CHAPTER 5

ACCOUNTING FOR INTANGIBLES—THE GLOBAL SCENE

➢ Goodwill

➢ Research and Development

➢ Brand

➢ Human Capital
The objective of this chapter is to study the accounting practices followed in ‘significant’ countries in respect of intangible assets. In the last chapter (Chapter-4), diversity regarding the requirements of accounting for intangible assets among those countries has been highlighted. This chapter examines how the various companies in those countries are implementing the rules regarding accounting for intangibles in actual practice and how they are disclosing their accounting policies regarding this contentious issue. For this purpose four important intangible assets namely goodwill, research and development, brand and human capital have been chosen.

**Goodwill**

As regarding inherent goodwill of a firm, there is complete harmonisation of accounting practices all over world. We have not come across any company capitalizing inherent goodwill. This is in conformity with the legal requirement. Purchased goodwill is almost universally recognised as asset also. However, in some countries, where immediate write-off of purchased goodwill is permissible, most companies follow the policy of immediate write-off. For example almost 90% of Dutch companies write-off goodwill immediately upon its acquisition (Roberts, Weetman and Gordon, 2002). Prior to the introduction of FRS10 in UK in 1997, most British companies also used to write-off goodwill against reserves taking the advantage of the flexibility granted in the then SSAP-22. Barring these cases, most of the companies in different countries amortise purchased goodwill over a period of time usually varying from 5 to 20 years. In countries like Canada, France etc., companies are found to amortise goodwill over a period as long as 40 years as permitted by their GAAP. In some rare cases where amortisation is not done; it is subjected to annual impairment test. Many American companies like Coca-Cola used to amortise their goodwill over a period not exceeding 40 years as permitted by the APB Opinion No. 17. The new American GAAP on intangibles SFAS 142 that has become effective from 15 December 2001, has, however, prohibited amortization of goodwill. It has now to be subjected to annual impairment test.

**Extract 1: Kingfisher, UK, annual report (2001)**

Intangible assets, which comprise goodwill, arising on acquisition and acquired licences and copyrights, are stated at cost less depreciation.
Goodwill arising on all acquisitions prior to 31st January 1998 remains eliminated against reserve. This goodwill is charged in the profit and loss account on subsequent disposal of the business to which it relates. Purchased goodwill arising on acquisition after 31 January 1998 is treated as an asset on the balance sheet. Where goodwill is regarded, as having an indefinite life it is not amortised. The estimated useful economic life is regarded as indefinite where goodwill is capable of continued measurement and durability of the acquired business can be demonstrated. Where goodwill is not amortised, an annual impairment review is performed and any impairment will be charged to profit and loss account.

In estimating the useful economic life of goodwill arising on the acquisition of a business, account has been taken of the nature of the business acquired, the stability of the industry, the extent of continuing barriers to market entry and the expected future impact of competition. With the exception of BUT S.A., all acquisitions since 31 January 1998 are considered by the directors to have an estimated useful economic life of 20 years.

Goodwill arising on the acquisition of shares in BUT S.A. .......... is not amortised...... instead annual impairment test is undertaken and any impairment that is identified will be charged to the profit and loss account. ......

Goodwill arising on purchase of pharmacy businesses is amortised over a useful economic life of 20 years. Acquired licences and copyrights are amortised over the period of the underlying legal agreements, which do not exceed 20 years.

Extract 2: Hoechst, Germany, annual report, 1997

Goodwill related to acquired business or assets is capitalised and amortised on a straight-line basis over its expected useful life. In accordance with IAS 22, goodwill is amortised over a period of 5 years, unless a longer period, not exceeding 20 years, can be justified.

Extract 3: Unisor, France, annual report, 1997

Goodwill acquired in business combination is amortised over its estimated useful life (usually between 2 and 20 years).

Extract 4: Pinault-printemps-Redoute Group, France, annual report, 2000

Goodwill is generally amortised on a straight-line basis over 40 years, except in cases where a shorter period is considered more appropriate based on the assumptions used and the objectives set at the time of acquisition of the shares.

