The UK Intangibles Landscape

This document provides a high-level summary of three reports developed by the UK Endorsement Board:

1. Accounting for Intangibles: UK stakeholders' views
2. Accounting for Intangibles: A survey of users' views
3. Accounting for Intangibles: A quantitative analysis of UK financial reports

The UK Endorsement Board

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. It aims to assess whether the current requirements are relevant and fairly reflect business models, or if they could be improved.

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

An overview of the UKEB research project

The UKEB has published three reports summarising our research work on the accounting for intangibles.

1: UK Stakeholders' Views (March 2023) - Explored UK stakeholders' views on the accounting for intangibles under IFRS Accounting Standards.

2: A survey of users' views (May 2024) - Engaged with investors to better understand their perspectives on the current and future reporting of intangibles in the financial statements.

3: A Quantitative Analysis of UK Financial Reports (May 2024) - Reviewed the current reporting practices for intangibles among UK listed companies.

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

Current IFRS Requirements for Intangibles

Most of the accounting requirements for 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 in-house and those 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 only if 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. Calculated as price paid less identifiable net assets acquired	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

UKEB Report 1: UK Stakeholders' Views

In 2022, semi-structured interviews were conducted with 35 UK stakeholders with an interest in 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 that have grown organically with those that have grown by acquisition is problematic due to the different accounting requirements applicable to internally generated and purchased intangibles.

> "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" Investor

- 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 disclosures because information in the financial statements is audited and therefore given more weight by investors.

"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". **Analyst**

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

"If management think [intangibles are] important they should be disclosing. But users are getting cynical, they want better information, and are fed up asking for it." **Investor**

UKEB Report 2: A survey of users' views

In September 2023, users of financial statements were asked to complete a detailed survey designed by the UKEB.

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.

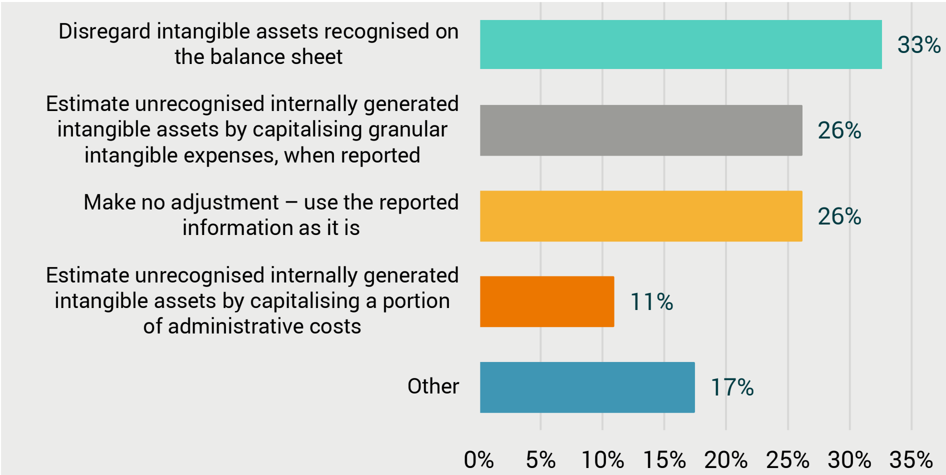
Users' views on current accounting

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.

Common adjustments made by users:



Users' views on future accounting

Respondents are concerned about the accounting for non-traditional intangibles and want improvements to accounting standards to ensure that there is better information about them in the financial statements.

The differences in accounting treatment of intangibles for companies that grow organically and those that grow through acquisition do not address investors' need for information to enable comparison of company financial statements.

There is strong evidence for enhancement of 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.

UKEB Report 3: Quantitative report

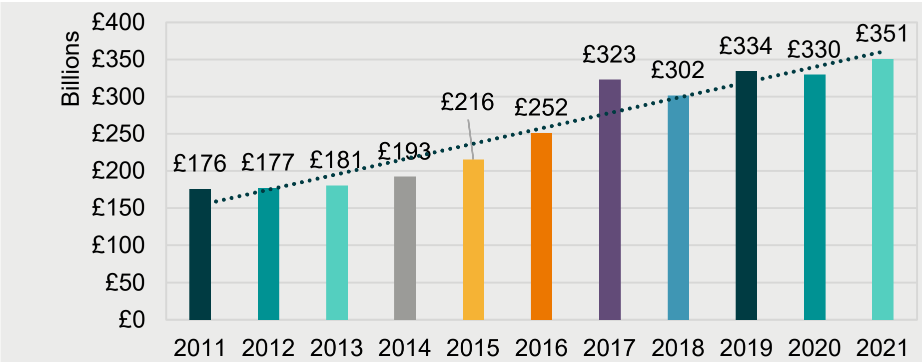
The UKEB quantitative work was conducted between 2022 and 2024. It gathered evidence from several different sources:

