

Recognition, Measurement, and Disclosure of Intangibles in Australia

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Background

- Intangibles play greater roles in today's economies.
- Advanced economies spend relatively more on intangibles [Australia in the middle of the pack] (OECD, 2015).
- Intangibles are the new sources of economic growth (OECD, 2015).
- The vast majority of intangibles remain unrecognised.
- We define intangibles broadly to include all those firm-level activities that potentially create economic benefits for more than a year but fall outside the definition of assets for one reason or another.

Research Questions and Scope of the Study

- RQ 1: What intangible assets do reporting entities recognize and measure in annual reports?
- RQ 2: What and where do reporting entities communicate to investors and other stakeholders about those intangibles that cannot be recognized under AASB 138?
- RQ 1: 161 (120 + 41) annual reports
- RQ 2:
 - 161 annual reports (used for RQ 1)
 - 6,510 ASX announcements made by the 120 sample firms identified for RQ 1.

Research Design

- Content analysis
- Coding Scheme:
 - Initial list from *IFRS 3 Business Combinations Illustrative Examples* (IASB, 2013)
 - Five categories: marketing-related, customer-related, artistic-related, contract-based, and technology-based.
 - Each co-author separately identified a list of potential intangibles for each industry (taking into account the business model of the industry)
 - Our final categories of intangibles: contract-based, **human capital**, marketing-related, relationship-based, **R & D**, and technology-based
 - Each author tested their list on five randomly selected firms in each industry.
 - We discussed the lists and test results, and agreed on a final list for each industry.

Some Examples (*Emphasis added*)

- **Contract-based intangibles:** Atrium Coal (Metals & mining) p. 5 of 2016 AR “*Groundhog now comprises 88 granted coal licenses covering an area of more than 800km²... Our tenements are prospective for high-grade and ultra-high-grade...*”; 8Common (software), p. 7 of 2016 AR: “...Department of Prime Minister and Cabinet was to take up and use Expense8. *This contract is projected at \$395,000 revenue over the 3 year contract period, with an ability for the contract to be extended for a further two years.*”
- **R & D:** Invion (Pharma), p. 5 2016, “*The principal activities during the year were the completion of clinical development programs...associated with the Group’s three drug assets INV102 (nadolol), INV103 (ala-Cpn10) and INV104 (zafirlukast).*”
- **Human capital:** (FPPSE) Australia’s NBN p. 9 2016 AR, “*We achieved our FY2016 targets thanks to the contribution of a passionate and engaged workforce, with the Company’s employee engagement score climbing into the top quartile of Australian and New Zealand businesses, a very pleasing outcome given our difficult starting point.*”
- **Relationship-based intangibles** (FPPSE): Aurora Energy (p. 6, 2016 AR), “*responded to customer feedback received through its expanded Voice of Customer program, resulting in above-target results for customer loyalty and nearly halving customer wait times.*”
- **Marketing-related:** Activistic Ltd (software) p. 8 2016 AR, “*Operating expenditure of \$6,023,837 (excluding exchange gains/losses, impairment and share options expense) was mainly focused on scaling up activities in the US, brand development of Veterans Call and Ralli, and development of new apps and the new Activistic Apps platform.*”

Sample Selection (RQ 1): Annual Reports

- Stratified, random sampling: An equal number of firms from each quartile of the distribution (Mkt Cap on 30 Dec 2016)

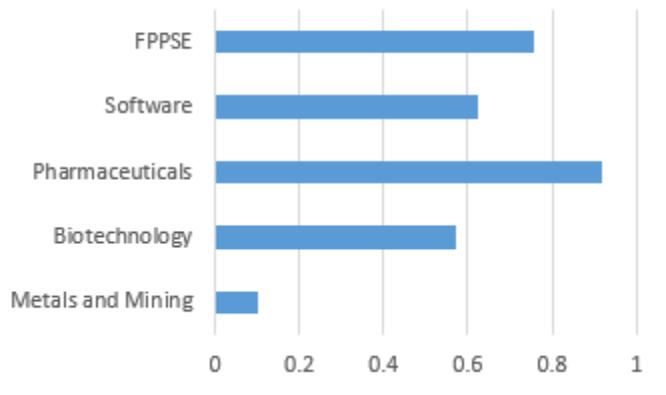
Table 2 Sample and Descriptive statistics

ASX firms	Sample size	Market Cap. (\$m)		Total Assets (\$m)		Intangibles-to-Total Assets (%)		Market-to-book ratio	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median
Metals	40	198	17	114	9	2.03	0.00	4.19	1.82
Biotech	28	1730	39	408	9	20.68	3.38	5.46	4.60
Pharma	12	61	41	25	18	34.82	41.62	5.41	2.65
Software	40	120	23	27	9	24.57	12.66	8.51	5.21

