# Intangible assets reporting – the accounting issues

Large Corporate | Tax voice



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*David Haigh* notes a strong demand for improved reporting of intangible assets

In 2016, an extensive study into the attitude of investment analysts in the City towards the reporting of intangible assets including brands was commissioned by Brand Finance. This repeated an earlier study conducted for five years from 1997 to 2001. Then, the feeling of analysts was that conventional accounts failed to give them the absolute values or the factual and narrative detail to form a correct view about the intangible assets owned by companies they followed. That research

programme prompted – an extensive annual research exercise into intangible assets, covering over 57,000 companies (with a total value of US$92 trillion) across more than 170 jurisdictions (running continuously for 16 years) and the launch of the Brand Finance Institute to advocate for more granular reporting of intangible assets among accounting professionals.

The study continues to show the huge black hole in conventional accounting and financial reporting. In particular, our Investment Analysts Study reveals that there is as much if not more dissatisfaction with the lack of information on intangible assets now as there was in 1997. Nothing has changed. Yet changes in the nature of the world economy over the last 20 years, and the inexorable growth in the number of intangibles-based enterprises, means that the need for better reporting is even stronger now than 20 years ago. The study, clearly shows that there is a strong demand from the most important users of financial reports for a sea change in the way intangible assets are recorded and reported.

## Systematic underreporting of intangible assets in balance sheets

When IFRS 3 was published in 2004, there was a great deal of optimism that this would be the first step towards better, more meaningful and more insightful reporting of intangible assets. However, for various reasons that optimism was hugely premature, and expectations have been dashed.

IFRS 3 specifically banned the recognition of internally generated intangible assets and the revaluation of externally acquired intangible assets, making it of limited relevance or use.

However, IFRS 3 made it compulsory for CFOs and their financial advisers to fairly value all tangible and intangible assets at the point of acquisition and to conduct impairment reviews as and when appropriate. This requirement has created a huge industry in point in time valuations for accounting purposes which has lined the pockets of valuers and accountants but has delivered very limited informational value to management or users of accounts. Arguably one of the most expensive and pointless financial reporting exercises of all time.

About 5 years after the introduction of IFRS 3, the Financial Reporting Council commissioned a review of compliance with IFRS 3 which found that CFOs tended to

underreport the number of intangibles acquired, perhaps because each asset identified required a specialist valuation and then amortisation or impairment testing thereafter. Better to leave them out and drop the value into residual goodwill, which is only subject to an annual impairment test, and only if there are reasons to believe there has been an impairment. Inevitably CFOs do not willingly instigate the impairment process because of the cost and perceived low value of the outcomes. The study also found that there was a tendency towards conservatism in the values attributed to those intangible assets which were identified. So, it is a widely held view that the utility of IFRS 3 reporting of intangible asset values is low. Hence the cynicism of many CFOs.

One aspect of this is that while the use of IFRS 3 valuations of brands and other intangibles for comparable valuation purposes is of some value it is unwise to rely on so-called comparable market transactions to value brands and other intangibles for all purposes. In many cases, IFRS 3 asset valuations tend to be very conservative with any excess value from the transaction amount dropping into residual goodwill.

A Swiss firm called Markables has created a database which records all IFRS 3 valuations as a reference source for valuers and companies to benchmark the value of their intangibles. The Markables database is of some value but it has to be recognised that Purchase Price Allocations are just that… allocations. They are not actual transaction values. They are not stand alone arm’s length valuations. Misdescribing them as transaction values creates the risk that conservative Allocations of value to specific intangibles will indicate lower values than the subject assets would command in standalone arm’s length transactions for the assets alone, separate from an enterprise valuation.

The upside with IFRS 3 reporting is that it has created a generation of professional valuers that are capable of producing reliable enterprise and intangible asset valuations from time to time. It is a huge resource waiting to be properly used. They could easily value the subject companies every year, identifying all internally and externally generated intangible asset and reconciling to enterprise value.

Anecdotally, it seems that the identification and fair valuation of all intangible assets post acquisition has improved. However, internally generated intangibles and revalued acquired intangibles are still ‘Cinderella Assets’ waiting to come to the financial reporting ball.

Recently, I have been made aware of certain companies which actually commission an IFRS 3 style valuation of their whole business each year with all intangible assets, both acquired and self-generated, identified and reported on. These valuations are used confidentially by the board to understand what assets are owned by the business and to aid decision making. This is the first step towards public disclosure.

Given the requirements of the IASB's own Conceptual Framework for financial reporting, which calls for the inclusion of all assets and liabilities in financial statements, to improve the usefulness of financial accounts for stakeholder decision making, it is surprising that such disclosure is not already compulsory.

## Breakthrough in setting standards for intangible asset valuation

Fortunately, there has been a progressive improvement in valuation standards led by International Valuation Standards Council (IVSC), at the instigation of the SEC and others. There is a strong and growing pressure from regulators worldwide for tighter standards on how these hugely valuable "Cinderella Assets" are valued. Sir David Tweedie, Chair of the IVSC, has become the unlikely "Prince Charming" for these long neglected assets.

## Massive change in accreditation of valuers

The final piece in the puzzle came in April 2017 when The Royal Institute of Chartered Surveyors (RICS), the Association of International Certified Professional Accountants (AICPA) and the American Society of Appraisers (ASA) launched a new valuation qualification, the Certificate in Enterprise and Intangible Valuation (CEIV). It is recommended by the SEC that values appearing in accounts for which the SEC is the regulator, should only be signed off by a CEIV valuer. The bar is set high and will no doubt transform the perception of the quality and reliability of intangible asset valuations in future. This should make it easier for accounting and other authorities to accept intangible asset values for publication.

## Action is required

There now needs to be a concerted call from all stakeholders to demand that these long neglected 'Cinderella Assets' should finally be allowed to attend the annual financial reporting ball!