

Getting a Grip on Accounting and Intellectual Property



Intellectual Property and Economic
Development Department

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The Main Take Away



While discussions on adequate accounting standards for IP continue, SMEs are best advised to develop a voluntary IP report which enhances their position in the market, facilitates access to funding & improves an SME's overall management



AGENDA

How Accounting meets IP

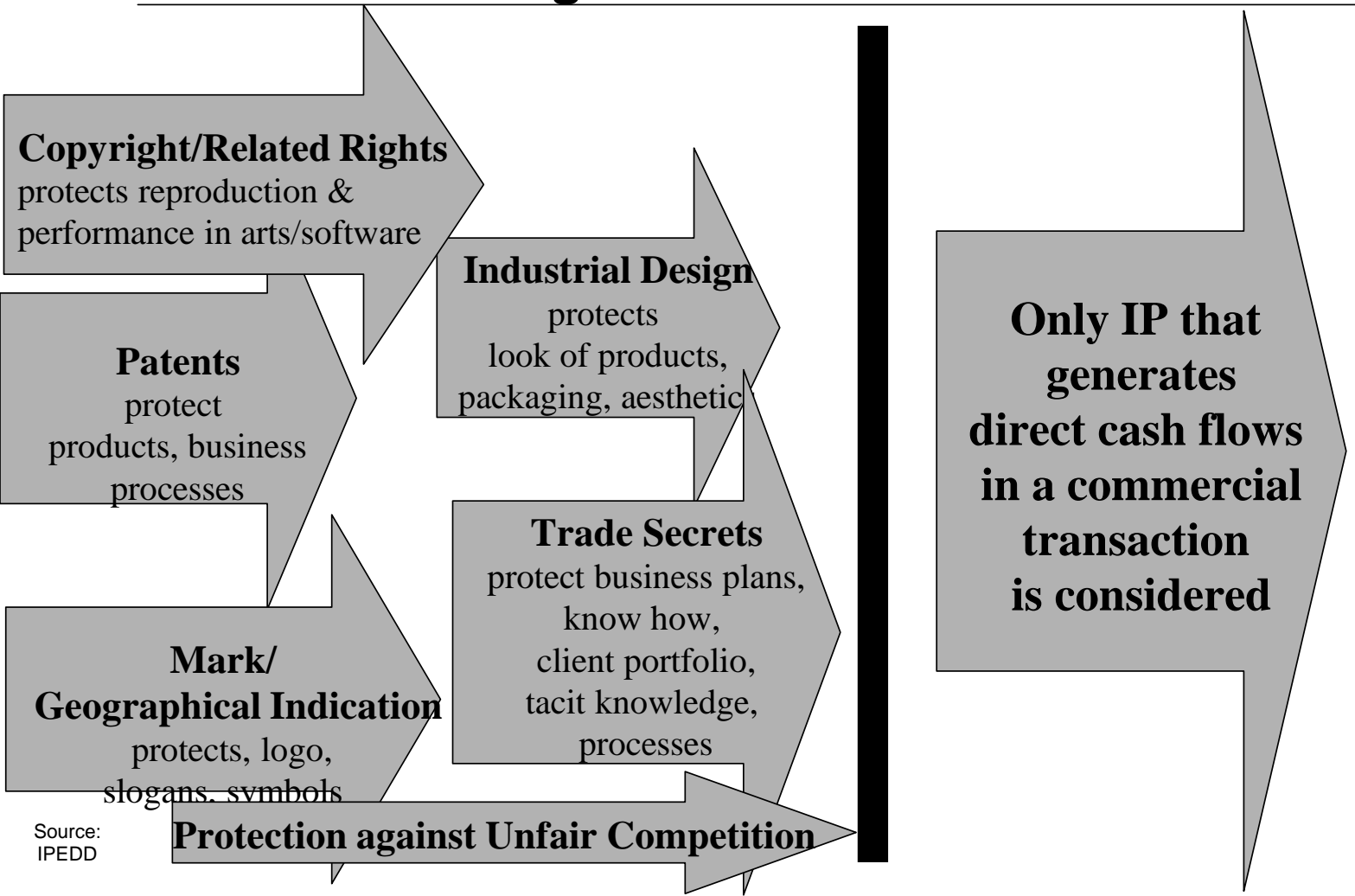
Accountants' initiatives to improve the reporting of IP

