The UK Intangibles Landscape

The UKEB

The UK Endorsement Board (UKEB) is responsible for the endorsement and adoption of IFRS Accounting Standards for use in the UK and is, therefore, the UK's National Standard Setter for IFRS Accounting Standards.

Which entities use IFRS Accounting Standards in the UK?

There are currently approximately 1,500 entities with equity listed on the London Stock Exchange that prepare their financial statements in accordance with IFRS Accounting Standards. In addition, UK law allows unlisted companies the option to use IFRS Accounting Standards and approximately 14,000 such companies currently take up this option.

Why has the UKEB conducted a research project on intangibles?

The International Accounting Standards Board has started a project to comprehensively review the accounting for intangibles. They want to know if the current requirements are relevant and fairly reflect business models, or if they could be improved.

In anticipation of an international debate, in 2022 the UKEB began a research project focused on understanding UK stakeholders' views on the accounting for intangibles and gathering evidence about the UK intangibles landscape.

The main IFRS intangibles requirements

Most of the accounting requirements on intangibles come from two IFRS Accounting Standards, IAS 38 *Intangible Assets* and IFRS 3 *Business Combinations*. The requirements are different for intangible assets that entities create inhouse and those that they acquire, either as separate assets or within a merger or acquisition deal (a 'business combination').

Type of intangible	Recognition	Examples	Standard and paragraph reference
Separately acquired intangible assets	Capitalise at cost	Licences, emissions trading certificates, brands	IAS 38 paragraphs 25-32
Identifiable intangible assets acquired in a business combination	Capitalise at fair value	Brands, customer relationships, technical developments	IAS 38 paragraphs 33-37 and IFRS 3 paragraph 18
Internally generated intangibles (development costs)	Capitalise at cost providing criteria are met otherwise expense	Only technological, scientific or software development allowed for recognition	IAS 38 paragraphs 51-67
Goodwill resulting from a business combination	Capitalise	An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.	IFRS 3 paragraph 32

An overview of the project

The UKEB has published three reports summarising our research work. We will use the findings as an evidence base in our future work on intangibles.

The UKEB's research project:

Explored UK stakeholders' views on the accounting for intangibles under IFRS Accounting Standards. The UKEB published a report on this stage of the project in March 2023.

Reviewed the nature and extent of current reporting practices for intangibles among listed UK companies. The UKEB published a report on this stage of the project in May 2024.

Engaged with investors to better understand their perspectives on the current and future reporting of intangibles in the financial statements. The UKEB published a report on this stage of the project in May 2024.

All three reports are available on the UKEB's website https://www.endorsement-board.uk/intangibles-project.

Qualitative report – key findings

In 2022, semi-structured interviews were conducted with 35 UK stakeholders, all preparers or users of financial statements prepared in accordance with IFRS Accounting Standards.

A number of common themes were raised by interviewees:

- IAS 38 *Intangible Assets* is not wholly aligned with the current *Conceptual Framework for Financial Reporting*.

- Comparing companies which have grown organically with those that have grown by acquisition is problematic because there are different requirements for internally generated and purchased intangibles.

"We spend a lot of time trying to figure out the intangible spend. Enhanced disclosure on expenses would be useful, like a breakdown of research and development and clear identification of marketing expenses." **Analyst**

- The disclosure about intangible expenditure in financial statements could be enhanced, with more disaggregation of information. This would be preferred over additional information in the narrative because information in the financial statements is audited and therefore given more weight by investors.

"The real opportunity is not necessarily putting in a number in the balance sheet, but other indicators could be useful that support the business model. Every genuine investor would welcome better insights into drivers." **User**

- Both qualitative and quantitative factors influence materiality judgements about intangibles.

Survey report – key findings

Users of financial statements were asked to complete a detailed survey designed by the UKEB in September 2023.

46 responses were received from a variety of users, including analysts and investors (50%), lenders and credit-rating agencies (6%) and others (44%).

