

Submission



Andrew Lennard
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via email: intangibles@frc.org.uk

Dear Mr Lennard:

Financial Reporting Council Business Reporting of Intangibles: Realistic proposals

RICS is pleased to submit its response to the consultation paper dated February 2019 pertaining to the Financial Reporting Council's (FRC) Business Reporting of Intangibles: Realistic proposals (the 'Discussion Paper'). We appreciate the opportunity to provide observations and comments, which we set out in detail on the pages that follow. We would naturally be happy to discuss any aspect of this response if you would find that helpful.

Yours sincerely

David Park MA FRICS

Chair, RICS Global Valuation Standards Board

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RICS Valuation Professional Group Directorate
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About RICS

RICS promotes and enforces the highest professional qualifications and standards in the valuation, development and management of land, real estate, construction and infrastructure.

Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit over 130,000 professionals and any individual or firm registered with RICS is subject to our quality assurance.

Their expertise covers property, asset valuation and real estate management; the costing and leadership of construction projects; the development of infrastructure; and the management of natural resources, such as mining, farms and woodland. From environmental assessments and building controls to negotiating land rights in an emerging economy; if our professionals are involved the same standards and ethics apply.

We believe that standards underpin effective markets. With up to seventy per cent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

With offices covering the major political and financial centres of the world, our market presence means we are ideally placed to influence policy and embed professional standards. We work at a cross-governmental level, delivering international standards that will support a safe and vibrant marketplace in valuation, land, real estate, construction and infrastructure, for the benefit of all.

We are proud of our reputation and we guard it fiercely, so clients who work with an RICS professional can have confidence in the quality and ethics of the services they receive.

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

Yes, in the interests of transparency, since the present constraints of the definition of assets and recognition criteria (paragraph 1.6 of the Discussion Paper) result in an actual or perceived risk of under-reporting.

For example, under a business combination, a company which owns numerous patents may not have any intangibles allocated to this asset on its financial statements if all the patents are not considered unique and proprietary. These improvements may provide better information of the company's goodwill and identifiable amortisable intangibles.

Also, even though the valuation analysis is performed in many cases by third-party valuers retained by company management, the identification of intangible assets, including intangibles, will continue to presumably be the responsibility of company management. Thus, additional guidance and/or education will be helpful to implement changes to the accounting standards.

Finally, all potential intangibles should be evaluated, discussed, and agreed upon among the valuer and company management as meeting the 'new' recognition criteria (assuming changes are made to the definition of assets and recognition criteria).

To help improve the reporting of intangibles, this process should be well documented by the valuer in his or her working papers.

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

- (i) *An intangible should be recognised at cost only where:*
- *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*
 - *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.*

Yes, we agree that an intangible should be recognised at cost under the two conditions.

However, some qualification is needed in relation to "estimated" - any estimate needs to be soundly based and be rooted in some clear rationale, so far as possible either factually-based or at least market-related (however indirectly). Advertising expenditure with a view to brand-building would be an illustration of where the cost can be readily specified, whilst quantifying the benefits is very difficult (and misjudged effort can result in a sudden surge in demand for the product(s) followed by a marked falling off in orders, which might not result in any overall benefit).

In many cases the economic benefits to be derived will be very subjective and not necessarily recognised by potential purchasers of the entity.

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

Yes, Section 2, specifically under each of the three approaches (the cost, market and income) in the Discussion Paper, captures the key points regarding measurement uncertainty of intangibles.

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

Yes; however, changes to the existing accounting standards that would allow more intangibles to be recognised within the financial statements should be assessed to ensure that the improvement of business reporting of intangibles does not reduce the objectivity and reliability of financial statements.

In addition, the recognition and valuation of these intangibles will increase the amount of effort and potential fees paid to external valuation service providers. Therefore, it is important that the FRC provides the rationale for improving business reporting of these intangibles and the consequences if these 'standards' are not met.

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

The proposition in paragraph 3.4 has definite merit, and it could be argued that transparency (or perhaps, in this particular context, simple visibility) outweighs the risk of allowing too much latitude to management. The supplementary disclosures proposal at paragraph 3.9 would provide some useful safeguards and certainly help to counter that risk.

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

Narrative reporting along the lines suggested would be a material step forward, without imposing unreasonable burdens. It would certainly assist investors as well as creditors, who would be able to make better informed judgements, even though the emphasis would continue to be on "judgement".

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?*

It is important to obtain sufficient market feedback from various stakeholders including, but not limited to, company management/directors, auditors, and valuers to understand the challenges and benefits of implementing the proposals made in the Discussion Paper about improving the business reporting of intangibles.

The discussion around measuring internally generated intangibles is not new. To our knowledge there is no definitive conclusion yet in other authoritative documents about whether to value internally generated intangibles; however, when valuations if properly

carried out and validated could be informative. As a result, robust fair value assessments for financial reporting purposes are likely to be more informative but also likely to be more costly for the market (valuers, companies, etc.).

Finally, quality work should never be sacrificed. However, the size of a business and its assets should be a factor in any decision on what intangibles are appropriate and affordable.

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.*

As a valuation professional organisation, many of our members perform valuations of intangibles for financial reporting purposes as well as lending, corporate tax and transfer pricing purposes for his or her clients, to name a few.

Question 9: *Do you have any suggestions, other those put forward in this paper, as to how improving the business reporting of intangibles might be achieved?*

In addition to improving the business reporting of intangibles, improvements in the process to value the intangibles should also be enhanced – to ensure appropriate valuation methods and reasonable and supportable assumptions are documented and used to support the conclusion of values.