SMEs' opportunity to bridge information asymmetry



Chart 4

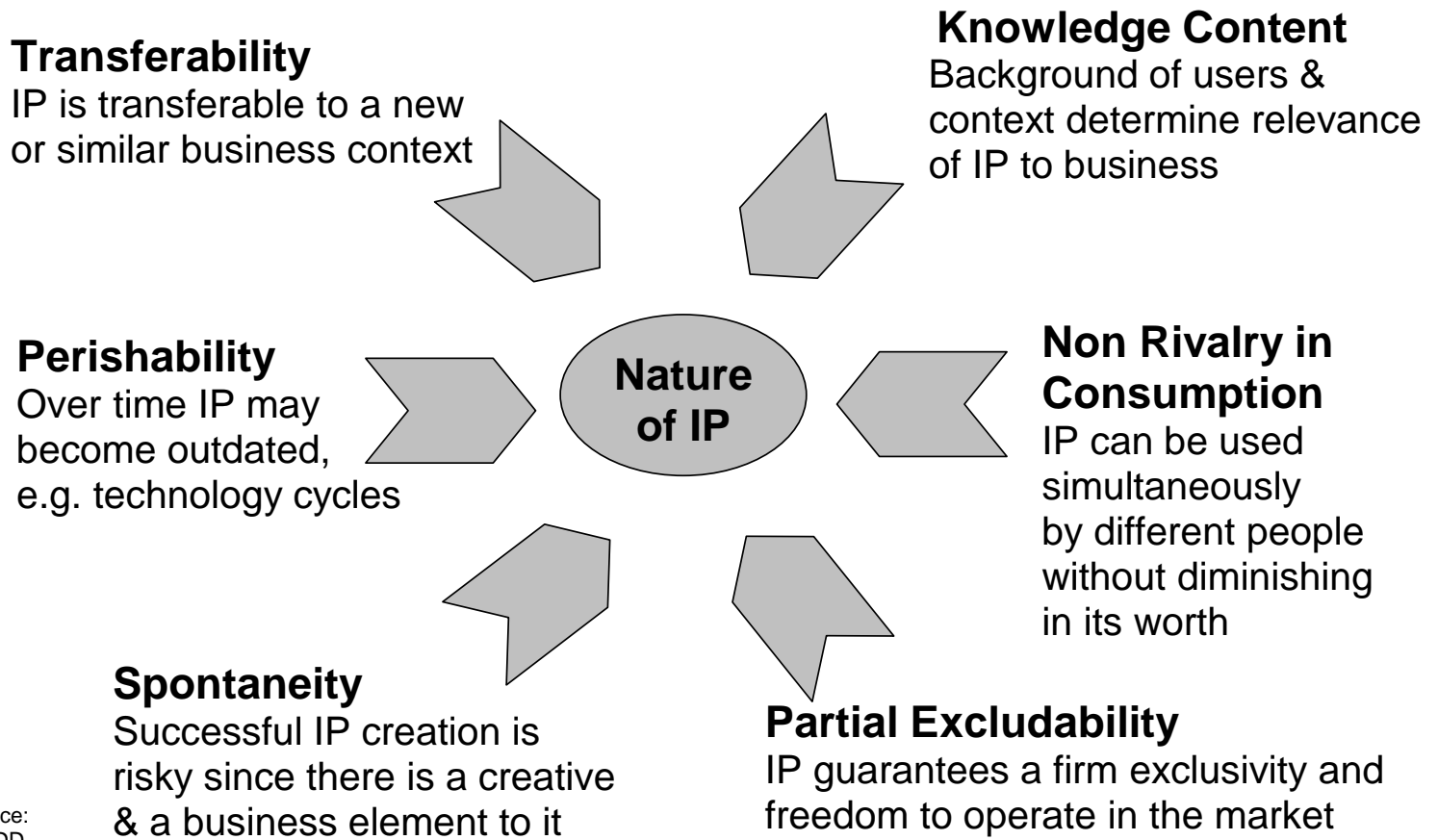
How Accounting meets IP



Source: IPEDD



IP is an intangible asset, ...





