Part 3

Chapter 11
Intangible assets

Question	Key issues
11.1	Short questions relating to: identity, control and measurement
11.2	Treatment of license
11.3	Treatment of research and development costs
11.4	Trademark – definition and recognition criteria, initial recognition, subsequent measurement and subsequent valuation
11.5	Research costs compared to development costs
11.6	Brand name
11.7	Measurement of purchased brand name, limited legal life renewable at insignificant cost
11.8	Measurement of purchased brand name, limited legal life renewable at significant cost
11.9	Journal entries
11.10	Purchased compared to internally generated brand, research and development costs, useful life of patent
11.11	Recognition and measurement of catalogues

Question 11.1

The following scenarios are all *un*related.

Part A

Apple Limited is a successful engineering business. Over the past number of years, the company has achieved a market share for its products of 30%. At a recent board meeting, the directors suggested recognising an intangible asset for this market share.

Required:

To briefly discuss whether the market share can be recognized as an intangible asset in terms of IAS 38, *Intangible Assets.*

A discussion of the recognition criteria is not required.

Part B

Banana Limited is a company in the IT industry. The success of the company is built around software which it has developed internally and for which a patent is registered *as well as* the skills of the staff that operate the software. Staff is required to give one month's notice of their resignation.

Required:

To briefly discuss whether the patent *and* the staff skills can be recognized as an intangible asset in terms of IAS 38, *Intangible Assets.*

A discussion of the identifiability criteria is not required.

Part C

Carrot Limited manages and operates toll roads on major national routes throughout the country. The company purchased a license to operate a toll road in the Eastern Cape seventeen years ago for an amount of C 10,000,000. It was expected that the toll road would be in use for twenty years and the economic benefits will flow to the entity *evenly* over the twenty year period. The estimated toll road usage is 1,000,000 cars per year. At the time, there were no plans to construct alternative routes in the area. There is no active market for toll road licenses.

During the current year, the government announced plans, and construction began on a bridge in the area that would significantly reduce usage of the toll road. The directors estimated that the economic benefits flowing to the entity would *decrease* each year over the remaining three years. The estimated toll road usage is expected to drop to 800 000 cars, 600 000 cars and 400 000 cars, respectively, over the remaining three years of the license.

The right to operate the toll road was correctly recognized as an intangible asset upon purchase seventeen years ago.

Required:

To discuss the accounting issues relating to the *measurement* of the license for the toll road over its economic life.

Question 11.2

Hurtigruten Limited is a small company involved in the fishing industry. It operates a number of fishing boats and fishes mainly for tuna. The fish is processed and canned in its factory and the canned tuna is supplied to supermarkets around the country.

On 2 January 20X6 the company acquired a fishing licence at a cost of C600 000. The license has a legal life of four years with no residual value. The licence grants Hurtigruten Limited the right to fish for tuna in a demarcated area off the Western Cape coast. No other fishing company may fish for tuna in this area during the term of the licence.

The financial director, a retired accountant, expensed the cost of the fishing licence on acquisition. The managing director (who has taken a keen interest in IFRS developments) has queried the expensing of the fishing licence:

No entries have been made in the accounting records relating to the fishing license during the current year.

Required:

Discuss the recognition, measurement and disclosure of the fishing license in the financial statements of Hurtigren Limited at 31 December 20X6, in terms of International Financial Reporting Standards.

Question 11.3

Quencher Limited's business involves the bottling and distribution of a wide variety of carbonated soft drinks. Some drinks are developed internally, whilst other brands are purchased. The following information is relevant to the business for the year ended 30 May 20X5.

N-Gee:

- On 1 April 20X5, Quencher acquired the well known brand, N-Gee for an amount of C2 500 000, which was paid in full at that date.
- In addition to this, an amount of C175 000 was spent on legal fees to secure the right to use this brand. The legal fees were paid on 31 April 20X5.
- Due to the fact that Quencher's staff had never previously been exposed to N-Gee, extensive training (by the staff at the company from whom the N-Gee brand had been purchased) took place during the month of April 20X5. The total cost of this training amounted to C200 000.
- Sales of N-Gee drinks commenced on 15 May 20X5.
- The N-Gee brand has an estimated useful life of fifteen years.

Fliptop:

Fliptop is a revolutionary type of can which has been developed internally by Quencher over the past two years. The can has a re-sealable top which allows the can to be sealed after opening to prevent the gas escaping. In January 20X4 the idea for this new product was launched, and a loan of C5million was obtained from Borrow Bank in order to finance this project.

