FA 3.2

EXERCISE 12-3 (10-15 minutes)

(a)	Development phase activities	29,000
	Trademarks	17,500
	Total intangible assets	$46,500

(b) Excess of cost over fair value of net assets of acquired subsidiary – Goodwill, $81,000, should be shown as a separate line item on the balance sheet.

Discount on bonds payable, $23,000, should be reported net with the bonds payable in the long-term liabilities section.

Deposits with advertising agency for ads to promote goodwill of company, $8,000, should be reported either as an expense or as prepaid advertising in the current assets section. Advertising costs in general are expensed when incurred or when first used.

Cost of equipment acquired for research and development projects, $125,000, should be reported with property, plant, and equipment. Even if it was to be used only with a specific project, but would be used on it over a number of periods, it would still be capitalized and depreciated as a research expense over the period of use.

Costs of researching a secret formula for a product that is expected to be marketed for at least 20 years ($75,000) should be expensed as part of Research and Development Expense.

Development expenses are expensed unless all criteria for capitalization are met.

The payment for a favourable lease is a long-term prepayment and should be shown in the non-current assets section.

Organization costs of $34,000 are a period cost and expensed in the income statement.

EXERCISE 12-4 (15-20 minutes)

(a) At December 31,2012, Olympus should report the patent at $1,080,000 ($1,800,000 net of $720,000 accumulated amortization) on the balance sheet. The calculation of accumulated amortization is as follows.

Amortization for 2010 and 2011:	
($1,800,000/10) X 2	$360,000
2012 amortization:	
($1,800,000 – $360,000) ÷ (6–2)	360,000
Accumulated amortization, 12/31/12	$720,000

(b) Olympus should amortize the franchise over 25 years, the period of identifiable cash flows. Even though the franchise is perpetual the company believes it will generate future economic benefits for only 60 years. The amount of amortization on the franchise for the year ended December 31, 2012, is $26,000: ($650,000/25).

(c) $150,000 ($375,000 net of $225,000 accumulated amortization) would be reported as unamortized development costs at December 31, 2012.

Amortization for 2010, 2011, and 2012:	
($375,000/5) X 3	$225,000

EXERCISE 12-7 (10-15 minutes)

(a) **Variables to consider in determining the appropriate amortization period for a definite life intangible include:**

- **the legal life of the trade name (15 years in Canada) - the registration is renewable which could extend the legal life indefinitely;**
- **The expected use of the trade name by the company;**
- **The effects of demand, competition and other economic factors;**
- **The period over which there are benefits provided;**

(b) **2010 amortization: $45,000 ÷ 15 = $3,000.**
12/31/10 carrying amount: $45,000 – $3,000 = $42,000.

2011 amortization: ($42,000 + $24,300) ÷ 14 = $4,736.
12/31/11 carrying amount: $42,000 + $24,300 – $4,736 = $61,564.

(c) **2010 amortization: $45,000 ÷ 5 = $9,000.**
12/31/10 carrying amount: $45,000 – $9,000 = $36,000.

2011 amortization: ($36,000 + $24,300) ÷ 4 = $15,075.
12/31/11 carrying amount: $36,000 + $24,300 – $15,075 = $45,225.

(d) **If indefinite life:**

- **Do not amortize if determined to have an indefinite life.**
- **Indefinite does not mean infinite life. If classified as indefinite life, management should review to ensure that conditions and circumstances continue to support the indefinite life assessment. This assessment is required on an annual basis. If there is a change in the useful life assessed, it will be accounted for prospectively as a change in estimate.**

EXERCISE 12-9 (15-20 minutes)

(a) **Fiscal 2010: The $414,000 is a research and development cost that should be charged to R & D Expense and, if not separately disclosed in the income statement, the total cost of R & D should be separately disclosed in the notes to the financial statements. These costs are not eligible for capitalization since the required criteria for capitalization as internally generated assets are not met (i.e. 6 required criteria about the technical, financial and commercial feasibility of the project).**

Fiscal 2011:

(b)	**Research and Development Expense.......**	**80,000**	
	Cash, Accts. Payable, etc.		**80,000**
	(To record research and development expense)		
	Assuming the criteria are not fulfilled for the development phase		
	Patents...	**15,000**	
	Cash, Accts. Payable, etc.		**15,000**
	(To record legal and admin. costs incurred to obtain patent)		

Amortization Expense - Patents	3,000	
Accumulated Amortization –		
Patents		3,000
[To record one year's amort.		
expense ($15,000 ÷ 5 = $3,000)]		

Fiscal 2012:

Patents..	12,400	
Cash, Accts. Payable, etc.		12,400
(To record legal cost of		
successfully defending patent)		
Amortization Expense - Patents.....................	3,050	
Accumulated Amortization - Patents....		3,050
(To record one year's amortization		
expense:		

$1,500
1,550
$3,050

The cost of defending the patent is capitalized because the defence was successful and because it extended the useful life of the patent.

