Core Financial Accounting (FADM)

Professor: Mark Finn

Kellogg School of Management
&
Indian School of Business

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i) What is accounting?

Accounting: A <u>formal system</u> for <u>communicating financial information</u> about <u>economic entities</u> to <u>interested users</u>

Constituencies for Accounting Information
- Interested users: shareholders, creditors, customers, vendors, employees, governments, communities
- Financial vs. Managerial (also Tax and Auditing)
- Entities: A spectrum from large publicly-held corporations to not-for-profits

Formal System
- I-GAAP: Indian generally accepted accounting principles
- US GAAP: SEC ⇒ FASB (Financial Accounting Standards Board)
- International Accounting Standards Board (IASB): International Financial Reporting Standards (IFRS)
- Auditing and enforcement

Communicating financial information
- "the language of business"
- Accounting vs. Bookkeeping
- Connections among financial and non-financial and sustainability reporting

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i) What is accounting?

Accounting: A formal system for communicating financial information about economic entities

India: IFRS compliant standards by 2011.

US: Fully interchangeability between IFRS and US GAAP by 2016. (US firms would be able to use IFRS accounting in lieu of US accounting in US capital markets.)

Formal System
- I-GAAP: Indian generally accepted accounting principles
- US GAAP: SEC ⇒ FASB (Financial Accounting Standards Board)
- International Accounting Standards Board (IASB): International Financial Reporting Standards (IFRS)
- Auditing and enforcement

Communicating financial information
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- Connections among financial and non-financial and sustainability reporting

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The New York Times
nytimes.com

September 6, 2006

Report Estimates the Costs of a Stock Options Scandal

By <u>ERIC DASH</u>

WASHINGTON, Sept. 5 — A new study estimates that the stock options backdating scandal may cost shareholders hundreds of millions of dollars. The study was released on the eve of two Senate committee hearings that plan to examine the scope of the widening investigation into improper options practices.

Three researchers at the <u>University of Michigan</u> estimated that backdating stock options between 2000 and 2004 helped sweeten the average executive's pay by more than 1.25 percent, or about $600,000. But the fallout from the recent options investigations has caused those executives' companies to fall in market value by an average of 8 percent, or $500 million each.

"For about $600,000 a year to the executives, shareholders are being put at risk to the tune of $500 million," the study concludes.

$600,000 of inappropriate compensation to senior executives
↓
$500,000,000 decline in market value

Information and Financial Markets

- Regular flow of information is essential to the functioning of financial markets
- Japanese measures to stop stock market slide
  "financial institutions would be permitted to withhold negative financial data from the public in the hope of easing worries about the system's fundamental health" (<u>NYTimes</u> August 19, 1992)
- Financial markets depend on information that is timely *and* relevant *and* objective.
- Companies, investors, and regulators adopt policies to speed access to information and make the access fairer to all market participants.

Information and Financial Markets

- Regular flow of information is essential to the functioning of financial markets
- Japanese measures to stop stock market slide
  "financial institutions would be permitted to withhold negative financial data from the public in the hope of easing worries about the system's fundamental health" (<u>NYTimes</u> August 19, 1992)

Rational Expectations: People may not have complete information about a company, but they will make intelligent forecasts of what they don't know.

y *and*

speed access to information and make the access fairer to all market participants.

Information and Financial Markets

- Regular flow of information is essential to the functioning of financial markets

The Efficient Markets Hypothesis: Market efficiency is defined with respect to information. In efficient financial markets, profits come mainly from gaining access to information not possessed by other traders.

d
f easing
Times

- Financial markets depend on information that is timely *and* relevant *and* objective.
- Companies, investors, and regulators adopt policies to speed access to information and make the access fairer to all market participants.

