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Mr. Timothy S. Lucas
Director of Research
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Lucas:

Re: Proposed Agenda Project on Disclosure of Information About Intangible Assets Not Recognized in Financial Statements

With great interest, I read your proposal for a new project on information disclosure about intangible assets. I strongly believe this step is most needed to improve the relevance of corporate financial reporting, in today's business environment. In this brief response, I include my comments on each of the four questions that are of interest to the FASB.

1. Is there a need for the FASB to comprehensively address the reporting of information about intangibles of a business enterprise?

An important objective of financial reporting standards is to promote comparability of financial information. As the Board acknowledges, this is hardly achieved by the current reporting model for intangibles. While the asymmetry in recognition for acquired intangibles versus internally developed intangibles is often cited as the cause for concern, diversity in existing disclosure practices more than exacerbates the problem. It is especially troublesome if value-relevant information is kept in secret.

In a research paper joint with Professor Baruch Lev of New York University, we find substantial non-uniformity in disclosure of royalty (licensing) income across firms.¹ Companies known to have royalty income in billions of dollars often refuse to disclose the information (e.g. IBM). Our findings indicate that royalty income is a highly relevant variable to investors (even more so than other income) and it provides investors with a strong signal concerning the value and potential of R&D expenditures. In our opinion, the enormous market of patent licensing (\$110 billion in 1999) and the broad value-

¹ F. Gu and B. Lev, Markets in Intangibles: Patent Licensing, working paper of Boston University and New York University, June, 2001.

relevance of royalty income highlight the need to address the issue of information disclosure.

Similar evidence on diversity of disclosure practices has been found elsewhere. For example, in its detailed examination of disclosures by six to nine large companies in several industries, the FASB concluded the following:

The detailed findings (Appendix C) show that companies in the pharmaceutical industry made considerable disclosures about their research and development activities and product development pipeline. Disclosures by companies in other industries were generally sparse. The few disclosures found tended to be somewhat vague and not particularly helpful.²

In an attempt to assess the pervasiveness of the diversity, I am currently conducting a large-scale study examining information disclosure by companies involved in research and development activities. Preliminary results of the study perhaps show an even more worrisome picture. While a number of companies (especially in biotech and pharmaceutical industries) made disclosures about breakthroughs in research and product development, overall disclosure pattern is hardly comparable even across firms in the same industry. Moreover, disclosure about other important intangibles, such as human resource practices, brand enhancement, customer acquisition, and changes in organizational structure is, at best, rare.

Evidence on the economic significance of intangibles and widespread diversity of disclosure practices heightens, in my opinion, the urgency and relevance of the proposed agenda item. This initiative by the FASB should represent a crucial step towards establishing the standards for information disclosure about intangibles. Some may argue that the information gap concerning intangibles could be taken care by the market force, via intermediaries such as financial analysts. The recent high-tech bubble and alleged role of analysts in misleading the market perhaps argue better for improving information disclosure.

2. Is the proposed scope of such a project as described in this Proposal insufficient, appropriate, or too ambitious?

The project will be better served by focusing on disclosure issues. I would, however, suggest that it not be limited to unrecognized intangibles. Supplemental information on the performance of externally acquired and therefore recognized intangibles (e.g. purchased patents, trademark, brands, etc.) is perhaps equally, if not more, important.

3. Should specific issues identified above be excluded from the scope of the proposed project?

² Improving Business Reporting: Insights into Enhancing Voluntary Disclosures, Steering Committee Report, Business Reporting Project, FASB, 2001.

While valuation of intangibles is of ultimate interest to investors, the issue may have to be deferred to a future project, due to concern of reliability, as well as the current state of our knowledge about the issue. The concern should not, however, exclude disclosure of quantitative data on investments in intangibles and associated outcome. Numerous studies to date have documented evidence on the usefulness of such data to investors (e.g. research and development expenditure, brand value, patent royalty). In another research paper joint with Professor Baruch Lev, we find strong evidence on the link between investments in various value drivers and the value of intangible assets.³ Although not included in our study, we believe that the list could be extended to other value indicators, such as usage of online resources, employee productivity, customer and employee satisfaction rate, brand performance, progress of research and product development, etc.

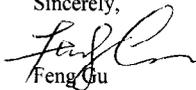
4. Should specific issues not identified above be addressed as part of the proposed project?

Two additional issues may deserve consideration. The first one concerns the ultimate deliverable of the project. Will it be a laundry list of information items deemed to be important, or more than that? I think the project will have a more profound impact if it takes a systematic and comprehensive view of how intangibles create shareholder value, by linking investment in value drivers to value indicators in all forms of intangibles.

Second, given the fast-changing nature of most types of intangibles, disclosure in a more frequent and timely fashion may be warranted. This will be different from most FASB requirements for disclosure, which mostly apply only to annual financial reports. Although it may not be fully in the jurisdiction of the FASB to decide on this, some recognition of the need will likely pave the way for future actions by other standard-setting bodies (e.g. SEC).

In sum, I firmly believe that the proposed project is the right step to address an issue that has gained tremendous importance in recent years. The interest of investors and other users of financial information will be better served by establishing formal standards for information disclosure about intangibles.

Sincerely,



Feng Gu

³ F. Gu and B. Lev, Intangible Assets: Measurement, Drivers, Usefulness, working paper, Boston University and New York University, May, 2001.