIEW

Course Overview

	1. Financial reporting under IFRS	14. Construction contracts	
	2. Financial analysis: Ratio analysis	15. Other Non-financial liabilities	
	3. Financial analysis: Segments and EPS	16. Review session	
	4. Review session	17. Mid term test	PGS
	5. Revenues	18. Financial Instruments 1	
PGS	6. Costs and expenses	19. Financial Instruments 2	
	7. Taxation - Direct and Indirect	20. Review session	
	8. Non-current assets - Intangible assets	21. Cash Flow Statement	
	9. Non-current assets - Tangible assets	22. Group accounts/Business comb	PT
	10. Financial leases	23. Review session	
	11. Impairment of assets	24. Review session	
	12. Review session	25. Final test	PGS
PT	13. Inventories		

Session 8 Overview

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Session Objectives

At the end of this session session students will be able to:

1. **Articulate** the difference between finite lived and indefinite lived intangible assets and how these are accounted for

2. **Perform** a simple calculation of goodwill and understand how intangible assets arise in a business combination

3. **Recognize** the different types of intangible fixed assets which arise in different industries

Session 8 Intangibles Overview

- Intangibles definition/examples
- Criteria for recognition and measurement (initial and subsequent)
- Finite vs. Indefinite and useful life considerations
- Different Types
  - Acquired
  - Goodwill and business combinations
  - Internally generated
  - Other, Government grant, exchanges (Fair Value)
- Industry comparison

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SESSION 7 RECAP AND PRE-WORK SESSION 8

Session 7 Summary

- Types of taxation
- Value added taxes
- Current income taxes
- Deferred income taxes
- Reconciliation of tax charge
- Uncertain tax positions

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Session 8 Pre-work

- Reading
  - Melville International Financial Reporting – A Practical Guide :
    - Chapter 15 – Taxation in Financial Statements
  - IASB Statements
    - IAS 12 Income Taxes
- Exercises
  - Melville 15.1 – 15.7
  - Melville on-line multiple choice questions for chapter 15
  - Ex 7 Income Taxes - Exercises
- Research assignment
  - RA 6 Intangible assets - accounting policies for, and nature of intangibles

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Research Assignment RA 6 Intangibles

Nature of Intangible assets

Accounting Policy (ies) for these

N.B. Ignore Impairment

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INTANGIBLE ASSETS

Intangible assets Definition –IAS 38

An Asset *is a resource:*

a) controlled by an entity as a result of past events; and

b) from which future economic benefits are expected to flow to the entity.

An Intangible asset *is an identifiable non-monetary asset without physical substance.*

Examples of intangibles

Business Expenditures

- Scientific/technical knowledge
- Design/implementation of new processes or systems
- Licenses
- Intellectual property
- Market knowledge
- Trademarks
- Brand names
- Publishing titles

Examples

- Computer software
- Patents
- Copyrights
- Motion picture films
- Customer lists
- Licenses
- Quotas
- Franchises
- Customer/supplier relationships
- Market share
- Marketing rights

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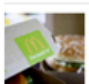
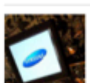
The World's Most Valuable Brands 2017

	Rank	Brand	Brand Value	1-Yr Value Change	Brand Revenue	Company Advertising	Industry
	#1	Apple	$170 B	10%	$214.2 B	$1.8 B	Technology
	#2	Google	$101.8 B	23%	$80.5 B	$3.9 B	Technology
	#3	Microsoft	$87 B	16%	$85.3 B	$1.6 B	Technology
	#4	Facebook	$73.5 B	40%	$25.6 B	$310 M	Technology
	#5	Coca-Cola	$56.4 B	-4%	$23 B	$4 B	Beverages
	#6	Amazon	$54.1 B	54%	$133 B	$5 B	Technology
	#7	Disney	$43.9 B	11%	$30.7 B	$2.9 B	Leisure
	#8	Toyota	$41.1 B	-2%	$168.8 B	$4.3 B	Automotive
	#9	McDonald's	$40.3 B	3%	$85 B	$646 M	Restaurants
	#10	Samsung	$38.2 B	6%	$166.7 B	$3.7 B	Technology

$billions

2013 Rankings

1. *Apple $104.3*
2. *Microsoft $56.7*
3. *Coca-Cola $54.9*
4. *IBM $50.7*
5. *Google $47.3*
6. *McDonalds $39.4*
7. *General Electric $34.2*
8. *Intel $30.9*
9. *Samsung $29.5*
10. *Louis Vuitton $28.4*