Economist.com

Accounting

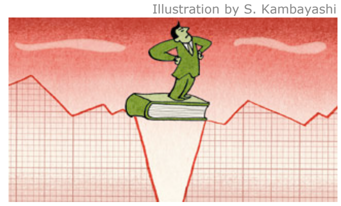
All's fair

Sep 18th 2008

From *The Economist* print edition

The crisis and fair-value accounting

Illustration by S. Kambayashi



SO CONTROVERSIAL has accounting become that even John McCain, a man not known for his interest in balance sheets, has an opinion. The Republican candidate for the American presidency thinks that "fair value" rules may be "exacerbating the credit crunch". His voice is part of a chorus of criticism against mark-to-market accounting, which forces banks to value assets at the estimated price they would fetch if sold now, rather than at historic cost. Some fear that accounting dogma has caused a cycle of falling asset prices and forced sales that endangers financial stability. The fate of Lehman Brothers and American International Group will have strengthened their conviction.

washingtonpost.com

SEC Loosens Accounting Rule Banks Blame for Crisis

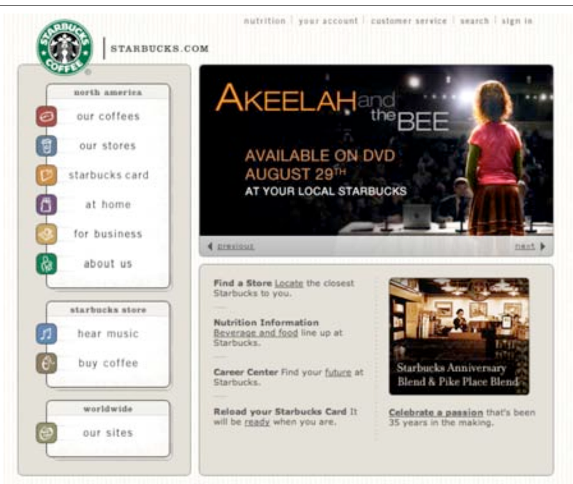
Firms Granted Leeway to Value Complex Mortgage-Related Investment

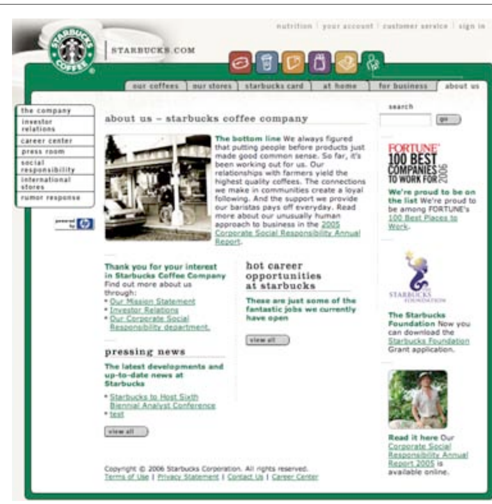
By Carrie Johnson
Washington Post Staff Writer
Tuesday, September 30, 2008; 6:24 PM

Under intense political pressure, regulators for securities and accounting standards this afternoon issued what they called a "clarification" to provisions that have come under fire from bank executives and some lawmakers for contributing to the credit crisis.

Regulators said that the new guidance will help companies figure out the value of complex mortgage-related investments at a time when there are few trading partners willing to purchase them.

Under an accounting standard that took effect last November, businesses are required to employ "fair value" accounting, in which they put a price tag on their assets even if they do not intend to sell them right away.





ii) Financial statement components: Dr. Reddy's 2007-08 Annual Report

- Balance Sheet - "Consolidated Balance Sheets"

  Assets = Liabilities + Shareholders' Equity

- Income Statement - "Consolidated Statements of Operation"

  Revenues - Expenses = Net Income

- Consolidated Statements of Cash Flows

  Activities: Operating, Investing, Financing

- Auditor's and Management's reports
- Management Discussion and Analysis
- Footnotes

DR. REDDY'S LABORATORIES LIMITED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	As of March 31, 2007	2008
ASSETS		
Current assets:		
Cash and cash equivalents	Rs.17,981,447	Rs. 7,398,285
Investment securities	15,325	4,753,580
Restricted cash	606,159	23,156
Accounts receivable, net of allowances	7,518,878	6,823,448
Inventories	7,545,580	11,132,830
Deferred income taxes and deferred charges	557,792	587,375
Due from related parties	145,086	72,817
Other current assets	3,096,129	3,828,714
Total current assets	37,466,396	34,620,205
Property, plant and equipment, net	12,427,798	16,765,432
Due from related parties	4,856	4,280
Investment securities	1,089,950	2,728
Investment in affiliates	225,905	237,054
Goodwill	15,540,688	16,978,916
Intangible assets, net	18,888,413	16,622,631
Other assets	275,097	213,810
Total assets	Rs.85,919,103	Rs.85,445,056

