

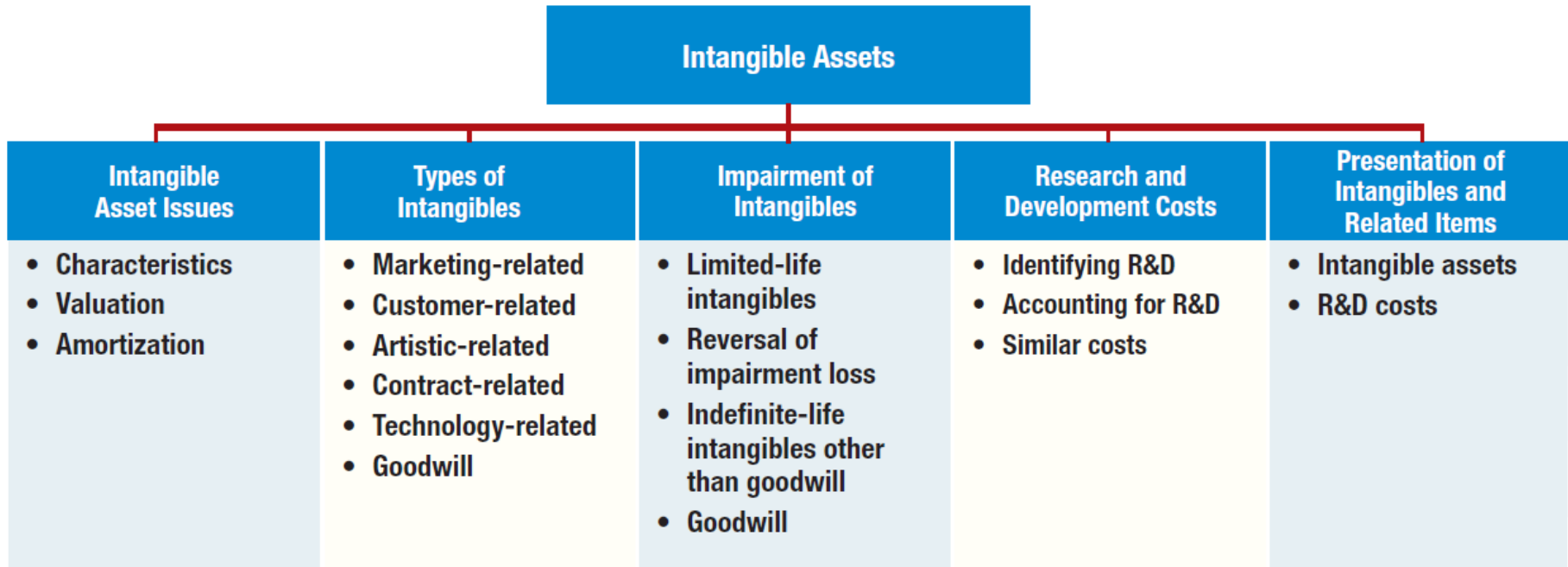
# **INTERMEDIATE ACCOUNTING: IFRS EDITION, 2/E**

## **Chapter 12**

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Westmont College**

# PREVIEW OF CHAPTER

# 12



Intermediate Accounting  
IFRS 2nd Edition  
Kieso, Weygandt, and Warfield

## LEARNING OBJECTIVES

*After studying this chapter, you should be able to:*

- 1. Describe the characteristics of intangible assets.**
2. Identify the costs to include in the initial valuation of intangible assets.
3. Explain the procedure for amortizing intangible assets.
4. Describe the types of intangible assets.
5. Explain the accounting issues for recording goodwill.
6. Explain the accounting issues related to intangible asset impairments.
7. Identify the conceptual issues related to research and development costs.
8. Describe the accounting for research and development and similar costs.
9. Indicate the presentation of intangible assets and related items.

# INTANGIBLE ASSET ISSUES

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## Characteristics

1. Identifiable.
2. Lack physical existence.
3. Not monetary assets.

**Coca-Cola Company's** (USA) success comes from its secret formula for making Coca-Cola, not its plant facilities.

Normally classified as non-current asset.

Common types of intangibles:

- ◆ Patent
- ◆ Copyright
- ◆ Franchise or license
- ◆ Trademark or trade name
- ◆ Customer list
- ◆ Goodwill

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# INTANGIBLE ASSET ISSUES

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## Valuation

### Purchased Intangibles

- ◆ Recorded at cost.
- ◆ Includes all acquisition costs plus expenditures to make the intangible asset ready for its intended use.
- ◆ Typical costs include:
  - ▶ Purchase price.
  - ▶ Legal fees.
  - ▶ Other incidental expenses.

# INTANGIBLE ASSET ISSUES

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## Valuation

### Internally Created Intangibles

- ◆ Companies expense all research phase costs and some development phase costs.
- ◆ Certain development costs are capitalized once economic viability criteria are met.
- ◆ **IFRS** identifies several specific criteria that must be met before development costs are capitalized.

#### Underlying Concepts

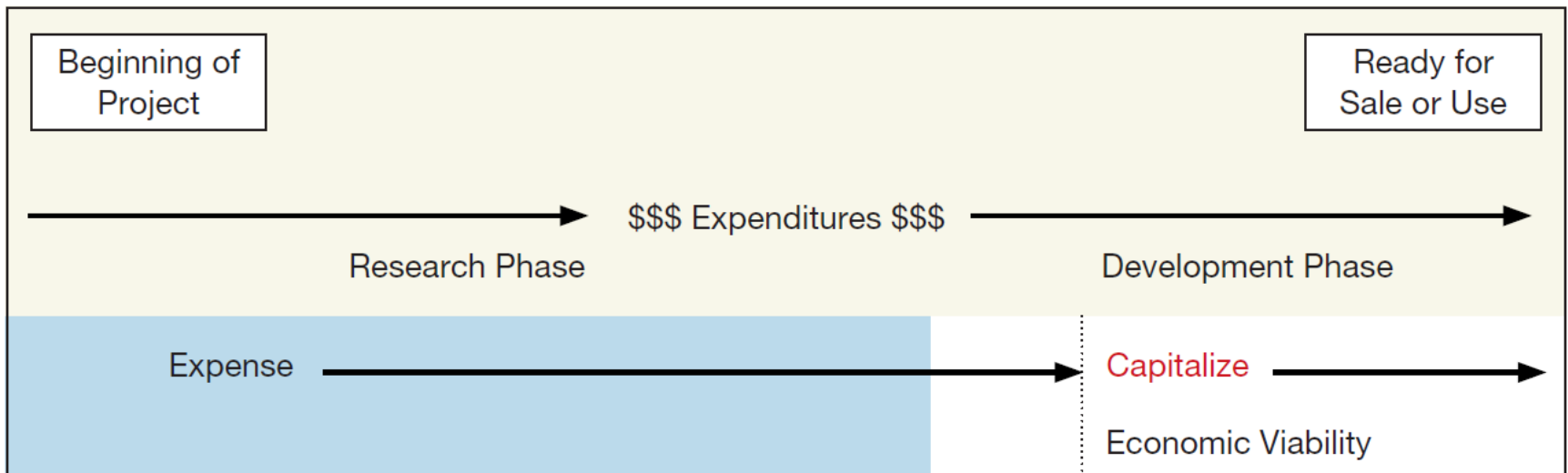


The controversy surrounding the accounting for R&D expenditures reflects a debate about whether such expenditures meet the definition of an asset. If so, then an “expense all R&D costs” policy results in overstated expenses and understated assets.

