UNLOCK THE VALUE OF YOUR BRANDS

The NSS secretariat,
at the United Kingdom Accounting Standards Board:

13th May 2009

Dear Sirs

Re: Initial Accounting for Internally Generated Intangible Assets

In the event that IAS 38 is adopted as recommended, trademarks and brands will have to be valued at their fair value for recognition as intangible assets. Presently this applies only to trademarks and brands that are acquired in a business combination in terms of IFRS 3. Under this regime, brands are recognised at cost and are carried in the balance sheet subject only to an annual impairment test. If the impairment test value is less than the carrying amount the difference is applied to the income statement as an impairment loss. I wish to make a case for a new requirement that applies if the value exceeds the carrying amount.

Trademarks and Brands have only been acknowledged as assets since the advent of SFAS 141 in the United States and IFRS 3 elsewhere. Apart from the need to devise ways of valuing this form of asset which, by definition, differs from assets that accountants are accustomed to, a critical characteristic of brands calls for special consideration.

The body of academic literature surrounding brands and brand equity is replete with evidence of the long lived nature of brands and of the generally increasing value they represent to their owners (see for example: Keller K.L. (1993) Conceptualisation, Measuring, and Managing Customer Based Brand Equity *Journal of Marketing*. January. Volume 57. Issue 1. 1 – 22.).

In his subsequent text book (2008, *Strategic Brand Management: Building, Measuring, and Managing Brand Equity*. 3rd. Edition. New Jersey. Prentice-Hall) Keller emphasises the longevity claim by demonstrating that of the 25 brands that are currently market leaders in major markets, 20 of these have retained their leadership role since at least 1923.

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The cost of developing, launching and building a brand is not only high, but is also something of a gamble. Most scholars agree that the failure rate of new brand introductions is at least three out of four. It was this reality that brought about the acquisition of brand owing companies in the 1980s which in turn lead to the inclusion of brands in IFRS 3. In any event, it is recognised in this DP that: "The importance of intangible assets is the distinguishing feature of the new economy" (clause 5, introduction). Brands have been shown to represent a major portion of this category.

A very straightforward view of brands is taken by most brand-owning companies:

1. They must generate a pre-determined gross margin contribution for the company;

2. If they fail the company either re-invents the brand and invests in it for a period to reverse the decline, or;

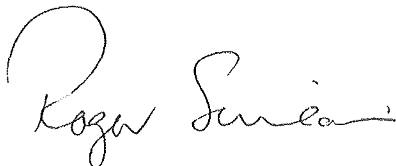
3. The brand is withdrawn from the market.

4. The exception is when brands are kept on the market at a low margin or at a loss for strategic reasons.

The conclusion from the above is that brands as assets will only occasionally register an impairment loss during the annual test. It is more likely that they will show that their value has increased beyond the carrying amount. Carrying brands on the balance sheet at their original cost will be similar to carrying property at book value: it could render the company ripe for a take-over by a predator asset-stripper looking for un-recognised value.

I propose that this reality be further considered and that a technically sound method be included in IAS 38 to take account of this phenomenon. This solution would presumably treat an impairment gain as a credit in the income statement, or a re-statement of asset value in the balance sheet.

Yours faithfully



ROGER SINCLAIR (PROFESSOR)