FPPSE

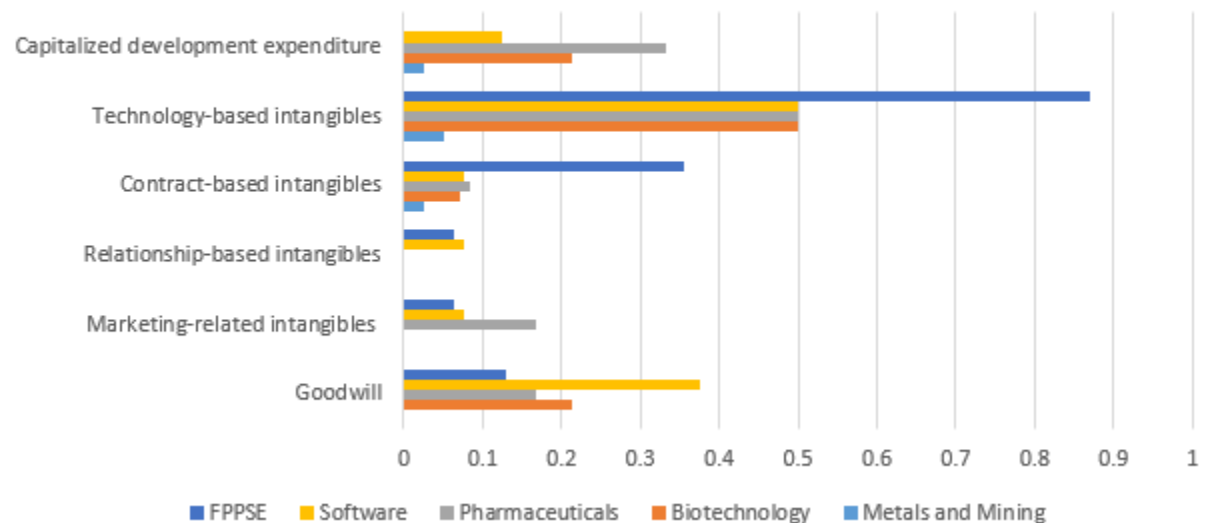
Industry	Sample size	Total assets (\$m)		Intangibles-to-total assets (%)	
		Mean	Median	Mean	Median
<u>C'wealth</u>	8	4638	2968	6.24%	3.73%
NSW	8	4671	2571	8.61%	0.72%
<u>Qld</u>	11	3415	1998	0.85%	0.55%
Tasmania	14	1417	254	1.02%	0.27%

Proportion of sample firms that recognised any form of intangible assets



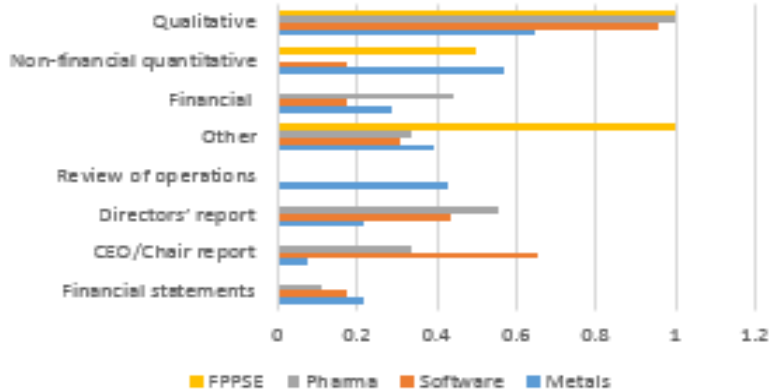
RQ 1 Results

Relative frequency of categories of intangibles recognised across industries

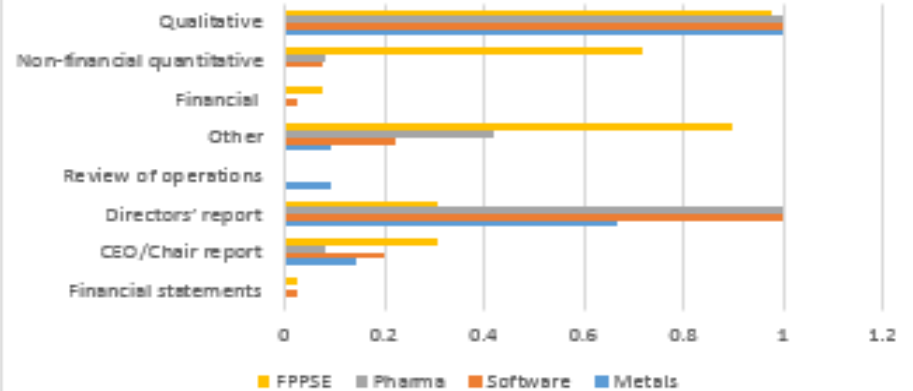


Relative Frequency of Unrecognised Intangibles in Annual Report (RQ 2)

