Financial Reporting Council

January 2021

Feedback Statement

Business Reporting of Intangibles: Realistic proposals

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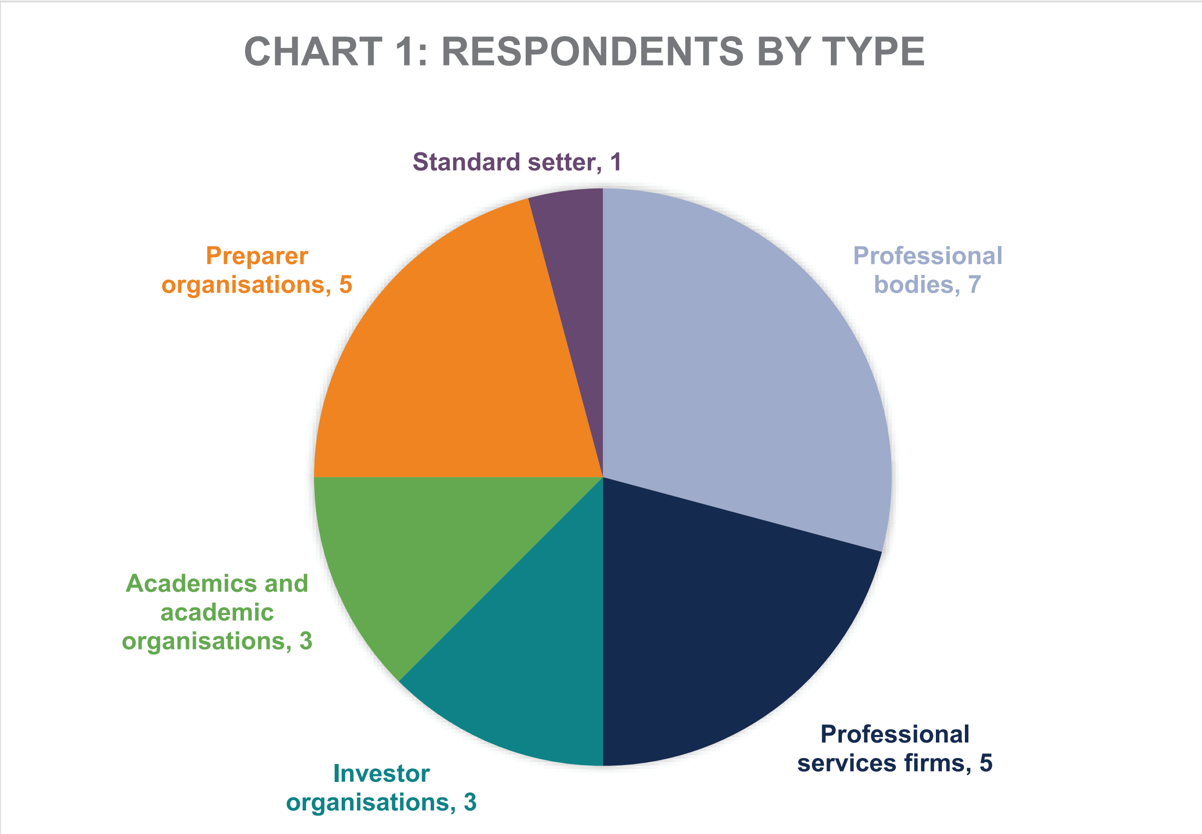
Contents

Overview of respondents

(i) In February 2019, FRC staff published the Discussion Paper *Business Reporting of Intangibles: Realistic Proposals*[1] (the Discussion Paper). This feedback statement provides a summary prepared by FRC staff of the views expressed in the responses to the Discussion Paper.

(ii) We received 24 responses. Chart 1 shows the types of individuals and organisations that responded. A full list of respondents is included in the Appendix. The responses are available on the FRC website at https://www.frc.org.uk/consultation-list/2019/discussion-paper-business-reporting-of-intangibl.



[1] The Discussion Paper is available at https://www.frc.org.uk/consultation-list/2019/discussion-paper-business-reporting-of-intangibl.

