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Better information on intangibles
Cover note

Objective

1 The purpose of this session is to ask whether EFRAG TEG can recommend the discussion paper drafted by the EFRAG Secretariat on Better Information on Intangibles for EFRAG Board approval.

Background and latest decisions of EFRAG TEG

2 In 2018, following the input received from the EFRAG research agenda consultation, EFRAG decided to add a research project on better information on intangibles to its agenda.

3 Since then, EFRAG has been working on a discussion paper. This Discussion Paper considers information to be provided in the financial statements (including the notes) and in the management report.

4 The Discussion Paper considers potential approaches to provide better information on intangibles and in particular how information on creating, maintaining and/or improving value can be provided in financial reports in a manner that is useful for decisions on providing resources to the entity.

5 Scope of the project: Some EFRAG TEG members, and members of the EFRAG Advisory Panel on Intangibles, have previously noted that there were specific application issues with current guidance (e.g., in relation to the scope of IAS 38 Intangible Assets). These issues are not considered in the Discussion Paper; they can be considered in a subsequent step of the project (should EFRAG TEG agree on this).

6 The final discussion paper will include a bibliography at the end, which is not included in the version prepared for the June 2021 EFRAG TEG meeting.

7 EFRAG TEG discussed the content of the Discussion Paper at its meetings on 30 March 2021 and 21 April 2021. The main comments made are summarised in the Appendix to this cover note and it is mentioned in brackets where or how the comment has been reflected in the redrafted version of the Discussion Paper. The Appendix also reflects the comments on the content of the Discussion Paper provided at the 10 May 2021 meeting of the EFRAG Advisory Panel on Intangibles (EFRAG API) and how these comments have been reflected in the redrafted version of the Discussion Paper.

8 In addition to the content changes mentioned in the Appendix to this agenda paper:

(a) An executive summary has been added;

(b) A few additional examples on information relating to specific intangibles have been included (based on comments of a former EFRAG TEG member that had not previously been included);

(c) A few lines about 'negative intangibles'/'intangible liabilities' have been included (based on a comment made by an EFRAG API observer that had not previously been included in the Discussion Paper);

(d) The Discussion Paper has been amended to make it more consistent and easier to read. This has involved restructuring some sections and amending the list of advantages and disadvantages of the various approaches considered.

Planning for this session

9 EFRAG TEG members will be asked whether they have any observations on how the comments on the content provided at previous EFRAG TEG meetings have been reflected in the Discussion Paper and whether they have any comments on the drafting. EFRAG TEG members will be asked for their comments to the elements in the following order: Chapters 1 and 2, Chapter 3, Chapter 4, Chapter 5, Chapter 6 and then Questions for constituents. Finally, EFRAG TEG members will be asked whether they think the executive summary provides a fair reflection of the Discussion Paper. After EFRAG TEG members have provided their comments on the elements of the Discussion Paper they will be asked whether they, subject to drafting changes, want to recommend issuance of the Discussion Paper to the EFRAG Board.

Questions for EFRAG TEG

10 Does EFRAG TEG approve of how the comments included in the Appendix have been reflected in the Discussion Paper?

11 Does EFRAG TEG have any additional comments or drafting suggestions?

12 Does EFRAG TEG agree to recommend issuance of the Discussion Paper to the EFRAG Board?

Agenda Papers

13 In addition to this cover note, the following agenda papers are prepared for this session:

(a) Agenda paper 04-02 – *Draft Discussion Paper*.

(b) Agenda paper 04-03 – Draft Discussion Paper – changes marked (from version presented at the April 2021 EFRAG TEG meeting).

Appendix – How comments of EFRAG TEG and the EFRAG API have been reflected in the Discussion Paper

14 EFRAG TEG discussed the content of the Discussion Paper at its meetings on 30 March 2021 and 21 April 2021. The main comments made are summarised in the below and it is mentioned in brackets where or how the comment has been reflected in the redrafted version of the Discussion Paper.

Questions for constituents

(a) To include a question to constituents on the placement of the information. (This comment is reflected in Question 12 to constituents).