Sources: Forbes

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Apple Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions, except number of shares which are reflected in thousands and par value)

	December 30, 2017	September 30, 2017
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 27,491	$ 20,289
Short-term marketable securities	49,662	53,892
Accounts receivable, less allowances of $59 and $58, respectively	23,440	17,874
Inventories	4,421	4,855
Vendor non-trade receivables	27,459	17,799
Other current assets	11,337	13,936
Total current assets	143,810	128,645
Long-term marketable securities	207,944	194,714
Property, plant and equipment, net	33,679	33,783
Goodwill	5,889	5,717
Acquired intangible assets, net	2,149	2,298
Other non-current assets	13,323	10,162
Total assets	$ 406,794	$ 375,319
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 62,985	$ 49,049
Accrued expenses	26,281	25,744
Deferred revenue	8,044	7,548
Commercial paper	11,980	11,977
Current portion of long-term debt	6,498	6,496
Total current liabilities	115,788	100,814
Deferred revenue, non-current	3,131	2,836
Long-term debt	103,922	97,207
Other non-current liabilities	43,754	40,415
Total liabilities	266,595	241,272
Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, $0.00001 par value: 12,600,000 shares authorized; 5,081,651 and 5,126,201 shares issued and outstanding, respectively	36,447	35,867
Retained earnings	104,593	98,330
Accumulated other comprehensive income/(loss)	(841)	(150)
Total shareholders' equity	140,199	134,047
Total liabilities and shareholders' equity	$ 406,794	$ 375,319

Only Acquired intangibles are reported

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Filed for liquidation on 15.01.2108.

- Mainly involved in long-term contracts. Revenues £5.2 billion in 2016
- Used reverse factoring to pay suppliers
- Intangibles and deferred tax assets 2.5 times shareholders' equity
- Pension fund deficit £810 million
- Paid Dividends of £82.7 million out of a profit of £129.5 million

Carillion plc

Consolidated balance sheet

As at 31 December 2016

	Note	2016 £m	2015[1] £m
Non-current assets			
Property, plant and equipment	10	**144.1**	140.5
Intangible assets	11	**1,669.3**	1,634.2
Retirement benefit assets	30	**5.8**	12.7
Investments in joint ventures	12	**174.9**	160.5
Other investments	13	**5.4**	4.7
Deferred tax assets	14	**163.8**	103.8
Total non-current assets		**2,163.3**	2,056.4
Current assets			
Inventories	15	**78.8**	64.3
Trade and other receivables	17	**1,664.0**	1,270.8
Cash and cash equivalents	18	**469.8**	462.2
Derivative financial instruments	26	**46.4**	14.6
Income tax receivable		**10.8**	1.2
Total current assets		**2,269.8**	1,813.1
Total assets		**4,433.1**	3,869.5
Current liabilities			
Borrowing	19	**(96.7)**	(33.5)
Derivative financial instruments	26	**(10.6)**	(11.6)
Trade and other payables	20	**(2,090.1)**	(1,714.3)
Provisions	21	**(7.8)**	(5.0)
Income tax payable		**(12.2)**	(7.2)
Total current liabilities		**(2,217.4)**	(1,771.6)
Non-current liabilities			
Borrowing	19	**(592.0)**	(598.5)
Other payables	20	**(67.3)**	(64.0)
Retirement benefit liabilities	30	**(810.6)**	(406.2)
Deferred tax liabilities	14	**(15.4)**	(10.5)
Provisions	21	**(0.5)**	(2.1)
Total non-current liabilities		**(1,485.8)**	(1,081.3)
Total liabilities		**(3,703.2)**	(2,852.9)
Net assets	2	**729.9**	1,016.6
Equity			
Share capital	22	**215.1**	215.1
Share premium	23	**21.2**	21.2
Translation reserve	23	**(0.9)**	(38.9)
Hedging reserve	23	**(16.5)**	(8.2)
Fair value reserve	23	**0.5**	0.3
Merger reserve	23	**389.0**	393.7
Retained earnings	23	**92.7**	410.3
Equity attributable to shareholders of the parent		**701.1**	993.5
Non-controlling interests		**28.8**	23.1
Total equity		**729.9**	1,016.6

(1) Restated for the retrospective adjustment to provisional amounts recognised on acquisitions in 2015.