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Borrowings from banks	Rs. 3,212,676	Rs 4,862,709
Current portion of long-term debt	3,670,266	1,814,806
Trade accounts payable	4,754,978	5,409,782
Due to related parties	871	16,750
Accrued expenses	3,958,539	4,155,252
Other current liabilities	2,936,103	3,132,965
Total current liabilities	18,533,433	19,392,264
Long-term debt, excluding current portion	17,870,983	12,864,163
Deferred income taxes	7,556,228	5,642,412
Other liabilities	369,758	479,633
Total liabilities	Rs.44,330,402	Rs 38,378,472
Minority interest	10,473	—
Stockholders' equity:		
Equity shares at Rs.5 par value; 200,000,000 shares authorized; Issued and outstanding; 167,912,180 shares and 168,172,746 shares as of March 31, 2007 and March 31, 2008, respectively	Rs. 839,561	Rs. 840,864
Additional paid-in capital	19,908,837	20,036,473
Equity options outstanding	564,937	709,006
Retained earnings	20,091,135	24,031,890
Treasury shares held by a consolidated trust: 82,800 shares	(4,882)	(4,882)
Accumulated other comprehensive income	178,640	1,453,233
Total stockholders' equity	41,578,228	47,066,584
Total liabilities and stockholders' equity	Rs.85,919,103	Rs.85,445,056

DR. REDDY'S LABORATORIES LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)

	Fiscal Year ended March 31, 2006	2007	2008
Revenues:			
Product sales, net of allowances for sales returns (includes excise duties of Rs.1,153,273, Rs.779,390 and Rs. 558,308 for the years ended March 31, 2006, 2007 and 2008, respectively)	Rs. 24,077,209	Rs. 64,185,378	Rs. 49,230,572
Service Income	142,317	882,172	740,232
License fees	47,521	27,542	34,822
	24,267,047	65,095,092	50,005,626
Cost of revenues	12,417,413	34,219,539	24,597,589
Gross profit	11,849,634	30,875,553	25,408,037
Operating expenses:			
Selling, general and administrative expenses	8,028,884	14,051,137	15,175,243
Research and development expenses, net	2,152,950	2,462,660	3,532,878
Amortization expenses	419,867	1,570,894	1,614,806
Write-down of intangible assets	—	1,770,221	2,488,514
Impairment of goodwill	—	—	90,437
Foreign exchange (gain)/loss, net	126,342	(136,753)	(744,915)
Other operating (income)/expenses, net	(327,688)	(174,058)	(106,627)
Total operating expenses:	10,400,355	19,544,101	22,050,336
Operating income	1,449,279	11,331,452	3,357,701
Equity in (loss) / income of affiliates, net	(88,235)	(62,676)	1,783
Other income/(expense), net	526,279	(768,501)	78,656
Income before income taxes and minority interest	1,887,323	10,500,275	3,438,140
Income taxes (expense)/benefit	(258,390)	(1,176,936)	1,229,429
Minority interest	(76)	3,499	10,473
Net income	Rs. 1,628,857	Rs. 9,326,838	Rs. 4,678,042