Question 11.4

You are the auditor of a number of small companies and have been asked to advise Food Limited on how to deal with the following transaction.

Food Limited is a fast-food company. In order to facilitate expansion, Food Limited purchased 100% of another successful food company. The purchase negotiations were settled during the year as follows:

- The total purchase price for the business amounted to C40 000.
- The net tangible assets acquired were stipulated in the purchase agreement at their fair value of C19 500.

Although the purchase agreement stipulated that Food Limited also acquired the legal rights to a trademark for a period of 22 years, no value was attached thereto. The reason is that the trademark was internally generated by the seller and was thus not recognised in the seller's financial statements, despite it having been a most profitable trademark for many years.

- **Initial Recognition:** Food Limited intends to record the purchased trademark in its financial statements at C20 500, calculated as follows:

	C
Purchase price	40 000
Less net tangible assets	19 500
Trademark	20 500

- **Amortisation:** Food Limited is unsure whether or not to amortise the trademark since it believes that the trademark is so profitable that it has an indefinite useful life.
- **Impairment testing and revaluing to fair values:** Food Limited intends to revalue the trademark annually using the revaluation model.

Required:

Discuss the proposed accounting treatment of the trademark in the financial statements of Foods Limited. Your discussion should be set out under the following sub-headings:

a) Definitions and recognition criteria relevant to the acquisition of the trademark

b) Initial recognition

c) Amortisation

d) Impairment testing and revaluing to fair values

Question 11.5

The accounting treatment of research costs differs from that of development costs.

Required

Discuss, with reference to both the Framework and IAS 38, Intangible Assets how and why the accounting treatment of research costs differs from that of development costs

A discussion of the circumstances under which research and development may be capitalised, should be included in your discussion.

Question 11.6

Yoyo has, for many years, manufactured a yoghurt drink called 'Yog-Nog'. This brand name was originally acquired 10 years ago from a competitor company. The cost of this acquisition came to C800 000, which was duly capitalised. No amortisation had been processed against this brand name since the brand was already 80 years old at the time of acquisition and, at that time, there was no indication that demand for this drink was diminishing.

Sales of Yog-Nog have, in recent times, been falling. The marketing department, after much research into the related consumer behaviour, suggested that the fall in sales was related to the outdated brand name of the drink. The suggestion was accepted and the drink was re-launched as 'Yogi-Yippi' during late December 20X10. The cost of re-launching the drink came to C450 000 and was capitalised as a Yogi-Yippi Brand name since it was expected that sales would now improve.

The previous brand name, 'Yog-Nog', with a carrying amount of C800 000, was expensed in full in the current year ended 31st December 20X10.

Required:

Critically analyse the above issue, explaining whether the treatment is correct or incorrect and justifying your advice with reference to International Financial Reporting Standards.

Question 11.7

Mince Limited is a company manufacturing and retailing food products. The current financial year ends on 31 December 20X3. The company owns one brand name, 'pie', shown in the balance sheet at its carrying amount of C300 000. The right to manufacture under this brand name for a period of 30 years was purchased on 1 January 20X0 for C300 000. These rights may be renewed at a cost of C10 000 (an immaterial cost to the company). The brand name is considered to have an indefinite useful life. Mince Limited intends not to calculate the recoverable amount of this brand at 31 December 20X3 since a detailed calculation of the recoverable amount was done at the end of 20X2 on which date there was an immaterial difference between the recoverable amount and carrying amount and there appears to be no indication of an impairment after having performed the indicator review.

Required:

Critically analyse the measurement of 'Pie' in the financial statements of Mince Limited.

Question 11.8

Goo Limited owns a brand 'gobblers', to which legal rights for a 25-year period were purchased on 1 January 20X1 for C500 000, renewable at a further cost of C1 000 000. The 'gobblers' brand is reflected in the balance sheet at its carrying amount of C500 000.

A review of past figures makes it clear that the profits from the brand 'gobblers' are diminishing dramatically. At the time of the purchase, it was estimated that this brand would render annual profits of C80 000 and at that time, it appeared so successful that its useful life appeared to be indefinite. The budgeted profit figures presented at the end of the 20X2 financial period indicated a slight (immaterial) dip in future expected profits, but taken together with the latest budgeted profits presented at a directors meeting on 29 December 20X3, makes it clear that these annual profits of C80 000 are on a downward spiral.

