

**Applied Case #4 (Chapters 8 and 9)**

Use the attached financial statements and selected notes to the financial statements excerpted from Sucampo Pharmaceuticals Inc.'s (NASDAQ: SCMP; Bethesda, MD; hereafter, "Sucampo" or "the Company") 10-K for the year ended December 31, 2014 to answer the following five questions.

---

1. What is the approximate age of the Company's "property and equipment?" Is that relatively new or relatively old compared to the expected life of the property and equipment? Explain.
2. Is the impairment charge in 2014 significant? Explain. Briefly describe the underlying reason for the impairment.
3. Assuming that accrued liabilities are recorded only once each year, what adjusting entry for "research and development" would the Company have made at the end of 2014?
4. What would be the journal entry required if the Company's operating leases were instead to be treated as capital leases? Base your response on the minimum lease payments and an annual discount rate of 4.3%.
5. Compute and evaluate the Company's current ratio as at December 31, 2014 and 2013.

## CONSOLIDATED BALANCE SHEETS

	December 31,	
	2014	2013
<i>(In thousands, except share and per share data)</i>		
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents	\$71,622	\$44,102
Investments, current	22,393	16,003
Product royalties receivable	18,576	14,829
Accounts receivable, net	5,338	5,407
Deferred tax assets, current	476	2,028
Deferred charge, current	295	673
Restricted cash, current	213	26,115
Inventory	—	209
Prepaid expenses and other current assets	3,411	3,987
Total current assets	122,324	113,353
Investments, non-current	13,540	7,219
Property and equipment, net	763	1,156
Intangible assets, net	151	6,438
Deferred tax assets, non-current	571	1,212
Deferred charge, non-current	1,695	4,540
Restricted cash, non-current	2,224	2,471
Other assets	306	488
Total assets	\$141,574	\$136,877
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>		
Current liabilities:		
Accounts payable	\$4,143	\$7,614
Accrued expenses	8,467	5,682
Deferred revenue, current	2,051	1,365
Collaboration obligation	6,000	—
Income tax payable	1,291	701
Notes payable, current	8,240	26,892
Other current liabilities	3,618	358
Total current liabilities	33,810	42,612
Notes payable, non-current	17,578	25,828
Deferred revenue, non-current	5,118	6,169
Deferred tax liability, non-current	820	2,066
Other liabilities	1,936	1,233
Total liabilities	59,262	77,908
Commitments and contingencies (Notes 8 and 11)		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized at December 31, 2014 and 2013; no shares issued and outstanding at December 31, 2014 and 2013	—	—
Class A common stock, \$0.01 par value; 270,000,000 shares authorized at December 31, 2014 and 2013; 44,602,988 and 43,315,749 shares issued and outstanding at December 31, 2014 and 2013, respectively	446	432
Class B common stock, \$0.01 par value; 75,000,000 shares authorized at December 31, 2014 and 2013; no shares issued and outstanding at December 31, 2014 and 2013	—	—
Additional paid-in capital	83,646	72,109
Accumulated other comprehensive income	14,265	15,601
Treasury stock, at cost; 524,792 shares at December 31, 2014 and 2013	(2,313)	(2,313)
Accumulated deficit	(13,732)	(26,860)
Total stockholders' equity	82,312	58,969
Total liabilities and stockholders' equity	\$141,574	\$136,877

