

Accounting Standards Advisory Forum
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*Business Reporting of Intangibles:
Realistic Proposals*

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Views expressed are personal and not necessarily those of the FRC.



Slide 1

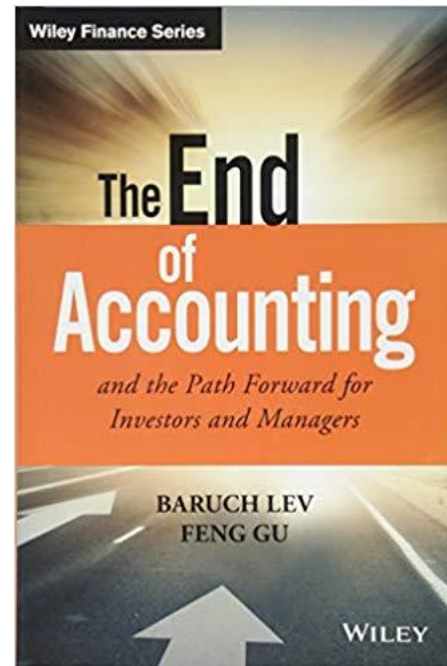
Agenda

- Background
- What respondents have said
- What should be done?



Many critics

- Intangibles are increasingly important
- Financial reporting does not reflect intangibles
- Divergence between book and market values



Perspectives

- Respond to criticism of business reporting of intangibles
- Develop realistic proposals
 - Use the Conceptual Framework
- Build on economic literature concerning the nature of intangibles
- Address narrative reporting, as well as financial statements
- Keep it short



Main topics

- Definition of an asset
 - Not met for many ‘intangibles’
- Recognition at cost or fair value
 - High measurement uncertainty for many intangibles
- Disclosure of expenditure on ‘future oriented intangibles’
 - In the income statement
 - Cumulative amounts In the notes
- Narrative reporting, supported by metrics
- Implementation?



Future-oriented intangibles: Income Statement

	20X1 £'000	20X2 £'000
Revenue	7,000	8,000
Cost of sales	3,900	4,500
Gross profit	3,100	3,500
This year's SGA	2,100	2,000
This year's operating profit	1,000	1,500
Staff training for the future	337	418
Profit before finance costs, tax etc	763	1082



Future-oriented intangibles: Note disclosure of cumulative amounts

<i>Production staff training for the future</i>	20X1	20X2
	£'000	£'000
Cumulative amount at the beginning of the year	510	627
Expenditure in the year	337	418
Deemed to have benefited current year	(170)	(209)
Reduction to reflect the abandonment of project X	(50)	—
Cumulative amount at the end of the year	627	836
<p>Training for production staff is deemed to benefit operations over the average product cycle of three years.</p>		



Narrative reporting

- Focus on intangibles that are relevant to the business model (value creation)
- Include metrics (rather than value)
 - Clearly defined
 - Disaggregated
 - Trends
 - Targets



Metrics illustration

CUSTOMER SATISFACTION

	20X1	20X2	20X3
Repeat customer ratio <i>(Percentage of customers who purchase again within 12 months)</i>	55.0	60.0	65.2

We believe that the increase in the repeat customer ratio reflects improvements in both our products and customer service. It continues to fall short of our target of 75%.

	20X1	20X2	20X3
Return ratio <i>(Value of products returned as a percentage of items delivered)</i>	8.0	6.0	6.1

As we consider it a necessary investment in our relationship with customers, we willingly accept customer returns. However, we recognise that returned sales indicate a disappointing customer experience and also increase our costs. The reduction in returns in 20X2 followed changes to our product specifications to provide more helpful information about our products. The slight increase in 20X3 was due to returns of new product X: excluding product X, the return ratio was 5.8%. We aim to achieve a return ratio of 5%.



What respondents said: *Importance of the topic*

- Many agree that intangibles are important, and welcomed efforts to improve their reporting
- General support from investors
- A few focused mainly on research and development



What respondents said *Revise IAS 38?*

- Views divided on revising the IAS 38 criteria for capitalisation of expenditure on intangibles
 - Existing rules work well
 - Proposed replacements subjective
 - Does not address the real issues?

What respondents said *Fair value*

Fair value?

- Majority agree that valuation of intangibles raises difficult problems:
 - A few think these are not insurmountable, and that valuation would provide useful information



What respondents said:
Future-oriented intangibles

- Divided views, many on both sides strongly held
- Main objection is subjective decision on what expenditure benefits the future



What respondents said: *Narrative reporting*

- Majority support for proposals, but with caveats and reservations
- Support for observations on metrics
- Concerns include costs and disclosure of commercially sensitive information



Questions for discussion by ASAF

1. Do you agree that the business reporting of intangibles requires improvement? If so, which areas should be prioritised?
2. Should the separate reporting of expenditure on future-oriented intangibles be required? If so, what are the main challenges in introducing such a requirement?
3. Do you agree that narrative reporting including metrics can assist users of financial statements in assessing an entity's intangibles?
4. How could accounting standard-setters assist in the implementation of the ideas suggested in the paper for narrative reporting? Which other parties should be involved, and what would their role be?

