Private and confidential

By email to: intangibles@frc.org.uk
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Dear Sir

Business Reporting of Intangibles: Realistic proposals – Discussion paper

We welcome the opportunity to comment, on behalf of PricewaterhouseCoopers LLP, on the aforementioned discussion paper. Our responses to the questions asked by the FRC and other comments are included in the appendix to this letter, while an overview of our thoughts is set out below.

PwC supports initiatives that aim to provide readers of annual reports with information that helps them get a better understanding of the underlying resources/relationships ('intangibles') essential to the long-term success of a company and its business model.

Over 20 years of experience in exploring this information, and the views of investors and preparers, has confirmed the view that narrative reporting, outside of the financial statements, is critically important in forming an opinion on the quality and sustainability of performance. Yet users remain frustrated in the quality of information they get in this area. For example, in our 2017 UK Investor Survey on Corporate Reporting, 43% of investors said that companies needed to improve how they report on their business models and how they make money, and intangibles are a key factor in this discussion.

The UK reporting model (the Strategic Report) already provides a framework that encourages companies to provide this information in the form of insights into market trends, strategy, business model, risks and performance. Our annual review of reporting practices in the FTSE 350 has shown a gradual improvement in the quality of information around these key components and related resources and relationships. However we feel there is a lot more companies can do to provide relevant information, supported with quantified data, around the strategies to support them, the risks in their continuing availability and performance.

The gradual change provokes the question as to whether further rules and requirements would improve reporting in this area, or whether a different approach, focusing on encouraging transparency, could have more impact. From a financial reporting perspective, we don't believe that requiring companies to put more intangibles on the balance sheet (with all the additional judgement and estimation that this requires) is the right way to go at the current time.

The UK has the right framework for companies to report this information and the challenge is how to encourage companies to provide more transparency around their intangibles - which will come from more engagement with/pressure from investors and companies' appetite to be more accountable.

In our view, one of the key barriers to improving reporting on intangibles will be the quality and availability of management information. Our recent global CEO survey shows the continuing gap that pervades between the relative importance of information on intangibles and CEOs' confidence in the quality of information that they have at their disposal. This would suggest that more pressure to put arbitrary values on intangibles for which companies don't have sufficient information is not the way forward.

Our research, and indeed the work of the FRC Reporting Lab, supports the idea of more quantified information and principles supporting its disclosure. The most recent update to the Strategic Report guidance in 2018 needs further time to be adopted. We encourage the FRC to continue to showcase and profile good practice through publications such as thematic reviews and FRC Lab implementation studies.

If you have any questions or would like to discuss any of the points raised in this letter in more detail, please contact Peter Hogarth (peter.hogarth@pwc.com).

Yours faithfully

PricewaterhouseCoopers LLP

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Appendix - PwC response to questions

Question 1: Do you agree that it is important to improve the business reporting of intangibles?

Yes we do agree, but in doing so we believe it is also important to define more clearly what is meant by intangibles and expenditure on intangibles. While some intangibles are more frequently seen, such as software and licences, there will inevitably be significant judgement in considering what sorts of intangibles business reporting should apply. For example, various UK tax reliefs for research and development permit items such as educational costs and pension costs for related staff - we would question whether disclosure of this expenditure would add to an understanding of intangibles. Further clarity is therefore required.

Notwithstanding the above, we do believe that improved reporting has the potential to reduce the difference in current disclosures for intangible assets that are generated internally (generally not recognised and often not disclosed) rather than purchased from market participants (generally recognised and disclosed). Additional disclosures could also help readers appreciate how much economic benefits the entity receives from intangible assets, both recognised and unrecognised, how these impact its business model and investment case and ultimately what the value created from these assets looks like.

Question 2: Do you agree that an intangible should be recognised at cost under the two conditions set out above in (i)?

No, we do not agree for the reasons set out in the discussion paper. IFRS currently does not allow these costs to be capitalised, so any change would require IASB action which is not currently in its pipeline.

Current standards (such as IAS 38) only allow recognition when there is a higher likelihood of the intangible asset being beneficial to the entity. This has two key advantages, that it prevents fluctuating results in the income statement (ie. if the company were to capitalise now then impair later if there is an unsuccessful outcome), and additionally that it allows users to understand the cost of assets that are likely to generate future revenue or generate value through future cost-savings. To replace this with a cost recognition model would remove these advantages.

Question 3: Do you agree with the assumptions the paper makes regarding measurement uncertainty of intangibles?

Measurement uncertainties would inevitably arise where fair value is applied.

