UK Endorsement Board
Research project
Accounting for Intangibles – UK Stakeholders’ views

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April 2023

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UKEB Role and Remit

Research	UKEB pro-active projects aimed at influencing the long-term development of IFRS and finding solutions to financial reporting issues
Influencing	UKEB consultations on draft responses to IASB consultations including Discussion Papers and Exposure Drafts
Endorsement	UKEB consultations on new IFRS or amendments to IFRS before endorsement for use by UK IFRS reporters

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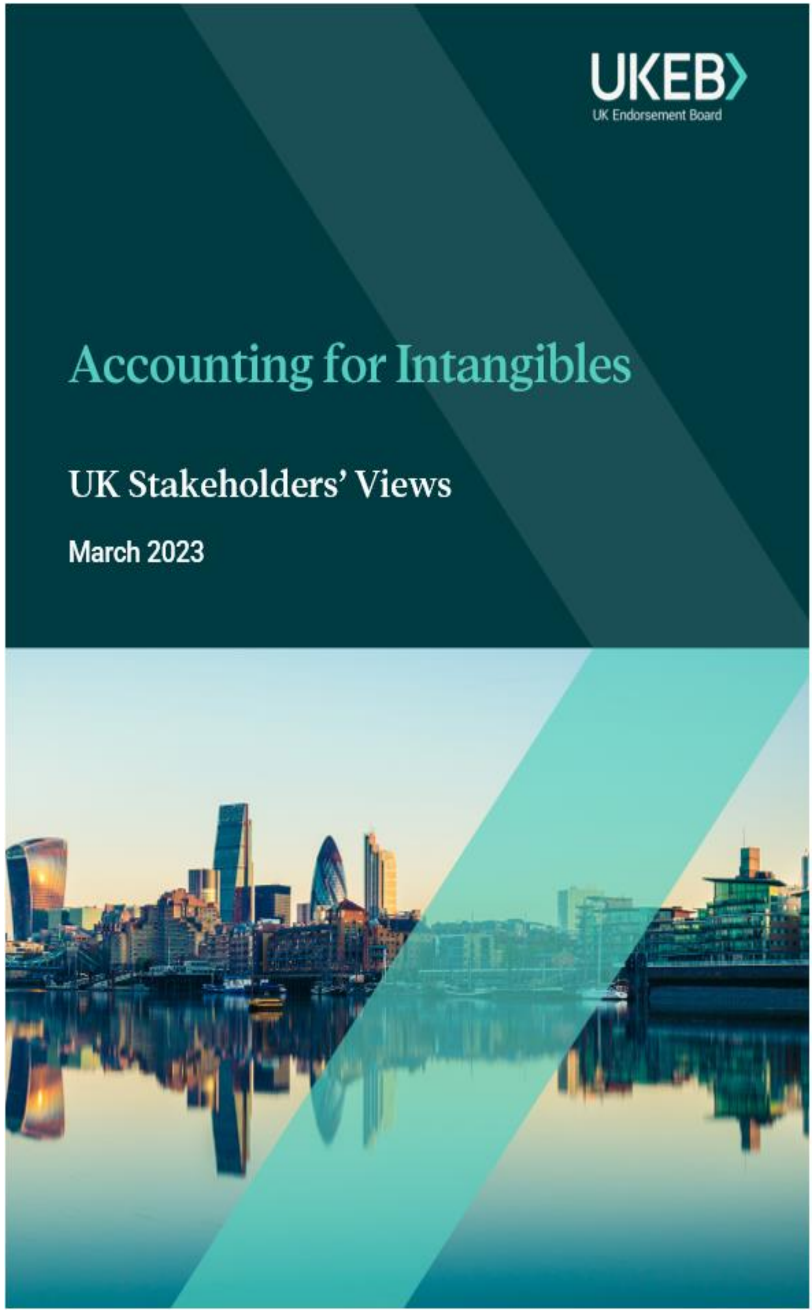
UK Stakeholder Views on Accounting for Intangibles

UK Stakeholder Views on Accounting for Intangibles – published on 22 March 2023

35 Interviews with a range of UK Stakeholders

Key findings:

1. Intangibles have increasing economic importance, but are difficult to identify and measure.
2. There is no single problem or answer to accounting for intangibles.
3. Current accounting is rules based and inconsistent.
4. While there is an appetite to explore enhancing the recognition of intangibles among some stakeholders.
5. Investors are clearly focused on enhanced disclosure.