DR. REDDY'S LABORATORIES LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	Fiscal Year ended March 31, 2006	2007	2008
Cash flows from operating activities:			
Net income	Rs 1,628,857	Rs. 9,326,838	Rs. 4,678,042
Adjustments to reconcile net income to net cash from operating activities:			
Deferred tax benefit	(55,157)	(1,103,598)	(2,351,120)
(Gain)/loss on sale of available for sale securities, net	3,924	(869)	(110,269)
Depreciation and amortization	1,567,090	3,010,192	3,388,304
Write-down of intangible assets	—	1,770,221	2,488,514
Impairment of goodwill	—	—	90,437
Loss/(gain) on sale of property, plant and equipment	(320,361)	(67,039)	7,629
Provision for doubtful accounts receivable	33,629	151,620	226,932
Allowance for sales returns	239,462	1,325,981	164,295
Inventory write-downs	100,783	306,235	327,997
Equity in loss/(income) of affiliates, net	88,235	62,676	(1,783)
Unrealized foreign exchange (gain)/loss, net	67,650	(97,232)	225,893
Stock based compensation	162,249	175,380	257,788
Minority interest	76	(3,499)	(10,473)
Changes in operating assets and liabilities:			
Accounts receivable	(781,607)	(3,032,373)	608,250
Inventories	(1,851,724)	(995,342)	(3,908,736)
Other assets	(1,123,076)	(371,099)	1,654,006
Due to/from related parties, net	15,223	(48,206)	88,724
Trade accounts payable	1,564,454	1,045,753	1,076,159
Accrued expenses	243,625	825,207	134,848
Other liabilities	113,201	(320,250)	(2,902,578)
Net cash provided by operating activities	1,696,533	11,960,596	6,122,627

DR REDDY'S LABORATORIES LIMITED

DR. REDDY'S

Cash flows from investing activities:			
Restricted cash	(6,017,219)	5,468,926	583,003
Expenditure on property, plant and equipment	(1,873,268)	(4,477,049)	(6,348,085)
Proceeds from sale of property, plant and equipment	691,273	84,061	55,032
Investment in affiliates	(100,800)	(158,474)	—
Purchase of investment securities	(5,074,184)	(331,000)	(15,859,878)
Proceeds from sale of investment securities	5,274,899	331,869	12,477,799
Expenditure on intangible assets	(41,517)	(259,198)	(421,503)
Cash paid towards contingent consideration	(114,244)	(66,677)	(86,319)
Cash paid for acquisition, net of cash acquired	(27,322,762)	(156,076)	—
Net cash provided by/(used in) investing activities	(34,577,822)	436,382	(9,599,951)
Cash flows from financing activities:			
Proceeds from issuance of equity shares	73,639	10,029,571	15,220
Proceeds from minority interest shareholder	—	10,473	—
Proceeds from bank borrowings	6,322,206	2,212,983	3,554,417
Repayment of bank borrowings	—	(8,083,745)	(1,941,458)
Proceeds from long-term debt	21,598,301	—	—
Repayment of long-term debt	(6,577)	(1,888,540)	(7,718,506)
Debt issuance costs	(340,243)	(89,565)	—
Dividends	(436,368)	(437,497)	(737,287)
Net cash provided by/(used in) financing activities	27,210,958	1,753,680	(6,827,614)
Net increase/(decrease) in cash and cash equivalents during the year	(5,670,331)	14,150,658	(10,304,938)
Effect of exchange rate changes on cash and cash equivalents, net	95,104	118,152	(278,224)
Cash and cash equivalents at the beginning of the year	9,287,864	3,712,637	17,981,447
Cash and cash equivalents at the end of the year	Rs. 3,712,637	Rs.17,981,447	Rs. 7,398,285

International Differences in English Terminology

Income Statement

- Income Statement vs. Profit and Loss Account
- Sales vs. Turnover
- Income or Earnings vs. Profit

Balance Sheet

- Accounts Receivable vs. Debtors or Sundry Debtors
- Accounts Payable vs. Sundry Creditors
- Inventory vs. Stocks
- Property, Plant, and Equipment vs. Tangible Fixed Assets
- Long-term Debt vs. Borrowings
- Shareholders' Equity vs. Capital and Reserves

Diageo, 2005 Annual Report
Consolidated balance sheet

	Notes	30 June 2005 £ million	£ million
Fixed assets			
Intangible assets	12	4,252	
Tangible assets	13	2,097	
Investment in associates	14	1,334	
Other investments	14	719	
			8,402
Current assets			
Stocks	15	2,335	
Debtors – due within one year	16	1,664	
Debtors – due after one year	16	68	
Cash at bank and liquid resources	17	817	
		4,884	
Creditors – due within one year			
Borrowings	17	(869)	
Other creditors	19	(3,183)	
		(4,052)	
Net current assets			832

