

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## **Project history and past EFRAG TEG discussions**

### **Background paper**

#### **Background**

- 1 The objectives of the EFRAG research project on intangibles are to:
  - (a) understand how entities, report on creating, maintaining and/or improving their value;
  - (b) understand how users, consume information on creating, maintaining and/or improving value, and the extent to which current financial reporting addresses their needs; and
  - (c) provide suggestions on 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.
- 2 In considering how an entity creates, maintains and improves its value, the project will focus on information on the entity's key intangibles. 'Intangibles' is to be considered in a broader sense than 'intangible assets' as it will include, for example, resources that are not controlled by the entity.

#### **Previous discussions**

- 3 In April 2019, EFRAG TEG and User Panel members agreed that the project should not attempt to fill the gap between the company's equity book value and its market capitalisation.
- 4 At its September 2019 meeting, EFRAG TEG further clarified that the research should:
  - (a) focus on financial reporting and consider the financial aspects of value creation and the needs for the primary users of financial statements and management commentary, as opposed to the creation of value to other stakeholders such as employees, the environment and community/society (broader corporate reporting);
  - (b) consider recognition and measurement of assets in financial statements, narrative information in the notes to the financial statements and in the management commentary, reported measures of value including drivers of value creation and risk (e.g., customer attrition rates), disaggregation of expenses, or other performance measures;

*EFRAG's Research on Better Information on Intangibles - Background paper*

- (c) aim to identify 'solutions' and good practices that would improve reporting on intangibles and facilitate users' own assessment of intangibles; and
  - (d) start by focusing on specific industries rather than specific types of intangibles, cover the more 'intangible-intensive' industries, develop solutions and then consider if identified principles can be applied more broadly.
- 5 At the March 2020 joint meeting of EFRAG User Panel and EFRAG TEG, some members reiterated their view that the project was right in looking holistically at better information on how entities report on creating, maintaining and/or improving value rather than focusing only on the debate about capitalisation of expenses. They recommended providing more information in the financial report or management commentary as for example KPIs.
- 6 At its April 2020 meeting, EFRAG TEG received an update from the first meeting of the Advisory Panel on Intangibles (API), and discussed the tentative contents of a first discussion paper on problem definition (['Content of the first discussion paper: Identification of issues'](#)), together with an updated scope of the project. EFRAG TEG members reiterated support for the project's objective to improve reporting on intangibles by looking at how to provide useful information to users about creation, maintenance and enhancement of value. Members noted the importance of the project for users and its interactions with other initiatives such as the revision of the Management Commentary Practice Statement.
- 7 At its November 2020 meeting, EFRAG TEG agreed that the discussion paper, which would probably not be the only discussion paper on the issue, should be structured similarly to EFRAG TEG November 2020 meeting [Paper 03-02](#) and should contain the following:
  - (a) Description of the current problems;
  - (b) The definition of 'intangibles' and the limits of the current notions of control, transferability, lack of physical substance and how the notion of intangible asset has evolved with technologic development;
  - (c) The different alternatives of measurement with their pros and cons, without providing a position; and
  - (d) Possible solutions related to direct information on intangibles and indirect information on intangibles based on the input received from members of the API;
  - (e) Challenges and issues to be considered when identifying possible solutions.
- 8 EFRAG TEG also suggested a few drafting guidelines for the discussion paper:
  - (a) Generalisation of specific inputs provided by API members to avoid focusing only on specific sectors;
  - (b) Inclusion of KPIs for illustrative purposes;
  - (c) Reflecting that there is a need to understand how much is regularly spent to regenerate the revenue streams, acknowledging that for some intangibles it is necessary to make recurring investments so as not to diminish their value;
  - (d) Taking into consideration the role of the Management Commentary Practice Statement IASB project as well as the placement of the information;
  - (e) Consideration of ESG matters as a sort of pre-financial information that provide contextual information on the value creation and, depending on the business, they may as well be key value generation factors.

### **Advisory Panel on Intangibles (API)**

- 9 Since April 2020 five meetings of the API meetings were held. Several aspects, including the following, were considered in those meetings in line with the project aims indicated above:
- (a) Share user/preparer examples of (good) reporting practices and how information is being reported/consumed. Each industry represented in the API (Pharma, Fast-moving Consumer Goods and IT/Media) was discussed based on members' presentations (both users and preparers);
  - (b) Discuss whether and how the current accounting framework could be improved;
  - (c) Discuss approaches on intangibles developed by other organisations;
  - (d) Gathering API members views on questions included in the EFRAG DP/2020/1 Business Combinations – Disclosures, Goodwill and Impairment.
- 10 The feedback received from the API was included in Agenda [Paper 03-02](#) of the November 2020 EFRAG TEG meeting.

### **Published document (reminder)**

- 11 In February 2020 EFRAG published a commissioned literature review ([‘the literature review’](#)) on intangibles. The literature review provided further evidence that only a limited number of studies have addressed how investors, analysts, and other users consume the information about intangibles, particularly unrecognised, and the information needs of the users in that regard. Some research papers have quantitatively looked at the way and frequency of information on intangibles mentioned in analysts' reports. However, only few have reached out directly to users to learn about their needs.

### **Interactions with other initiatives**

- 12 In the second half of 2020 EFRAG was contacted by ICAS for co-operation on an academic study on reporting on intangibles. EFRAG is participating in this study which will provide an opportunity to have some of the proposals tested in a questionnaire to preparers and users of financial statements. The study is expected to be finalised during the last quarter of 2021.
- 13 EFRAG has also, together with ICAS, sponsored a study examining whether and how companies disclose information about their intellectual capital. More information on this study is available at the [website of ICAS](#).
- 14 Both studies are in progress. We intend to consider their findings and conclusions in the final version of the discussion paper.
- 15 It is the intention that the project will also inform EFRAG for its response to IASB's project on the Management Commentary Practice Statement (expected in April 2021), and in responding to IASB's agenda consultation (request for information expected in late March 2021).