(d)

Pre Sept 2012:

Internally generated intangible assets are recognized only in limited circumstances, and projects may be quite far along in the development stage before all of the required criteria are met. As such, costs incurred before the future benefits are reasonably certain (i.e. the technical and/or financial feasibility are not established), must be expensed. The $123,000 must be expensed as it was incurred before the future benefits were reasonably certain (i.e. these expenditures helped establish the existence of future benefits).

Research and Development expense	**123,000**	
Cash, Accts. Payable, etc........................		**123,000**
(To record research and development costs)		

Post Sept 2012:

Costs incurred after the technological and financial feasibility are established are capitalized. Therefore, the $78,000 would be deferred as development costs.

Development Costs	**78,000**	
Cash, Accts. Payable, etc........................		**78,000**

(To record costs meeting the development phase criteria)

EXERCISE 12-18 (15-20 minutes)

Net assets of Athenian as reported		**$272,000**
Adjustments to fair value		
Increase in land value	**$40,000**	
Decrease in equipment value	**(12,000)**	**28,000**
Fair value of identifiable net assets		**300,000**
Fair value of consideration transferred		**382,000**
Amount of goodwill to be recorded		**$82,000**

The journal entry to record this transaction is as follows:

Cash	**118,000**	
Land	**110,000**	
Building	**244,000**	
Equipment	**173,000**	
Copyright	**98,000**	
Goodwill	**82,000**	
Accounts Payable		**92,000**
Long-term Notes Payable		**351,000**
Cash		**382,000**

In reality, only cash equal to the difference would change hands: 382,000 – 118,000 = 264,000

EXERCISE 12-20 (30-40 minutes)

(a) December 31, 2010

Loss on Impairment	44 million	
Goodwill		44 million

Carrying value (incl. goodwill)	390 million
Fair value of unit	<u>346 million</u>
	44 million

(a) A reversal of goodwill impairment is not permitted under PE GAAP

(b) Impairment under IFRS

Loss on Impairment of Goodwill	5 million	
Goodwill		5 million

Carrying value (incld goodwill)	390 million
Recoverable amount	<u>385(*) million</u>
	5 million

(*) Recoverable amount:

Higher of VIU of 385,000 and FV-SC of 341 (346-5)

(d)A reversal of goodwill impairment is not permitted under IFRS.

***EXERCISE 12-23 (10-15 minutes)**

(a)

Richmond's valuation of goodwill =	$\dfrac{\$175{,}000}{.15}$	**= $1,166,667**
Aswan Corporation's valuation of goodwill =		
4.56376* X $175,000		**= (798,658)**
Difference		**$368,009**

***Present value of annuity of 1 factor, 7 years @ 12%.**

(b) **Both the seller and the buyer are attempting to determine the present value of the goodwill, which consists of future receipts; the annual excess earnings. Because these future receipts are not contractual in nature, a considerable degree of uncertainty surrounds the measurement of them. While both parties agree on the amount of excess earnings during the prior six-year period, they disagree as to the certainty of the continuance of such excess earnings. As a result, differing risk factors and longevity factors are imputed with regard to the same base of $175,000 in their valuations of goodwill. The seller assumes a discount factor of 15% in perpetuity while the buyer assumes a risk factor of 12% for seven years.**

EXERCISE 12-10 (10-15 minutes)

(a)

Amortization of equipment acquired for use in research and development projects over the next 5 years ($240,000 ÷ 5)	$ 48,000
Materials consumed in research projects	61,000
Consulting fees paid to outsiders for research and development projects ($95,000 - $4,500)	90,500
Personnel costs of persons involved in research and development projects	108,000
Indirect costs reasonably allocable to research and development projects	25,000
Total to be expensed in 2010 for research and Development	$332,500

(b) Capitalization criteria as internally generated assets are met:

- Training costs relate to selling activities and should not be categorized as research and development activities. If these costs were associated with development activities after the capitalization criteria were met, they would not be capitalized because they are not direct costs of creating, producing and preparing the asset to be capable of operating in the manner intended by management. They are specifically excluded as capitalizable costs.

- **Under IFRS, borrowing costs that are directly attributable to the acquisition, construction or development of an intangible asset are capitalized once the required capitalization criteria are fulfilled.**

- **Under PE GAAP, borrowing costs directly attributable to the acquisition, construction or development of an intangible asset may be capitalized or expensed depending on the entity’s accounting policy for internally generated assets and the entity`s policy on capitalization of interest costs.**