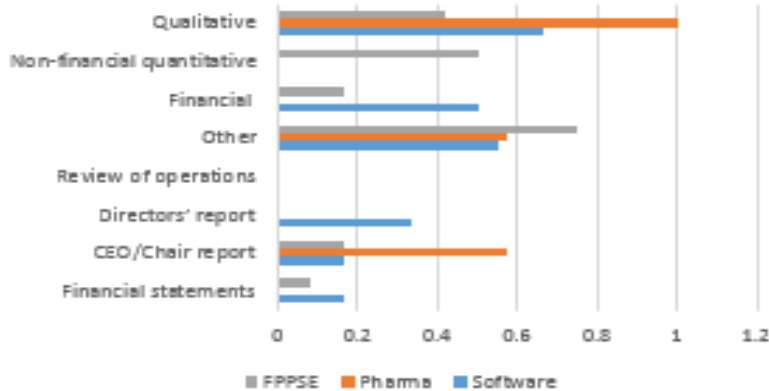
Contract-based Intangibles



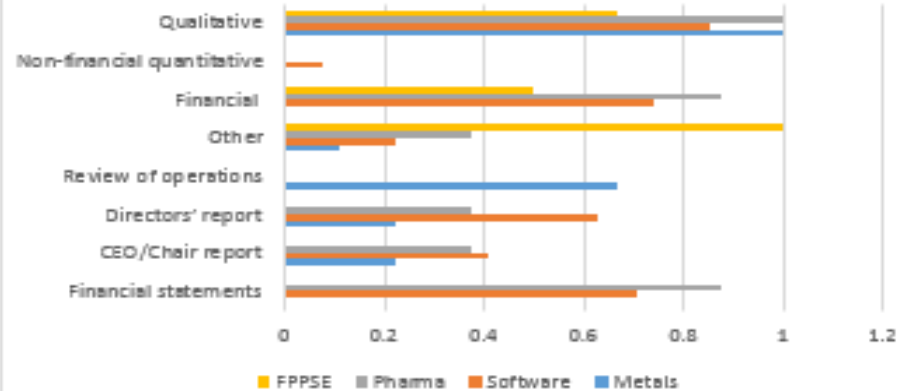
Human Capital



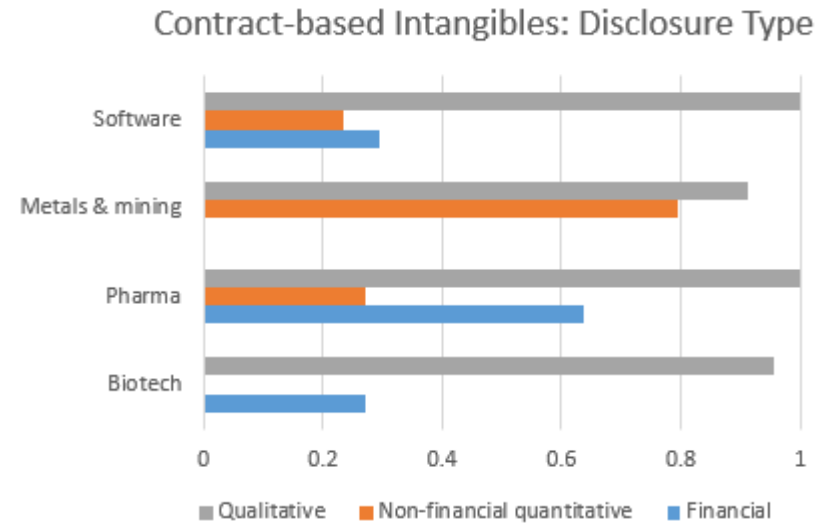
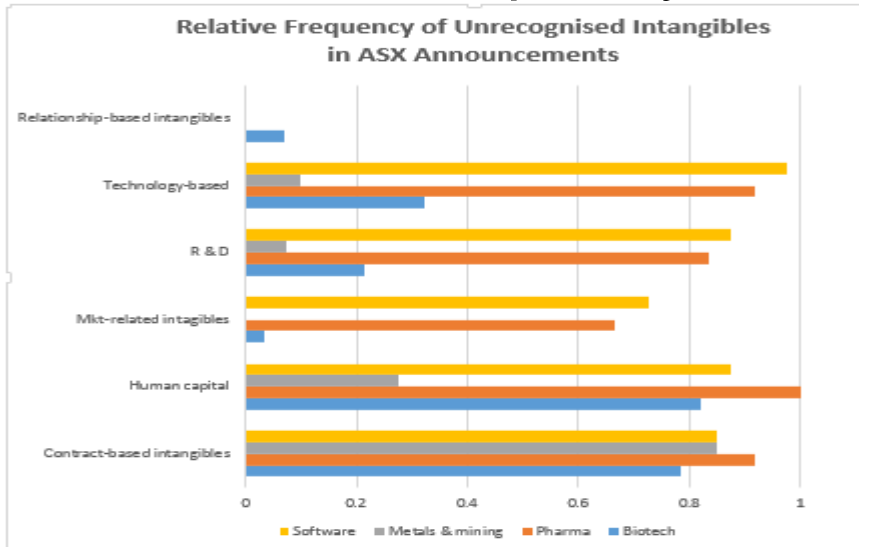
Marketing-related Intangibles



