Chapter 3.4.1 - Balance Sheets

*Please note that the case studies will no longer include answer keys as per the business department's request

Financial Statements

All businesses need to keep records of their financial statements. Whilst proper accounting allows managers to have better financial control and planning, it can also be a legal requirement. Where there is a separation of ownership and control (see Chapter 2), much of the firm's sources of finance may have come from shareholders. Financial reporting is a way to account for the money of the business, whether it belongs to the owners, investors or lenders. Hence, having to produce final accounts ensures that all payments and receipts of a business have to be officially accounted for. All companies (businesses owned by shareholders) must provide a set of final accounts to their various stakeholder groups. These **final accounts** consist of two statements:

- The **profit and loss account** - This reports the revenues and expenses of a business at the end of a specified accounting period.

- The **balance sheet** - This reports the value of assets and liabilities of a business at a particular point in time.

It is a legal requirement in most countries for companies to have their final accounts audited by independent and chartered accountants who certify the financial statements to be accurate and truthful. Incorporated businesses, which are owned by shareholders, are legally obliged to produce final accounts. This is to ensure transparency in the use of a company's funds.

However, as there is no universal method to present the final accounts, there is some degree of flexibility in reporting the financial position of a company so long as the final accounts are produced in line with the rules and regulations of the country.

Users of Accounting

Internal stakeholders such as executives and directors (see Chapter 4) can use final accounts to manage the business and to aid strategic decision-making. The purpose of final accounts for external stakeholders is to support evaluative judgements, such as the firm's ability to pay suppliers or repay financiers. The purpose of final accounts for different stakeholder groups is considered below.

- **Shareholders** - The owners of a company are interested to see where their money was spent and the return on their investments. Based on its financial performance, shareholders can decide whether to hold, sell or buy (more of) the company's shares.

- **Employees** - Staff are interested in their organization's financial accounts to assess the likelihood of or present a case for, pay rises. The final accounts can also enable employees to assess the degree of job security based on its financial position.

- **Managers** - Managers use financial accounts to judge the operational efficiency of their organizations. Financial analysis can also be useful for target setting and strategic planning.

- **Competitors** - Rival businesses are interested in the final accounts of a business to make comparisons of their financial performance (see Chapter 18).

- **Government** - The tax authority examines the final accounts of businesses, especially large multinational companies, to ensure that they pay the correct amount of tax on their corporate profits.

- **Financiers** - Financial lenders such as Commercial banks or business angels (see Chapter 15) scrutinize the accounts of a business before approving any funds.

- **Suppliers** - Suppliers examine a firm's final accounts to determine the extent to which trade credit (see Chapter 15) should be given. Suppliers need to know that their business clients are financially stable so they can be assured of receiving payments.

- **Potential investors** - Private and institutional investors use final accounts and ratio analysis (see Chapter 18 and 19) to assess whether investment in a particular business would be financially worthwhile, such as by calculating its profitability ratio, measuring its gearing ratio and determining the organization's liquidity position.

What is The Balance Sheet?

A **balance sheet** (or **statement of financial position**) is one of the annual financial statements that all limited liability companies are legally required to produce for auditing purposes. It contains information on the value of an organization's assets, liabilities and the capital invested by the owners. As it shows the financial position of a business on one particular day only (usually the last day of the firm's accounting year), it is often described as a 'snapshot' of the organization's financial situation.

It is called a balance sheet because the document shows a firm's sources of finance (shown as the *equity*) and where that money has been used (shown as the *net assets*), i.e. it reveals where a firm's money has come from (such as share capital and retained earnings) and what it has been spent on (net assets). For example, if a firm's building has a market value of $550,000 but has an outstanding mortgage of $350,000, the difference of $200,000 is the firm's equity, representing the portion of the property that the business actually owns. Thus, the balance sheet helps to ensure that all monies within the organization are properly accounted for.