These latest budgeted figures show a total estimated net cash inflow of C70 000 over the remaining legal life. Goo Limited has the option to dispose of this brand to a local businessman who has recently (December 20X3) offered to purchase it for C220 000. The only selling costs that are expected will be C2 000 in legal fees. The current financial year ends on 31 December 20X3.

Required:

Critically analyse the measurement of the 'gobblers' brand in the financial statements of Goo Limited.

Question 11.9

Ozone Limited has been working on a project to develop a chemical that can be released into the atmosphere to break the greenhouse gases into gases that are less damaging to the environment.

The accountant is aware that C1 500 000 has been incurred, and paid for, between 20X1 and 20X4 but he has been told by the auditors that the manner in which he has accounted for these costs is incorrect and that given the significant amounts involved, that they would have to qualify the report if it was not corrected. The auditors had already indicated he should correct this a month ago but he had not done so, since he had lost the original detail provided to him by the chief scientist.

Question 11.10

Beehive Limited is a company that owns a number of intangible assets. A list of the intangible assets owned by Beehive Limited together with some detail is provided below:

- A brand called 'Orange blossom'. This brand was acquired on 1 April 20X6 for C2 000 000. The life of the 'Orange blossom' brand is expected to be ten years. There is no active market for this brand.

- A brand called 'Infused ginger'. This brand has been developed by Beehive Limited during 20X6 at a cost of C300 000 (incurred in May 20X6). The life of the 'Infused ginger' brand is expected to be ten years. There is no active market for this brand.

- A lollipop that can be used as a flashlight in the dark is currently being developed. The initial research into the technical feasibility of this product and its potential market cost C800 000 during 20X4. Development began on 1 March 20X4 and has cost Beehive Limited a total of C34 000 000 to 31 December 20X6. All criteria were met for capitalization of development costs in 20X4. Throughout 20X5, cash flow problems resulted in Beehive Limited being unsure of their ability to continue the development of this prototype. The cash flow problems were resolved in early January 20X6 with the securing of a loan liability from Dodge Bank. Development costs were incurred evenly over the three years.

- The right to manufacture under a patent for a period of five years was purchased on 1 September 20X6 for C5 000 000. The patent has an expected life of twenty years. This patent may be renewed for a further period of three years for a sum of C30 000.

Required:

a) *Briefly compare* aspects of the recognition and measurement of each of the two brands, Orange blossom and Infused ginger. Your answer should consider:

   i) Recognition: Infused ginger Brand versus Orange blossom Brand
   ii) Measurement: residual value for purposes of amortising the Infused ginger Brand and Orange blossom Brand
   iii) Measurement models: Infused ginger Brand versus Orange blossom Brand
   iv) Journal entries: show the journal entries (relating to both brands) that would have been processed during 20X6

b) *Briefly discuss* aspects of the recognition and measurement of the research and development of the lollipop flashlight in the financial statements of Beehive Limited. Your discussion should consider:

   i) Recognition: research versus development of the flashlight lollipop in each of its years ended 31 December 20X4, 20X5 and 20X6
   ii) Measurement: amortization and impairment testing of research versus development of the flashlight lollipop

c) *Discuss* the determination of useful life for the purpose of amortising the patent in the financial statements of Beehive Limited for the year ended 31 December 20X6.

Question 11.11

Part A

Alastair's Natural Remedies Limited is a retailer of health products, including vitamins and supplements. The company orders 12 000 catalogues to advertise its products. These catalogues are receive from the printers on 15 September 20X8 and are to be distributed to customers evenly from 1 September 20X8 to 15 December 20X8, as a promotional activity for the holiday season.

The catalogues have a cost of C2 each. The amount owing to the printer will be settled in 30 days from delivery of the catalogues.

Alastair's Natural Remedies Limited has a financial year end of 30 September.

Required:

Discuss the recognition and measurement of the cost of the catalogues in the financial statements of Alastair's Natural Remedies for the year ended 30 September 20X8.

Part B

Same information as in Part A, except:

- the amount owing to the printer has been paid in advance on 15 August 20X8, when the order was placed.
- Alastair's Natural Remedies Limited has a financial year end of 30 August.

Required:

Discuss the recognition and measurement of the cost of the catalogues in the financial statements of Alastair's Natural Remedies for the year ended 31 August 20X8, in terms of IAS 38, Intangible Assets.