# INTANGIBLE ASSET ISSUES

## Internally Created Intangibles

**ILLUSTRATION 12-1**  
Research and  
Development Stages





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# INTANGIBLE ASSET ISSUES

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## Underlying Concepts

The terms “carrying amount,” “carrying value,” and “book value” are all used to refer to the cost less accumulated amortization of intangible assets.

## Amortization of Intangibles

### Limited-Life Intangibles

- ◆ Amortize by systematic charge to expense over useful life.
- ◆ Credit asset account or accumulated amortization.
- ◆ Useful life should reflect the periods over which the asset will contribute to cash flows.
- ◆ Amortization should be cost less residual value.
- ◆ Companies must evaluate the limited-life intangibles annually for impairment.

# INTANGIBLE ASSET ISSUES

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## Amortization of Intangibles

### Indefinite-Life Intangibles

- ◆ No foreseeable limit on time the asset is expected to provide cash flows.
- ◆ Must test indefinite-life intangibles for impairment at least annually.
- ◆ No amortization.

# INTANGIBLE ASSET ISSUES

## Amortization of Intangibles

**ILLUSTRATION 12-2**  
Accounting Treatment  
for Intangibles

Type of Intangible	Manner Acquired		Amortization	Impairment Test
	Purchased	Internally Created		
Limited-life intangibles	Capitalize	Expense*	Over useful life	Compare recoverable amount to carrying value.
Indefinite-life intangibles	Capitalize	Expense*	Do not amortize	Compare recoverable amount to carrying value.

\* (Except for certain limited costs that meet recognition criteria.)

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# TYPES OF INTANGIBLE ASSETS

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## Six Major Categories:

- (1) Marketing-related.
- (2) Customer-related.
- (3) Artistic-related.
- (4) Contract-related.
- (5) Technology-related.
- (6) Goodwill.

# TYPES OF INTANGIBLE ASSETS

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## Marketing-Related Intangible Assets

- ◆ **Examples:**

- ▶ **Trademarks** or **trade names**, newspaper mastheads, Internet domain names, and non-competition agreements.

- ◆ In the **United States** trademarks or trade names have legal protection for indefinite number of 10 year renewal periods.

- ◆ Capitalize purchase price.

- ◆ No amortization.



## What do the numbers mean?

## KEEP YOUR HANDS OFF MY INTANGIBLE!

Companies go to great extremes to protect their valuable intangible assets. Consider how the creators of the highly successful game Trivial Pursuit protected their creation. First, they copyrighted the 6,000 questions that are at the heart of the game. Then they shielded the Trivial Pursuit name by applying for a registered trademark. As a third mode of protection, they obtained a design patent on the playing board's design as a unique graphic creation.

Another example is the iPhone trade name. **Cisco Systems** (USA) sued **Apple** (USA) for using the iPhone

trade name when Apple introduced its hot new phone in 2007. Not so fast, said Cisco, which had held the iPhone trade name since 2000 and was using it on its own Voice over Internet Protocol (VoIP) products. The two companies came to an agreement for joint use of the name. It was not disclosed what Apple paid for this arrangement, but it is not surprising why Apple would want to settle—to avoid a costly delay to the launch of its highly anticipated iPhone.

Source: Nick Wingfield, "Apple, Cisco Reach Accord Over iPhone," Wall Street Journal Online (February 22, 2007).



# TYPES OF INTANGIBLE ASSETS

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## Customer-Related Intangible Assets

- ◆ **Examples:**

- ▶ Customer lists, order or production backlogs, and both contractual and non-contractual customer relationships.

- ◆ Capitalize acquisition costs.

- ◆ Amortized to expense over useful life.

# TYPES OF INTANGIBLE ASSETS

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**Illustration:** Green Market Inc. acquires the customer list of a large newspaper for €6,000,000 on January 1, 2015. Green Market expects to benefit from the information **evenly** over a three-year period. Record the purchase of the customer list and the amortization of the customer list at the end of each year.

Jan. 1 2015	Customer List	6,000,000	
	Cash		6,000,000
Dec. 31 2015	Amortization Expense	2,000,000	
2016	Customer List *		2,000,000
2017			

# TYPES OF INTANGIBLE ASSETS

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## Artistic-Related Intangible Assets

- ◆ **Examples:**

- ▶ Plays, literary works, musical works, pictures, photographs, and video and audiovisual material.

- ◆ **Copyright** granted for the life of the creator plus 70 years.

- ◆ Capitalize costs of acquiring and defending.

- ◆ Amortized to expense over useful life if less than the legal life.



# TYPES OF INTANGIBLE ASSETS

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## Contract-Related Intangible Assets



### ◆ Examples:

- ▶ Franchise and licensing agreements, construction permits, broadcast rights, and service or supply contracts.
- ◆ **Franchise** (or license) with a limited life should be amortized as operating expense over the life of the franchise.
- ◆ Franchise with an indefinite life should be carried at cost and not amortized.



# TYPES OF INTANGIBLE ASSETS

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## Technology-Related Intangible Assets

### ◆ Examples:



- ▶ Patented technology and trade secrets granted by a government body.

- ◆ **Patent** gives holder exclusive use for a period of 20 years.
- ◆ Capitalize costs of purchasing a patent.
- ◆ Expense any R&D costs in developing a patent.
- ◆ Amortize over legal life or useful life, whichever is shorter.

The Canon logo is the word "Canon" in a bold, red, sans-serif font.

# TYPES OF INTANGIBLE ASSETS

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**Illustration:** Harcott Co. incurs \$180,000 in legal costs on January 1, 2015, to successfully defend a patent. The patent's useful life is 20 years, amortized on a straight-line basis. Harcott records the legal fees and the amortization at the end of 2015 as follows.

Jan. 1	Patents	180,000	
	Cash		180,000
Dec. 31	Patent Amortization Expense	9,000	
	Patents (or Accumulated Amortization)		9,000

$$\text{Patent Amortization Expense} = (\$180,000 \div 20) = \$9,000$$

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# TYPES OF INTANGIBLE ASSETS

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## Goodwill

Conceptually, represents the future economic benefits arising from the other assets acquired in a business combination that are not individually identified and separately recognized.