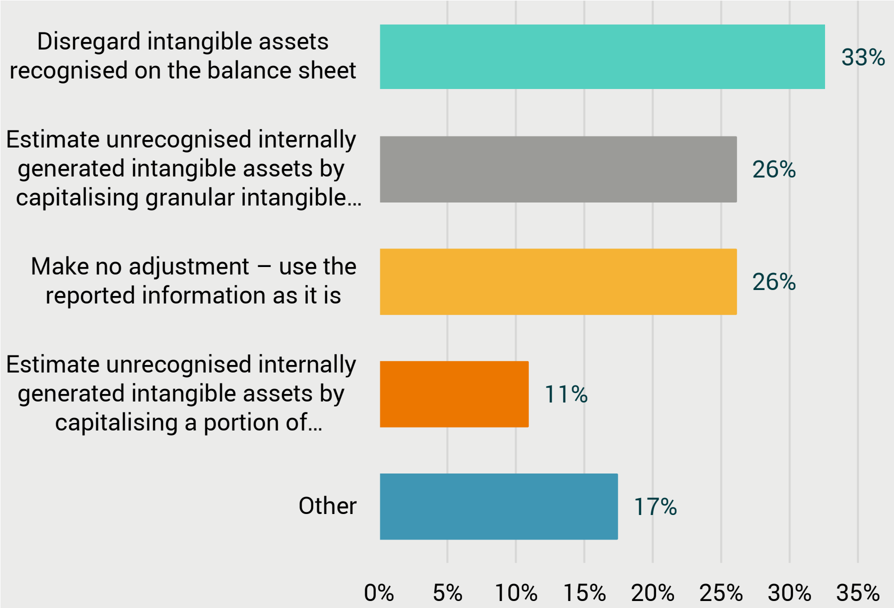
Respondents were asked about their views on the current accounting for intangibles and their preferences for future accounting.

Current accounting

85% of survey respondents told us that intangibles are ‘very or extremely’ economically important.

However, only 52% of respondents said that the current financial statement information is ‘very or extremely’ useful. So, there appears to be an expectations gap in this area.

Almost three quarters of respondents reported that they make adjustments to the intangibles figures in financial statements. This applies especially when they compare companies which have grown organically and those that have grown through acquisitions.



Future accounting

For most internally generated intangibles, most respondents preferred expensing to capitalising. For software and product development, the majority preferred capitalising (the current treatment).

Respondents were mixed on whether to expense or capitalise acquired items (and were particularly split on the treatment of acquired customer lists and corporate data).

Respondents were also mixed on whether to expense or capitalise non-traditional intangibles. If capitalised, there was a preference for the use of fair value as opposed to cost, with the exception of emission certificates held to offset future emissions

79% would find information about revenue potential from intangibles a useful disclosure.

Quantitative report – key findings

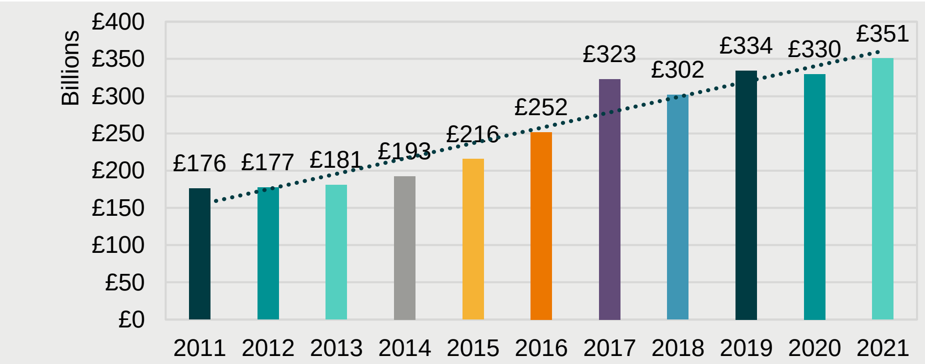
The UKEB quantitative work was conducted between 2022 and 2024. It involved several different analyses:

- Examination of financial statement data on intangible assets reported by all UK listed companies (population) from 2011-2021
- Review of intangibles financial statement data of a sample of 80 companies for 2021
- Investigation of M&A transactions from 2011-2021 at market level and selected sample from the 20 largest deals
- Estimate of value of unrecognised intangibles in UK listed companies for 2011-2021, and estimated distribution between industries and companies of different sizes

Population

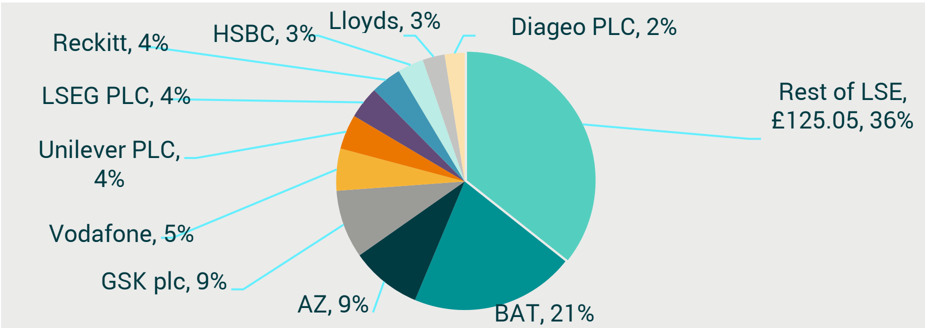
In 2021, the carrying amount of intangible assets (excluding goodwill) on listed UK Companies' balance sheets was £351bn.