Feedback statement

General comments

1 A wide range of stakeholders responded to the Discussion Paper. It was generally well received as an important step towards improving reporting in this area. There was wide recognition of the growing importance of intangibles as we move towards a knowledge-based economy, given that they are critical to the business models of many companies. The majority of respondents acknowledged the limitations of the current reporting framework in capturing and presenting clearly the nature and value of intangibles and were supportive of efforts to address this issue, including strong support from investor respondents.

2 The importance of outreach with investors to ensure that any new requirements or guidance adequately addresses their information needs was emphasised by many respondents. The main reservation expressed about the proposals in the Discussion Paper was that, given the inherent measurement uncertainty relating to intangible assets, and the difficulty in identifying future-oriented expenditure, efforts to provide greater transparency would lead to highly subjective disclosures and involve a high degree of management judgement. There were also concerns around the commercial sensitivity of the information and compliance costs. However, some respondents noted that a potential lack of comparability should not be a barrier to providing information that is useful for investors, and that frameworks such as the WICI Intangibles Reporting Framework[2] enable the flexibility to disclose a range of metrics that allow for general comparison, industry-specific comparison and entity-specific measures.

3 We were encouraged by the general view of respondents that the Discussion Paper is a helpful contribution towards consideration of potential improvements to the reporting of intangibles, particularly in light of the forthcoming IASB agenda consultation.

Question 1

Do you agree that it is important to improve the business reporting of intangibles?

4 All respondents agreed with the importance of reporting on intangibles and many commented on the increasing significance of this in a knowledge-based economy. Three respondents (Business Europe, CRUF and the Wellcome Trust) noted that financial statements do not aim to present the market value of a company so the difference between net asset value and market value of a company is not, in itself, an issue. However, there was wide acknowledgement that intangibles are critical to long-term value generation in many businesses and therefore more transparency in this area is needed.

5 The ACCA response refers to joint research published in February 2019 by ACCA and Deloitte which supports the need for improved reporting on intangibles.[3] It found that generally companies do not provide a high quantity of R&D-related disclosure, despite the importance of intangibles such as R&D. It also noted that most companies expense the costs immediately and provide little disclosure of the reasons for this or the nature of the costs. It also identified a lack of disclosure in the rest of the annual report to compensate for the low level of disclosure in the financial statements.

2 WICI Intangibles Reporting Framework: http://www.wici-global.com/framework
3 https://www.accaglobal.com/lk/en/professional-insights/global-profession/the-capitalisation-debate.html

6 Investor respondents were unanimous in their support for improving the quality of reporting on intangibles. In particular, CRUF highlighted the need for improved disclosure around identifiable cash flows, separability and the justification for the useful economic life (or indefinite life) selected. There was also concern over information on intangibles being provided primarily outside the financial statements if this results in it not being audited (ShareSoc & UK Shareholders' Association).

7 The Investor Relations Society noted that companies may be reluctant to disclose more detailed information due to concerns over commercial sensitivity. Some respondents raised concerns over the potential introduction of new mandatory reporting requirements, particularly in terms of the burden this might place on small and medium-sized quoted companies (100 Group, QCA).

8 Several respondents (100 Group, ABI, GT, ICAEW, ICAS, KPMG, PwC, and the QCA) suggested a Financial Reporting Lab project on this topic to clearly define investor information needs, develop best practice and to identify why the existing requirements and guidance are not sufficient to encourage more useful disclosure. WICI referred to the framework and metrics that it has developed as a useful first step towards improving reporting on intangibles.

Question 2

Do you agree that an intangible should be recognised at cost under the two conditions set out above in (i)?

Note: The conditions suggested in the Discussion Paper to which Question 2 refers are that capitalisation of an intangible asset at cost is appropriate only where:

(i) the costs to be incurred on development of an intangible asset can be estimated at the time when a project to develop an intangible is undertaken. The amount capitalised should not exceed these estimated costs in view of the difficulty of establishing the future economic benefits; and

(ii) the economic benefits to be derived from the intangible can be specified when the costs are first incurred, and hence a relevant method of amortisation or monitoring for impairment can be established.

9 Respondents' views were split on the proposed criteria for recognition of intangibles at cost. Some respondents were in favour of retaining the existing recognition requirements in IAS 38 *Intangible Assets* (100 Group, ABI, Business Europe, CPA Australia, CPA Ireland, EY, ICAEW, PwC). Other respondents were broadly supportive of the proposals (CRUF, Dr Janice Denoncourt, EAA, ICAS, RICS, ShareSoc & UK Shareholders' Association, WICI).