Extract 5: Novartis, Switzerland, annual report, 1997

Goodwill, which is denominated in the local currency of the related acquisition, is amortised to income on a straight-line basis over its useful life. The amortisation period is determined at the date of acquisition, based upon the particular circumstances, and ranges from 5 to 20 years. Goodwill relating to acquisition arising prior to 1 January 1995 has been fully written off against reserves.

Extract 6: Nokia, Finland, annual report, 1997

Goodwill is amortised on a straight-line basis over its expected useful life. Useful lives vary between two and five years depending upon the nature of the acquisition, unless a longer period not exceeding 20 years can be
justified. Expected useful lives are reviewed at each balance sheet date and where these differ significantly
from previous estimates, amortisation periods are changed accordingly.

**Research and Development**

As regards accounting for research and development costs, there is significant
difference among countries as we have seen in the last chapter. In some countries like
the USA, Australia, Germany, Japan etc. there is complete prohibition of capitalisation
of R&D costs. In most other countries, while capitalisation of research costs is
prohibited, development costs that meet certain conditions are allowed to be
capitalised. IAS 38 has also taken this position; development costs that pass certain
specified tests should be capitalised. However there is a great deal of divergence
between theory and practice. The universal practice is to charge R&D costs in the year
in which they are incurred. Therefore, the provision of IAS 38 which requires
capitalisation of development costs that pass the stated tests, is largely ignored and
most organisations act as if development costs fail to meet the tests as set out in IAS
38.

The present practice is illustrated by mentioning the accounting policies of some
world renowned pharmaceutical companies which spend enormous sums on R&D.
Obviously these R&D activities in many cases lead to invention of new drugs which
generate a substantial amount of revenue to the firm. However, without exception
these firms charge R&D costs to profit in the year in which they are incurred, except
when the expenditure results in some tangible fixed assets

**Extract 1:** Roche, Switzerland, annual report, 1999

Research costs are charged against income as incurred with the exception of buildings and major items of
equipment, which are capitalised and depreciated. Development costs are also charged against income as
incurred since in the opinion of management the criteria for their recognition as an asset are not currently being
met.

**Extract 2:** Hoechst, Germany, annual report, 1997

In accordance with IAS 9 research costs are generally expensed in the period in which they are incurred.
Development costs are also expensed when incurred since the requirements of IAS 9 for the recognition of
development costs as an asset are generally not met due to the uncertainty of the future economic benefit.
Brands

Brands names, such as Coca-Cola, Microsoft etc., are the most valuable assets owned by the companies. Very often the values of brand names constitute a lion’s share in the market values of the firms. However there is significant difference throughout the world with regard to accounting for this asset, particularly when it is internally generated. The GAAP of most of the countries have permitted recognition of purchased brand. Many countries have permitted recognition of internally generated brand. However, countries such as Japan, India, USA, Germany and the supra-national accounting organisation IASC have prohibited recognition of this asset when it is internally generated. In fact USA and Germany have prohibited recognition of any kind of self-generated intangibles. So some of the most valuable American brands like Coca-Cola ($72.5 billion), Microsoft ($70.2 billion), IBM ($53.2 billion), Intel ($39.0 billion), General Electric ($38.1 billion), Ford ($36.4 billion), Marlboro ($27.9 billion) etc., do not appear in the balance sheets of the respective companies. However many American companies have been found to have capitalised acquired brands as permitted by the US GAAP. For example, the 1999 annual report of Philip Morris, which owns the famous marlboro brand, states in the accounting policy that ‘goodwill and other intangible assets substantially comprise brand names purchased through acquisition which are amortised on the straight-line method over 40 years...’. The notes to the balance sheet of Coca-Cola in 1996 containing goodwill and other intangible assets $753 m, stated that ‘goodwill and other intangible assets are stated on the basis of cost and are amortized, principally on a straight-line basis, over the estimated future periods to be benefitted (not exceeding 40 years). Goodwill and other intangible assets are periodically reviewed for impairment based on an assessment of future operations to ensure they are appropriately valued.’ The revised US GAAP has however dispensed with the requirement of amortisation of goodwill.