(b) To include a question to constituents on whether additional factors than those listed in Chapter 6 of the Discussion Paper should be considered when making proposals on how to provide better information on intangibles. (This comment is reflected in Question 11 to constituents).

(c) To include a question on how to combine the approaches in the Discussion Paper should be included. (This comment is reflected in Question 2 to constituents).

Chapters 1 and 2

(d) To clarify that the Discussion Paper presents various alternatives and considers their effects but does not intend to provide recommendations on the alternatives. (This comment is reflected in the introduction to Chapter 1 and in paragraph 1.17).

(e) To include a reference to EFRAG's Discussion Paper on crypto-assets as an example of a discussion on how to account for non-operating intangibles. (This comment is reflected in paragraph 1.20).

(f) To clarify in Chapter 2, that the issues arising from the non-recognition of most internally generated intangibles have two facets: the fact that return-generating resources are not recognised and the fact the entity is itself spending resources on intangibles (stewardship aspect). (This comment is reflected in paragraph 2.5).

(g) To clarify (throughout the document) the reference to information about the 'value of intangible': the DP addresses how entity creates value using intangible resources and is not focusing on fair value measurement of intangibles. (The reference has been amended and is now covered by the term 'information relating to specific intangibles').

(h) To add as an additional issue with the current information, that the statement of performance is hit twice by intangibles acquired (and hence amortised) that would be replaced organically by the entity's operation (but these costs would not be capitalised). (This comment is reflected in paragraph 2.5).

(i) To note that currently financial statements do not provide useful information on returns as intangibles were not capitalised. (This comment has been reflected in, for example, paragraph 2.5).

Chapter 3

(j) To include a discussion on the conceptual factors to consider in choosing a measurement basis (based on guidance in the Conceptual Framework). (This comment is reflected in paragraphs 3.79 – 3.86).

(k) To consider, in the discussion on conditional capitalisation, an alternative to the use of Other Comprehensive Income to record project expenses until the condition is met. (This comment is reflected in paragraphs 3.56 – 3.59).

(l) To clarify the effects of synergies between intangibles and other assets on impairment testing at CGU level. (This comment is reflected in paragraph 3.31 (d)).

(m) To clarify that comparability between internally developed and acquired intangibles would only be increased if fair value is used as initial measurement of internally generated intangibles. (This comment is reflected in the table following paragraph 3.68).

(n) To mention that to achieve comparability, it should be considered to capitalise expenses for internally generated intangibles. (This comment is, for example, reflected in paragraphs 3.15 – 3.22).

Chapter 4

(o) To clarify whether we are considering the value of the intangible on a stand-alone basis or whether we are looking for disclosures on how the intangible is contributing to the value of the entity. (This comment is reflected in the introduction to Chapter 4).

(p) To include that the entity itself could provide an assessment of how an intangible contributes to the value of the entity and the entity's understanding or expectation of the market size or share associated to products that can be sold relating to the specific intangible, rather than leave it only to the user to assess. (This comment is reflected in paragraphs 4.2 and 4.19).

(q) To clarify the notion of 'direct' information. (The term has been replaced with information relating to specific intangibles').

(r) To remove discussion on auditability relating to the placement of the information. (The discussion has been removed).

(s) To avoid financial only aspects of value creation should be avoided. (The reference to 'financial only aspects of value creation' has been removed).

(t) To avoid the references to 'ESG'. (The term 'ESG' has been replaced with 'sustainability information' in what is now paragraph 4.22).

(u) To reconsider the classification of some of the suggested disclosures on information relating to specific intangibles between qualitative and quantitative. (Changes have been made to the classification appearing in the table following paragraph 4.18).

(v) To emphasise that examples of disclosures provided (SAP) are deemed useful only to the extent that the information can be compared with peers. (The comment has been reflected in paragraph 4.27).

(w) To review the appropriateness of the example presented in Figure 4.1 as the purpose of the Discussion Paper is not to bridge the gap between book value and market value and the second paragraph of the example presented in Figure 4.3 as it may include boilerplate information. (Part of the text in Figure 4.1 and Figure 4.3 has been removed).