It is common practice and a legal requirement in many countries, for established businesses to report the balance sheet figures for two consecutive years. This allows different stakeholder groups to make comparisons regarding the financial performance of the business.

Balance Sheet Components

Non-Current (Fixed) Assets

1- Tangible Assets

They are physical assets and have to be listed in the balance sheets under fixed assets or non current assets. They are illiquid assets. An illiquid asset is the asset which is the most difficult to turn into cash in a short period of time without the loss of its value. For example lands and buildings are considered to be illiquid assets. If you need to turn them into cash in a short period of time you have to lower their value. The most illiquid assets are usually highly specialised machinery. This is an asset that proves difficult to be sold.

Liquid assets can easily be turned into cash within a short period of time without losing its value. For example raw materials.

2- Intangible Assets

i - GoodWil

Over the years the business develops good customer relationships, superior management, manufacturing efficiency, a weak competition, and a favourable reputation. All of these constitute GoodWill.

How is GoodWill registered in the balance sheet?

It is registered as the excess by which the purchase price/ market price of the business exceeds the audited value (Value on the financial statement- balance sheet - after the liabilities have been deducted) of the business. If the audited value of the business is $200,000 after deducting liabilities and a buyer is willing to pay $250,000 to purchase this business, then the GoodWill is $50,000.

How much is an investor willing to pay for GoodWill?

It is a matter of subjectivity and personal opinion but there are still certain ways of calculating it. One method is the above average earning method. It is equal to the amount by which the expected annual earnings (the above average earnings) will exceed annual normal earnings multiplied by a certain number of years. The number of years the investor believes that these above average earnings will continue after he acquires the business. If he believes it will continue for 5 years the multiplied factor is 5.

Example:

For example, In a specific industry the average normal earnings/returns of a business is $200,000 per year. If an investor decides to purchase a particular firm, and he believes that this firm will make above average returns, for example $250,000 a year over a period of 4 years, the GoodWill will be 50,000 x 4 = $200,000.

A goodwill also depreciates but it is said that its value is written off or amortised over the period of its useful life. The useful life is the period where the Goodwill will be helping the business generating revenue.

The useful life of the GoodWill in the US should not exceed 40 years. In the UK if it is not generated internally it is not included in the balance sheet.

Note: amortisation is also applied to all other intangible assets, based on their useful life of generating revenue.

Intangible assets are non-physical fixed assets that have the ability to earn revenue for a business, such as brand names, goodwill, trademarks, copyrights and patents. They are legally protected by laws collectively known as **intellectual property rights**. Intangible assets can account for a large proportion of a firm's asset value, although it is usually difficult to place an objective and accurate price on such assets. The main intangible fixed assets that can appear in a balance sheet include (i) branding, (ii) patents, (iii) copyrights, (iv) goodwill and (v) registered trademarks.

(i) Branding

Brand recognition and brand value (see Chapter 27) help to drive global sales for companies such as Apple and Coca-Cola, year after year. Hence, branding is an indefinite asset as brand recognition and brand loyalty stay with the company for as long as it exists. According to Statista, the Apple brand was worth $264bn in 2021, more than any other global brand that year.

(ii) Patents

Patents provide legal protection for inventors, preventing others from copying their creation for a fixed number of years. For example, compact discs were patented by Philips, the electronics giant. Patents act as an incentive for firms to innovate. If competitors can simply copy the invention, there would be no need for them to spend large amounts of money on research and development. Patents allow the inventor to have exclusive rights to commercial production for a specified time period. Other firms must apply and pay a fee to the patent holder if they wish to use or copy the ideas, processes or products created by the inventor.

(iii) Copyrights

Copyrights© provide legal protection for the original artistic work of the creator, such as an author, photographer, painter or musician. Media sources such as newspapers, sound recordings, computer software and movies are examples of such works. Anyone wishing to reproduce or modify the artist's work must first seek permission from the copyright holder, usually for a fee. The legal copyrights of the contents of this textbook are shared by the author and IBID Press.