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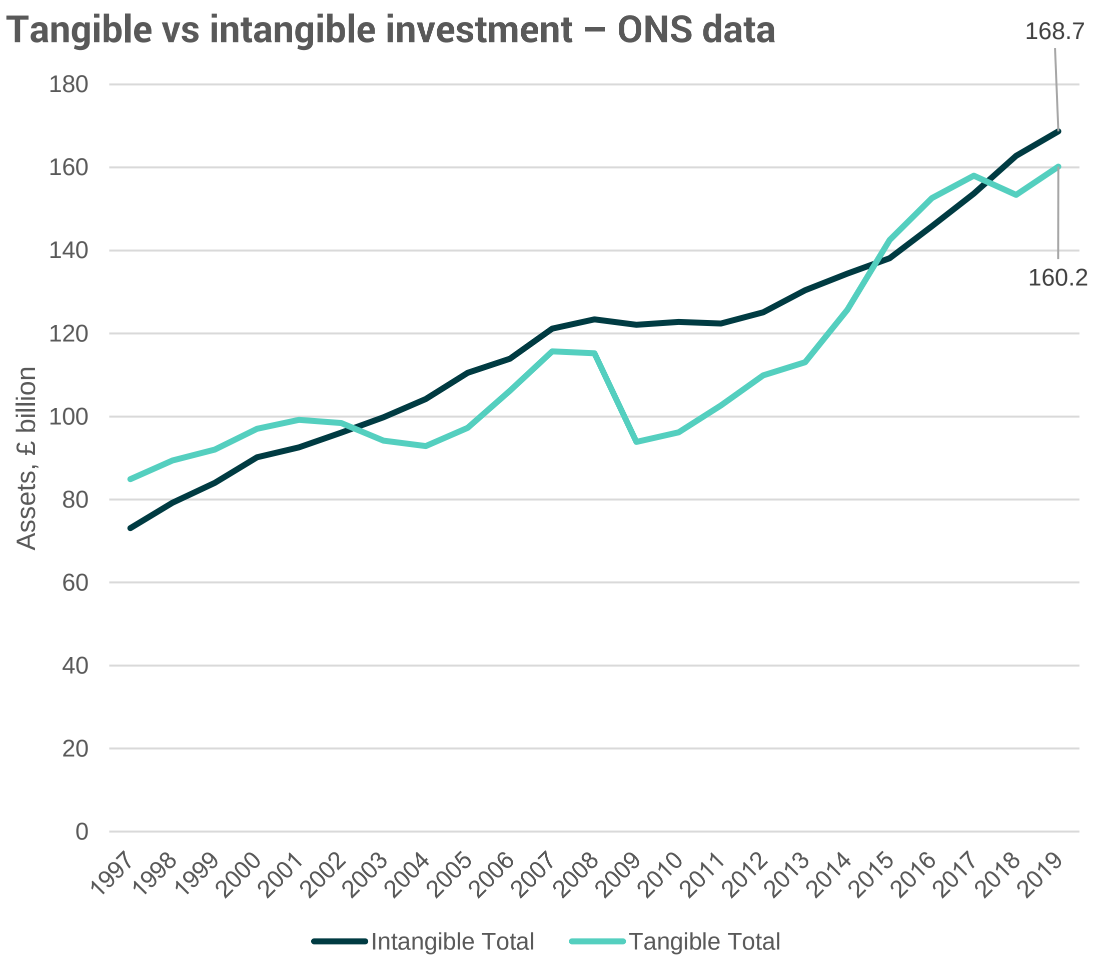
Economics: lessons from the literature

Macroeconomics	Microeconomics	Financial markets	New intangibles

• Intangibles largely absent from national accounts
• ONS has been looking at ways to capture this information
• Intangibles contribute to productivity at a UK level
• “Missing intangibles” in part explain UK productivity puzzle
• **More recognition of intangibles at a company level could improve quality of national accounts**
	• Intangibles positively correlated with companies’ performance
	• In particular, research has found a correlation between intangibles and productivity in the UK
	• Still in the UK, a positive correlation found between R&D and profitability
	• Results generalisable to other jurisdictions
	• **Information about intangible assets important to evaluate a company’s performance**
		• Unrecognised intangible assets found to partly (but not entirely) explain the market-to-book value puzzle
		• Asset pricing: companies with more intangible assets generate an excess return of 4.6% per annum
		• Information: asset recognition adds relevant information to stock prices
		• **Information about intangible assets important for price discovery**
			• A new set of assets that would count as intangibles from an economic point of view has emerged. Under IAS 38 however these can’t be recognised: These include:
			  • **Digital capital**
			  • **Big data**
			  • **AI Algorithms**
			• Cryptoassets also discussed in the report because of IFRIC Agenda Decision