- 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 a selected sample of the 20 largest deals
- Estimation of value of unrecognised intangibles in UK listed companies for 2011-2021, and estimated distribution between industries and companies of different sizes

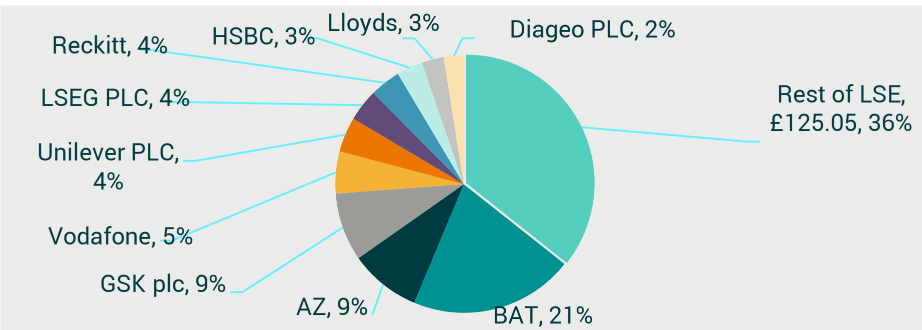
Findings: Intangible growth and distribution

In 2021, the carrying amount of intangible assets (excluding goodwill) on UK listed 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. Intangibles on balance sheet:



While 79% of companies had at least one intangible asset on their balance sheet in 2021, the largest 25% of companies held 97% of the value of recognised intangible assets of the population. 10 companies held almost two thirds of the total intangibles balance in 2021 –mainly driven by purchased intangibles from M&A activity:



Findings: Types of recognised intangibles

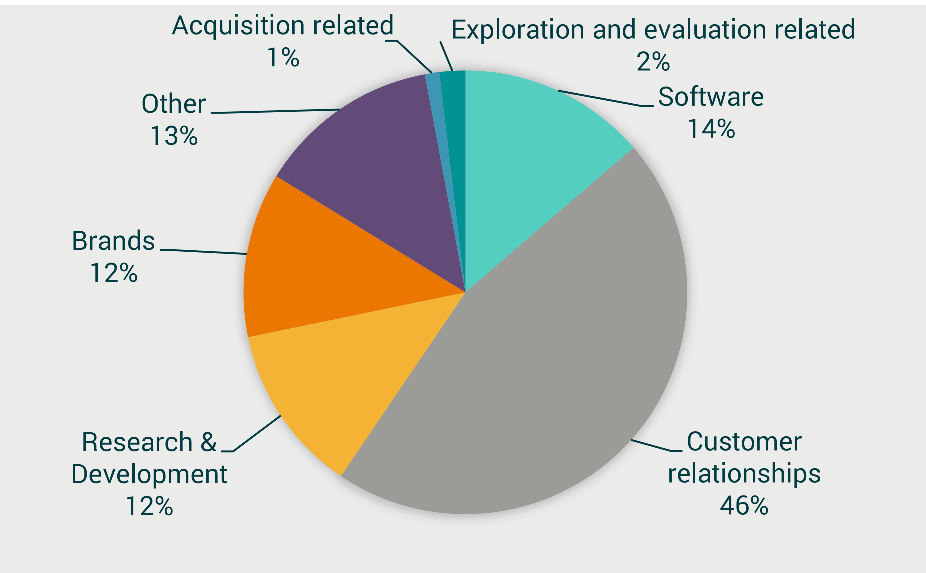
A wide variety of categories and terminology is used to describe intangible assets in the financial statements.

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

Intangibles are most prevalent in the health care, consumer staples and technology industries. However, technology companies' largest intangible was frequently customer relationships.