Diageo, 2006 Annual Report
Consolidated balance sheet

	Notes	30 June 2006 £ million	£ million
Non-current assets			
Intangible assets	11	4,534	
Property, plant and equipment	12	1,952	
Biological assets	13	13	
Investments in associates	14	1,341	
Other investments	16	69	
Other receivables	18	12	
Other financial assets	21	42	
Deferred tax assets	25	1,113	
Post employment benefit assets	4	14	
			9,090
Current assets			
Inventories	17	2,386	
Trade and other receivables	18	1,681	
Other financial assets	21	71	
Cash and cash equivalents	19	699	
			4,837
Total assets			13,927

Consolidated profit and loss account

	Notes	Year ended 30 June 2005 Before exceptional items £ million	Exceptional items £ million	Total £ million
Turnover				
Continuing operations		9,036	–	9,036
Discontinued operations		–	–	–
	2	9,036	–	9,036
Operating costs	4/7	(7,092)	(208)	(7,300)
Operating profit				
Continuing operations		1,944	(208)	1,736
Discontinued operations		–	–	–
	2	1,944	(208)	1,736
Share of associates' profits	6	185	–	185
		2,129	(208)	1,921
Disposal of fixed assets				
Continuing operations			(19)	(19)
Discontinued operations			–	–
	7		(19)	(19)
Sale of businesses				
Continuing operations			(7)	(7)
Discontinued operations			53	53
	7		46	46
Investment income		17	–	17
Interest payable (net)	8	(151)	–	(151)
Other finance income/(charges)	8	8	–	8
Profit before taxation		2,003	(181)	1,822
Taxation	9	(481)	98	(383)
Profit after taxation		1,522	(83)	1,439
Minority interests				
Equity		(53)	–	(53)
Non-equity		(11)	–	(11)
Profit for the year		1,458	(83)	1,375

Consolidated profit and loss account

Consolidated income statement

	Notes	Year ended 30 June 2006 Before exceptional items £ million	Exceptional items £ million	Total £ million
Sales	2	9,704	–	9,704
Excise duties	3	(2,444)	–	(2,444)
Net sales		7,260	–	7,260
Cost of sales	3	(2,921)	–	(2,921)
Gross profit		4,339	–	4,339
Marketing	3	(1,127)	–	(1,127)
Other operating expenses	3	(1,168)	–	(1,168)
Operating profit	2/5	2,044	–	2,044
Sale of General Mills shares	5		151	151
Sale of other businesses	5		6	6
Interest receivable	6	51	–	51
Interest payable	6	(244)	–	(244)
Other finance income	6	24	–	24
Other finance charges	6	(17)	–	(17)
Share of associates' profits after tax	7	131	–	131
Profit before taxation		1,989	157	2,146
Taxation	8	(496)	315	(181)
Profit from continuing operations		1,493	472	1,965
Discontinued operations				
Profit after tax from disposal of businesses	9		–	–
Profit for the year		1,493	472	1,965

Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, G. V. Prasad, certify that:

1. I have reviewed this annual report on Form 20-F of Dr. Reddy's Laboratories Limited (the "Company").
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this annual report.
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Company and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this annual report based on such evaluation; and

   (c) Disclosed in this report any change in the Company's internal control over financial reporting that occurred subsequent to the date of our most recent evaluation that has materially affected or is reasonably likely to materially affect the Company's internal control over financial reporting.