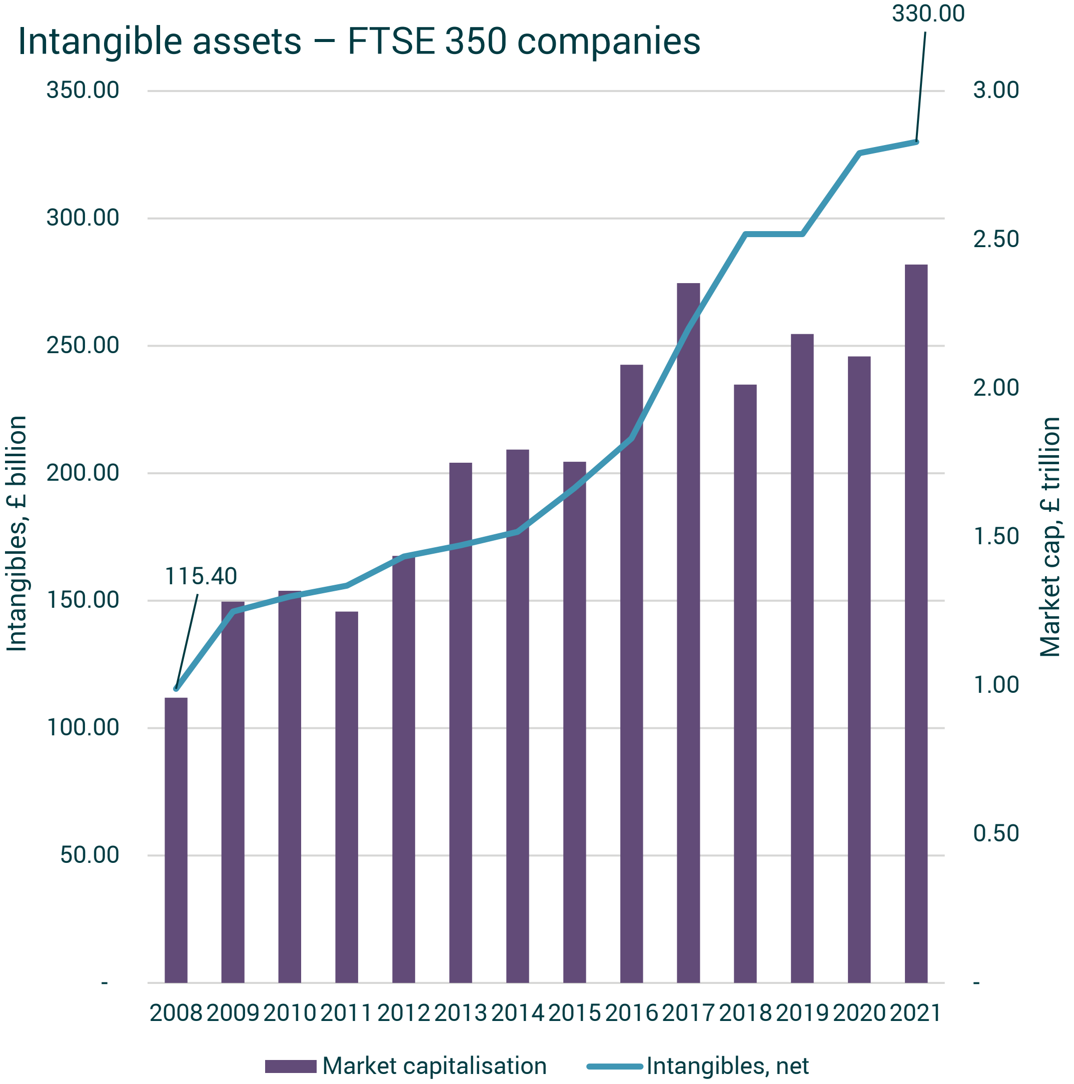
Economics: prevalence at a national level