(x) To clarify in relation to the KASB initiative that there is a risk of double counting the value of some intangible resources. (This comment has been reflected in paragraph 4.35).

(y) To mention the disclosure suggested in the UK FRC discussion paper on the cumulative amount of non-recognised costs in Chapter 4. (This comment has been reflected in paragraph 4.39. The following has been added "The FRC discussion paper also suggests that an entity should disclose the cumulative amount of future-oriented expenditure that is expected to benefit future periods, and movements in this amount. To the extent that it would be possible to relate this information to specific intangibles, this information could be covered by the discussion in this chapter. The FRC's proposal on this information is further considered in Chapter 5.").

Chapter 5

(z) To amend the introduction of Chapter 5 not to give the impression that the statement of financial position not important and not to imply that more intangibles should be recognised to receive matching. (Chapter 5 has been amended accordingly).

(aa) To explain the term 'factors' in the beginning of Chapter 5. (Chapter 5 now refers to risks/opportunity factors).

(bb) To refer to expenses that are not capitalised but could have an effect on future earnings instead of 'changes in intangibles' (Chapter 5 now refers to expenses that may affect future performance / uncapitalised costs).

(cc) To focus on how the intangible contribute to the value of the entity instead of considering the value of an intangible on its own. (This comment has been reflected several places in the Discussion Paper, for example, paragraphs 5.1, 5.3, ES13, Question 8 and paragraph 1.7).

(dd) To amend the matrix in Chapter 5 showing both the management's assessments of costs relating to the current and future periods and the costs classified by both function and nature to showing only costs classified by function and nature. (The matrix (appearing in Figure 5.2) has been amended).

(ee) To note in Chapter 5 that some costs, recognised as expenses in a period, could relate to the past. (This comment has been reflected in, for example, paragraph 5.10).

(ff) To ensure that the proposals would also work in an environment in which financial information would be provided electronically. (The EFRAG Secretariat has not identified any issues with the approaches suggested in this regard).

(gg) Disclosures of future commitments in contracts related to intangibles that would not be recognised would be useful. (This comment has not been reflected as it would be covered by IAS 1 *Presentation of Financial Statements*).

(hh) To include as an argument against asking entities to categorise uncapitalised costs between those relating to the current (and past) period and those relating to the future that users would not consider an entity's distinctions reliable. (This comment is reflected in paragraph 5.15).

(ii) To include as an argument against asking entities to categorise uncapitalised costs between those relating to the current (and past) period and those relating to the future that it would be difficult for preparers to do so. (This comment is reflected in paragraphs 5.14 and in the table following paragraph 5.40).

(jj) To include as an argument in favour of presenting different types of costs that benefits in the future are mostly related to the synergies achieved from the different types of costs. (This comment is reflected in the table following paragraph 5.40).

(kk) To include as an argument against the approach of providing information on costs that may relate to future performance that the information would be commercially sensitive. (This comment is reflected in the table following paragraph 5.40).

(ll) To note that it is important to identify the intangibles of an entity. (This comment is, for example, reflected in the table following paragraph 5.40 – it is mentioned as a disadvantage of the providing information on costs relating to future performance).

Chapter 6

(mm) To remove the discussion on auditing issues. (A discussion on auditability was removed from Chapter 6).

(nn) To discuss advantages and disadvantages of placing information in the management commentary and the notes, respectively. The information on value creation and the business model should be proposed to be included in the management report. Information on specific intangibles could be included in the notes. A question to constituents should be added on this. (This comment is reflected in paragraphs 6.8 – 6.13 and in Question 12 to constituents).

15 At the 10 May 2021 meeting of the EFRAG Advisory Panel on Intangibles (EFRAG API), made some additional comment to the substance of the content of the Discussion Paper. The comments were discussed by EFRAG TEG as part of the update of the EFRAG API Chairwoman at the 19 – 20 May 2021 EFRAG TEG meeting. The comments are listed below and in brackets it is noted how/whether/where the comments have been reflected in the updated version of the Discussion Paper.

(a) Users are not interested in the value of intangibles per se. Instead, they focus on the value of a company as a whole. (This comment has been reflected several places in the Discussion Paper, for example, paragraphs ES13, Question 8 and paragraph 1.7).