5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: July 14, 2008

/s/ G. V. Prasad
G. V. Prasad
Chief Executive Officer and Executive Vice Chairman

Topical Course Schedule

Session	Subject	Text Readings	Suggested Problems
1	Introduction to Financial Reporting; the Balance Sheet	Ch. 1; Begin Ch. 3	1-26, 1-29, 1-38, 1-42, 2-50
2	The Income Statement	Ch. 2; Finish Ch.3	2-32, 2-54, 3-18, 3-32, 3-33, 3-36, 3-45
3	The Income Statement: Adjusting Entries, Geography	Ch. 4; Ch.12, pp.557-559	4-22, 4-24, 4-31, 4-35, 12-35, 12-36, 12-41
4	Statement of Cash Flows, incl. transitional topics	Ch. 8, pp.350-355, Ch.10 pp.462-465 Begin Ch.5	8-49, 8-50,10-41, 10-60, 10-64, 5-40
5	Finish Stmt. of Cash Flows; Revenue Recognition	Finish Ch. 5	5-45, 5-52, 5-59, 8-52
6	Accounts Receivable and Allowances	Ch. 6	6-35, 6-45, 6-51, 6-56, 6-66, 9-33
7	Mfg. Inventory Liabilities: Bonds	Ch. 7 Appendix Begin Ch. 9	7.85, 9-40, 9-42, 9-43, 9-61, 9-62
8	Liabilities: Leases, Deferred Taxes, Contingent Liabilities	Finish Ch. 9	9-37, 9.65, 9.66, 9.68, 9-70, 9-71
9	Begin Investments	Begin Ch. 11	11-27, 11-28, 11-31, 11-32, 11-53
10	Finish Investments; Shareholders' Equity – Share-based compensation	Ch. 11 Ch.10, pp.452-454	11-43, 11-44, 11-46, 11-48, 10-67, 10-56, 10-72

Course Requirements and Grading

Midterm - 25% of grade
Final Examination – 40% of grade
On-line (Blackboard) Quizzes - 10% of grade
Group Assignment – 25% of grade (May 30th)

Materials

Horngren, Sundem, Elliott, and Philbrick. Introduction to Financial Accounting. 9th Edition. Prentice Hall, 2006

Handouts and overheads

Supplement

Narayanaswamy, R. H. Accounting: A Managerial Perspective. 2nd Edition. Prentice Hall of India, 2005

Help with Problems

Solutions Manual
TA Help Sessions - TBA
E-mail
Professor's Office Hours

Classroom Organization

Lecture format
Preparation and participation
Attendance & Punctuality
No laptops; cell phones off

Common Questions from ISB Students

Pace and level of difficulty
Comparisons between Kellogg and the ISB
Indian vs. non-Indian content:

Special Option for Chartered Accountants

Small group project on advanced topic
Due date of final exam
Non-CAs must have CA-level background

Common Questions from ISB Students

Pace and level of difficulty
Comparisons between Kellogg and the ISB
Indian vs. non-Indian content:

Special Option for Chartered Accountants

CA Grade Distribution in the Past:

A grades: 9% greater with CA option
A- grades: 10% less with CA option
B or below: 1% greater with CA option

Course Requirements and Grading

Midterm - 25% of grade

Final Examination – 40% of grade

On-line (Blackboard) Quizzes - 10% of grade

Group Assignment – 25% of grade (May 29th)

Materials

Horngren, Sundem, Elliott, and Philbrick. Introduction to Financial Accounting. 9th Edition. Prentice Hall, 2006

Handouts and overheads

Supplement

Narayanaswamy, R. H. Accounting: A Managerial Perspective. 2nd Edition. Prentice Hall of India, 2005

I) The Balance Sheet Equation

Assets = Liabilities + Shareholders' Equity

Assets: Resources providing future economic benefits - generating future cash inflows or reducing future cash outflows.

Examples from Dr. Reddy's Laboratories:

- Cash and cash equivalents
- Accounts receivable
- Inventories
- Property, plant, and equipment
- Trademarks
- Core technology rights
- Marketing know-how
- Goodwill

Liabilities: Probable future sacrifice of economic benefits. Often, obligations to pay definite amounts at particular points in time.