10 Several respondents raised concerns that the proposed criteria are too restrictive (ABI, ACCA, some members of the EAA, EY, GT, ICAS). Several respondents also noted that the scope of a development project may change as it progresses, leading to increased costs but also increased future economic benefits, and that it would seem unreasonable to require companies to write off such costs if they are recoverable (ABI, ACCA, Christopher de Nahlik, EY GT, Mazars). PwC stated that the stringent recognition criteria in IAS 38 have two key advantages; preventing fluctuating results in the income statement, and highlighting the costs of only those assets that are likely to generate future revenue. It argued that replacing this with a cost recognition model would remove these advantages. GT suggested testing the conditions against different types of intangibles to assess how they would operate in practice. KPMG stated that the basis for the first condition seems arbitrary and was concerned that this would introduce additional subjectivity.

11 WICI's response made several observations in relation to question 2. It noted that there are existing capitalisation processes within IFRS, similar to that proposed in the discussion paper. IFRS 6 *Exploration for and Evaluation of Mineral Resources* allows a process for capitalisation of costs with uncertain future economic benefits. IAS 23 *Borrowing Costs* also mandates capitalisation of interest expenses on qualifying assets. WICI also noted that it is not clear why it is commonly accepted to have assets such as securities with no active market whose value is totally contingent upon financial models (fair value level 3), or investment properties fair valued according to a discounted cash flow formula (IAS 40 *Investment Property*), whilst intangibles—that are vital to businesses—are not recognised because there are uncertainties in the valuation process. WICI argued that either we accept the use of 'mark to model' for valuing assets or it is irrational not to accept it only for intangibles.

Question 3

> Do you agree with the assumptions the paper makes regarding the measurement uncertainty of intangibles? (paragraphs 2.7–2.24 of the Discussion Paper).

12 All respondents who answered this question agreed with the assumptions in the Discussion Paper regarding the measurement uncertainty of intangibles, although some with qualifications. ACCA and Mazars stated that the Discussion Paper concludes too quickly that little progress can be made on recognition and measurement. The EAA and Mazars suggested further research to evidence whether the measurement uncertainties for internally-generated intangibles really are greater than those for internally-generated tangible assets or externally-purchased intangibles. The 100 Group noted that the reason IAS 38 has such strict recognition and measurement criteria is due to the inherent limitations and subjectivity in valuing intangibles. PwC stated that there was little measurement uncertainty in a cost recognition model, but arguably it would produce less relevant information, and vice versa for a valuation model. KPMG observed that measurement of intangibles acquired in a business combination at fair value is only a means of allocation of an actual cost to the acquirer, whereas to measure an internally-generated intangible at fair value would (in many cases) be to carry it at a valuation exceeding its cost.

13 WICI argued that the measurement uncertainty is not insurmountable and suggested that, ideally, separable intangibles should be valued at value in use, to reflect the fact that the value of the same intangible to two different businesses would be different. It also stated that fair value measurement could be considered for intangibles that are separable, legally identifiable and already employed in company operations.

14 Dr Janice Denoncourt stated that the UK 'true and fair' legal requirement is relevant to this issue. While this doesn't require absolute quantitative certainty of present financial value, it is appropriate that a true and fair view comprise an assessment of all corporate assets, tangible and intangible. In her view, 'off-balance sheet' intangible assets need to have a visible and transparent place in modern business reporting.

Question 4

> Do you agree that existing accounting standards should be revised with the aim of improving the accounting for intangibles?

15 Respondents' views were divided on this question. A significant minority of respondents argued that the current requirements of IAS 38 should not be revisited unless there is a compelling need, as they are well understood and appropriate (100 Group, ABI, Business Europe, ICAEW, ICAS, EY, GT, PwC, Swedish Enterprise). Many of these respondents

favoured focusing on improvements to narrative reporting. However, the majority of respondents supported revisiting the current requirements (ACCA, Christopher de Nahlik, CPA Australia, CPA Ireland, CRUF, Dr Janice Denoncourt, EAA, KPMG, Mazars, QCA, RICS, ShareSoc & UK Shareholders' Association, WICI).