**The accompanying notes are an integral part of these Consolidated Financial Statements.**

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

<i>(In thousands, except per share data)</i>	<b>Year Ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
Revenues:			
Research and development revenue	\$ 7,246	\$20,354	\$21,545
Product royalty revenue	62,775	52,100	50,696
Product sales revenue	33,252	16,425	5,037
Co-promotion revenue	3,360	61	3,576
Contract and collaboration revenue	8,817	654	633
Total revenues	115,450	89,594	81,487
Costs and expenses:			
Costs of goods sold	16,269	12,402	3,030
Intangible assets impairment	5,631	—	—
Research and development	20,566	21,524	21,292
General and administrative	31,230	25,413	30,157
Selling and marketing	14,523	21,059	18,691
Total costs and expenses	88,219	80,398	73,170
Income from operations	27,231	9,196	8,317
Non-operating income (expense):			
Interest income	172	124	179
Interest expense	(1,520)	(1,894)	(2,346)
Other income, net	1,250	3,517	1,827
Total non-operating income (expense), net	(98)	1,747	(340)
Income before income taxes	27,133	10,943	7,977
Income tax provision	(14,005)	(3,928)	(2,916)
Net income	\$ 13,128	\$ 7,015	\$ 5,061
Net income per share:			
Basic	\$ 0.30	\$ 0.17	\$ 0.12
Diluted	\$ 0.29	\$ 0.16	\$ 0.12
Weighted average common shares outstanding:			
Basic	43,691	41,716	41,660
Diluted	44,506	42,544	41,785
Comprehensive income:			
Net income	\$ 13,128	\$ 7,015	\$ 5,061
Other comprehensive income (loss):			
Unrealized loss on pension benefit obligation	(978)	—	—
Unrealized gain (loss) on investments, net of tax effect	(7)	2	36
Foreign currency translation	(351)	(567)	(1,724)
Total comprehensive income	\$ 11,792	\$ 6,450	\$ 3,373

***The accompanying notes are an integral part of these Consolidated Financial Statements.***

## 4. Current and Non-Current Investments

At December 31, 2014 and 2013, current and non-current investments consisted of the following securities:

<i>(In thousands)</i>	<b>December 31, 2014</b>			
	<b>Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
<i>Current:</i>				
U.S. government agencies	\$ 4,203	\$ 1	\$ —	\$ 4,204
Certificates of deposit	2,500	—	—	2,500
Corporate bonds	4,575	—	(3)	4,572
U.S. commercial paper	11,109	8	—	11,117
Total	\$22,387	\$ 9	\$ (3)	\$22,393
<i>Non-current:</i>				
U.S. government agencies	\$ 8,047	\$—	\$(15)	\$ 8,032
Certificates of deposit	5,000	—	—	5,000
Corporate bonds	509	—	(1)	508
Total	\$13,556	\$—	\$(16)	\$13,540

<i>(In thousands)</i>	<b>December 31, 2013</b>			
	<b>Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
<i>Current:</i>				
U.S. government securities	\$ 1,000	\$—	\$—	\$ 1,000
U.S. government agencies	9,048	3	—	9,051
Certificates of deposit	3,500	—	—	3,500
Corporate bonds	752	—	—	752
Municipal securities	1,700	—	—	1,700
Total	\$16,000	\$ 3	\$—	\$16,003
<i>Non-current:</i>				
U.S. government agencies	\$ 4,212	\$—	\$ (3)	\$ 4,209
Certificates of deposit	\$ 2,500	—	—	\$ 2,500
Corporate bonds	511	—	(1)	510
Total	\$ 7,223	\$—	\$ (4)	\$ 7,219

## 5. Property and Equipment

Property and equipment consists of the following at December 31, 2014 and 2013:

<i>(In thousands)</i>	<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>
Computer and office machines	\$ 2,622	\$ 2,607
Furniture and fixtures	473	480
Leasehold improvements	1,415	1,444
Total cost	4,510	4,531
Less: accumulated depreciation	(3,747)	(3,375)
Total	\$ 763	\$ 1,156

Depreciation expense for the years ended December 31, 2014, 2013 and 2012 was approximately \$422,000, \$512,000 and \$542,000, respectively.

The leasehold improvements as of December 31, 2014 and 2013 are tenant improvements to the Company's headquarters in Bethesda, Maryland.

## 6. Intangible Assets

The Company reviews definite lived intangible assets for impairment when events or changes in circumstances indicate that the carrying value of its intangible assets may not be recoverable. The carrying value of an intangible asset is assessed for impairment whenever anticipated future undiscounted cash flows from an intangible asset are estimated to be less than its carrying value. The amount of impairment loss recognized is the amount the carrying value exceeds its fair value.

During the three months ended September 30, 2014 the Company ceased RESCULA direct commercialization activities and ceased marketing RESCULA for its approved FDA indication. Accordingly, the Company recorded an impairment charge of \$5.6 million during the three months ended September 30, 2014 which represented the full amount of the remaining balances of the unamortized intangibles related to its two RESCULA license agreements described below. Both license agreements were for the development and commercialization of RESCULA for its approved indication and for any new indications for unoprostone isopropyl. Of the total impairment charge, \$1.5 million is included in the Company's Americas segment, and \$4.1 million is included in the Company's Europe segment for the twelve months ended December 31, 2014. There were no impairment charges recorded during the twelve months ended December 31, 2013 and 2012.