Examples from Dr. Reddy's Laboratories:

- Trade accounts payable
- Borrowings from banks
- Gratuity benefits (defined benefit pension plan)

II) Asset Valuation and Recognition

Valuation:

Acquisition (Historical) Cost vs. Market Value $\begin{cases} \text{Replacement Cost} \\ \text{Net Realizable Value} \\ \text{Valuation models} \end{cases}$

Replacement Cost – What you can buy the asset for at current prices…

- Diageo (UK): Guinness brewery in Dublin
- Sinopec (China): oil refineries
- China Eastern (China): aircraft

Net Realizable Value – What you sell the asset for at current prices…

- GMM Grammy (Thailand – music company): tapes, CDs, magazines, books
- Louis Vuitton Moët Hennessy (France): vines for champagnes, cognacs, and other wines

Valuation Modeling:

- Morgan Stanley (US): derivative securities
- Infosys (India): corporate brand and human resources

II) Asset Valuation and Recognition (cont'd.)

Asset recognition under acquisition cost:

- Past transaction or exchange
- Ability to quantify future benefits
- Examples of assets often failing to meet the accountant's test:
  - ◊ Research and development
  - ◊ Brand names
  - ◊ Other comparative advantages developed "in house"

Questioning the *<u>relevance</u>* of acquisition costs: Brand and human resource accounting in India

- Infosys, Satyam Computers, Bharat Heavy Electricals Limited (BHEL)
- Infosys uses Interbrand, a brand equity valuation specialist
- Does not need an explicit link to past transactions

Questioning the *<u>reliability</u>* of fair value accounting

- *Enron:* market value accounting for energy contracts
- *Royal Dutch Shell:* overestimated the fair value of oil reserves in 2003.
- *New Century Financial Corporation* (first prominent collapse of the subprime crisis): Due complexities of bankruptcy accounting and fair value accounting for impaired assets, "it is unlikely that the Company will ever be able to file its financial statements." SEC Form 12b-25, Notification of Late Filing.

Intangible assets that could be acquired or home grown…

Market-related intangible assets:
1. Trademarks, tradenames
2. Service marks, collective marks, certification marks
3. Trade dress (unique color, shape or package design)
4. Newspaper mastheads
5. Internet domain names
6. Noncompetition agreements

Customer-related intangible assets:
1. Customer lists
2. Order or production backlog
3. Customer contracts and related customer relationships
4. Noncontractual customer relationships

Artistic-related intangible assets:
1. Plays, operas and ballets
2. Books, magazines, newspapers, literary works
3. Musical works such as compositions, song lyrics, advertising jingles
4. Pictures and photographs
5. Video and audiovisual material, including motion pictures, music videos, and television programs

Contract-based intangible assets:
1. Licensing, royalty, standstill agreements
2. Advertising, construction, management, service, or supply contracts
3. Lease agreements
4. Construction permits
5. Franchise agreements
6. Operating and broadcast rights
7. Use rights such as landing, drilling, water, mineral, timber cutting and route authorities
8. Servicing contracts, such as mortgage servicing contracts
9. Employment contracts

Technology-based intangible assets:
1. Patented technology
2. Computer software and mask works
3. Unpatented technology
4. Databases, including title plants
5. Trade secrets, including secret formulas, processes, recipes

Two Fundamental Arguments Against Acquisition Cost Accounting

- Acquisition costs do not depict current economic value.
- Because acquisition costs require a past transaction or exchange, they tend to ignore homegrown intangible assets

Traditional defense: Companies are assumed to be "going concerns" that will be in business long enough to realize increases in asset values as higher profits.

Infosys Fair Value Accounting of Intangible Assets

Balance Sheets as of 31 March 2008 (in crores of Indian rupees)	Acquisition Cost Balance Sheet	Fair Value Balance Sheet
Brand equity	-	31,863
Human resources	-	98,821
Other assets	17,221	18,286
Liabilities	3731	4,191
Shareholders' Equity	13,490	144,779

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Brand valuation

in Rs. crore

	2008	2007	2006
Profit before interest and tax	4,640	3,877	2,654
Less: Non-brand income	634	335	125
Adjusted profit before tax	4,006	3,542	2,529
Inflation factor	1.000	1.075	1.156
Present value of brand profits	4,006	3,808	2,924
Weightage factor	3	2	1
Weighted average profits	3,760		
Remuneration of capital	626		
Brand-related profits	3,134		
Tax	1,065		
Brand earnings	2,069		
Brand multiple	15.4		
Brand value	31.863		

Human resources valuation

The dichotomy in accounting between human and non-human capital is fundamental. The latter is recognized as an asset and is, therefore, recorded in the books and reported in the financial statements, whereas the former is ignored by accountants. The definition of wealth as a source of income inevitably leads to the recognition of human capital as one of the several forms of wealth such as money, securities and physical capital.