16 ShareSoc & UK Shareholders' Association stated that the starting point for revising the standards should be identifying and defining what investors want to know, and consideration of what caveats are required to ensure investors are not misled. CPA Australia stated that a market-driven demand for the presentation of financial information on intangibles presents a compelling case for revisiting the Conceptual Framework. Dr Janice Denoncourt suggested incorporating technological readiness levels (TRLs) developed by NASA[4] to measure research and development and technology intangibles. She argued that this would enable consistent, uniform discussions of technical maturity across different types of technology, supporting the assessment of investment and funding risks.

Question 5

Do you agree with the above proposals relating to expenditure on intangibles?

Note: The proposals in the Discussion Paper to which Question 5 refers are that separate disclosure should be provided (perhaps as a separate line item) for expenditure on 'future-oriented intangibles', that is expenditure which is incurred with a view to benefitting future periods, but is written off as a matter of accounting policy because it does not result in an item that meets the definition of an asset or fulfil the recognition criteria. The Discussion Paper acknowledged that determining which expenditure is 'future-oriented' will inevitably be subjective and judgmental.

The Discussion Paper also suggested disclosure (perhaps in a note to the financial statements) of the cumulative amount of expenditure on future-oriented intangibles that was still expected to benefit future periods. It provided the following illustrative example:

Production staff training for the future	20X1 £'000	20X2 £'000
Cumulative amount at the beginning of the year	510	627
Expenditure in the year	337	418
Deemed to have benefited current year	(170)	(209)
Reduction to reflect the abandonment of project X	(50)	—
Cumulative amount at the end of the year	627	836

Training for production staff is deemed to benefit operations over the average product cycle of three years.

17 Respondents' views were also divided on this question. The proposals were broadly supported by ACCA, EAA, Christopher de Nahlik, CPA Ireland, Dr Janice Denoncourt, ICAEW, ICAS, KPMG, PwC, RICS, ShareSoc & UK Shareholders' Association, Wellcome Trust, WICI. The proposals were not supported by 100 Group, ABI, Business Europe, CPA Australia, CRUF, EY, GT, Mazars, QCA, Swedish Enterprise.

18 The main concern of those who did not support the proposals was the inherently subjective nature of the allocation of costs between current period expenses and

4 https://www.nasa.gov/directorates/heo/scan/engineering/technology/txt_accordion1.html

expenditure on future-oriented intangibles. Many respondents believed that this could not be done in a consistent and non-arbitrary manner. There were also concerns that it would be open to manipulation by management, with a view to presenting a more favourable view of current period earnings.

19 QCA felt that the costs involved in providing the proposed disclosure may outweigh the benefits to users, but that material expenditure should be disclosed as part of the business model. EAA and EY suggested that further research is required to ascertain the demand from users for this information. Business Europe noted that this information may be commercially sensitive. GT argued that, as it is not possible to measure some intangibles at cost, the proposals would reduce comparability between companies with different types of intangibles. KPMG supported disclosure of the future-oriented expenditure but not on a cumulative basis as this would be tantamount to capitalisation and might invite users not to distinguish between capitalised and written-off expenditure. Mazars and CRUF stated that they would prefer the information to be included as a footnote. They also suggested it might be more practical to disclose separate line items for expenses that often contribute towards intangibles such as advertising and staff training. CRUF observed that users could combine such information with growth rate trends to make judgements on how much of this expenditure was future-oriented.

20 Those who supported the proposals felt that the benefits of the additional information outweighed the challenges. Several respondents emphasised the importance of the supplementary footnote disclosures to explain and provide context. PwC suggested combining this disclosure in the same place as disclosure of metrics to give a clearer picture of how spend has translated into economic benefits. Dr Janice Denoncourt noted that quantitative information enables users and other stakeholders to begin to understand and examine critically the directors' stewardship of corporate intangibles. RICS stated that visibility arguably outweighs the risk of allowing too much latitude to management. EAA observed that, contrary to concerns that it may lead to earnings management, the proposed income statement segregation may discourage value-destroying 'real activities' earnings management (e.g. cutting research and development or other expenditure on intangibles to hit a current period earnings target). WICI stated that the proposals would lead to a more accurate prospective evaluation of future profit and would also give a clearer picture of current period earnings, therefore improving comparability between companies.