In April 2009, the Company entered into an agreement with R-Tech (2009 R-Tech Agreement) to license all patents and other intellectual property rights related to RESCULA for its FDA approved indication and any new indications for unoprostone isopropyl in the U.S. and Canada. A sNDA for RESCULA (unoprostone isopropyl ophthalmic solution) 0.15% for the lowering of IOP in patients with open-angle glaucoma or ocular hypertension was approved by the FDA in December 2012 and the Company began commercializing the product in February 2013. Under the terms of the 2009 R-Tech Agreement, the Company made upfront and milestone payments totaling \$3.5 million, of which \$3.4 million was allocated to an intangible asset and is included in "intangible assets, net" in the accompanying Consolidated Balance Sheet as of December 31, 2013. During the three months ended September 30, 2014, the Company ceased direct commercialization activities for RESCULA and has fully impaired the unamortized value of this intangible asset, resulting in a charge of \$1.5 million. The Company had been amortizing the \$3.4 million intangible over the 10-year life of the 2009 R-Tech Agreement, which the Company believed approximated the useful life of the underlying rights and data for the approved FDA indication. Amortization expense was approximately \$227,000 and \$341,000 for the twelve months ended December 31, 2014 and 2013, respectively. The unamortized amount included in intangible assets was nil at December 31, 2014 and \$1.8 million at December 31, 2013.

In March 2011, the Company entered into a license agreement with R-Tech for unoprostone isopropyl, (2011 R-Tech Agreement) expanding the Company's development and commercialization rights as well as its territories beyond their previously agreed territory of the U.S. and Canada to the rest of the world, with the exception of the R-Tech Territory. Pursuant

to the 2011 R-Tech Agreement, the Company made payments to R-Tech of \$6.0 million, which is reflected in “intangible assets, net” in the accompanying Consolidated Balance Sheet as of December 31, 2013. During the three months ended September 30, 2014, the Company ceased direct commercialization activities for RESCULA and has fully impaired the unamortized value of this intangible asset, resulting in a charge of \$4.1 million. The Company had been amortizing the \$6.0 million intangible over the 10-year life of the 2011 R-Tech Agreement, which the Company believed approximated the useful life of the underlying rights and data for the indication previously approved in Europe. Amortization expense was approximately \$409,000 and \$613,000 for the twelve months ended December 31, 2014 and 2013, respectively. The unamortized amount included in intangible assets was nil at December 31, 2014 and \$4.4 million at December 31, 2013.

## 7. Accrued Expenses

Accrued expenses consist of the following at December 31, 2014 and 2013:

<i>(In thousands)</i>	<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>
Research and development costs	\$3,537	\$1,775
Employee compensation	3,459	2,531
Selling and marketing costs	163	584
Legal service fees	612	14
Other accrued expenses	696	778
Total	\$8,467	\$5,682

## 8. Collaboration Obligation

Under the Global License Agreement (see Note 14), the Company received an upfront payment from Takeda of \$14.0 million in 2014, of which the Company is obligated to reimburse Takeda for the first \$6.0 million in developmental expenses incurred by Takeda.

## 9. Other Current Liabilities

Other current liabilities consist of the following at December 31, 2014 and 2013:

<i>(In thousands)</i>	<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>
Indirect taxes payable	3,075	—
Other liabilities	543	358
Total	\$3,618	\$358

## 10. Other Liabilities

Other liabilities consist of the following at December 31, 2014 and 2013:

<i>(In thousands)</i>	<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>
Deferred leasehold incentive	137	255
Deferred rent expense	243	341
Defined benefit obligation	977	—
Other liabilities	579	637
Total	\$1,936	\$1,233

## 11. Commitments and Contingencies

### Operating Leases

The Company leases office space in the U.S., Switzerland, and Japan, under operating leases through 2017. At December 31, 2014, total future minimum, non-cancelable lease payments under operating leases are as follows:

<i>(In thousands of U.S. dollars)</i>	<b>December 31, 2014</b>
2015	\$1,198
2016	1,189
2017	244
2018	104
2019	—
Total minimum lease payments	\$2,735

Rent expense for all operating leases was \$1.4 million, \$1.5 million and \$1.6 million for the years ended December 31, 2014, 2013 and 2012, respectively.