

Jeffrey A. Schmidt
Managing Director
Strategy & Organization

200 West Madison Street, Suite 3100
Chicago, IL 60606-3414
312 609-9436
Fax: 312 609-9865

Towers Perrin

September 18, 2001

Letter of Comment No: 24
File Reference: 1123-001
Date Received:

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

Dear Mr. Lucas:

I am writing regarding the Financial Accounting Standards Board's (FASB's) "Proposal for a New Agenda Project: Disclosure of Information About Intangible Assets not Recognized in Financial Statements." We strongly recommend following this proposed new agenda. Better measurement and reporting on corporate intangible assets will provide enormous benefits for business managers, investors, creditors, and the entire national economy.

The scope of the project should include a study of the drivers of intangible asset value. Moreover, to understand a firm's comprehensive value, the FASB should look beyond the value drivers of those intangible assets that can be easily accounted for. Indeed, recent studies have shown that human capital, organizational capital, and brand equity are major contributors to earnings associated with intangible assets. While these latter types of intangibles are difficult to measure with the information disclosed today, they are central to a complete and accurate understanding of a firm's value, especially in the many industries where more than half of all earnings are derived from intangibles. Furthermore, since the new agenda project is exploring what degree of disclosure would be most beneficial, it would be imprudent to disregard these intangibles simply because they are more difficult to measure.

The balance of this letter addresses each of four FASB requests.

- 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?*

It is clear that intangibles reporting is an issue that the FASB should address. There is growing interest among investors and the business community in the large investments being made in intangibles, and in the research that shows clear links between intangibles performance and stock returns.

But, should FASB address this issue by itself? Academic researchers and others have already spent considerable time, money, and energy on the study of intangibles.

Towers Perrin _____

Nonetheless, putting together a team of experts drawn from various fields of research could provide FASB with a fresh and more complete view. For example, we have done extensive research on the drivers of intangible asset value derived from human and organizational capital. Other firms have done extensive research on the value of brands and how to measure this value. And, of course, many academics — including Professor Baruch Lev— and law firms have done extensive research on the value of intellectual property.

In summary, the FASB should not only undertake this proposed agenda item, but should also enlist the help of those who have already studied related issues.

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 scope of the new agenda project is entirely appropriate, with a focus on disclosure rather than recognition issues. However, the scope should be expanded to include a thorough examination of which factors drive earnings associated with intangible assets .

Using the intangibles performance measures created by Professor Baruch Lev, we have been able to find statistically significant links between specific human resource management programs and the earnings associated with intangible assets. Furthermore, building on correlation and regression tests, we have developed strong causality arguments that the highly correlated human resource programs do indeed contribute to intangibles performance.

We believe that the research we have done already with Professor Lev can be extended into other types of intangible assets as well as deepen our understanding of human and organizational capital. This research will provide companies with the means to leverage their intangibles for improved competitiveness and financial results.

Finally, if the FASB determines that companies should report on those major elements proven to be drivers of intangibles-based earnings, the benefits will encompass better investment decisions and greater accountability for their results.

Towers Perrin

- 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.*

Traditional accounting, which focuses on tangible assets, will not easily place a value on brands, quality of people, business processes, organization structures, etc. Many accountants will likely hold this issue as central to the argument against reporting of intangibles. However, disclosure of important information to investors in whatever form the study recommends will add huge value for investment decision-making.

- 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 why it is sufficiently crucial that it should be addressed as part of the proposed project.*

The FASB needs to understand what drives the value of intangibles before deciding which intangibles measures should be disclosed. It is the drivers of this value at the individual firm level that will propel the economy and thus need to be disclosed.

* * * * *

In summary, we support the new proposed agenda. The results will benefit firms, investors, creditors, and the overall economy. And, the FASB is in a unique position to facilitate a major, positive change in valuations and performance management through the project.

Feel free to contact me if you have any questions, or if you feel that we can assist you with this proposed agenda item.

Sincerely,



Jeffrey A. Schmidt

JAS/rt