(iv) Goodwill

Goodwill is an intangible asset which exists when the value of a firm exceeds its book value (the value of the firm's net assets). It includes the value of an organization's reputation and corporate image as well as its business connections. A business that treats its workers well is likely to see a lot of goodwill from its workforce, meaning that employees are loyal to the firm and consequently add greater value. Goodwill is then the sum of customer and employee loyalty and can provide a major competitive edge for any business. As US entrepreneur Marshall Field (1834 - 1906) said, "*Goodwill is the one and only asset that competition cannot undersell or destroy*".

However, it can be rather subjective to place a value on goodwill. For example, in early 2022, Boots, the UK's largest health and beauty retailer and pharmacy chain, was put up for sale. Analysts struggled to determine a price tag for the retailer, which ranged from £5 billion (7.1$ bn) and £12bn ($17bn).

(v) Registered trademarks

Registered trademarks™ are distinctive signs that uniquely identify a brand, a product or a business entity. Trademarks can be expressed by names, symbols, phrases or an image, such as the Nike 'swoosh' mark or the four interlocking circles of the Audi logo. Like copyrights and patents, trademarks provide legal protection against those who might try to copy their creations and inventions. As assets, registered trademarks can be sold meaning that ownership can be transferred for appropriate fees and this is reflected in the firm's balance sheet. For example, in 1998 Volkswagen bought the Bentley brand (luxury automobiles) for £430m ($615m).

Current assets

1- Cash at Bank & Petty Cash

2-Debtors

Debtors/ notes receivable or account receivablels are the amount of money owed by the customers to the business. The business considers them as assets because they are simply the business's money that is still with the customer. Note receivables and account receivable are both debtors. Notre receivables are with interest and account receivables are without interest.

Usually debtors are received within 30, 60, 90 days.

3- Stocks

Stocks are mainly finished goods. They are called current assets because they are expected to be sold within a year. Stocks could also be semi-finished goods or work in progress meaning they need more processing to be finished goods, they are called current assets because they are expected to be finished and sold within a year. Raw materials are also current assets.

A **current asset** refers to cash or any other liquid asset that is likely to be turned into cash within twelve months of the balance sheet date. The three main types of current assets are cash, debtors and stocks (inventories).

- **Cash** - This is the money that is held in the business or at the bank.
- **Debtors** - This refers to people or other organizations that owe money to the business as they have purchased goods on credit. The value of debtors is a current asset because the money is owed to (or belongs to) the business.
- **Stocks** - These are unsold supplies of raw materials, semi-finished goods (work-in-progress) and finished goods. Finished stocks are relatively liquid in comparison to raw materials.

Current Liabilities

Current liabilities are debts that must be settled within one year of the balance sheet date. Examples include bank overdrafts, trade creditors and other short-term loans.

- **Bank overdrafts** - This is a short-term source of finance (see Chapter 15) that enables a business to withdraw more from its bank account than the amount that exists. Overdrafts need to be repaid quickly as interest rates tend to be very high.
- **Trade creditors** - Suppliers need to be repaid for items that have been purchased on trade credit, usually within 30 to 60 days.
- **Other short-term loans** - Businesses may have other short-term loans that fall due within 12 months of the balance sheet date.

Examples:

Bank Overdrafts, Trade Creditors, and Other short term loans

Non-Current Liabilities

Non-current liabilities (also known as **long-term liabilities**) are debts that are due to be repaid after twelve months of the balance sheet date. Hence, they are the firm's sources of long-term borrowing. Examples include mortgages, bank loans, debentures and any other type of long-term borrowing.

Examples:
Mortgages, Bank loans, and Debentures.

Net Liabilities

A **liability** is a legal obligation of a business to repay its lenders or suppliers at a later date. Hence, liabilities are the amount of money owed by the business.