Only recorded when an entire business is purchased.

Goodwill is measured as the excess of ...

*cost of the purchase **over** the fair value of the identifiable net assets (assets less liabilities) purchased.*

Internally created goodwill should not be capitalized.



# RECORDING GOODWILL

**Illustration:** Feng, Inc. decides that it needs a parts division to supplement its existing tractor distributorship. The president of Feng is interested in buying Tractorling Company. The illustration presents the statement of financial position of Tractorling Company.

ILLUSTRATION 12-4

TRACTORLING CO. STATEMENT OF FINANCIAL POSITION AS OF DECEMBER 31, 2015			
Assets		Equities	
Property, plant, and equipment, net	\$153,000	Share capital	\$100,000
Inventories	42,000	Retained earnings	100,000
Receivables	35,000	Current liabilities	55,000
Cash	25,000		
<b>Total assets</b>	<b><u>\$255,000</u></b>	<b>Total equities</b>	<b><u>\$255,000</u></b>

# RECORDING GOODWILL

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**Illustration:** Feng investigates Tractorling's underlying assets to determine their fair values.

ILLUSTRATION 12-5

Fair Values	
Property, plant, and equipment, net	\$205,000
Patents	18,000
Inventories	122,000
Receivables	35,000
Cash	25,000
Liabilities	<u>(55,000)</u>
Fair value of net assets	<u><u>\$350,000</u></u>

Tractorling Company decides to accept Feng's offer of \$400,000. What is the value of the goodwill, if any?

# RECORDING GOODWILL

## Illustration: Determination of Goodwill.

ILLUSTRATION 12-6

Assigned to purchase price of \$400,000	→	Property, plant, and equipment, net	\$ 205,000
	→	Patents	18,000
	→	Inventories	122,000
	→	Receivables	35,000
	→	Cash	25,000
	→	Liabilities	<u>(55,000)</u>
		Fair value of net identifiable assets	\$ 350,000
		Purchase price	<u>(400,000)</u>
		Value assigned to goodwill	<u><u>\$ 50,000</u></u>

# RECORDING GOODWILL

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**Illustration:** Feng records this transaction as follows.

Property, Plant, and Equipment	205,000	
Patents	18,000	
Inventory	122,000	
Accounts Receivables	35,000	
Cash	25,000	
Goodwill	50,000	
Liabilities		55,000
Cash		400,000

# RECORDING GOODWILL

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## Goodwill Write-Off

- ◆ Goodwill considered to have an **indefinite life**.
- ◆ Should **not** be amortized.
- ◆ Only adjust carrying value when goodwill is impaired.

## Bargain Purchase

- ◆ Purchase price **less than** the fair value of net assets acquired.
- ◆ Amount is recorded as a **gain** by the purchaser.

## LEARNING OBJECTIVES

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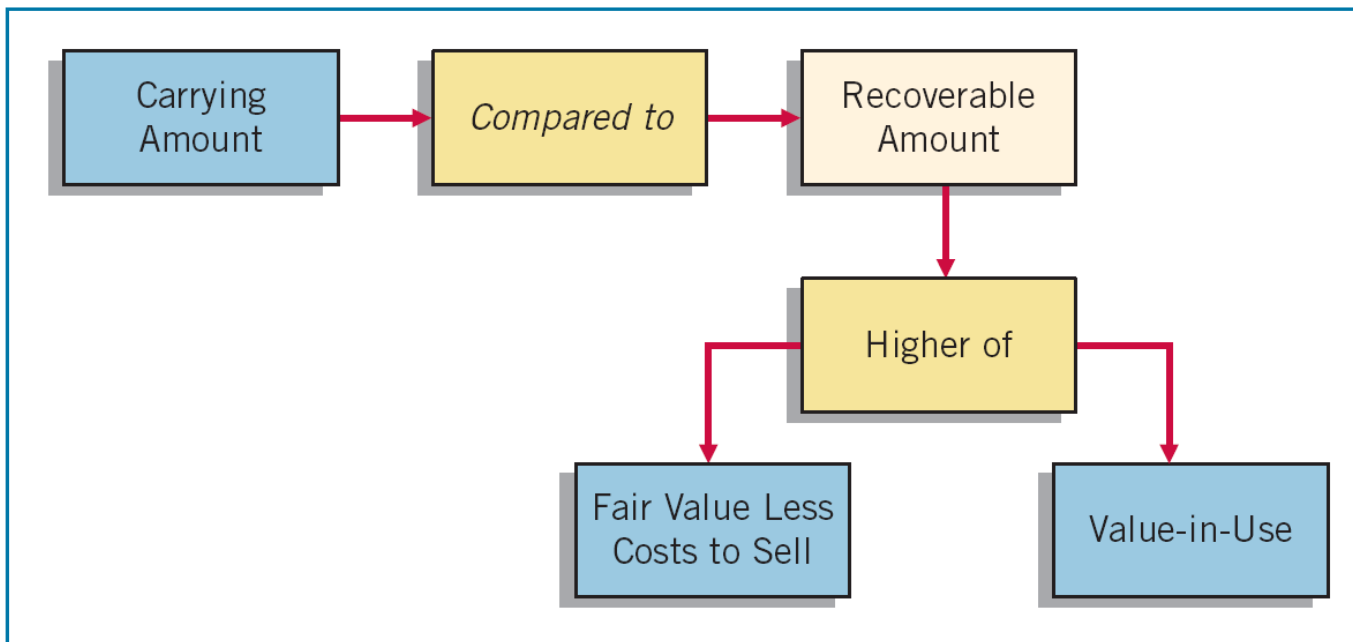
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# IMPAIRMENT OF INTANGIBLE ASSETS

## Impairment of Limited-Life Intangibles

The impairment loss is the carrying amount of the asset less the recoverable amount of the impaired asset.