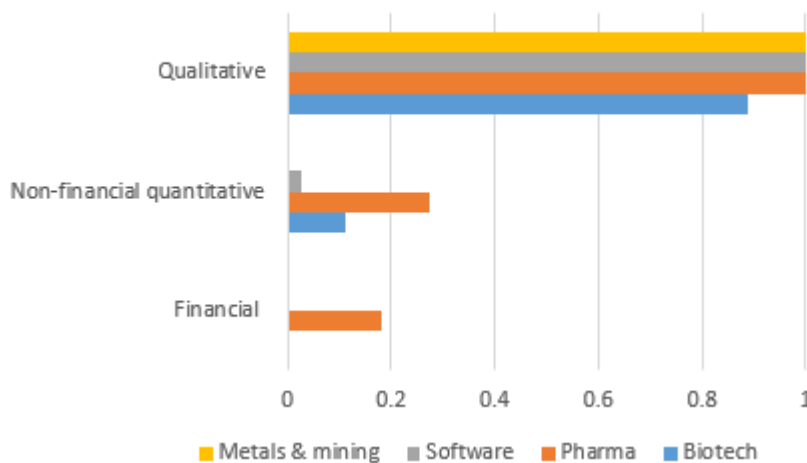
R & D



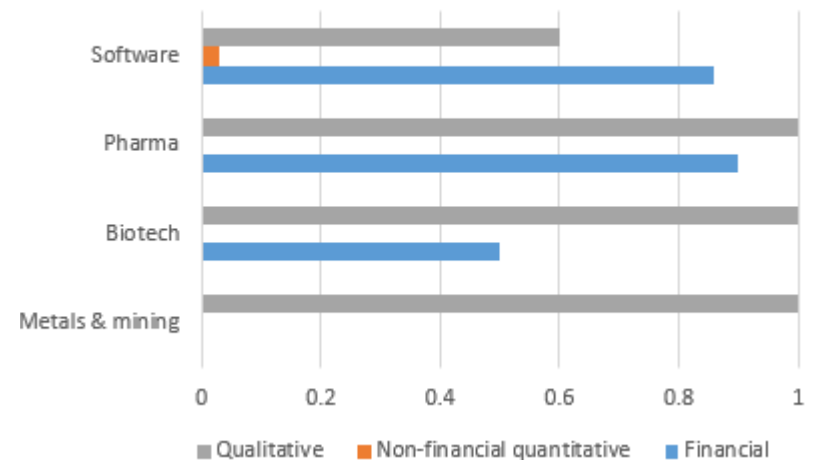
ASX Announcements: Relative Frequency and Disclosure Type (RQ 2)



Technology-based Intangibles: Disclosure Type



R & D: Disclosure Type



Conclusion

- Strong evidence that intangibles are industry-specific.
- Their complexity, diversity, and uncertainty surrounding future economic benefits make it very difficult for recognition.
- Yet managers spend significant time and resources in making disclosures related to intangibles as evidenced by the prominence and volume of disclosure.
- Such disclosures appear to be value-relevant (High M/B ratio in the four industries we examined).
- **Recommendation:** AASB and the IASB could encourage reporting entities (1) to enumerate in their annual reports what unrecognised intangibles contributed to firm value during the year and how and (2) how much expenditure the reporting entities have incurred on such intangibles during the year.
- Investors and analysts may benefit from such structured disclosure.