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October 5, 2001

**Letter of Comment No:** 28  
**File Reference:** 1122-001  
**Date Received:** 10/5/01

Mr. Timothy Lucas  
Director of Research and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
Post Office Box 5116  
Norwalk, Connecticut 06856-5116

**Re:** Proposals for New Agenda Projects for *Disclosure of Information about Intangible Assets not Recognized in Financial Statements* and *Reporting Information about the Financial Performance of Business Enterprises*.

Dear Mr. Lucas:

The Financial Accounting Policy Committee (FAPC) of the Association for Investment Management and Research (AIMR)<sup>1</sup> is pleased to comment on the Financial Accounting Standards Board's (FASB) Proposals for New Agenda Projects. The FAPC is a standing committee of AIMR charged with maintaining liaison with and responding to initiatives of bodies, which set financial accounting standards and regulate financial statement disclosures. The FAPC also maintains contact with professional, academic, and other organizations interested in financial reporting.

### ***General Comments***

We appreciate the opportunity to comment on the FASB's proposed Agenda projects. While each of these projects is important to investors in the capital markets, our support would be reserved if resource constraints of the FASB would prevent it from addressing other projects for which there is an immediate need. In particular, we believe that if the Board has to choose between projects, then addressing revenue recognition, the recognition of financial instruments at fair value, and comprehensive income should be given higher priority than disclosure for unrecognized intangibles. We believe that the FASB should address the issue of reporting financial performance.

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<sup>1</sup> The Association for Investment Management and Research is a global, nonprofit organization of more than 50,000 investment professionals from over 100 countries worldwide. Through its headquarters in Charlottesville, Virginia, and more than 100 member Societies and Chapters throughout the world, AIMR provides global leadership in investment education, professional standards, and advocacy programs.

## **Disclosure About Intangibles**

- 1. Is there a need for the FASB or others to comprehensively address the reporting of information about intangibles of a business enterprise? If yes, should the FASB take on such an effort or defer to others? If so, to whom?**

We recommend that the FASB take on the effort to provide disclosure of additional information about intangibles of a business enterprise that the investing public can use to assess the value of their investments. Robert A. Bayless, Chief Accountant – Division of Corporate Finance U.S. Securities & Exchange Commission best addresses the importance of intangible assets in a speech (March 2, 2001) wherein he states:

*Speaking of value, intangible assets are very important in this economy. Wide variations between a company's stock price and its underlying book value per share frequently are attributed to the failure of the current accounting model to recognize a company's internally generated intangibles. Despite the importance that investors evidently place on those intangibles, a FASB Business Reporting Project Steering Committee observed that filings by public companies generally lacked meaningful and useful disclosures about intangible assets.*

*The staff can be expected to comment on that deficiency, soliciting better disclosure about intangibles outside of financial statements, and in the MD&A and Description of Business. Those disclosure requirements are not bound by the recognition and measurement rules of generally accepted accounting principles that treat intangible assets differently than tangible assets. If intangible assets are important to the business, registrants should identify them and explain what management does to develop, protect and exploit them. Operational, non-financial, measures can be very effective in explaining to investors the value of a company's intangibles.*

- 2. Is the proposed scope of such a project as described in this Proposal insufficient, appropriate, or too ambitious? One alternative would be a broader scope that might encompass other constituent recommendations, for example, (a) disclosure about nonfinancial indicators, management's key goals for them, and related risks, strategies, efforts, and accomplishments in meeting its goals or (b) recognition and measurement of certain internally generated intangible assets. Another alternative would be a limited-scope project that focuses solely on, for example, disclosure of expenditures to develop and maintain unrecognized intangible assets or on disclosure of information about research and development activities.**

The FAPC strongly recommends that the FASB develop a clear definition of intangible assets and that the scope should include such disclosure derived as a result of this definition. The scope should include:

- A. Disclosure that would help analysts in determining the value of intangibles. Such disclosure may include non-financial indicators, such as market size and share, customer retention, etc., elements of the intangible asset, characteristics, value drivers and internally generated intangibles.
- B. Disclosure of recognition and measurement criteria for research and development and other project-related intangible assets which is in accordance with paragraphs 11-17 and implementation guidelines outlined in Statement of Financial Accounting Standards 142, "Goodwill and Other Intangible Assets."
- C. Disclosure of separate recognition and measurement criteria of intangibles that are embedded within tangible and financial assets, such as a core deposit intangible which is in accordance with paragraphs 11-17 and implementation guidelines outlined in Statement of Financial Accounting Standards 142, "Goodwill and Other Intangible Assets."

We disagree with the Board's proposal to limit the scope to disclosure "about intangible assets that are not recognized in statements of financial position, but would have been recognized if acquired either separately or in a business combination." The FAPC notes that some internally generated intangibles are recognized as well. The values of recognized intangibles will frequently be different from the amounts at which they are initially recorded, or carried at amortized historical cost. Therefore, similar disclosures are needed about unrecognized intangibles, intangibles recognized because they were acquired, and recognized internally generated intangibles. The FAPC is of the view that additional qualitative and quantitative disclosure about all intangible assets is needed to enable analysis of a business, especially due to the fundamental changes in the economy.

The FAPC proposes that initially information should be provided in a manner similar to that of MD&A type disclosures. Management should provide information that describes the intangible assets that are relevant to the business activities and factors that may affect the valuation of intangibles. This disclosure could include sensitivity and risk factors as they relate to these intangibles. In addition, information would be aimed at providing a comparative basis between companies that create their assets internally and expense them directly, and those that buy their intangibles and record them in the balance sheet.

- 3. Should specific issues identified above be excluded from the scope of the proposed project on reporting information about intangibles? If yes, for each specific issue, please indicate whether it should be addressed as part of another FASB project, by others, or not at all and why.**

The FAPC supports a broader scope and does not want to exclude issues identified above from the proposed project. However, please refer to the general comments on the priority of this project in relation to other projects.