ILLUSTRATION 11-15



# IMPAIRMENT OF INTANGIBLE ASSETS

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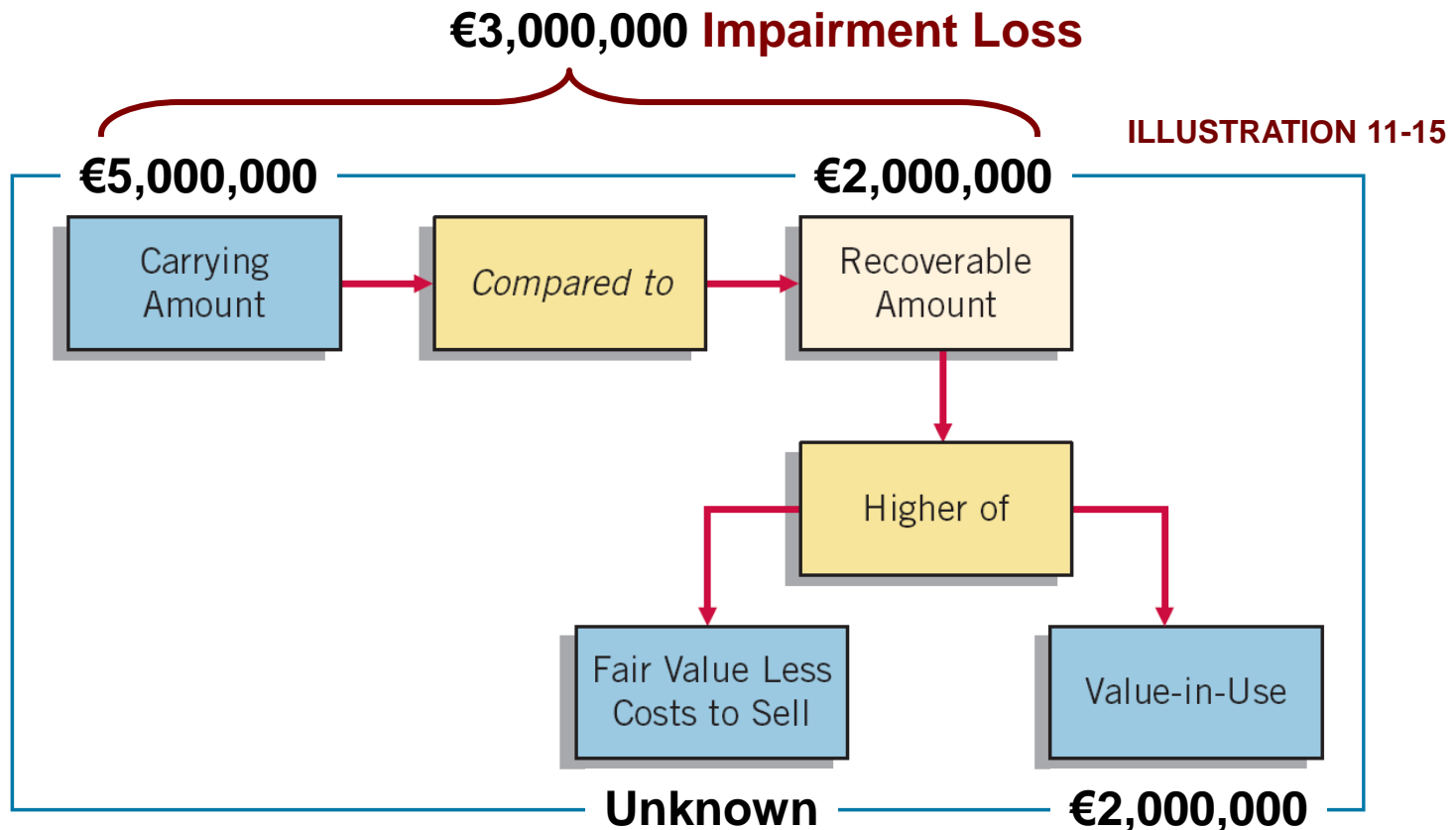
**Illustration:** Lerch, Inc. has a patent on how to extract oil from shale rock, with a carrying value of €5,000,000 at the end of 2014. Unfortunately, several recent non-shale-oil discoveries adversely affected the demand for shale-oil technology, indicating that the patent is impaired. Lerch determines the recoverable amount for the patent, based on value-in-use (because there is no active market for the patent). Lerch estimates the patent's value-in-use at €2,000,000, based on the discounted expected net future cash flows at its market rate of interest.

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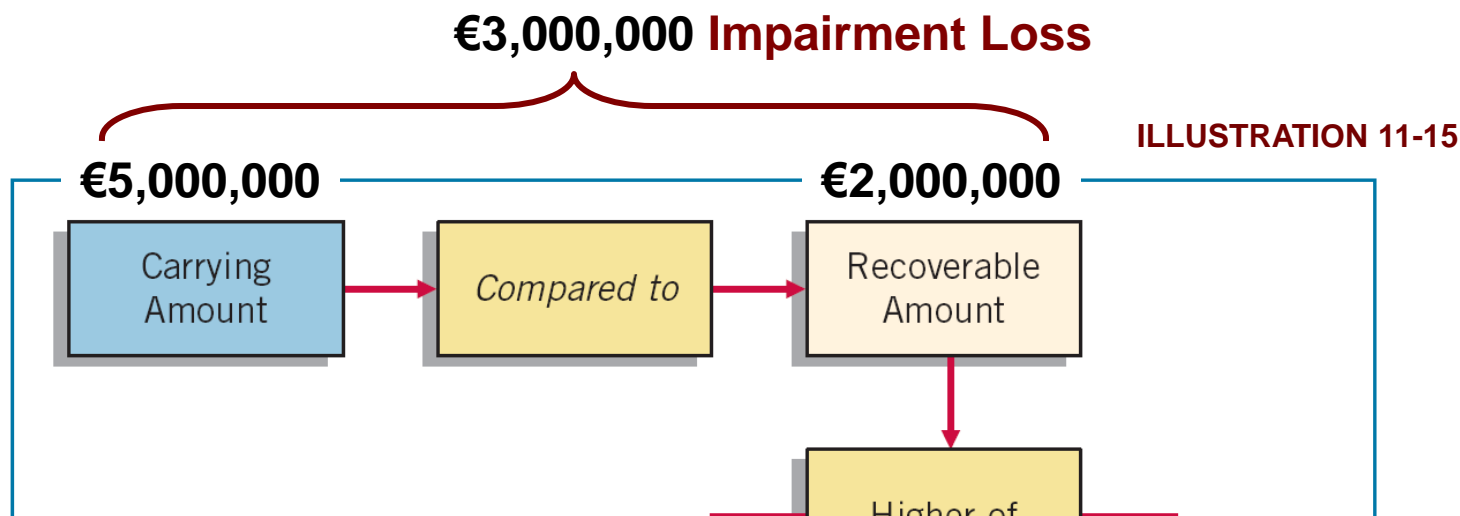
# IMPAIRMENT OF INTANGIBLE ASSETS

Calculate the impairment loss (based on value-in-use).



# IMPAIRMENT OF INTANGIBLE ASSETS

Calculate the impairment loss (based on value-in-use).



Lerch makes the following entry to record the impairment.