... which Accounting finds difficult to grasp

Rationale behind Accounting

- Historically evolved to report tangible assets/liabilities
- Quantitative stock of performance
- Documentation of past financial position
- Factual, precise, objective, comparable information
- Determines perception of a firm's management and other market participants



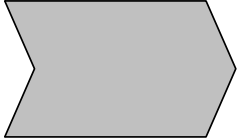

Impact on Type of Language developed for IP

- Silence about a lot of a firm's IP due to inherent definitions and assumptions in accounting
- Internally and externally generated IP is treated differently
- Goodwill



Chart 7

How Accounting Concepts Impact Business

Concept	Impact
<p>Internally Generated IP is immediately expensed, Acquired IP is valued at its acquisition cost, amortized or subject to an impairment test</p>	 <p>The same IP may be perceived to be worth nothing or 100 Mn \$</p>
<p>Fair value: “Amount at which an asset could be bought or sold in a current transaction between 2 willing parties, other than a liquidation.”</p>	 <p>Implies a benchmark, yet worth of IP depends also on context & background</p>
<p>Intangible Asset: “... identifiable, controlled by an enterprise as result of past events & should generate future economic benefits for the firm.”</p>	 <p>Much IP won't qualify since it has an indirect impact on cash flows</p>
<p>Goodwill: “price a market participant is ready to pay in excess of the value of a firm's tangible assets.”</p>	 <p>Difficult to make worth of IP explicit & compare Goodwill of different firms</p>

Source:
IPEDD



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Accountants recognize the Challenge

- **FASB & SEC recommend Voluntary IP Reports**

“Companies are encouraged to continue improving their business reporting & to experiment with types of information disclosed & the manner by which it is disclosed.”

- **US GAAP allows to account IP explicitly in M&A**

FAS 141 & 142 require to identify each single asset & determine its fair value

The amortization of Goodwill is replaced by an annual impairment tests

- **Basel Committee on Banking Supervision recognizes the inadequacy of “fair value” for financial assets**

“In the absence of active markets it will be difficult to obtain or calculate a reliable fair value for certain non-marketable financial instruments held at cost.”



Chart 10

Explicit IP accounting gains momentum

— Comparison of different Accounting Standards —

	German HGB	IAS/IFRS	US-GAAP
Recognition of IP	<ul style="list-style-type: none"> ·Forbidden: § 248/2 HGB ·Exception: acquired IP 	<ul style="list-style-type: none"> ·Recognition of IP if IAS criteria are met: IAS 38 	<ul style="list-style-type: none"> ·Recognition of IP: Novel approach under FAS 141 & 142
Acquired IP	<ul style="list-style-type: none"> ·Recognition of acquired IP: § 255/4 HGB 	<ul style="list-style-type: none"> ·Recognition of acquired IP if IAS criteria are met: IAS 38 	<ul style="list-style-type: none"> ·Purchase Price distributed across all items: FAS 141 ·Impairment Test of Goodwill: FAS 142
Internally Generated IP	<ul style="list-style-type: none"> ·Immediately expensed 	<ul style="list-style-type: none"> ·Immediately expensed 	<ul style="list-style-type: none"> ·Immediately expensed

Source: IPEDD

Trend towards the explicit recognition of IP increases



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Advantages of Reporting IP

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- Communicates the value of IP to investors
- Shows what IP the company owns
- Puts a value to the IP
- Explains how the IP relates to business segments