The average growth rate in intangible assets from 2011-2021 was 8%. This far exceeded both inflation and the growth in total assets over the same period.



79% of companies had at least one intangible asset on their balance sheet in 2021.

The largest 25% of companies had 97% of the intangible assets in the population. 10 companies held almost two thirds of the total intangibles balance in 2021 –driven by purchased intangibles from M&A activity.



Sample

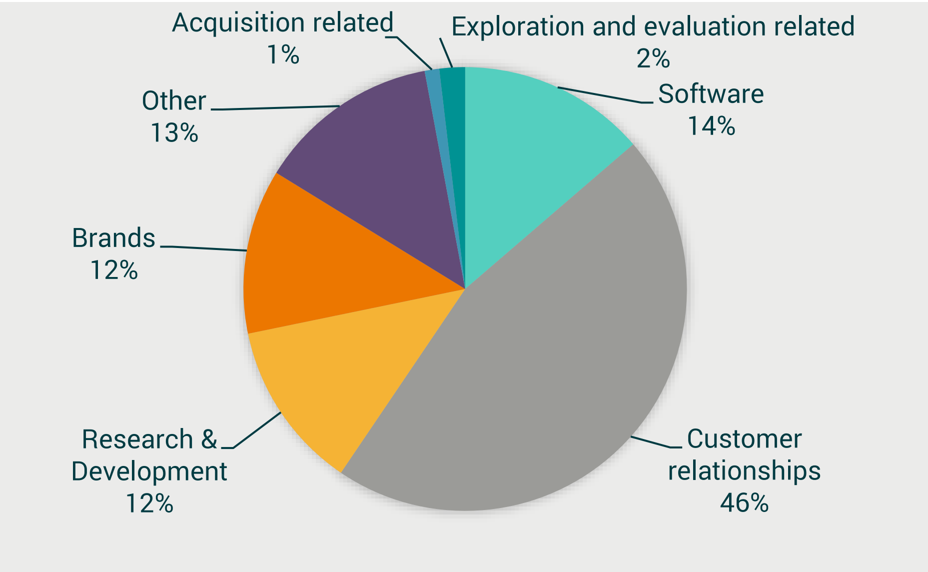
A wide variety of categories and terminology is used in financial statements' intangibles notes to the financial statements.

Intellectual property spanned research and development and brand items.

Smaller companies are more likely to have R&D and software intangibles (internally generated) and a wider range of intangible assets than larger companies.

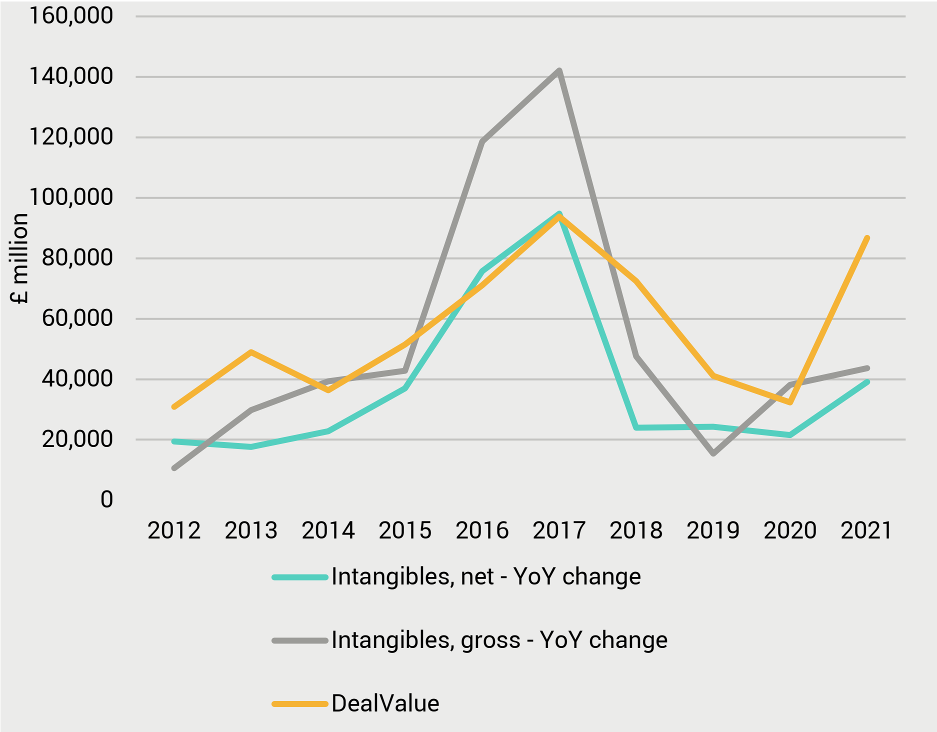
24% of companies in the sample did not appear to clearly distinguish between purchased and internally generated intangibles.

