Comments on Discussion Paper

Initial Accounting for Internally Generated Intangible Assets

by

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I commend the authors of this paper for so clearly identifying the inconsistency in the treatment mandated for intangible assets depending on whether they have been acquired externally or generated internally.

I believe this is an important issue that needs to be addressed if Accounting Standards are to faciltate the presentation of financial statements that provide *value relevant*, *reliable* and *comparable* information.

Together with two of my colleagues, I have been involved in a study examining the *value relevance* and *reliability* of both goodwill and identifiable intangible assets over the period 1994-2003, prior to the adoption by AASB of international accounting standards (Dahmash, Durand and Watson In Press 2009[1]). During this period, compared to other jurisdictions, Australian GAAP was characterised by relatively restrictive reporting requirements for goodwill and relatively flexible requirements for identifiable intangible assets.

The fact that Australian GAAP provided more flexibility than most other jurisdictions with respect to the reporting of identifiable intangible assets and, potentially, less flexibility with respect to the reporting of goodwill, suggests the Australian reporting environment provides an ideal setting in which to test a number of propositions regarding the *value relevance* of the accounting treatment for intangible assets and the *reliability* with which intangible assets are reported. We believe our findings could provide useful input to policy makers and international standard setters involved in any future review of the accounting treatment of this important class of assets.

In summary, two key findings emerged from our study:

1. In the financial statements for the average Australian company (prior to 2003), identifiable intangible assets were overvalued and the market (in valuing Australian companies) discounted such assets significantly (and the opposite was true for goodwill).

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[1] Dahmash, F. N., Durand, R. B. & Watson, J. (In Press 2009). The value relevance and reliability of reported goodwill and identifiable intangible assets. *The British Accounting Review*, 42, doi:10.1016/j.bar.2009.03.002.

2. However, for high performing Australian companies (that is, companies that earned positive abnormal returns in successive years) our findings suggest that:

   (a) the accounting for identifiable intangible assets in company financial statements is highly conservative; and

   (b) the market attaches no value to reported identifiable intangible assets but, instead, attaches a significant premium to abnormal earnings (that is, the information presented with respect to identifiable intangible assets is seen by the market as *irrelevant*).

Given our findings, we suggest that the move to IASs is likely to be associated with a reduction in the level of bias with which intangible assets are reported by the average Australian company. However, for high performing Australian firms the results indicate that the additional restrictions placed on the recognition (and revaluation) of identifiable intangible assets under IASs, particularly with respect to internally generated intangible assets, is likely to do little to improve (and may indeed reduce) the usefulness of information reported with respect to this important class of assets for this sub-set of firms.