The financial statements were approved by the Board of Directors on 1 March 2017 and were signed on its behalf by:

Zafar Khan
Group Finance Director
1 March 2017

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Intangibles – Criteria for recognition

1. **Identifiable**
   1. Separable (i.e. you can sell it, transfer it, license it, rent it or exchange it), or
   2. Arises from contractual or legal rights (even if not separable)
2. **Control** – *the power to obtain the future economic benefits and restrict access to others*
3. **Existence of future economic benefits**
   1. Revenues, or
   2. Cost savings

Intangibles – initial recognition and measurement

If an item meets the definition of an intangible asset it should be recognized if at the time of initial recognition of the expenditure, and **only if**

a. It is probable that the expected future economic benefits that are attributable to the asset will flow to the entity
b. The cost of the asset can be measured reliably.

An intangible asset shall be measured initially at cost

There are **separate rules** for recognition and initial measurement of intangibles depending on whether they were:

- Acquired separately-*all directly attributable costs*
- Acquired as part of a business combination-*Fair Value*
- Subsequent expenditure on an acquired in-process R&D project
- Acquired by way of government grant-*Fair Value or nominal amount*
- Obtained in an exchange of assets-*Fair Value or cost of asset exchanged*
- Generated internally-*Depends on the phase*

Subsequent measurement

Accounting choice

Cost Model	OR	Revaluation Model Must be applied to all other assets in it class
Carried at cost less any accumulated amortisation and any accumulated impairment losses		Fair value at the date of revaluation less any subsequent accumulated amortisation and any accumulated impairment losses

Fair Value must be determined by reference to an active market.
Must be performed regularly to ensure no material difference from Fair Value

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Useful Lives: Finite vs Indefinite (N.B. Not Infinite)

Finite

- The entity estimates the length of its useful life or the number of production units (or similar units) constituting that useful life.
- *Amortized over the useful life*
- *Can't exceed contractual or legal rights*

Indefinite

- No foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
- *Not amortized*
- *Annual impairment test and assessment of useful life*

Useful Life Considerations – Review Annually

- The expected usage of the asset by the entity
- Typical product life cycles for the asset
- Technical, technological, commercial obsolescence
- Stability of the industry and changes in the market demand for the products or services output from the asset
- Expected actions by competitors or potential competitors
- Level of maintenance expenditure required
- Period of control and legal limits on usage
- Dependency on other assets' useful lives

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Revaluation gains and losses

In general, revaluation gains and losses are accounted for as follows:

- revaluation gains are credited to a revaluation reserve and are recognised as other comprehensive income;
- revaluation losses are recognised as an expense in the calculation of profit or loss.

The situation is more complex if an item is revalued upwards after a previous downwards revaluation (or vice versa).

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RESEARCH ASSIGNMENT AND: INDUSTRY COMPARISON

Research Assignment RA 6 Intangibles

Nature of Intangible assets

Accounting Policy (ies) for these

N.B. Ignore Impairment

Industry Comparison

SM 8.1 Intangible Assets Comparison

SM 8.1 Intangible Assets Industry Comparison

Company 2012		Total	Goodwill	Other			Software Internally Generated	Patents licenses	Customer relationships	Trademarks	Ammortized Brands	Idefinite lived Brands	IPRD	Product in use	Product Not in use	Marketing	Technology	Other	Contract Based	Exploration and Evalauation	Distribution Rights	In Progress	Oil & Gas Prospects
Siemens		22,940	17,883	5,057		5,057	1,241	3,816															
SAP		16,508	13,274	3,234		3,234	198		2,101				935										
Roche		11,694	7,480	4,214		4,214								2,381	1,775	8	50						
Sanofi		58,265	38,073	20,192		20,192	267			11,940			4,083			3,902							
GSK		14,520	4,359	10,161		10,161	450	7,402			177	2,132											
Novartis		61,421	31,090	30,331		30,331						2,980	2,314	13,662		5,484	5,528	363					
Novo Nordisk	DKK	1,495		1,495		1,495	532	762										201					
Rio Tinto		9,402	2,774	6,628		6,628				212								478	3,885	2,053			
Bayer		18,757	9,293	9,464		9,464		4,661		1,939			893	418		679		874					
BASF		12,241	6,385	5,856		5,856	37	1,290								1,017		475			3,037		
Vodafone		59,514	38,350	21,164		21,164	2,998	17,523										643					
Shell		4,470	2,615	1,855		1,855	1,855																
BP		35,902	11,861	24,041		24,041												1,192		22,849			
ENI		4,487	2,461	2,026		2,026		138		683								394		548		263	
Statoli	NOK	87,600	9,700	77,900		77,900												2,000		18,600			57,300
Total		12,858	889	11,969		11,969												954		11,015			
LVMH		19,316	7,806	11,510		11,510	200	22		2,009	8,819							460					
L'Oreal		9,103	6,478	2,625		2,625	267	583			21	1,436						318					
SABMiller		29,498	19,862	9,636		9,636	433				8,645							558					
AB INBev		76,137	51,766	24,371		24,371	211					22,124				1,739		297					
Diageo		9,048	1,377	7,671		7,671	227					6,244						1,200					
Nestlé		46,258	32,615	13,643		13,643	579	935			12,129												
Unilever		21,718	14,619	7,099		7,099	772				29	6,298											
BAT		11,710	10,793	917		917	150			594												173	
Inditex		333	333			0																	
VW		59,157	23,935	35,222		35,223						17,079		9,263				5,282				3,599	
HSBC		29,853	29,853			0																	
Santander		28,062	24,626	3,436		3,436	3,422					14											