Loss on Impairment	3,000,000
Patents	3,000,000

# IMPAIRMENT OF INTANGIBLE ASSETS

## Reversal of Impairment Loss

**Illustration:** The carrying value of the patent after impairment is €2,000,000. Lerch's amortization is €400,000 ( $€2,000,000 \div 5$ ) over the remaining five years of the patent's life. The amortization expense and related carrying amount after the impairment is shown below:

**ILLUSTRATION 12-8**

<u>Year</u>	<u>Amortization Expense</u>	<u>Carrying Amount</u>	
2015	€400,000	€1,600,000	(€2,000,000 – €400,000)
2016	400,000	1,200,000	(€1,600,000 – €400,000)
2017	400,000	800,000	(€1,200,000 – €400,000)
2018	400,000	400,000	(€800,000 – €400,000)
2019	400,000	0	(€400,000 – €400,000)

# IMPAIRMENT OF INTANGIBLE ASSETS

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## Reversal of Impairment Loss

Early in 2016, based on improving conditions in the market for shale-oil technology, Lerch remeasures the recoverable amount of the patent to be €1,750,000. In this case, Lerch reverses a portion of the recognized impairment loss.

Patents (€1,750,000 - €1,600,000)	150,000	
Recovery of Impairment Loss		150,000

# IMPAIRMENT OF INTANGIBLE ASSETS

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## Impairment of Indefinite-Life Intangibles Other than Goodwill

- ◆ Should be tested for impairment at least annually.
- ◆ Impairment test is the same as that for limited-life intangibles. That is,
  - ▶ compare the recoverable amount of the intangible asset with the asset's carrying value.
  - ▶ If the recoverable amount is less than the carrying amount, the company recognizes an impairment.

# IMPAIRMENT OF INTANGIBLE ASSETS

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**Illustration:** Arcon Radio purchased a broadcast license for €2,000,000. The license is renewable every 10 years. Arcon Radio has renewed the license with the GCC twice, at a minimal cost. Because it expects cash flows to last indefinitely, Arcon reports the license as an indefinite-life intangible asset. Recently, the GCC decided to auction these licenses to the highest bidder instead of renewing them. Based on recent auctions of similar licenses, Arcon Radio estimates the fair value less costs to sell (the recoverable amount) of its license to be €1,500,000.

**ILLUSTRATION 12-9**  
Computation of Loss on  
Impairment of Broadcast License

Carrying value of broadcast license	€2,000,000
Recoverable amount (based on fair value less costs to sell)	<u>(1,500,000)</u>
<b>Loss on impairment</b>	<b>€ 500,000</b>

# IMPAIRMENT OF INTANGIBLE ASSETS

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## Impairment of Goodwill

- ◆ Companies must test goodwill at least **annually**.
- ◆ Impairment test is conducted based on the **cash-generating unit** to which the goodwill is assigned.
  - ▶ **Cash-generating unit** = smallest identifiable group of assets that generate cash flow.
- ◆ Because there is rarely a market for cash-generating units, estimation of the recoverable amount for goodwill impairments is usually based on **value-in-use estimates**.

# IMPAIRMENT OF INTANGIBLE ASSETS

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**Illustration:** Kohlbuy Corporation has three divisions. It purchased one division, Pritt Products, four years ago for €2 million. Unfortunately, Pritt experienced operating losses over the last three quarters. Kohlbuy management is now reviewing the division (the cash-generating unit), for purposes of its annual impairment testing. Illustration 12-10 lists the Pritt Division's net assets, including the associated goodwill of €900,000 from the purchase.

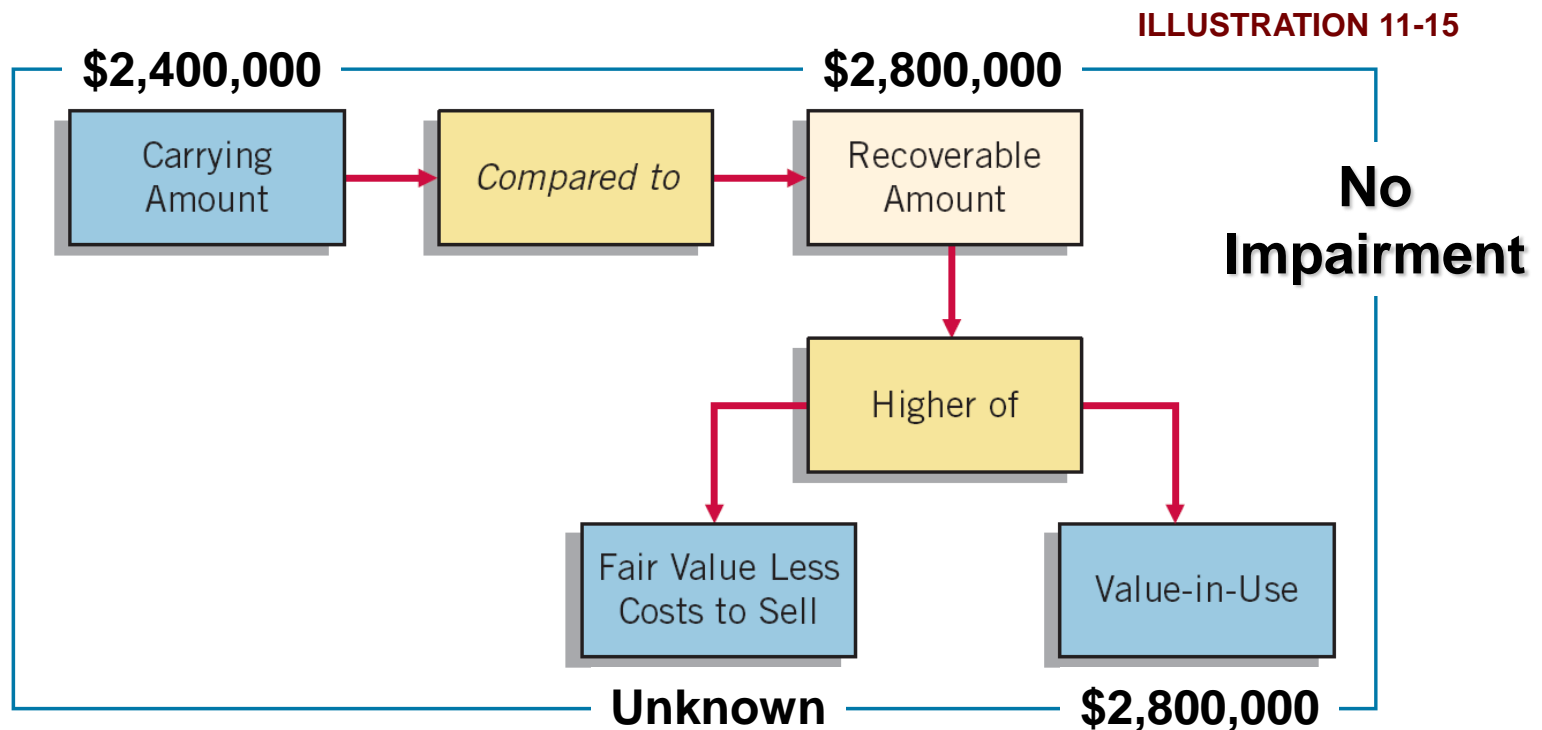
**ILLUSTRATION 12-10**

Property, plant, and equipment (net)	€ 800,000
Goodwill	900,000
Inventory	700,000
Receivables	300,000
Cash	200,000
Accounts and notes payable	(500,000)
Net assets	<u>€2,400,000</u>



