This Proposal discusses a proposed FASB project to establish standards for improving disclosure of information about intangible assets that are not recognized in financial statements. This Proposal is part of an August 17, 2001 request for comments about the objective and scope of this project, as well as a proposed project on reporting financial performance.¹ Comments are requested by September 19, 2001.

DESCRIPTION OF THE PROPOSED PROJECT

This potential FASB project on disclosure about intangibles would focus on improving information about intangible assets that are seen by many as increasingly important to business success but are not currently recognized as assets in financial statements. Intangible assets are generally recognized only if acquired, either separately or as part of a business combination. Intangible assets that are generated internally, and some acquired assets that are written off immediately after being acquired, are not reflected in financial statements, and little quantitative or qualitative information about them is reported in the notes to the financial statements.

The principal goals of the project would be to make new information available to investors and creditors and to improve the quality of information currently being provided—information vital to well-reasoned investment and credit resource allocation decisions. A secondary goal of the project would be to take a first step in what might become an evolution toward recognition in an entity’s financial statements of internally generated intangible assets.

The balance of this Proposal discusses the problem to be addressed, the scope of the project, the issues that would have to be resolved, how practice might change, and the FASB agenda criteria. It concludes with a request for comments and several questions for constituents.

¹ Further information about that request, including the Proposal for the project on reporting financial performance, is available at www.fasb.org/project/proposals.html.
THE PROBLEM

Hundreds of recent articles, studies, and consultants’ reports have decried what they consider accounting’s failures to respond to recent fundamental changes in the economy. Some suggest that the important value drivers in the new economy are largely nonfinancial, and that a set of measures could and should be developed that would allow investors and creditors to better evaluate entities and compare them with one another. Others suggest that the importance of intangibles is the distinguishing feature of the new economy, that intangible assets are recognized in financial statements only when acquired from others, and that accounting standard setters should require information about internally generated intangible assets. This proposed project would respond to those suggestions.

One aspect of the problem is comparability. Intangible assets are generally recognized in financial statements if they are acquired, either by themselves or as part of a business combination. However, otherwise identical intangible assets generally are not recognized if developed internally. It is therefore difficult to compare the financial statements of an entity that has built up substantial intangible assets internally with those of another entity that has purchased most of its intangible assets. Disclosure can help diligent investors in making such a comparison, but quantitative disclosures are currently required only about the recognized intangible assets. Therefore, the comparative procedure available now is to subtract all recognized intangibles, which allows investors to compare adjusted amounts that ignore all intangible assets. In view of the increasing importance of intangibles, that approach is suboptimal. Disclosures about unrecognized intangibles would potentially allow investors to make a more complete comparison.

Without the leadership of the FASB, the IASB, or other standard-setting or regulatory bodies, it is unlikely that companies will consistently provide financial statement users with reasonably comparable information about intangible assets. Users of financial reports will continue to find relatively little information in the financial statements about key value drivers, and to have little confidence in what information they do receive.

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2 FASB Statement No. 142, Goodwill and Other Intangible Assets, issued in June 2001, improves disclosures about recognized intangible assets and about research and development assets in the year they are written off immediately after being acquired, but it does not address unrecognized intangibles.
THE SCOPE

The principal source material for this Proposal is the April 2001 Special Report, *Business and Financial Reporting, Challenges from the New Economy*, by former FASB staff member Wayne S. Upton Jr. (the New Economy Report), which is available on the FASB website ([www.fasb.org/new_economy.html](http://www.fasb.org/new_economy.html)) or in print from the FASB order department. The New Economy Report suggested four possible FASB projects. This potential FASB project on disclosure about intangibles would take on one of those suggestions, to address the format and content of disclosure about unrecognized intangible assets. That might be a first step in an evolution toward recognition of some internally generated intangible assets, or the disclosure project might be undertaken without any presumption about eventual recognition. Either way, it would stimulate companies to identify intangible assets and other value drivers and to collect some information about intangibles not previously captured in management reporting systems. It would also allow standard setters to refine the definition of an intangible asset and, most importantly, would provide investors, creditors, and other users of financial reports with additional information to assess an entity’s intangible assets.

This Proposal suggests a project scope focused on 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. It would also include in-process research and development assets that, under FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, are written off to expense on the day they are acquired.

Other project scopes have been suggested. One would be *disclosure of nonfinancial indicators* about intangible factors, such as market size and share, customer satisfaction levels, new product success rates, and employee retention rates. Another would be *recognition and measurement*, in statements of financial position, of *research and development and other project-related intangible assets*. A third would be *separate recognition and measurement of intangible assets or liabilities embedded* in tangible or financial assets, for example, banks’ core deposit intangibles and insurers’ claim-handling obligations.³ The Board does not propose to include those matters in this potential project but welcomes comments from constituents on that conclusion.

³ The New Economy Report identified that possible project on recognition of embedded intangibles and service obligations. The proposed project on disclosure about intangibles would not touch on those issues, many of which are closely related to and may be inseparable from issues under active consideration in the Board’s project on measuring financial assets and liabilities at fair value.
RELEVANT RESEARCH, ISSUES, AND CONCERNS

The project would include considering matters raised in—and comments received by the FASB and other standard-setting bodies on—the recommendations of the:

1. November 1993 report of the Association for Investment Management and Research (AIMR), *Financial Reporting in the 1990s and Beyond*


The substantial body of research by Professor Baruch Lev of New York University and others summarized in the New Economy Report also should be of considerable assistance in resolving the principal issues in this project.