- Get information on how IP drives growth
- Receive adequate inputs for earnings/sales forecasts
- Can better estimate risks/revenues of an investment
- Can better understand the nature of a business
- Increases predictability while decreasing volatility

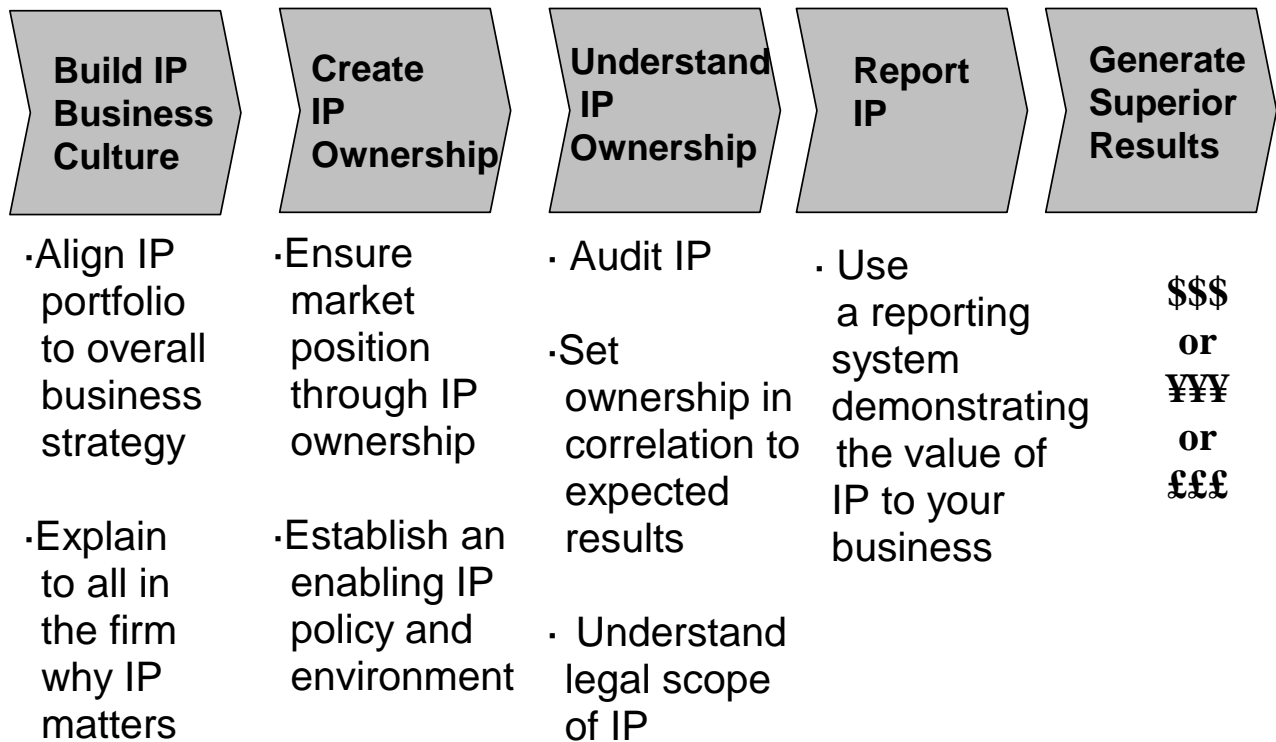
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Chart 13

The IP Reporting Process





Elements of an IP Report

· **Executive Summary**

How does IP relate to the bottom line of your business?

How do you make money and what role does the IP play in it?

· **Relate your income streams to IP**

What were the returns from IP protected business segments?

Does the IP help you to gain market share or profits?

· **Relate IP to your position in the Market**

How did IP give you an advantage over competitors?

Do you have freedom to operate & exclusivity in the market?

· **Demonstrate your managerial skills**

How determined are you to extract revenue from IP?

What experience do you have in managing IP?

· **Understand the legal scope of the IP rights**

What level of protection does your IP guarantee you?

Is there a risk that you infringe the IP of competitors or that competitors (legally) steal your IP?