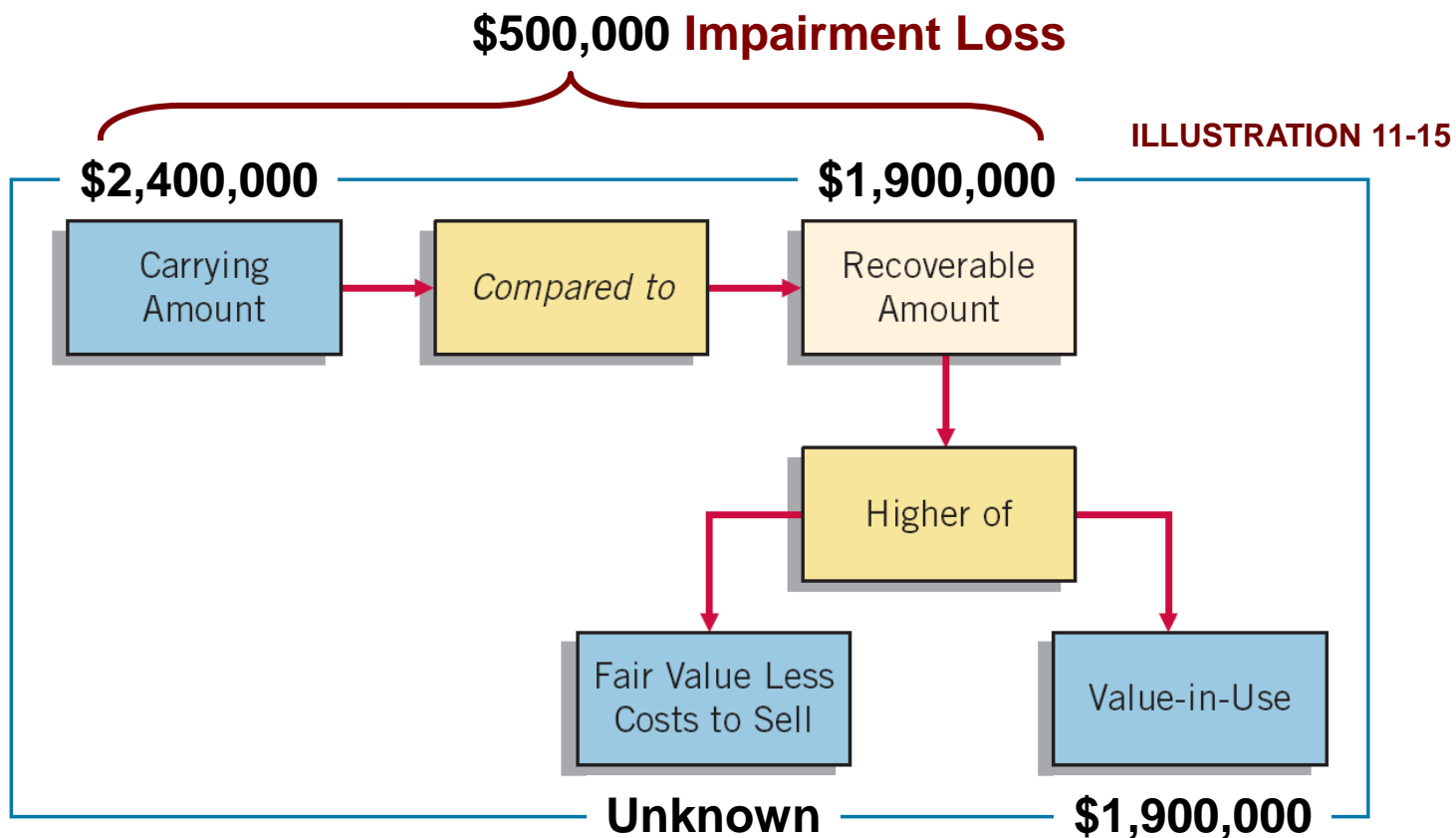
# IMPAIRMENT OF INTANGIBLE ASSETS

Kohlbuy determines the recoverable amount for the Pritt Division to be €2,800,000, based on a value-in-use estimate.



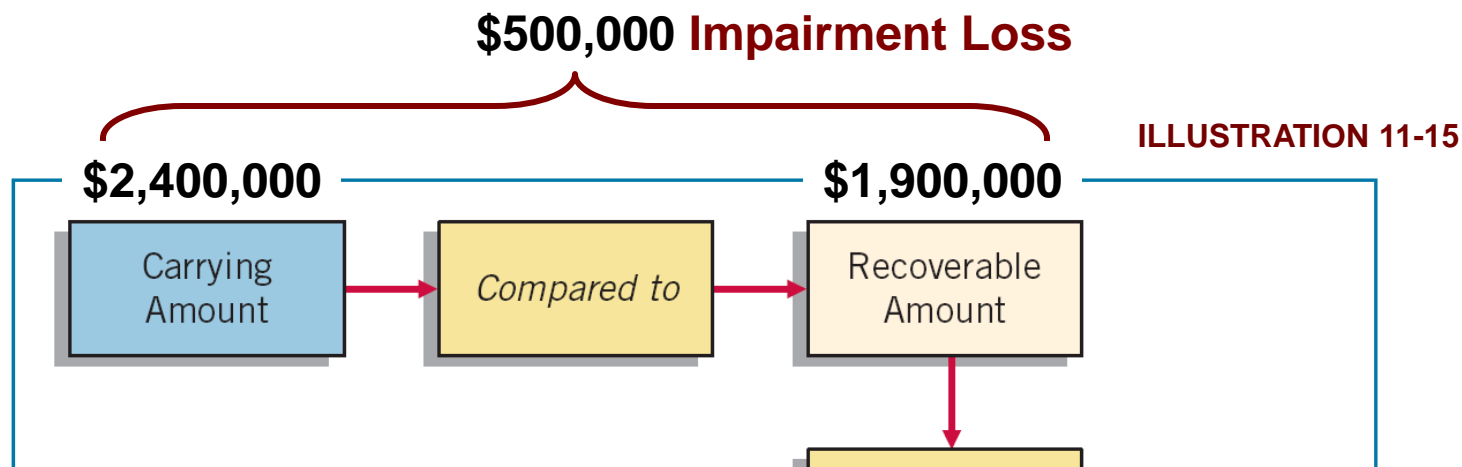
# IMPAIRMENT OF INTANGIBLE ASSETS

Assume that the recoverable amount for the Pritt Division is €1,900,000 instead of €2,800,000.



# IMPAIRMENT OF INTANGIBLE ASSETS

Assume that the recoverable amount for the Pritt Division is €1,900,000 instead of €2,800,000.