The value of a firm's **net assets** is therefore the value of all its assets minus all its liabilities.
The value of net assets must be equal to (balance with) the firm's **equity** as recorded on the balance sheet.

Net assets are calculated by using the formula:

Net assets = (Non-current assets + Current assets) – (Non-current liabilities + Current liabilities)

Or

Net assets = Total assets – Total liabilities

(iii) Equity

Equity (also known as **capital and reserves**) refers to the value of the business that belongs to the owners. For limited liability companies, equity is comprised of share capital and retained earnings (the sum of accumulated retained profits). For sole traders and partnerships, only retained earnings are recorded as these entities do not have shareholders. Hence, there are two sections to this part of the balance sheet: (i) share capital and (ii) retained earnings.

- **Share capital** refers to the amount of money raised through the sale of shares. For publicly traded companies, this is done via a Stock Exchange. Share capital on a balance sheet shows the value raised when the shares were first sold, rather than their current market value.
- **Retained earnings** are the total amount of accrued profit after interest, tax and dividends have been paid. The accumulated retained profit is then reinvested in the business for its own use. This money, of course, belongs to the owners of the business so appears under owners' equity or shareholders' equity in the balance sheet. The figures for retained earnings come from the firm's P&L accounts.

From a balance sheet, we can see that:

Total assets – Total liabilities = Net assets = Total equity

This means that the owners own the value of the assets of the business after deductions have been made for all its debts.

Balance Sheet Format

Statement of financial position for Bellamkonda Restaurants Ltd., as at 31st October 20XX

	$'000	**$'000**	
Non-current assets			Non-current assets are items owned by the firm that are not intended for resale within the next 12 months but are used to generate output and sales, e.g. the physical restaurants (premises), tables equipment, chairs, fridges, cash registers, drinks machines and air conditioning.
Property, plant & equipment		2 200	
Accumulated depreciation		(200)	This refers to the provisions or allowances made for the fall in the value of non-current assets over time, e.g. due to wear and tear of the machinery and equipment used in the restaurants.
Non-current assets		2 000	This is the net value of the restaurant's non-current assets after provisions are made for depreciation.
Current assets			Current assets are items owned by the business that are in the form of cash or what it intends to change into cash within one year of the balance sheet date, e.g. stocks (food and drinks) and debtors (customers who have paid by cheque or credit card). Current assets include cash, debtors and stocks
Cash	250		
Debtors	30		
Stock	200		
Current assets		480	
Total assets		2 480	Total assets refer to the sum of non-current assets plus current assets.
Current liabilities			Current liabilities are debts that the business must pay to its creditors within 12 months of the balance sheet date, e.g. money owed to the bank for overdrafts, to trade creditors (suppliers of food and drinks) and any other form of short-term borrowing.
Bank overdraft	15		
Trade creditors	250		
Other short-term loans	55		
Current liabilities		320	
Non-current liabilities		160	Non-current liabilities are the debts owed by a firm, repayable after 12 months from the balance sheet date. They are long term sources of borrowing, such as mortgages (to purchase the restaurants) and outstanding bank loans (which may have been for the purchase of machinery and equipment used in the restaurants).
Borrowings (long term)	500		
Non-current liabilities		500	
Total liabilities		820	This is the sum of non-current liabilities plus current liabilities, i.e. the total sum of money owed by the business.
Net assets		**1 660**	This is the sum of total assets minus total liabilities. It must match (or balance with) the figure for the firm's equity.
Equity			Equity refers to the sum of money that belongs to the owners of the restaurant, i.e. the owners' equity. It is equal to share capital plus retained earnings (as reported in the profit and loss account).
Share capital		1 000	
Retained earnings		660	
Total equity		**1 660**	

Exam tip !

What's the correct format?

Different firms and different countries use slightly different methods to present their balance sheets. In the IB exams, use the format presented in Table 17.3. Remember to place an appropriate title at the top of the balance sheet.