- ONS in the UK produces experimental statistics on intangible assets at a national level
- The “missing half”: investment in intangible assets roughly equal to that in physical assets, and slightly higher.
- Largest components:
  - Organisational capital, 21%
  - R&D, 18%
  - Training, 19%
  - Branding, 15%
- UKEB estimates based on ONS data suggest that in the UK intangible investment every year is slightly larger than physical investment and that the stock of intangibles could amount to roughly £670 billion



Economics: prevalence among UK's largest 350 listed companies

- Between 2008 and 2021 **recognised intangible assets** for FTSE 350 companies nearly trebled in value, from £115 to £330 billion (a 185% increase over the period)
- Recognised intangible assets **grew at a faster pace than assets** overall, physical assets or market capitalisation
- As a share of total assets they went from 1.61% to 2.87%. Excluding financial services, they nearly doubled, from 6.73% to 12.2%
- Accounting requirements meant that companies and industries with largest amounts of intangibles tend to be the ones involved in large deals (e.g. British American Tobacco)
- Using a quantitative method to capitalise intangible expenses shows that:
  - AstraZeneca and GSK would have additional intangible assets from research component of R&D in the range of £2–3 billion each
  - Unilever would have capitalised advertising in the range of £15 billion



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Results – overview summary

Stakeholders identified the following as significant issues with the accounting for intangibles:

- Limited recognition
- Inconsistent accounting for intangibles
  - under IAS 38, and
  - when compared with other IFRS Accounting Standards e.g. IFRS 6, IFRS 3;
- Limited disclosure

Stakeholders would like:

- Enhanced disclosure
- An approach grounded in the conceptual framework (and principle based)
- A re-evaluation of the approach to recognition and measurement

Concerns with IAS 38 – Limited recognition

Analyst

- “There has been a rise in intangibles, resilience, networks, brand value etc, and the accounting is bad at capturing this, along with the creative process. This problem will grow as the economy continues to move towards intangibles. If you want accounting to remain relevant there should be a solution”.

Concerns with IAS 38 – Inconsistent accounting

Investor

- "There is disparity [in the accounting for] acquisition growth and organic growth. I don't think it changes decision making, but it can lead to confusion".

Concerns with IAS 38 – Limited disclosure

Investor

- "If management think it is important they should be disclosing. But users are getting cynical, they want better information, and are fed up asking for it."

IAS 38 – support to the status quo (i.e., not to change IAS 38)

Asset Manager

- “On one level there is not a problem. Investors use financial information along with other information to form their positions. The investment market takes a sceptical view of accounting information, it is the product of a range of assumptions and also incomplete. When you are valuing a company you do not start with a balance sheet, and in many ways the market is already coping”.

Accountant

- “Companies are not interested in capitalising, life is easier, no need to impairment test”.

Preparer

- “The current standard allows organisations to choose how much to spend (expense) on research and development etc. By not capitalising Return on Investment looks better and there are no shocks from impairment. Also, you can smooth income”.

Opportunities to enhance IAS 38 — Recognition

Many stakeholders want recognition to be principles based and grounded in the conceptual framework. However:

Increased judgement:	Reduced comparability:	Prudence:
whether there is an asset to recognise and its quantum, difficult to identify expenses with potential to be recognised as asset	some users were concerned about understandability of financial statements if intangibles are recognised more widely	stakeholders are concerned that capitalisation of intangibles at an early stage is not prudent

Opportunities to enhance IAS 38 – Measurement

Cost Model generally favoured over Fair Value. However:

Cost model		Fair value model
The hurdle of separating maintenance and investment costs	Identifying and assigning costs to specific intangibles can be difficult, as any allocation is subjective	Likely to be costly but more beneficial for investor Higher volatility in FS More relevant in some circumstances

Opportunities to enhance IAS 38 - Disclosure

Analyst

- “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”

User

- “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”.

Opportunities to enhance IAS 38 – Investors' view

What we heard from Investors

- Want more disclosure on intangibles to help them better understand companies' investment in intangibles and their performance.
- Don't put significant weight on the recognition of intangibles in the balance sheet, as they are not convinced it will always give reliable information.
- Would rather have detailed disclosures of expenditure on such items to allow them to make their own assessment of the potential value that may be created.

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Next steps

- The UKEB is continuing to build its understanding through research

- The UKEB is examining disclosures on intangibles made by UK companies. Including the quantitative and qualitative information provided in the financial statements and the management commentary in annual reports.

- The UKEB will survey users more extensively to develop a greater understanding of their approach to information on intangibles, their concerns about the current accounting, and solutions that most appropriately meet their needs.

Thank You

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