**4. Should specific issues *not* identified above be addressed as part of the proposed project on reporting information about intangibles? If yes, please describe the specific issue and indicate it is sufficiently crucial that it should be addressed as part of the proposed project.**

The FAPC recommends that the FASB provide a clear definition of intangibles, and, further, provide detailed guidance on disclosure. It is not clear under the current definition what would be included in intangibles and we are concerned about the possible omission of items that would not be recognized separately from goodwill under Statement 141, such as customer base or workforce value. Under the purchase method of accounting in business combinations, these would not be captured but would likely be buried under the residual of goodwill. The FAPC proposes that at a minimum intangibles be classified by the following characteristics:

- a. Identifiability
- b. Separability/transferability
- c. Legal standing or contractual basis
- d. Linkage to future sources of value, including cash flows from revenues as well as reduction in expenses.

The examples of intangible assets lists provided in SFAS 141 are those recognized by virtue of meeting one or both of the characteristics of separability/transferability and legal standing or contractual basis. The FAPC is concerned about those that are not identified in SFAS 141, particularly those that fall under the fourth characteristic of having a link to a future source of value. A clear definition should capture all four characteristics noted above and not constrain a company from identifying an intangible asset that is not contained in the list.

An area of concern with defining intangible assets as a list is that it does not give management the latitude to define those assets that it considers relevant to the business and that may not be listed. Disclosure by management should identify the link between the asset and the future benefits, whether they are future revenue, cost reduction, or effect on cash flow. The fourth characteristic would include intangibles such as goodwill, workforce value and other intangible assets that may not be defined at this time.

A key factor in valuing an intangible asset is having information on the expected life of the asset and the pattern of distribution of benefits over the life of the asset. Not only would such disclosures provide additional information that analysts can use to assess the value of a company but it would also convey to the reader the depth of management's understanding of their business.

For the initial phase, the FAPC recommends that enhanced disclosure be provided and that the FASB consider developing guidelines to include this information as un-audited supplemental information. Furthermore, this should not be limiting and could encourage companies to define new intangibles that may not be included in a current exhaustive list.

The FAPC recognizes that a difficulty with quantifying any intangibles is the lack of standardized evaluation models. Consequently disclosures would not be comparable. The FASB could consider outlining the theoretical justification for valuation models. Perhaps there are lessons to be learned from the different approaches in some countries. We note that periodic re-valuation of intangibles is permitted in Australia.

### **Reporting Financial Performance**

**1. Is there a need for the FASB or others to comprehensively address the reporting of information for assessing the financial performance of a business enterprise? If yes, should the FASB take on such an effort or defer to others? If defer to others, to whom?**

The FAPC is pleased to see that the FASB is considering comprehensively addressing the issue of reporting information about the financial performance of a business enterprise. We agree with the FASB that disclosure of alternative measures of performance needs to be standardized. Additional disclosure and transparency of the measures of performance such as revenue growth, earnings before interest and taxes (EBIT); earnings before interest, taxes, depreciation, and amortization (EBITDA); operating cash flow; free cash flow and other such measures are necessary. Based on recent articles in Barron's and the Wall Street Journal, it appears that there is a need for measurement guidelines as companies are inconsistent in their use of measures of performance and lack disclosures needed to provide clarity.

Furthermore, this could provide disclosures that are consistent with those from the IASB project on performance reporting. We support harmonizing presentation of financial performance to promote international comparability including the reconsideration of comprehensive income.

We do not believe that the FASB should expand the proposal to include the measurement of key financial performance metrics, nor the broader approach to require business enterprises to provide certain specific financial metrics.

**2. Is the proposal scope of such a project as described in this Proposal insufficient, appropriate, or too ambitious? Two somewhat broader alternatives are noted on page 2 of this Proposal.**

The FAPC supports the minimum approach described in the proposal. However, most of the FAPC members would like the Board to consider requiring the direct method of presenting the operating section of the cash flow statement regardless of whether key components of operating cash flows are identified as key performance indicators.

**3. Should specific issues identified above be excluded from the scope of the proposed project on reporting financial performance? If yes, for each specific issue, please indicate whether it should be addressed as part of another FASB project, by others, or not at all and why.**

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The FAPC does not believe that any issues identified should be excluded from the scope of the proposed project.

**4. Should specific issues *not* identified above be addressed as part of the proposed project on reporting financial performance? If yes, please describe the specific issue and indicate why it is sufficiently crucial that it should be addressed as part of the proposed project.**

The FAPC recommends that the scope include the requirement to disclose the definition and specific composition of performance measures that are aggregate or summarized amounts. Transparency requires consistency in the preparation of these amounts over time in measurement for a company itself, within industries and across accounting regimes. Currently, some costs are treated as sales, general and administrative by one company, and as cost of goods sold by another. Unaddressed, this type of treatment will affect the performance measures of the two companies. We recommend that disparate treatment of items such as these be included as part of the project.

***Concluding Remarks***

The Financial Accounting Policy Committee appreciates the opportunity to express its views on the Board's proposed projects dealing with the disclosure of unrecognized intangibles and reporting financial performance. If you, the Board, or its staff have questions or seek amplification of our views, please contact Nazir Rahemtulla at 1-434-951-5337 or at [nazir.rahemtulla@aimr.org](mailto:nazir.rahemtulla@aimr.org). We would be pleased to answer any questions or provide additional information you might request.

Respectfully yours,

*/s/ Ashwinpaul C. Sondhi*

*/s/ Nazir S. Rahemtulla*

Ashwinpaul C. Sondhi, Ph.D.  
Chair, Financial Accounting Policy Committee

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