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ACQUIRED INTANGIBLES

Acquired intangibles

Capitalize

- Purchase price
- Any directly attributable costs of preparing the asset for its intended use
  - Employee benefits
  - Professional fees
  - Costs of testing
- Capitalization stops when the asset is ready for use.

Expense

- Costs of introducing a new product or service, including advertising and promotion
- Costs of conducting business in a new location or with new customers including training
- Administration and general overheads
- Costs incurred in using or redeploying
- Costs while waiting to be put into use
- Initial operating losses

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GOODWILL AND BUSINESS COMBINATIONS

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Business combinations

	Company A	Company B
Assets	100	40
Liabilities	60	30
Net equity	40	10

Company A acquires Company B for 50 and pays cash

	Company A	Company B
Assets	50	40
Investment in B	50	__
	100	40
Liabilities	60	30
Net equity	40	10

Purchase Price Allocation

	Company A	Company B	Fair Value B
Assets	50	40	70
Investment in B	50	__	__
	100	40	
Liabilities	60	30	40
Net equity	40	10	30

Intangibles not recorded by B e.g. brand, customer lists

Liabilities not recorded by B e.g. pension fund liability

The difference between the purchase price of 50 and the net book value of net assets acquired 10 is 40 (50 – 10) but the difference between the fair value is only 20 (50 – 30).

Examples of identifiable intangible assets - IFRS 3

- Marketing-related
  - Trademarks, trade names, service marks
  - Trade dress (Unique color, shape, packaging)
  - Newspaper mastheads
  - Internet domain names
  - Non-competition agreements
- Customer-related
  - Customer lists
  - Order or production backlog
  - Customer contracts or relationships
  - Non-contractual customer relationships
- Artistic-related
  - Plays, operas, ballets
  - Books, magazines, newspapers
  - Musical works
  - Pictures and photographs
  - Video and audiovisual material(films, TV shows, music videos)
- Contract-based
  - Licensing, royalty agreements
  - Advertising, construction, management, service and supply contracts
  - Lease agreements
  - Construction permits
  - Franchise agreements
  - Operating and broadcasting rights
  - Servicing contracts
  - Employment contracts
  - Use rights such as drilling, water, air, timber cutting
- Technology-based
  - Patented technology
  - Computer software
  - Unpatented technology, database, trade secrets

Common reasons why a company will be prepared to pay more than an entity's net book value to acquire it.

Consolidation and Goodwill

At Fair Values

	Company A	Company B	Combined	Eliminations	Consolidated
Goodwill				20	20
Assets	50	70	120		120
Investment in B	50	__	~~50~~	(50)	_____
	100	70	170	(30)	140
Liabilities	(60)	(40)	(100)	_____	(100)
Net equity	40	~~30~~	70	(30)	40

The cost of Company A's investment in Company B is eliminated against the Fair Value of net assets acquired in Company B. The difference is Goodwill.

IFRS 3 *Business Combinations*

- Goodwill is defined as "*an asset representing the future economic benefits arising from … assets acquired in a business combination that are not individually identified and separately recognised*".
- A business combination occurs when an entity acquires control of a business.
- Goodwill acquired in a business combination is recognised as an asset and measured initially at cost.
- The cost of the goodwill is equal to the excess of the cost of the business combination over the net fair value of the identifiable assets and liabilities which have been acquired.