31 companies disclosed research expense in the notes, but only 55% of these also had capitalised development costs.



M&A review

Intangibles at cost (gross) and carrying amount (net) correlate with deal values over the period 2011-2021



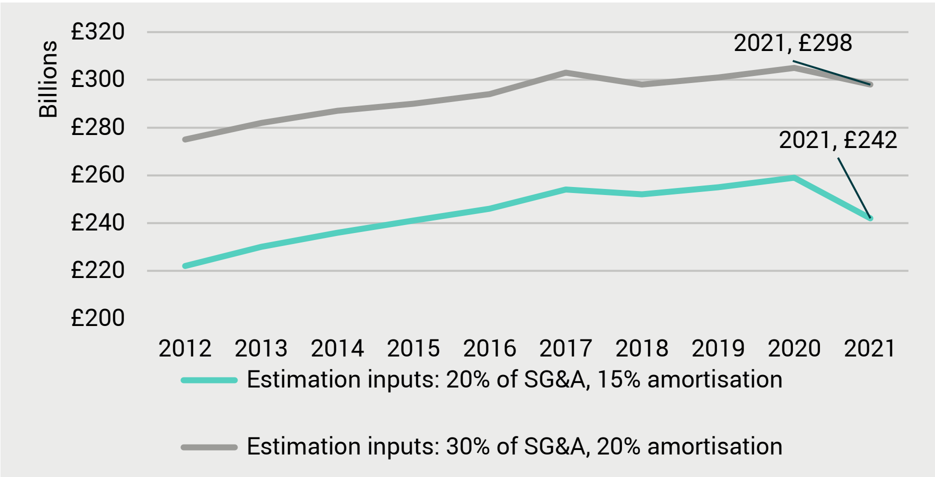
For the 20 largest deals during the period, average intangible assets were 33% of purchased assets but varied from 0-84%.

Deal narratives in the 'front half' of the annual report largely aligned with the profile of assets acquired and reflected in the financial statements (intangible/tangible/financial assets/goodwill).

Estimate of unrecognised intangibles

From an economic perspective it can be argued that intangibles that are acquired in a business combination bring (or are expected to bring in the future) economic benefit to the target firms prior to acquisition, even if they were not previously recognised on the target's balance sheet.

The perpetual inventory method (Peters and Taylor, 2017) was used to estimate the amount of unrecognised balance sheet intangible assets over 2011-2021. Two sets of assumptions were used.



The order of magnitude of the estimate is similar to estimates made by the Office of National Statistics (Martin, 2019).

The distribution of these intangibles by company size and industry mirrors that found in the data on recognised intangible assets from UK listed companies .

Conclusions and next steps

UK stakeholders want improvements to the accounting for intangibles.

There is a clear call for change in relation to the disclosures of intangible expenditure in the financial statements. Users want more granular information to be disclosed about company spending on intangibles, and the expected benefits from that spending.

Differences in accounting treatment for internally generated and acquired intangibles hamper comparisons of companies based on commonly used performance indicators.

There was no clear consensus on changes to accounting treatments, with the exception of non-traditional intangibles, for which demand for enhanced recognition and measurement compared with current practice was evident from many respondents.

Lenders have expressed the view that IP-backed finance is growing in importance, but that interactions between company accounting and Banks' regulatory capital rules may be impeding lending to innovative companies, because only capitalised intangible assets are used in lending decisions.

While intangible assets are widespread and increasing in value, they still only represent around 3% of the balance sheet of UK listed companies.

A few companies, particularly those that have grown through acquisition, report most of the recognised intangibles.

The disclosures in the notes to the financial statements are not as clear as they could be, and it is sometimes difficult to distinguish between different types of intangibles.

While acknowledging the limitations of methods for estimating unrecognised intangibles and the sensitivity of estimates to the assumptions made in the estimation method, it is reasonable to assume that UK listed companies may have a significant amount of unrecognised intangibles (in the order of hundreds of billions of pounds).

UKEB Chair, Pauline Wallace "The UKEB's research will provide an important foundation for the UK's response to this once in a generation opportunity for change."

References:

Peters, R. and Taylor, L.A. (2017). Intangible capital and the investment-q relation. Journal of Financial Economics, 123(2), pp.251–272. Available at: https://econpapers.repec.org/article/eeejfinec/v_3a123_3ay_3a2017_3ai_3a2_3ap_3a251-272

Martin, J. (2019). Measuring the Other Half: New Measures of Intangible Investment from the ONS. National Institute Economic Review, 249(1), R17–R29. https://doi.org/10.1177/002795011924900111

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