Although the German GAAP has permitted recognition of acquired brand, none of the companies in that country have been found to have included brands as assets in the balance sheet (Flower, 2002).

Many French companies have been found to have capitalised internally generated brand as permitted by the French GAAP. This asset is mostly kept in the balance sheet as permanent asset and when its value is permanently impaired, an allowance is made
through the profit and loss account. For example, the note to the balance sheet in the annual report 1999 of the Danone Group states ‘the brands which have been separately identified are only premium brands, with a value that is substantial and considered to be of a long-term nature, sustained by advertising expenses. The valuation of these brands is determined with the assistance of specialized consultants, taking into account various factors including brand recognition and earnings contribution. These brands, which are legally protected, are not amortised. In the event that the recorded value of a brand becomes permanently impaired, an allowance would be recorded via income. Purchased goodwill, licenses, patents and leasehold rights are recorded at cost and they are amortised on a straight-line basis over their estimated useful lives, not exceeding forty years’.

The UK companies were the pathfinders in reporting internally generated brands in the balance sheet. In the late 1980s a number of British enterprises were found to have included the internally generated brands in their balance sheets. For example Rank Hovis McDougall showed the internally generated brand as assets in its balance sheet. The accounting policy of the company in this regard stated in the annual report 1990 that Intangibles assets – Brands, both acquired and created within the group – are included at ‘current costs’. Such cost, which is reviewed annually, is not subject to amortisation.

The main reason for this development was the fear of take-over. It was felt that omission of brand from the balance sheet would seriously understate the net worth of the company and make the company vulnerable to corporate predation. In 1988 the Swiss company, Nestle took over the British company, Rowntree. It was widely believed that as the brand names of Rowntree such as Kit-Kat, were not reported as assets in Rowntree’s balance sheet, its shareholders undervalued their shares on the stock exchange and this gave the opportunity to Nestle to take over Rowntree comfortably. So many British companies determined not to be the next take-over victims, resolved to put their brands as assets in their balance sheet.

The British standard-setting body was very much disturbed with this development and began to doubt the reliability of the value of this asset. This asset was mostly valued on the basis of its estimated future earning. But nothing was done and the practice was largely unregulated for a long time. Lastly, in 1997, the ASB issued FRS 10 which
permits reporting of internally generated brand in the balance sheet only when it has got readily ascertainable market value. Since then no major British company has reported the internally generated brand as asset in the balance sheet. In fact, the cases of reporting even the acquired brand in the balance sheets are also now very few and far between. According to a survey by Company Reporting (1998), only 8 out of 448 British companies reported this asset in the balance sheet (Flower, 2002). One of these is Cadbury Schweppers, the well known chocolate and soft drinks manufacturer which described its accounting policy in the annual report 1998 in this regard in the following terms: Intangibles represent significant owned brands acquired since 1985 valued at historical costs. No amortization is charged as the annual results reflect significant expenditure in support of these brands. For the 1998 financial statements, the group has adopted FRS 10 ....As permitted by FRS 10 the Group will continue its policy of capitalising acquired intangible assets (brands) and reviewing the carrying values on an annual basis for any impairment in value.

Human capital

The GAAP of almost all countries has not permitted capitalisation of employee-related costs. So intangible assets relating to employees are not generally found in the balance sheet. Many companies in different countries, however, disclose the value of human assets outside the balance sheet. The US Company R. G. Barry Corporation was the pioneer in this regard. It started valuing its human resources right from 1969.

However professional sports clubs generally capitalise transfer fees as intangible assets in the balance sheet. The accounting policy of one of these clubs, Tottenham Hotspur PLC, the famous British football club, states in this regard in the annual report of 1996 that 'the cost of players’ registrations are capitalised and amortized over the period of the respective players’ contracts.