Question 6

Do you agree with the proposals aimed at improving the quality of information on recognised and unrecognised intangibles in narrative reporting?

21 A majority of respondents expressed support for the proposals, albeit some with caveats or reservations (ACCA, Christopher de Nahlik, CPA Australia, CRUF, Dr Janice Denoncourt, EY, ICAEW, ICAS, Investor Relations Society, KPMG, Mazars, PwC, RICS, Wellcome Trust, WICI).

22 ICAS stated that the proposals do not go much beyond the existing recommendations in the Guidance on the Strategic Report. GT noted that there are various existing relevant requirements and sources of guidance that should capture this information – such as paragraph 5.11 of the Conceptual Framework and the UK Corporate Governance Code – and argued that it is unclear why these are not encouraging sufficient disclosure.

23 Several respondents specifically noted the importance of focusing on those intangibles that are critical to the business model and value generation (EY, GT, Investor Relations Society, Mazars, QCA, PwC, ShareSoc & UK Shareholders' Association). However, ShareSoc & UK Shareholders' Association argued that business model reporting is

generally poor quality and is unaudited and therefore constitutes a weak foundation for improved reporting on intangibles.

24 There was significant support for disclosure of metrics standardised by industry (ACCA, Christopher de Nahlik, CPA Australia, CRUF, Dr Janice Denoncourt, EAA, EY, ICAS, Mazars, WICI). Dr Janice Denoncourt noted that a framework for disclosure would reduce the risk of selective disclosure of positive metrics. EAA and WICI suggested referring to the WICI industry-based metrics and ‘inverted pyramid’ approach which would enable comparison across companies, supplemented by some entity-specific measures.

25 CPA Ireland and QCA expressed concerns over compliance costs in producing the metrics. PwC argued that it may be unrealistic at this time to expect companies to consistently report quantified metrics for all intangibles, but that this is an evolving area of reporting and that availability and transparency should take precedence over comparability. KPMG emphasised that it is important not to create apparent comparability between entities within the same industry that are pursuing different strategies. The 100 Group, Christopher de Nahlik and ShareSoc & UK Shareholders’ Association stated that they expected companies to be reluctant to disclose this information as they deem it to be commercially sensitive. Conversely, Dr Janice Denoncourt argued that increased disclosure would reduce information asymmetries and therefore has the potential to reduce cost of capital, help companies access finance, lower interest rates and help to foster trust.

Question 7

> What are your views about how the various participants involved in business reporting could or should contribute to the implementation of the proposals made in the paper?

26 Many respondents emphasised the importance of collaboration between the various participants to develop best practice (100 Group, EY, GT, ICAS, QCA, Pwc, ShareSoc & UK Shareholders’ Association). Several suggested this could be facilitated by a Financial Reporting Lab project on the topic. 100 Group, Dr Janice Denoncourt, EAA and Mazars stated that assurance over the information would be important, even if disclosed outside the financial statements. Dr Janice Denoncourt argued that audits should focus on IP and technology as well as financial audit.

27 ACCA, EAA, EY, Mazars and WICI noted the importance of involving global organisations already involved in this area or looking at existing frameworks that are consistent with the proposals in the Discussion Paper (examples provided included the WICI Intangibles Reporting Framework, Integrated Reporting Framework, Task Force on Climate-Related Financial Disclosures framework, Natural Capital Coalition, or the work of the Embankment Project for Inclusive Capitalism).

28 Many respondents highlighted the importance of further outreach with investors, to ensure their information needs are clearly understood and that any proposals taken forward will meet those needs (100 Group, Business Europe, Christopher de Nahlik, CPA Ireland, CRUF, ICAEW, Investor Relations Society, Mazars, PwC, SEAG, ShareSoc & UK Shareholders’ Association). EAA and QCA noted that industry associations should be consulted if developing industry-specific metrics or guidance, and could provide a route to preparer engagement. Several respondents stated that regulators and standard setters have an important role to play in co-ordinating efforts to improve quality (ABI, CPA Australia, Christopher de Nahlik, GT, EY, ICAS, Mazars, QCA).

