Putting intangible assets on the balance sheet

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When a company buys another company or business at a premium, historically the premium has been classed as goodwill, put on the balance sheet and amortised over its expected useful life.

What is goodwill?

Accounting standards talk about the definition – the excess of the cost of the business acquired over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. If that's a bit of a mouthful let's think of it as the worth to the acquirer of the business over and above the actual physical assets and liabilities acquired.

Is that it?

For long enough it has been that simple! But in most cases calling it goodwill does not really reflect the full reality of the acquisition. For many acquirers, that extra worth could and should be thought of as distinct non physical assets and if you have paid for them why not value them and put them on the balance sheet – let the world know what that extra worth really is!

Are you allowed to do that?

Not only are you allowed but UK GAAP and International GAAP (IFRS) expects it. The real difference is that under IFRS the emphasis is much stronger. Under IFRS, specifically International Accounting Standard 38, an intangible asset is an identifiable non monetary asset without physical substance. To be identifiable it must be capable of being sold separately from the entity or arise from contractual or other legal rights.

What does that mean?

IAS 38 helpfully sets out example categories that give an idea of what we are talking about:

- marketing related such as trademarks, trade names and non competition agreements
- customer related such as customer lists, customer contracts or order or production backlogs
- artistic related such as books, magazines, pictures and photographs
- contract based such as licensing and royalty agreements, service and supply agreements or franchise agreements
- technology based such as patented or unpatented technology, computer software, databases or secret formulas

There are other conditions that have to be met but these are not usually over problematic. If the intangible asset will bring the acquirer economic benefits, is controlled by the acquirer, is separable and its value can be adequately measured then it can be valued and put on the balance sheet.

Sounds complicated

Well it's definitely not straightforward but it can be done with a bit of effort and the application of logic supported by appropriate investigation, calculation and conclusions. And of course it really should be done because the chances are as an acquirer, you have, as part of the acquisition rationale identified these intangibles in some shape or form as being why the purchase price is higher than the value of the physical bits and pieces being acquired. It can be thought of as a tough job, but it has to be done as the value of businesses has been and is shifting from the tangibles to the intangibles. Intangibles are the keys to shareholder value in a knowledge economy – and they are much better than a simple generic and undefined goodwill.

Do we need to amortise it?

Remember that goodwill needs to be amortised and so do other specific intangibles unless you can show they have an indefinite life. Where an indefinite life is asserted, IAS 38 requires an annual impairment review. In short intangible assets are normally no different to tangible assets and lose value over time.

In conclusion

If you have paid a purchase price for a business that represents more than just the physical assets and liabilities then identify them, value them and put them on the balance sheet. ■

Do you think your business has growth potential?

- Thinking of expanding overseas?
- Thinking of diversifying into new markets?
- Thinking of developing new products?
- Thinking of making a strategic acquisition?

IF YOU WANT TO ENERGISE YOUR BUSINESS STRATEGY – THINK OF US!

Contact Mike Brown or Douglas Martin on 01224 625111

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