We have used the Lev & Schwartz model to compute the value of human resources. The evaluation is based on the present value of future earnings of employees and on the following assumptions: a) employee compensation includes all direct and indirect benefits earned both in India and abroad, b) the incremental earnings based on group / age have been considered, and c) the future earnings have been discounted at the cost of capital of 13.32% (previous year – 14.97%).

in Rs. crore, unless stated otherwise

	2008	2007
Employees (No.)		
Software professionals	85,013	68,156
Support	6,174	4,085
Total	91,187	72,241
Value of human resources		
Software professionals	92,331	53,592
Support	6,490	3,860
Total	98,821	57,452
Total income	16,692	13,893
Total employee cost	8,878	7,112
Value-added	14,820	11,879
Net profits excluding exceptional items	4,659	3,861
Ratios		
Value of human resources per employee	1.08	0.80
Total income / human resources value (ratio)	0.17	0.24
Employee cost / human resources value (%)	9.0	12.4
Value-added / human resources value (ratio)	0.15	0.21
Return on human resources value (%)	4.7	6.7

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Infosys marketcap & brand value double in '05 fiscal

ARUN IYER
TIMES NEWS NETWORK[MONDAY, MAY 16, 2005 01:34:39 AM]

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BANGALORE: Infosys saw its brand value and market capitalisation close to double during the recently concluded fiscal. Brand value was placed at Rs 14,153 crore($3.24 billion) for the year ended March 31, 2005 compared to Rs 8,185 crore($1.87 billion) for FY '04 and Rs 7,488 crore ($1.71 billion) for FY '03, according to the company's annual report for FY 2004-05.

The company's market capitalisation (after the liberal 3:1 bonus) saw this figure stand at Rs 61,073 crore(over $14 billion) against Rs 32,909 crore($7.54 billion) representing a year on year growth of 85.58%. Market capitalisation in FY '03 stood at Rs 26,847 crore($6.15 billion). Interestingly enough, the m-cap in Feb 1993(year when Infosys listed) stood at Rs 31.84 crore!

The central theme of the FY '05 annual report is "Scale" as compared to "New games, new rules" in FY '04. On the theme, the annual report has this to say:" For companies scaling up is vital for longevity and prosperity. Employees need the growth to expand their horizons and career. In the IT industry scale is non-negotiable. The question is how best and how quickly we can scale."

The report speaking of the company's several multi-million dollar clients says: "Large accounts have been our engines of growth. But they have not happened. Deliberate action and concerted action have made them possible."

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Hey Infosys guys! Together you are worth $6.4 bn

R SUBRAMANYAM
TIMES NEWS NETWORK[SUNDAY, MAY 15, 2005 01:58:06 AM]

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BANGALORE: After brand valuations, it is the valuation of the workforce that is catching on. People, after all, are as important an asset as the brand.

The 36,750 employees of the leading software firm Infosys Technologies have been valued at Rs 28,334 crore ($6.4-billion). In its annual report for 2004-05, the company has reported a software delivery staff of 34,747 valued at Rs 26,550 crore and 2003 support staff value at Rs 1,784 crore.

In the previous year, Infosys had valued its human capital at Rs 21,139 crore. It then had 25,634 employees, comprising of 24,110 software staff and 1,524 support personnel. Infosys revenue from software in 2005 was Rs 7129.65 crore, while its total employee cost was Rs 3539.11 crore.

Infosys has adopted the Lev & Schwartz model to compute the value of human resources. In knowledge-based industry such as the software industry, human capital is the most vital asset.

There are other models to value human resources. The Lev & Schwartz model is more monetary-centric and is based on the likely future earnings of an employee till his retirement.