Kohlbuy makes the following entry to record the impairment.

Loss on Impairment	500,000
Goodwill	500,000

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# RESEARCH AND DEVELOPMENT COSTS

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**Research and development (R&D) costs** are not in themselves intangible assets.

Frequently results in the development of **patents** or **copyrights** such as new

- ◆ product,
- ◆ process,
- ◆ idea,
- ◆ formula,
- ◆ composition, or
- ◆ literary work.

# RESEARCH AND DEVELOPMENT COSTS

Companies spend considerable sums on **research and development**.

**ILLUSTRATION 12-12**  
R&D Outlays, as a  
Percentage of Sales

<u>Company</u>	<u>Sales (millions)</u>	<u>R&amp;D/Sales</u>
Canon (JPN)	¥3,479,788	8.52%
Daimler (DEU)	€114,297	3.66%
GlaxoSmithKline (GBR)	£26,431	15.01%
Johnson & Johnson (USA)	\$67,224	13.13%
Nokia (FIN)	€30,176	15.85%
Roche (CHE)	CHF45,449	21.02%
Procter & Gamble (USA)	\$83,680	2.42%
Samsung (KOR)	₩201,103,613	5.73%

# RESEARCH AND DEVELOPMENT COSTS



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- ◆ **Research** costs must be expensed as incurred.
- ◆ **Development** costs may or may not be expensed as incurred.
- ◆ Capitalization begins when the project is far enough along in the process such that the economic benefits of the R&D project will flow to the company (the project is **economically viable**).

# RESEARCH AND DEVELOPMENT COSTS

## Identifying R & D Activities

**ILLUSTRATION 12-13**  
Research Activities versus  
Development Activities

<p><b>Research Activities</b></p> <p>Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.</p>	 <p><b>Examples</b></p> <p>Laboratory research aimed at discovery of new knowledge; searching for applications of new research findings.</p>
<p><b>Development Activities</b></p> <p>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.</p>	 <p><b>Examples</b></p> <p>Conceptual formulation and design of possible product or process alternatives; construction of prototypes and operation of pilot plants.</p>



Research and development investments are the lifeblood of product and process developments that lead to future cash flows and growth. Countries around the world understand this and as a result provide significant incentives in the form of tax credits, “superdeductions” (deductions greater than 100%), and corporate tax rate reductions, including “patent box” rates for companies that own and use patents registered in that country. Here is a summary for seven major economies.

Country	Statutory Tax Rate	R&D Incentives
China	25.00%	Offers a reduced corporate income tax rate for certain entities, along with a 150% superdeduction. China also offers several other indirect tax incentives for R&D.
France	33.33%	Offers a 30% tax credit for research expenses, as well as a patent box incentive reducing the corporate tax rate to 15% on qualifying intellectual property income.
Ireland	12.50%	Offers corporations a refundable 25% credit for research expenses and has implemented various government grants for expanding R&D activities in Ireland.
Japan	28.01%	Provides a non-refundable maximum credit of a percentage of R&D expenditures, up to 20% of the corporation’s total tax liability.
United States	35.00%	Offers an annual deduction for R&D spending and a non-refundable tax credit for incremental R&D spending and permits an incremental credit for “qualified research” and “basic research” equal to 20% of eligible expenses.

Source: L. Cutler, D. Sayuk, and Camille Shoff, “Global R&D Incentives Compared,” *Journal of Accountancy* (June 2013).

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# RESEARCH AND DEVELOPMENT COSTS

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## Accounting for R & D Activities

Costs Associated with R&D Activities:

- ◆ Materials, equipment, and facilities.
- ◆ Personnel.
- ◆ Purchased intangibles.
- ◆ Contract Services.
- ◆ Indirect Costs.



The requirement that companies expense immediately all R&D costs (as well as start-up costs) incurred internally is a practical solution. It ensures consistency in practice and uniformity among companies. But the practice of immediately writing off expenditures made in the expectation of benefiting future periods is conceptually incorrect.

Proponents of immediate expensing contend that from an income statement standpoint, long-run application of this standard frequently makes little difference. They argue that because of the ongoing nature of most companies' R&D activities, the amount of R&D cost charged to expense each accounting period is about the same, whether there is immediate expensing or capitalization and subsequent amortization.

Others criticize this practice. They believe that the statement of financial position should report an intangible asset related to expenditures that have future benefit. To preclude capitalization of all R&D expenditures removes from the statement of financial position what may be a company's most valuable asset. Indeed, research findings indicate that capitalizing R&D costs may be helpful to investors.

The current accounting for R&D and other internally generated intangible assets represents one of the many trade-offs made among relevance, faithful representation, and cost-benefit considerations. The FASB and IASB have completed some limited-scope projects on the accounting for intangible assets, and the Boards have contemplated a joint project on the accounting for identifiable intangible assets (i.e., excluding goodwill). (See <http://www.ifrs.org/Current-Projects/IASBProjects/Intangible-Assets/Pages/Intangible-Assets.aspx>.)

# RESEARCH AND DEVELOPMENT COSTS

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## Costs Similar to R & D Costs

- ◆ Start-up costs for a new operation.
- ◆ Initial operating losses.
- ◆ Advertising costs.

These costs are expensed as incurred, similar to the accounting for R&D costs.

## What do the numbers mean?

## BRANDED

For many companies, developing a strong brand image is as important as developing the products they sell. Now more than ever, companies see the power of a strong brand, enhanced by significant and effective advertising investments. As the following chart indicates, the value of brand investments is substantial. Coca-Cola (USA) heads the list with an estimated brand value of about \$78 billion. Companies from around the globe are represented in the top 20 brands.

Occasionally, you may find the value of a brand included in a company's financial statements under goodwill. But generally you will not find the estimated values of brands recorded in companies' statements of financial position. The reason? The subjectivity that goes into estimating a brand's value. In some cases, analysts base an estimate of brand value on opinion polls or on some multiple of ad spending. For example, in estimating the brand values shown above, Interbrand Corp. (USA) estimates the percentage of the overall future revenues the brand will generate and then discounts the net cash flows, to arrive at a present value. Some analysts believe that information on brand values is relevant. Others voice valid concerns about the reliability of brand value estimates due to subjectivity in the estimates for revenues, costs, and the risk component of the discount rate.

### Valuable Global Brands

(in billions)

1 <b>Coca-Cola</b> (USA)	\$77.8	9 <b>Samsung</b> (KOR)	\$32.9
2 <b>Apple</b> (USA)	76.6	10 <b>Toyota</b> (JPN)	30.3
3 <b>IBM</b> (USA)	75.5	11 <b>Mercedes-Benz</b> (DEU)	30.1
4 <b>Google</b> (USA)	69.7	12 <b>BMW</b> (DEU)	29.1
5 <b>Microsoft</b> (USA)	57.9	17 <b>Louis Vuitton</b> (FRA)	23.6

Source: 2012 data, from Interbrand Corp.