The initial phase of the project would build on those and other earlier efforts. A first step would be to establish a working group of outside experts to assist the FASB, especially in identifying the relevant issues and possible solutions and in refining user surveys.

After Board deliberations, an Exposure Draft, and consideration of comments from constituents, the project would result in a final Statement calling for disclosures. The project is expected to take about two years.

The Principal Issues

The first issue, alluded to in the discussion of scope, is what intangible assets are to be covered by the Statement. The proposed scope is intangible assets that are not recognized, but would have been recognized had they been acquired from others, as well as in-process research and development assets written off after acquisition. The project would consider whether existing guidance is adequate for preparers and practitioners to determine what is and is not included, or whether additional guidance is needed. The conceptual analysis in Chapter 4 of the New Economy Report should be useful in resolving that scope issue.  

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4 For example, in FASB Statements No. 141, *Business Combinations,* and No. 142, *Goodwill and Other Intangible Assets.*

5 Part 2 of Chapter 4 of the New Economy Report presents a list of intangible assets, classified according to whether they are separable from the entity and whether they are based on contractual or other legal rights. The list includes agreements with suppliers and customers, rights to scarce resources, permits, franchises, patents and copyrights, computer programs, secret formulas and processes, databases, and research and development, among others.
The second principal issue is what information should be disclosed about intangible assets. Possible quantitative and qualitative disclosures about unrecognized intangible assets might include:

- Major classes of intangible assets and their characteristics
- Expenditures to develop and maintain them
- Values of those assets
- Significant events that change the anticipated future benefits arising from intangible assets.

The *time gap* and the *correlation gap* between expenditures and values of resulting intangible assets, noted on page ix of the New Economy Report, will present challenges in resolving what information should be disclosed.

The FASB conceptual framework contains only general guidance about disclosure, mainly focused on qualitative characteristics, which will be of limited help to the Board in selecting from the alternatives those that will best improve financial reporting. A second concern is that it may not be feasible to develop and verify some of the information about intangibles that is desired by some investors, creditors, and other users of financial reports.

**Other Issues**

*Should the Disclosures Be Voluntary or Required?*

The Business Reporting Steering Committee and others suggest that, in view of such factors as the variations between and even within industries, disclosures should be voluntary. That would certainly reduce resistance to the proposed Statement. However, the potential participation level in response to encouraging voluntary disclosures may not be acceptable.\(^7\)

*Should the Disclosures Be Made Annually or More Frequently?*

Most FASB requirements for disclosure effectively apply only to the full sets of financial statements and notes commonly presented in annual financial reports. Some information is required to be disclosed in interim financial information, and the Board could require that for information about intangibles

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\(^6\) While the main emphasis of this project would be on unrecognized intangible assets, the project might also consider disclosures about values of recognized intangible assets.

\(^7\) For example, FASB Statement 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*, encouraged disclosure of quantitative information about market risks of derivative instruments in 1994, but few entities reported such information until the SEC mandated it in 1997. FASB Statement No. 89, *Financial Reporting and Changing Prices*, encouraged continued disclosure of current-cost and constant-purchasing-power information, but very few entities provide it.
Concerns Likely to Be Raised

Users of financial reports will likely support improvements in information about unrecognized intangibles. On the other hand, preparers of financial reports and their auditors may have concerns regarding competitive harm, fears of failure to meet expectations, lack of expertise, and preparations costs.

However, not taking on such a project may mean that financial reports continue to fail to provide information about what many argue are increasingly the main drivers of values in the capital markets. Chapter 1 of the New Economy Report discusses those arguments.

AGENDA CRITERIA

This Proposal is one of several means by which the Board seeks to obtain advice from its constituents about possible additions to its technical agenda. After receiving input from constituents, the Board must make its own decisions regarding its technical agenda. To aid in the decision-making process, the Board has developed a list of factors to which it refers in evaluating proposed topics. Those factors, which are more fully discussed in Facts about FASB (www.fasb.org/facts/fasfact3.html), include consideration of (a) the pervasiveness of the issue, (b) alternative solutions, (c) technical feasibility, and (d) practical consequences. At this time, the Board believes that this proposed project on disclosures about intangibles satisfies each of those factors. However, the Board’s resources are limited and it is aware of other potential projects suggested by constituents that also satisfy those factors.

In addition, the Board has determined that all topics under consideration for the FASB’s agenda should be assessed to determine whether they provide opportunities for cooperative efforts with the IASB or other national standard setters. More specifically, that assessment is to include consideration of (a) the possibility that resolution of the issues addressed would increase convergence of standards worldwide, (b) the opportunities the topic presents for cooperation with the IASB or other standard setters, and (c) whether appropriate and sufficient resources are available for a joint project or other cooperative effort. In contrast to some other proposed projects, it seems less likely, given their other priorities and resource constraints, that the IASB or other national standard setters will address information about intangibles in the near term. Therefore, the FASB would likely be working separately on this proposed project. However, the same concerns that have been noted in the United States will likely be heard in other countries.
REQUEST FOR COMMENTS

The Board has not decided whether to add a project on reporting information about intangibles to its agenda or about the scope of such a project. The Board is seeking comments from its constituents on this Proposal, particularly on the following major questions:

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?

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.

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.

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.