Exam tip !

The main difference between the balance sheet of incorporated and unincorporated businesses is that share capital does not appear as part of their equity, because the latter do not have shareholders. This is essentially what you need to know and remember for the exams. The vast majority of IB examination questions will ask you to interpret the balance sheet of a limited liability company.

Table 17.3 Format of the balance sheet (for a profit-making business entity)

Statement of financial position for (Company Name) as at (Date)

	$m	**$m**
Non-current assets:		
Property, plant and equipment	500	
Accumulated depreciation	(20)	
Total non-current assets		480
Current assets		
Cash	10	
Debtors	12	
Stock	35	
Non-current assets		57
Total assets		342
Current liabilities		
Bank overdraft	5	
Trade creditors	15	
Other short-term loans	22	
Total current liabilities		42
Non-current liabilities		
Borrowings (long term)	300	
Non-current liabilities		300
Total liabilities		342
Net assets		**195**
Equity		
Share capital*	110	
Retained earnings	85	
Total equity		**195**

**Note*: for sole traders and partnerships as well as non-profit entities, there is no share capital so this is not recorded in the balance sheet.

Comparison Between The Balance Sheets of Different Types of Firms

The balance sheets of sole traders, partnerships and non-profit entities (which are not owned by shareholders) differ slightly to those produced by limited liability companies. For example:

- Sources of finance will differ. Limited companies can raise finance through the sale of shares as well as debentures (recorded under long-term liabilities, as outlined in Chapter 15), whereas this would not appear on the balance sheet of unincorporated businesses.

- Technically, any funds invested by the owners of sole traders and partnerships are recorded as owners' equity or owners' capital (rather than share capital), as unincorporated firms do not have shareholders.

- Since there are no shareholders in a partnership or sole proprietorship, dividends will not appear under their current liabilities. Instead, the sole trader or partners might take out funds from the business for their personal use (known as drawings to accountants).

Difficulty of Evaluating Intangible Assets

Note that intangible assets are not always recorded in a balance sheet because their value is very difficult to measure in an objective or scientific way. For example, what are the Google or Coca-Cola brands really worth? How do we value the goodwill of employees in a school or hospital? Does this value depend on whether the organizations are in the private or public sector? No two firms are likely to answer these questions in exactly the same way. The subjective nature of valuing intangible assets renders it unnecessary or even impossible to include on a balance sheet. After all, goodwill is only truly realised when an acquisition or takeover has taken place with the buyer paying a premium for the purchase of the target business. This premium represents the goodwill - the difference between the value of the business and the purchase price.

Therefore, adding the value of intangible assets on a balance sheet can be seen as a form of window dressing to artificially inflate the value of a business. This is perfectly legal, but can distort the underlying financial health of the business. For example, Vodafone managed to turn a €11 billion ($15bn) loss into a €10 billion ($13.7bn) profit in 2006 by the legal use of creative accounting to include goodwill. There is no doubt that intangible assets add value to a business beyond its book value; the uncertainty lies in how to place an accurate value on such assets.

Limitations of Balance Sheets

Limitations of balance sheets

- As balance sheets are static documents, the financial position of a business might be very different in subsequent periods. For example, the value of capital and reserves can change the next day due to the business using the funds for expansion purposes.

- The figures are, at best, only 'accurate' estimates of the value of assets and liabilities. The *market value* of an asset is not necessarily the same as its *book value* (the value shown on the balance sheet). The true market value of a non-current asset is only known once the item has actually been sold. Also, the values shown do not show a detailed breakdown of a firm's assets, so the information is somewhat incomplete.

- Since there is no specific or universal format required for producing a balance sheet, different businesses (or their accountants) will produce accounts in varying formats and include different assets and liabilities. This can make it difficult to compare the financial position of different firms, even those that operate in the same industry.