# Intangible Assets

## LEARNING OBJECTIVES

*After studying this chapter, you should be able to:*

1. Describe the characteristics of intangible assets.
2. Identify the costs to include in the initial valuation of intangible assets.
3. Explain the procedure for amortizing intangible assets.
4. Describe the types of intangible assets.
5. Explain the accounting issues for recording goodwill.
6. Explain the accounting issues related to intangible asset impairments.
7. Identify the conceptual issues related to research and development costs.
8. Describe the accounting for research and development and similar costs.
9. **Indicate the presentation of intangible assets and related items.**

# PRESENTATION OF INTANGIBLES

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## Presentation of Intangible Assets

### Statement of Financial Position

- ◆ Companies should report as a separate item all intangible assets other than goodwill.
- ◆ Reporting is similar to the reporting of property, plant, and equipment.
- ◆ Contra accounts may not normally shown for intangibles.



# PRESENTATION OF INTANGIBLES

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## Presentation of Intangible Assets

### Income Statement

Companies should report

- ◆ amortization expense and
- ◆ impairment losses and reversals

for intangible assets other than goodwill separately in net income (usually in the operating section).

Notes to the financial statements should include the amortization expense for each type of asset.

# PRESENTATION OF INTANGIBLES

## Presentation of Intangible Assets

**ILLUSTRATION 12-15**  
Nestlé's Intangible Asset  
Disclosures



**Nestlé**  
(CHF 000,000)

**INCOME STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2012**

Amortization expense	439
Impairments of goodwill	14

**BALANCE SHEET  
AT 31 DECEMBER 2012**

Goodwill (note 14)	32,615
Intangible assets	13,643

# PRESENTATION OF INTANGIBLES

## Presentation of Research and Development Costs

Companies should disclose the total R&D costs charged to expense each period.

**ILLUSTRATION 12-16**  
R&D Reporting



### **GlaxoSmithKline**

(000,000)

**31 December 2012**

Turnover	£26,431
Cost of Sales	(7,894)
Gross Profit	<u>18,537</u>
Selling, General, and Administrative	(8,739)
<b>Research and Development</b>	<b>(3,968)</b>
Other Operating Income	<u>1,562</u>
Operating Profit	<u><u>£ 7,392</u></u>



## **Relevant Facts**

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Following are the key similarities and differences between U.S. GAAP and IFRS related to intangible assets.

### **Similarities**

- Like U.S. GAAP, under IFRS intangible assets (1) lack physical substance and (2) are not financial instruments. In addition, under IFRS an intangible asset is identifiable. To be identifiable, an intangible asset must either be separable from the company (can be sold or transferred) or it arises from a contractual or legal right from which economic benefits will flow to the company. Fair value is used as the measurement basis for intangible assets under IFRS if it is more clearly evident.



# GLOBAL ACCOUNTING INSIGHTS

## Relevant Facts

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### Similarities

- With the issuance of a recently converged statement on business combinations (IFRS 3 and SFAS No. 141—Revised), IFRS and U.S. GAAP are very similar for intangibles acquired in a business combination. That is, companies recognize an intangible asset separately from goodwill if the intangible represents contractual or legal rights or is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged. In addition, under both U.S. GAAP and IFRS, companies recognize acquired in-process research and development (IPR&D) as a separate intangible asset if it meets the definition of an intangible asset and its fair value can be measured reliably.



## **Relevant Facts**

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### **Similarities**

- As in U.S. GAAP, under IFRS the costs associated with research and development are segregated into the two components. Costs in the research phase are always expensed under both IFRS and U.S. GAAP.

### **Differences**

- IFRS permits revaluation on limited-life intangible assets. Revaluations are not permitted for goodwill; revaluation of other indefinite-life intangible assets are rare because revaluations are not allowed unless there is an active market for the intangible asset.



## Relevant Facts

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### Differences

- IFRS permits some capitalization of internally generated intangible assets (e.g., brand value) if it is probable there will be a future benefit and the amount can be reliably measured. U.S. GAAP requires expensing of all costs associated with internally generated intangibles.
- IFRS requires an impairment test at each reporting date for long-lived assets and intangibles, and records an impairment if the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value-in-use. **Value-in-use** is the future cash flows to be derived from the particular asset, discounted to present value. Under U.S. GAAP, impairment loss is measured as the excess of the carrying amount over the asset's fair value.



## **Relevant Facts**

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### **Differences**

- U.S. GAAP gives companies the option to perform a qualitative assessment to determine whether it is more likely than not (i.e., a likelihood of more than 50 percent) that an indefinite-life intangible asset (including goodwill) is impaired. If the qualitative assessment indicates that the fair value of the reporting unit is more likely than not to be greater than the carrying value (i.e., the asset is not impaired), the company need not continue with the fair value test.





## Relevant Facts

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### Differences

- IFRS allows reversal of impairment losses when there has been a change in economic conditions or in the expected use of limited-life intangibles and indefinite-life intangibles other than goodwill. Under U.S. GAAP, impairment losses cannot be reversed for assets to be held and used; the impairment loss results in a new cost basis for the asset. IFRS and U.S. GAAP are similar in the accounting for impairments of assets held for disposal.
- Under IFRS, costs in the development phase of a research and development project are capitalized once technological feasibility (referred to as economic viability) is achieved. Under U.S. GAAP, all development costs are expensed as incurred.



# GLOBAL ACCOUNTING INSIGHTS

## About The Numbers

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To illustrate the effect of differences in the accounting for brands, consider the following disclosure by **GlaxoSmithKline** (GBR) in a recent annual report. Note that GlaxoSmithKline would report lower income by £1.3 billion if it accounted for its brands under U.S. GAAP.

### Notes to the Financial Statements

#### Intangible assets (in part):

The following table sets out the IFRS to U.S. GAAP adjustments required to the IFRS income statement for amortisation of brands:

<u>Income Statement</u>	
	<u>(£ million)</u>
Amortisation charge under IFRS	(139)
Amortisation charge under US GAAP	<u>1,454</u>
IFRS to U.S. GAAP adjustment	<u><u>1,315</u></u>



# GLOBAL ACCOUNTING INSIGHTS

## **On the Horizon**

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The IASB has identified a project, in a very preliminary stage, which would consider expanded recognition of internally generated intangible assets. As indicated, IFRS permits more recognition of intangibles compared to U.S. GAAP. Thus, it will be challenging to develop converged standards for intangible assets, given the long-standing prohibition on capitalizing internally generated intangible assets and research and development in U.S. GAAP. Learn more about the timeline for the intangible asset project at the IASB website: <http://www.ifrs.org/Current-Projects/IASB-Projects/Intangible-Assets/Pages/Intangible-Assets.aspx>.

# COPYRIGHT

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