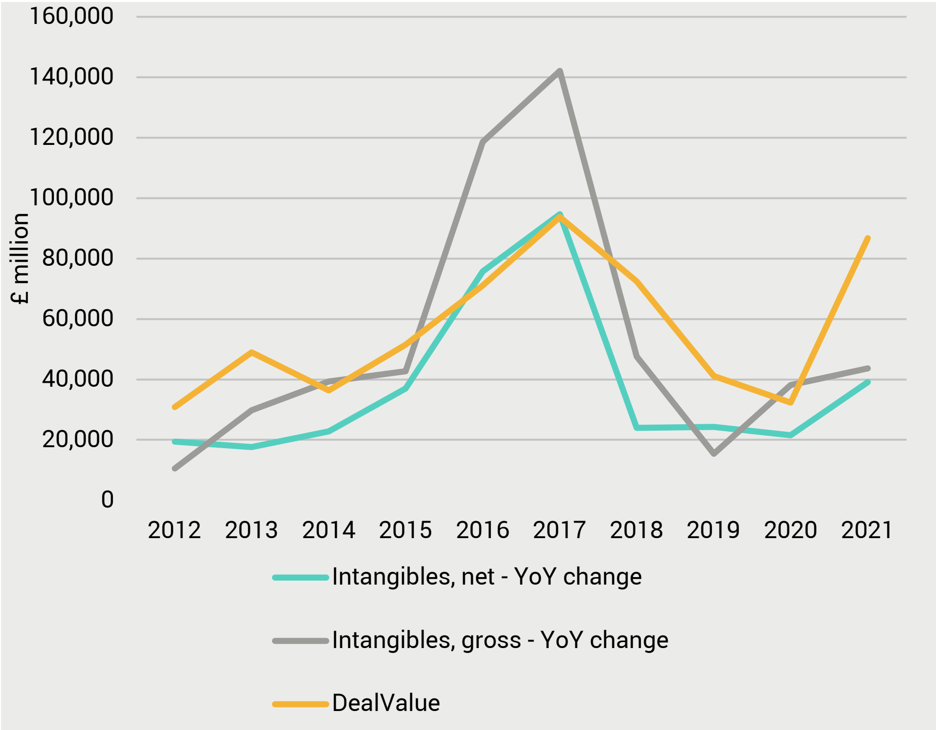
31 companies disclosed research expense in the notes, but only 55% of these also had capitalised development costs.

Proportion of types of intangibles recognised:



Findings: M&A is strongly related to intangibles

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



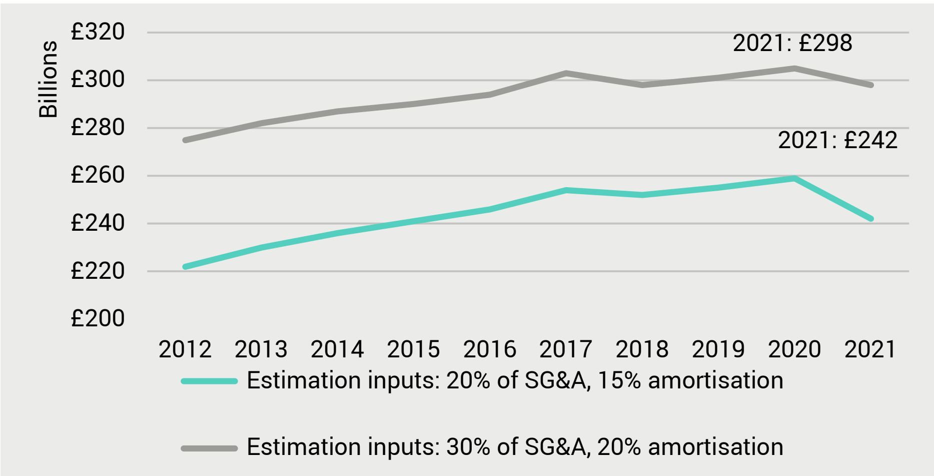
For the 20 largest deals during the period, average intangible assets were 33% of purchased assets, but varied from 0-84%.

Narrative reporting and notes to the financial statements seem to suggest that intangibles were an important driver for these acquisitions.

Estimate of unrecognised intangibles

It can be argued that intangibles acquired in a business combination bring (or are expected to bring in the future) economic benefit to the target company prior to acquisition, even if they were not previously recognised on its balance sheet.

The perpetual inventory method[1] 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 for National Statistics[2].

1: Peters, R. and Taylor, L.A. (2017). Intangible capital and the investment-q relation. Journal of Financial Economics, 123(2), pp.251–272.

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

Conclusions and next steps

UK stakeholders want improvements to the accounting for intangibles.

While intangible assets are widespread and increasing in value, they still only represent around 3% of the items recognised on the balance sheet of UK listed companies. However, they clearly represent an important driver of value for UK companies.

UKEB research indicates there are opportunities to enhance the accounting for intangibles. Users need high quality, comparable information and would prefer that to be in the financial statements and notes, rather than relying on other sources. They would like the accounting to be improved but there are mixed views as to how this can be achieved.

It is clear users want more granular information about companies' intangibles, and the expected benefits they can bring. This is particularly true for emerging intangibles. In addition, differences in accounting treatment for internally generated and acquired intangibles hamper users' ability to compare companies based on commonly used performance indicators.

The IASB's intangibles project offers the opportunity to comprehensively consider the accounting for intangibles. A thorough exploration of stakeholder views about different alternatives will be important. This includes examining the recognition, measurement and disclosures of intangible expenditure in the financial statements.

Intangibles make up a growing, and for some extremely significant, proportion of the economic resources underpinning the growth in the value of UK companies, yet accounting standards have not kept pace with the rise of new technology including the emergence of big data and emissions trading schemes.

The IASB already recognises the need to revisit the accounting for intangibles, so it delivers the high quality, comparable information that investors and users need.

The UKEB's research will provide an important foundation for the UK's response to this once in a generation opportunity to develop comprehensive improvements to the accounting standard for intangibles.

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