- Not all assets of a business are included in a balance sheet, especially intangible assets and the value of human capital. For example, professional sports clubs do not include the market value of their players in their balance sheet. To do so would be difficult as each organization would need to determine which players to include in their valuation. Similarly, the club's manager or coach has a market value, but this is not shown on the balance sheet. If the argument that employees are a firm's most valuable assets is actually true, this means that the financial position of a business is not accurately represented in a balance sheet.

The Principles And Ethics of The Accounting Practice

When compiling the final accounts, accountants and financial professionals must abide by the principles and ethics of accounting practice established by a regulatory body. This is important for maintaining a positive reputation of their businesses and to prevent fraudulent practices. The Association of Chartered Certified Accountants (ACCA) is a global regulatory body for professional accountants, assuring that its members are appropriately regulated. The ACCA's Code of Ethics and Conduct sets out five guiding principles for accounting practice:

- *Integrity* Accounting practice should be "straightforward and honest in all professional and business relationships." Integrity also implies fair and truthful behaviour.

- *Objectivity* Accounting practice should be free from bias and any conflict of interest. Professional judgement should not be compromised by undue influence from other people.

- *Professional competence and due care* Accountants are obliged to maintain their professional knowledge and skills to ensure they provide a competent professional service. They must also act diligently when providing professional accounting services.

- *Confidentiality* Accountants must respect the confidentiality of information they acquire in their professional duties and must not disclose any of this information (unless they have permission or a legal obligation to do so). Very importantly, accountants must not use the confidential information for their personal gain.

- *Professional behaviour* Accounting practices must comply with relevant laws and regulations. Accountants must avoid any action that could discredit their profession. They should, in their professional capacity, behave with courtesy and consideration towards others.

Case Studies

Case 1

Statement of Financial Position For IKNS Restaurant Ltd as at 31, 2023

		Dollars '000
	Cash	250
	Share Capital	1000
	Property plant and equipment	2200
	Debtors	30
	Bank overdraft	15
	Long term borrowing	500
	Retained earnings	660
	Accumulated depreciation	200
	Trade creditors	250
	Stock	200
	Other short term loans	55

Construct a Balance sheet

Case 2

Statement of Financial Position For Khoury Homes Ltd as at October 31, 2023

	Dollars '000
Stocks	900
Trade creditors	500
Mortgage	550
Retained Profit	700
Premises	1300
Accumulated depreciation	100
Debtors	200
Bank overdraft	200
Debentures	550
Other short term loans	150
Fixtures and fittings	1100
Share Capital	2000
Bank Loan	200
Equipment	900
Cash	550

Construct a Balance sheet

Case 3

Statement of Financial Position For Pranali Ltd as at September 30, 2023

Bank loan	5000
Premises and equipment	60,000
Stock	11,000
Debtors	8,000
Share capital	30,000
Retained earning	?
Bank Overdraft	1500
Total liabilities	15, 500
Trade creditors	?
Accumulated depreciation	?
Total non current assets	40,000
Long term borrowing	7000
Cash	2000

Construct a Balance sheet

Question 17.5 - Marc Brothers Motor Repairs

The financial data for Marc Brothers Motor Repairs (MBMR) are shown below. The company's reporting day for the balance sheet is 31st March of each year.

Property = $630,000, Machinery and vehicles = $230,000, Accumulated depreciation = $144,000, Stock = 30,000, Cash = $12,000, Debtors = $16,000, **Overdraft** = $13,000, Long term bank loan = $380,000, Share capital = $300,000 and Retained earnings = $81,000

(a) Define the term *overdraft*. *[2 marks]*

(b) Outline why cash is important for a business such as Marc Brothers Motor Repairs (MBMR). *[2 marks]*

(c) Use the data above to construct a balance sheet for Marc Brothers Motor Repairs (MBMR). *[6 marks]*

Question 17.6 - Bajaj Electronics

Bajaj Electronics is an importer and exporter of consumer electronic products and computer accessories. Sonali Bajaj, the company's chief financial officer, has presented the following financial data to shareholders at the annual general meeting (AGM). The company reports its **balance sheet** on 31st December each year.