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Goodwill

Goodwill arises from factors such as an entity's good reputation and strong customer relationships.

IAS 38 forbids internally generated goodwill to be recognised as an asset.

Goodwill which is purchased in a business combination is dealt with by IFRS3 *Business Combinations*.

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INTERNALLY GENERATED

Internally Generated

Project

Research stage

Commercial launch

Development stage

Production stage

IAS 38 ← Research phase → ← Development phase →

Expense all expenditure

Commercial viability determined

Six Conditions. Ability to demonstrate:

1. **Technical feasibility**
2. **Intention to complete**
3. **Ability to use or sell**
4. **How economic benefits will be generated**
5. **Availability of adequate resources to complete**
6. **Ability to measure reliably the expenditure**

Internally generated intangible assets

Internal generation of an intangible asset is split into a research phase and a development phase.

- **Research** is defined as "*original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding*".
- **Development** is defined as "*the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use*".

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Internally generated

Costs eligible for capitalization

- Costs of materials and services used or consumed
- Costs of employee benefits
- Fees to register the asset
- Amortization of patents and licenses used to generate the intangible asset
- Borrowing costs meeting criteria in IAS 23

Costs required to be expensed

- Indirect costs such as selling, general and administrative costs
- Identified inefficiencies and initial operating losses incurred before the asset achieves planned performance
- Expenditure on training staff to operate the asset
- Advertising and promotional costs
- Relocation and reorganization costs

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Intangibles - Summary

Initial measurement				Subsequent measurement		
Internally Generated	**Acquired**	**Acquired in Business Combination**		**Revalue ***	**Amortize**	**Impairment Test**
✖	✔	✔	Goodwill	✖	✖	✔
✔	✔	✔	Finite lived	✔	✔	✔
✔	✔	✔	Indefinite lived	✔	✖	✔
Cost	Cost	Fair Value		Fair Value		

* Only if there is an active market

IAS 38 disclosure requirements

For each class of intangible asset, distinguishing between internally generated assets and others:

- whether the useful lives are indefinite or finite
- if finite, the useful lives or amortisation rates used
- the amortisation methods used
- gross carrying amount and accumulated amortisation at the beginning and end of the accounting period
- the line item in the statement of comprehensive income in which amortisation is included
- a reconciliation of the carrying amount at the beginning and end of the period, showing additions, disposals, revaluation increases and decreases, amortisation, impairment losses and any other movements.

Main disclosure requirements of IFRS 3

The main disclosure requirements of IFRS3 in relation to goodwill are:

- a reconciliation of the carrying amount of goodwill at the beginning and end of the period, showing additions, disposals, impairment losses and any other movements;
- the amount of any negative goodwill which has been included in profit or loss and the line item in the statement of comprehensive income in which this is included.

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REQUIRED READING AND ASSIGNMENT FOR NEXT SESSION

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Overview of Session 9

- Tangible Fixed Assets
  - Acquired vs constructed
  - Capital vs. revenue expenditures
  - Interest
  - Government Grants
  - Depreciation
  - Revaluations
  - Leasing - briefly

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Session 9 Pre-work

- Reading
  - Melville International Financial Reporting :
    - Chapter 6 – Intangible assets
  - IASB Statements
    - IAS 38 Intangible assets
    - IFRS 3 Business Combinations
- Exercises
  - Melville
    - On-line multiple choice questions for Chapter 6
    - Melville exercises 6.1 – 6.9
    - EX 8 Intangible assets - Exercises
- Research
  - Research assignment RA 7 Identify the nature of the Property, plant and equipment in your chosen company and how these are classified and accounted for and the accounting policies applied.

RA 7 Property, plant and equipment

Company_____________

Nature of Property, plant and equipment

Accounting policies for this

N.B. Ignore Leases

SUMMARY AND VALIDATION

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Session 8 Summary

- Intangibles definition/examples
- Criteria for recognition and measurement c.f. Apple
- Finite vs. Indefinite and useful life considerations
- Different Types
  - Acquired
  - Goodwill and business combinations
  - Internally generated
  - Government grant, exchanges (Fair Value)
- Industry comparison

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Session 8 Validation

- What is the difference in the way finite and indefinite intangible assets are subsequently measured?
- How is Goodwill initially determined?
- At what point in time is it possible to capitalize the costs of an internal project to develop an intangible asset?
- Why do Pharmaceutical companies have so little capitalized research and development when they incur significant expenditure on this?