29 Dr Janice Denoncourt emphasised the importance of corporate governance and board oversight in addition to reporting. She suggested that large and listed companies should

ensure that at least one appropriately qualified person is appointed and publicly reported as having oversight and responsibility for intangibles (for example, a director, NED, specialist advisory board, or an external professional adviser). She also suggested the formation of a high-level expert group of accountants, corporate governance specialists, intangibles and IP experts, regulatory bodies, UKIPO and government, to inform the FRC's future guidelines.

Question 8

> Do you use additional information other than the financial statements when assessing and valuing intangibles? If so, can you please specify what additional information you use.

30 Respondents listed a wide range of sources of information: narrative information elsewhere in the annual report; information that has been collected for commercial sale; information on IP, technology, patents and trademarks; external estimates of brand value/recognition; voluntary disclosures on research and development activities; pipeline of new products; marketing-related indicators such as page views or subscriber base statistics; organisational indicators on training, quality targets, productivity, personnel features, and employee engagement and attrition; ESG disclosures; strategy and strategic alliances with other entities; information on customer and supplier markets, reputation, customer satisfaction and loyalty/repeat business; general business macro-environmental information; industry-based KPIs; media and broker reports; sharing information with other investors; company visits to ascertain culture and quality of management; direct engagement with senior management; focus on diversity and inclusiveness and social purpose, including possible impact on reputation; market capitalisation; general internet searches; and analyst presentations.

Question 9

> Do you have any suggestions, other than those put forward in this paper, as to how improving the business reporting of intangibles might be achieved?

31 QCA stated that clearer guidance on the reporting of intangibles would be helpful and suggested that the FRC carry out a thematic review on this topic. RICS stated the importance of improving the valuation process for intangibles. Christopher de Nahlik suggested that clearer definitions to distinguish between research and development are needed. SEAG suggested the reintroduction of amortisation of goodwill as a pragmatic way to reduce the impact of different accounting treatment for acquired and internally-generated intangibles. PwC suggested focusing on industries where innovation through research and development is already monitored – such as pharmaceuticals – to establish an industry-specific approach before expanding this to broader consultation. CRUF stated that companies should be encouraged to disclose all items of material 'revenue investment' (i.e. future-oriented expenditure), such as research and development, information technology and advertising. Dr Janice Denoncourt referred to additional publications that might be relevant. KPMG stated that improving reporting of intangibles is a global challenge that is best dealt with through the same channels as traditional financial reporting, and urged the FRC to support development through the IASB.

Appendix
List of respondents

Name	Type of respondent	Geographic location
100 Group	Preparer organisation	UK
Association of British Insurers (ABI)	Preparer Organisation	UK
Association of Chartered Certified Accountants (ACCA)	Professional body	International
Business Europe	Preparer organisation	International
Certified Practising Accountants Australia (CPA Australia)	Professional body	Australia
Christopher de Nahlik	Academic	UK
Corporate Reporting Users Forum (CRUF)	Investor organisation	International
Dr Janice Denoncourt	Academic	UK
Ernst & Young LLP (EY)	Professional services firm	UK
European Accounting Association – Corporate Reporting Committee (EAA)	Academic organisation	International
Grant Thornton UK LLP (GT)	Professional services firm	UK
Institute of Certified Public Accountants in Ireland (CPA Ireland)	Professional body	Ireland
Institute of Chartered Accountants in England and Wales (ICAEW)	Professional body	UK
Institute of Chartered Accountants of Scotland (ICAS)	Professional body	UK
Investor Relations Society (IR Society)	Professional body	UK
KPMG LLP (KPMG)	Professional services firm	UK
Mazars LLP (Mazars)	Professional services firm	UK
PricewaterhouseCoopers LLP (PwC)	Professional services firm	UK
Quoted Companies Alliance (QCA)	Preparer organisation	UK
Royal Institution of Chartered Surveyors (RICS)	Professional body	UK
Swedish Enterprise Accounting Group (SEAG)	Preparer organisation	Sweden
The Wellcome Trust	Charity/investor	UK

Name	Type of respondent	Geographic location
UK Individual Shareholders Society (ShareSoc) & UK Shareholders' Association	Investor organisations	UK
World Intellectual Capital/ Assets Initiative (WICI)	Standard setter	International

Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk