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By email: intangibles@frc.org.uk

Dear Andrew

Discussion Paper - Business Reporting of Intangibles: Realistic proposals

We welcome the opportunity to comment on the Financial Reporting Council's (FRC's) discussion paper (DP) on *Business Reporting of Intangibles: Realistic proposals*. Whilst we have not answered all the individual questions in the consultation, as we feel some questions are best answered by individual companies or other stakeholders, we have included in the appendix to this letter detailed responses to a number of the questions.

We understand some of the concerns this DP raises in relation to the complexities around recognition of intangible assets and the difficulties in communicating the extent of expenditure on future-oriented intangibles in annual reports. However, we do not feel that the proposals put forward are providing any more of a reasonable basis than that already covered by existing standards as a way to measure and report information of intangibles. Determination and valuation of future-oriented intangibles is highly subjective and unique to each business. Therefore, prescribing a way in which businesses should report this information may actually make the process and disclosure more complex.

Our members represent a range of sectors and are all impacted by reporting of intangibles in different ways. In our experience, for those for whom intangibles are a key component of their business and material to their accounts, the reporting they currently provide is already above and beyond what the standards require. Keeping in mind the FRC's 'clear and concise' reporting requirement, we would encourage our members to ensure their disclosures in relation to investments in future-oriented intangibles are sufficient and appropriate if the information is considered useful for users of accounts. We are not, however, of the view that this reporting requirement needs to be mandated or prescribed in such detail as this DP proposes. Furthermore, any proposal to increase reporting in relation to potentially immaterial intangibles would, we feel, not add value to accounts and risks going against the FRC's 'clear and concise' requirement.

As currently proposed, we have significant concerns with the DP, most notably in relation to how the intangibles would be valued, disclosing expenditure within the profit and loss account, and the extent of details proposed in the notes to the accounts. The definition of '*future-oriented intangibles*' is highly subjective; not all expenses will give rise to an intangible asset and the appropriate methodology to calculate this will vary between sectors and companies, meaning that comparability between accounts will not be possible. Intangibles, whether recognised or not, are distinctive for each business, and this must be kept in mind for reporting purposes. Furthermore, the proposed disclosure could also have the unintended consequence of giving insight to commercially sensitive information, which we would not be supportive of.

In relation to extending the narrative reporting on intangibles, either through the use of metrics or additional disclosure, we would be supportive to the extent of enhancing narrative reporting over future-oriented intangibles where deemed necessary by the business and useful by investors. In our

experience, many of our members already do this. This could either be in the notes to the financial statements or elsewhere in the annual report. We do not think prescribing what the metrics or narrative should be is appropriate, given the uniqueness of the subject matter.

Intangibles are so diverse in their nature that prescribing a set of narrative requirements will likely lessen the ability of companies to disclose the information they think most relevant and helpful to users of accounts. We therefore propose that the FRC considers whether this subject should be on the FRC FR Lab agenda, to ascertain what industries would be most affected by narrative reporting and how, what investor views are on the matter, and what value the information would add to annual reports. We also note the work that the FRC is doing on the Future of Corporate Reporting, and believe that findings from this consultation will be integral to that discussion.

The DP does not provide background as to where the call for this information is coming from. Based on our experience, investors and portfolio managers have raised questions over it and we would consider the views of investors to be significant in determining what, if any, disclosure on future-oriented intangibles should look like. We further note that this will impact sectors in different ways and therefore have concerns that due regard has not been given to certain sectors, for example where some future-oriented intangibles may be an area of competitive advantage.

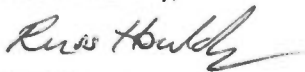
If this additional narrative is considered to be helpful, the concept of materiality from the investor perspective would undoubtedly need to be applied. In our view there is a risk of adding extensive disclosures without any benefit to users of accounts.

Who we are

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the UK FTSE 100 Index. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers.

Please feel free to contact me at russ.houlden@the100group.co.uk should you wish to discuss our comments. I would be more than happy to meet to discuss these, or any other relevant items, further.

Yours sincerely,



Russ Houlden

Chairman

Financial Reporting Committee

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

Quality of business reporting of intangibles is paramount in annual reports, and we are fully supportive of disclosures providing users of accounts with as much information as is required to be useful.

We understand the views put forward that there are a number of expenses incurred by businesses that, under the conceptual framework, cannot be recognised as intangible assets. We are fully supportive of narrative reporting being a way to support information in financial statements and help users of accounts understand the financial position of a business. In our view, with the definition of 'intangibles' being so vast, as noted in paragraph 1.4, it is not always possible to communicate to users of accounts all intangibles in narrative reporting. The sheer volume and subjective nature of this would be too much to appropriately report on in a clear and concise way. We appreciate that the speed of technological innovation and the changes in investment strategy mean that there is likely to be a greater expenditure on intangibles that may not meet the definition under the conceptual framework, and it would be to the benefit of users to understand this. However, as discussed below, we do not consider the proposals put forward to be an appropriate way of achieving this.

In our view, if intangibles, whether recognised or not, are a significant part of a business, these should be disclosed in accounts as best determined by the business. In our experience, many companies whose intangibles are significant to their business already go above and beyond the narrative reporting requirements set out in the standards. These additional disclosures are presented in a way that cannot be prescribed or required as they need to be tailored to the business and intangibles they invest in.

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

We are supportive of the current requirements under IAS 38 in determining whether an intangible asset is able to be recognised and how to subsequently value it. As noted in paragraph 2.14, "*reporting intangible assets at cost will often not provide relevant information*" given their unique characteristics.

We are comfortable that the standards, as currently written, are appropriate and do not require change. They are flexible enough for preparers to disclose further narrative information if they deem it necessary to help users of accounts understand their intangible strategy. Based on our experience, many of our members already do this within their reporting. We are in agreement with paragraph 1.5 of the consultation that, in relation to IAS 38 and measurement of intangible assets, "*while the possibility of radical change cannot be discounted, it undoubtedly will not be achieved in the near future*".

3) Do you agree with the assumptions the paper makes regarding measurement uncertainty of intangibles?

We recognise the concerns that have been raised in relation to uncertainty over the use of fair value measurement for intangibles. However in our view the reason the accounting standard has such strict recognition and measurement criteria is due to the inherent limitations and subjectivity in placing a value on intangibles. The variations in intangibles across sectors and different ways to interpret and allocate the costs, mean that not all intangibles can be recognised in the same way. We appreciate that the annual report can be a mechanism to further explain such expenditure, but do not feel it is appropriate to set measurement criteria and prescribe quantitative balances to achieve this. Where there is ambiguity and uncertainty in determining

such costs and values, explanation through narrative would be more preferable to provide insight to such future-oriented intangibles rather than trying to measure them quantitatively.

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

As noted in our response to question 2, we do not agree that existing accounting standards need to be revisited.

In our view, this is for the IASB to consider in their work plan based on feedback from all their stakeholders, most notably users of annual reports. We are comfortable that IAS 38, as currently drafted, is appropriate for the measurement of intangibles and prescription of associated disclosures. Where significant and material to accounts, we would encourage preparers to disclose information they determine to be useful.

5) Do you agree with the above proposals relating to expenditure on intangibles?

We have significant reservations over the proposals put forward in relation to expenditure being drawn out explicitly in the profit and loss account and the example illustration of what possible financial reporting may look like.

In our view, given the subjective nature and difficulties noted in paragraph 3.7 in splitting out costs incurred on future-oriented intangibles, we do not think it would be advantageous, for users of accounts, for the statement of profit or loss to be divided into "*net income before investment in future-oriented intangibles*" and "*expenditure on future-oriented intangibles, analysed by nature*". The calculation of this information is highly subjective, does not have robust accounting methodology underpinning it, and adds unnecessary complexity to the primary statements. Furthermore, for some companies it may not be material to disclose such a split, which will lead to accounts being less comparable and/or risk them disclosing the breakdown unnecessarily.

The proposals in relation to expenditure on intangibles within the notes may appear to work in the DP theoretically. However, we have significant concerns over the practicality of them. As noted in paragraphs 3.7 – 3.8 of the consultation, this approach requires being able to distinguish one-off benefits from recurring benefits, and being able to identify the exact expense which gives rise to an asset, which not only would be a complex and time-consuming task, but which is also highly subjective. Should different companies interpret their expenses in different ways, there would not be comparability between accounts. We also believe that disclosing information in this manner has the potential to give rise to a risk of sharing commercially sensitive information about future projects or previous projects, and how well the investments in intangibles have fared.

Given the size and scale of many of our members, the variations in expenses and volume of possible future-oriented intangibles means this task could be significantly onerous to perform. In our view, the time and costs incurred to get the information and provide a narrative that supports the costs, whilst not disclosing commercially sensitive information, would likely outweigh the potential benefits users would get from the information. We can understand that for many businesses, most notably technology companies, there is significant expenditure on unrecognised intangibles which they do not articulate in their reports, and this DP proposes a way to do this. We would encourage that they use their accounts to provide information on such expenditure as they deem necessary. However, we do not feel that prescribing the content of the narrative as noted in paragraph 3.9 is appropriate. It should be down to the discretion of the business to disclose information that they determine to be relevant and helpful for users.

We note that this paper does not make reference to whether there should be a materiality concept applied to the disclosures, which in our view would be integral. As currently proposed, businesses would need to account for all costs incurred, which would take considerable time and effort, for minimal value add. Applying materiality, through the lens of an investor, could eliminate the need for unessential disclosures, and would also align to the FRC's 'clear and concise' reporting requirement.

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

We are supportive of narrative reporting being of high quality, adding colour and value to the accounts. For subjects that fall outside the remits of accounting standards, such as investment in future-oriented intangibles, we feel it should be the decision of the business to disclose what they feel most appropriate and valuable for their users. We do not support the view that this narrative be prescribed. Having defined rules as to what needs to be reported could prevent companies from disclosing information they currently provide or risk shoehorning disclosures in a way that does not complement the business's intangibles. We are fully supportive of improving the quality of narrative disclosures, but have concern that many of the metrics proposed could have the unintended consequence of disclosing commercially sensitive information. Furthermore, it is likely that such narrative disclosure will have greater impacts on certain sectors than it does on others, and we would suggest that the FRC seeks feedback on which sectors this may apply to the most, and seek their views and potential areas of concern.

Based on the experience of our members, for many of whom intangibles are significant, they already go above and beyond the requirements of accounting standards to ensure their narrative disclosures are sufficient for users' needs. This proposal may therefore unintentionally affect businesses for which unrecognised intangibles are not particularly significant or material, but which would now require narrative disclosure.

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?

In our view the key aspect of this should be for the users of accounts - most importantly portfolio managers and investors - to determine whether they are in need of this information and how they would use it to impact their decision-making. We propose that the FRC engages in investor outreach, potentially through an FRC FR Lab project and/or the FRC project on the Future of Corporate Reporting to understand these views further. The FR Lab could explore what is currently disclosed in annual reports on future-oriented intangibles, what best practice looks like, and most importantly whether investors would benefit from further information on the subject matter. Ideas can then be discussed as to what is or is not needed and how best to proceed.

We also propose that any outcomes from this consultation are discussed with the Brydon Review, who are assessing the quality and effectiveness of audit, as any new narrative would be subject to an audit, as well as discussed as part of the FRC project on the future of Corporate Reporting.