In a cost model, it does not appear there would be measurement uncertainty in determining costs incurred. If there were no (or minimal) costs then nothing would be capitalised. It is debatable whether the amount of cost provides relevant information, but this is not a consequence of uncertain measurement.

In a fair value model, as the paper points out, there are challenges around choosing the appropriate valuation approach/methodology which does potentially introduce greater measurement uncertainty but would provide more relevant information, if considered reliable.

Question 4: Do you agree that existing accounting standards should be revisited with the aim of improving the accounting for intangibles?

The existing accounting standards should only be changed if this would result in more relevant and reliable information. The current standards only allow capitalisation when it is probable that future economic benefits will be generated. The proposed recognition criteria reduce the distinction between an asset and a contingent asset and this may not achieve the aim of providing more relevant and reliable information.

An alternative approach could be to concentrate on providing additional narrative information regarding spend, key metrics, the strategy in relation to intangibles and the pipeline for future spend and use of intangibles. These points are explored further in our response to question 6.

Question 5: Do you agree with the above proposals relating to expenditure on intangibles?

In principle these proposals are a good idea since they could improve transparency in reporting, although they could also lead to boilerplate disclosure if made too prescriptive. Conversely a less prescriptive approach could result in a disparity in outcomes, making comparability between companies/sectors difficult.

Whilst we highlight some of our concerns in defining "expenditure", we expect that relevant disclosures for future-oriented intangible assets would be useful for the readers of the financial statements. It would allow readers to understand: a) how much expenditure did not result in capitalisation; and b) how efficient the company is regarding spend on research and development

The proposals relating to expenditure on intangibles would be useful, however they would not in isolation explain the future benefits the entity hopes to derive from these assets. An enhanced disclosure could be to include both the spend and relevant metrics in the same document (presumably the annual report) to allow users to appreciate how the spend has subsequently translated into economic benefits for the entity.

Question 6: Do you agree with the proposals aimed at improving the quality of information on recognised and unrecognised intangibles in narrative reporting?

We agree with the overarching aim to improve the quality of this information, and we welcome the recent improvements to the FRC's Strategic Report Guidance which provides further clarity on how this can be achieved (for example, the focus on intangibles and "other" assets as part of the explanation of a company's business model).

Regarding the specific proposals within the discussion paper, we set out our views below.

i) Comparability of reporting. Whilst we agree that comparability of information is useful, we believe the success of this proposal would vary depending on the company's industry and its ability to gather information. At this point in time, greater availability and transparency of information should take precedence over comparability, which is an issue that many companies continue to grapple with. However we would emphasise the importance of comparability for a company across periods.

ii) Identification of metrics. Similar to our first point, the use of identifiable and reconcilable metrics would be a useful source of information where these already exist. For key intangibles, some companies may already monitor their progress or success through a KPI/metric, but as many companies continue to grapple with the quality of availability of data sources relevant to their business, it may be too soon to expect companies to consistently report quantified metrics for all intangibles.

In our view, companies' reporting in this area continues to evolve and there is a risk that additional requirements for narrative reporting might create an additional burden and could lead to boilerplate reporting.

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?

Any consultation on changes to business reporting should focus on the users of the information, but also include the views of preparers of this information. As we highlight in our response to question 6, the readiness of companies and the availability of information will be key in implementing any significant change in the reporting of intangibles.

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.

Our Valuation experts use a broad array of information outside of the financial statements in their activities. Examples of the information used include:

- Customers - data on repeat business/customer attrition provides insights on the durability of customer relationships
- Brands - brand recognition provides insights on the strength of the brand (the role it plays in customer behaviour) and potentially its longevity.
- Employees - information on satisfaction/engagement and the level of turnover provides insights into the value of the workforce and the company's culture.
- Purpose - a focus on diversity and inclusion, and social purpose, will provide a perspective on a company's brand/standing in the market and possible impact on its reputation.
- Innovation - information on R&D, return on innovation and success of the pipeline provides insights into a company's agility and ability to innovate which will ultimately impact the business's ability to compete in new markets/launch new products.
- Patents - insights into a company's approach to contracting/patenting/trademarking provides insights into the degree of their legal focus and help users understand how well the business is seeking to protect the value of its intangibles.

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?

As set out in our covering letter, we welcome continued improvements to business reporting of intangibles. The recent examples, through the FRC Lab, of showcasing and celebrating innovation and good practice in reporting can be a useful tool to encourage improved reporting, rather than mandating change.

As the topic of business reporting for intangibles evolves, it may serve as a useful starting point to focus on industries where innovation through research and development is already monitored, such as Pharmaceuticals. An industry-specific approach to intangible business reporting could be established, before expanding this to a broader consultation.