	2022 ($'000)	2021 ($'000)
Bank overdraft	20	10
Cash	25	20
Creditors	50	50
Debtors	70	50
Mortgage	50	50
Noncurrent assets	250	250
Noncurrent liabilities	50	80
Retained earnings	75	75
Share capital	200	150
Stock	100	95

(a) Define the term *balance sheets.* *[2 marks]*

(b) Identify **one** example of noncurrent assets and **one** example of stocks for Bajaj Electronics. *[2 marks]*

(c) Construct a balance sheet for Bajaj Electronics for both years. *[6 marks]*

Question 17.7 - Senjaya Fabrics Ltd.

Hendra Senjaya is the founder of Senjaya Fabrics Ltd., a manufacturer of fabric garments, shoes and handbags in Banten, Indonesia. Hendra has been provided with the following data from the finance department. All figures are in millions of Indonesian rupiah (IDR) as at 31st March of this year.

Cash = IDR32m, Debtors = IDR35m, Mortgage = IDR127m, Overdraft = IDR30m, Property = IDR350m, Retained earnings = IDR100m, **Share capital** = IDR175m, Stocks = IDR60m and Trade creditors = IDR45m.

(a) Define the term *share capital*. *[2 marks]*

(b) Explain **one** reason why stocks (inventories) are important for an organisation such as Senjaya Fabrics Ltd. *[2 marks]*

(c) Using the above data, construct the balance sheet for Senjaya Fabrics Ltd. *[5 marks]*

Question 17.8 - Harry Potter (J.K. Rowling)

J.K. Rowling was unemployed at the time when she wrote her first Harry Potter fantasy novel, back in 1994. In 1998, Warner Bros purchased the rights for film adaptations of the Harry Potter novels. By 2007, Warner Bros and Universal Studios announced the construction of 'Harry Potter World' at the Universal Islands of Adventure theme park in Orlando, Florida in the US.

Prior to the release of Rowling's seventh and final instalment of the series, global sales of her books had already exceeded 400 million copies and been translated into over 65 languages. According to TIME, the Harry Potter brand is worth over $25 billion. The huge commercial success and high market value of the Harry Potter franchise means that Rowling, her publishers and Warner Bros are keen to protect their **intangible assets** including the international copyrights of the Harry Potter books.

(a) Define the term *intangible assets.* *[2 marks]*

(b) In the context of the case study, explain **two** benefits of protecting copyrights. *[4 marks]*

(c) Comment on how the $25 billion valuation of the Harry Potter brand might be affected by the subjective nature of placing values on intangible assets. *[4 marks]*

Typical IB Question:

In 1988 the value of brand names was a focus of attention following the acquisition of the York based chocolate manufacturer, Rowntree, by the Swiss company, Nestlé. The true value of Rowntree's attractive brand names, Polo, Kit Kat and Aero, became apparent when the share price of Rowntree increased rapidly from 447p to 1075p. The share price soared as Nestlé and another confectioner, Suchard, engaged in a bidding war. It was believed that £1.9 billion of the £2.3 billion paid by Nestlé for Rowntree was for the value of their brand names. The chairman of Grand Metropolitan, the hotels and drinks giant, whose main brand names include Ski, Ruddles and Smirnoff, has since argued that the true worth of a company should be shown to the shareholders by including these brand names in the balance sheet. According to standard accountancy convention, if a particular business asset can be 'stripped', identified, and sold separately then it may be valued as such. Some accountants believe that, on acquisition, brand names can be listed on the balance sheet. However, it must be remembered that brand names do not have an infinite life.

(a) What are the advantages and disadvantages of including brand names on a company balance sheet?

(b) What difficulties would be encountered if a company decided to write off a brand.