(b) A separate market for intangibles would generally not exist to provide a separate valuation. (This comment is reflected in paragraph 2.8).

(c) Sustainability or climate should be mentioned in relation to risk/opportunity factors. (This comment is reflected in paragraphs 1.22 and 5.28).

(d) Non-GAAP measures are sometimes being used to address the lack of comparability (at least for performance measures) in the accounting of acquired versus internally developed intangibles. However, a proliferation of entity specific non-GAAP measures is not desirable and a sign that the existing Standards are not working as intended. (This comment is reflected in the introduction to Chapter 3 in in paragraph 3.69. However, the reference is not to non-GAAP measures, but to alternative performance measures. The comment that a proliferation of entity specific non-GAAP measures is not desirable and a sign that the existing Standards are not working as intended has been softened following comments from EFRAG TEG members at the May 2021 EFRAG TEG meeting).

(e) In assessing the advantages and disadvantages of the accounting alternatives, the stewardship objective of financial reporting should be further considered. (This comment is reflected in several places, for example, in the tables including advantages and disadvantages of the various approaches (that is the tables following paragraphs 3.68, 4.42 and 5.40).

(f) It should be considered whether the alternative to recognise fewer intangibles than currently (in particular in relation to the feedback received by EFRAG in the Goodwill and Impairment project) is given enough emphasis in the DP and the advantages and disadvantages of this alternative enough considered. (This has been further mentioned in, for example, paragraphs 3.69 – 3.71).

(g) It should be acknowledged in Chapter 3 that that currently IAS 38 addresses the recognition of some investments in intangibles such as development costs. The importance of the connection between the phases of a project and the recognition criteria should be stressed (i.e., moment of recognition). For that purpose, a reference to development costs in paragraph 3.13 should be included (in addition to the 'brand' and 'client relationship' examples already provided). (It appears now several places, for example in the introduction to Chapter 3, that development costs are capitalised. The moment of recognition issue is mentioned in, for example, paragraph 3.46. It is indicated in paragraph 3.24 (formerly paragraph 3.13) that development costs are capitalised).

(h) A flow chart should be included in relation to Chapter 3 to help present the different recognition and measurement alternatives in a more understandable way. (It has not been possible to introduce a flow chart, but Figure 3.1 has been included to illustrate the different recognition approaches).

(i) It should be considered renaming chapter 4 and 5 as 4.A (currently Chapter 4) and 4.B (currently Chapter 5) to separate disclosure proposals from recognition proposals. (As an EFRAG TEG member has expressed disagreement with this proposal it has not been included).

(j) Guidance may be necessary on how to identify key intangibles for the approach described in Chapter 4. (This comment has been reflected in paragraph 4.46).

(k) Regarding the advantages and disadvantages of information on expenses that may relate to future performance, it should be mentioned that such information could have system implications. (This comment has been reflected in paragraph 5.48).

(l) The expected time period when benefits would be achieved from uncapitalised costs could be very uncertain for items such as research. (This comment has been reflected in paragraph 5.13).

(m) Disaggregation of operational expenses between future oriented and other was considered useful information but not always easy to implement. For example, it would be useful for training or marketing costs, but for research and development costs it could seem contradictory to have costs that are future oriented while they are not yet capitalised as the probability of future benefits cannot be yet demonstrated. In addition, it was suggested to consider the possibility that instead of having a disclosure requirement in IAS 38 or belonging to the Intangibles area, the IASB could consider this disaggregation of expenses as part of their work on General Presentation and Disclosure. (These comments are not reflected as 1) the Discussion Paper does not take the position that information on uncapitalised costs is the best way forward and 2) the Discussion Paper does not consider in which standards the suggested requirements should be included).

(n) It was considered where to locate the proposed information, noting that granular information about the costs and specific information about key intangibles could belong to the financial statements, while broader concepts such as risks/opportunity factors that impact the value creation could be more efficiently linked with the proposals contained in the CSRD and the upcoming MCPS and CSRD. (This comment is considered in paragraphs 6.8 – 6.13).