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Better information on intangibles

Feedback in response to the public consultation on EFRAG's Discussion Paper

EFRAG FR TEG meeting on 9 November 2022

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OVERVIEW

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Issues with current information

Discussion Paper

- Financial statements do not reflect the underpinning drivers of value for intangible intensive businesses.
- Comparability between internally generated assets and acquired assets.
- Distorted performance measures
    - Return on assets ratios do not provide useful information;
    - Expenses not correctly matched;
    - Statement of performance is hit twice when acquired intangibles are replaced by internally generated intangibles.

Input received

Comments on issues identified

- Many thought the issues identified in the Discussion Paper were relevant and valid. However, some disagreed on some aspects and noted that (see Paper 05-03):
    - Users have generally sufficient information on intangibles (often received from other sources than the financial statements)
    - Financial statements are not losing value relevance because of how intangibles are accounted for
    - IFRS performance figures are not important
    - Acquired assets are different from internally generated
- Some additional issues were mentioned (see Paper 05-03):
    - Problems with the application of current requirements
    - Current requirements are complex
    - IFRIC decision on software does not make sense
    - Insufficient disclosures for intangibles that are not recognised
    - Consequences of the issues
    - Relationship with sustainability

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received on the issues with the current information on intangibles?

Which way to go?

Input received

Which approach(es)?

Most respondents thought a combination of the approaches should be the way forward. But some favoured only one or two of the approaches.

Types of intangibles

Respondents mentioned a list of factors that distinguish intangibles (and how they should be reported). Including:

- Investment like versus non-investment like
- Complexity related to measurement
- Distinctly observable
- Possibility to disclose expected future performance
- Extent of control
- Part of value creation or a result of the value creation
- Uncertainty regarding product development
- Function in the entity’s business model

Phased approach

Some respondents suggested a phased approach. For example, first try to improve disclosures about (unrecognised) intangibles and then consider recognition and measurement at a later stage.

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received on the manner to provide better information on intangibles?

Recognition

Discussion Paper

Chapter 3 of the DP ask stakeholders if IAS *38 Intangible Assets* should be amended to permit the recognition of certain internally generated intangible assets and if so, how.

Chapter 3 states that it would be a radical approach to recognise intangibles that are not controlled by an entity and focuses on intangibles that meet the definition of an asset under the Conceptual Framework for Financial Reporting

Chapter 3 presents four different approaches to recognition of intangible assets and presents their advantages and disadvantages without indicating a preferred one.:

(i) an approach under which all intangible assets are generally recognised,

(ii) a threshold for recognition (of an asset) approach under which intangible assets are recognised if certain criteria are met,

(iii) a conditional recognition (of an asset) approach under which intangible assets are recognised when they meet certain criteria, and

(iv) an approach under which no internally generated intangible assets are recognised. The advantages and disadvantages of these approaches are considered

Stakeholders are invited to indicate whether they support any of the approaches and how they could be implemented.

Input received

Overall views - Need to revise IAS 38

- Support from a majority of respondents/participant for more recognition of IGA in particular Preparers, Academics, Standard Setters, Accounting/professional organisations and Auditors. More mixed views from Users

- Support for removing the explicit prohibition in IAS 38 to recognise some types of IGA (brands, mastheads, publishing titles, customer lists, staff training and marketing) in favour of a more **principle-based approach**.

- However, general view that any change to the recognition principles for intangibles should preserve the existing definition of an asset in the conceptual framework: Existence of a resource/right that is controlled and has potential to produce economic benefits

- Mixed views on the ‘extent’ of changes needed to IAS 38.

Input received

Overall views - the 4 proposed approaches

Some prefer only targeted improvements to IAS 38 to address known deficiencies but no fundamental changes to recognition principles. This could be combined with a review of BC accounting to limit separately recognised intangibles and reintroduction of amortisation of goodwill. (Additional details on slide 15).

Some support a broader review of IAS 38 principles exploring the conditional recognition approach proposed in the DP. (Additional details on slide 16).

Only a few respondents/participants support recognising all IGA meeting the definition of intangibles; with no specified conditions or thresholds.

No support expressed in feedback for expensing all intangibles (including those currently capitalised).

Input received

Targeted improvements but no fundamental changes

Targeted improvements to address specific identified areas of deficiencies for examples:

- Capitalisation of internally generated Software - substantial investments in software fails to meet the current recognition criteria.
- Research and development current requirement more suite for traditional linear R&D; les suited for and less suited to modern research and development processes, such as agile development.

Some consider addressing the lack of comparability between acquired and internally developed intangibles y looking at both ends:

- Bring the recognition requirements of IAS 38 more closely to IFRS 3 as the former are too narrow and the latter too broad.
- Could be addressed by revising BC accounting to reduce or eliminate requirement separately recognised intangibles from goodwill and re-introduce goodwill amortisation.

Caution that any changes are first assessed from the cost-benefit perspective.

Input received

Conditional recognition

Supporters of this approach preferred in majority option 2 (Costs capitalised and fully impaired until the condition is met, at which point in time the impairment is reversed)

- Allows for a recognition (capitalisation) of all the cost not partial recognition
- More comparable to internally generated tangible

However, challenges are noted

- Difficulty to identify conditions and measure progress in fulfilling them
- Diversity of nature of intangibles: conditional recognition approach could become too complex and costly to implement for some
- Compatibility what the Conceptual Framework

Less support for Option 1 (Costs are expensed in profit and loss until the condition is met) as it results in partial recognition.
No support for accounting cost in OCI until the condition is met and recycle.

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received in response to Question 3 of EFRAG's DP on recognition?

Measurement

Discussion Paper

The Discussion Paper considers possible measurement bases for internally generated intangibles and analyse their advantages and disadvantages without suggesting a preferred approach.

Stakeholders who assessed that IAS 38 should be amended to permit the recognition of certain IGA were invited to consider four possible measurement methods

A. Initial and subsequent measurement at amortised cost with impairment (‘Cost model’);
B. Initial measurement at cost and subsequent measurement at fair value (‘Revaluation model’);
C. Initial and subsequent measurement at fair value (‘Fair value model’);
D. Initial measurement at fair value (as deemed cost) and subsequent measurement at amortised cost with impairment (‘IFRS 3 model’)?

Input received

Overall input – Measurement

A majority of respondents preferred the Cost Model for the following reasons:

- Consistent with accounting of internally generated tangible assets and the measurement of separately purchased intangibles
- Greater insights into the capital invested in internally generated intangibles, resulting in better information for assessing an entity's return on investment made
- Less subjective than FV (no active market, uncertainties…)
- Less costly

Limitations of cost measurement were however noted

- Difficulty/complexity to identify and allocate cost for some IGA
- Intangibles with no cost associated
- Lesser or no predictive value on future cash flow

Input received

Overall input – Measurement

Only a few respondents/participants supported a FV model for both initial and subsequent measurements

- Imply more subjectivity and expose financial reporting to a higher degree of uncertainty in the absence of active market
- Complexity and cost of evaluation
- Some noted a possible exception the case of IGA held as investments or for trading and for which there were active markets in them

Only a few respondents/participants suggest a mixed model associating initial recognition at fair value and subsequent measurement at cost for internally generated intangibles

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received in response to Question 4 of EFRAG’s DP on Measurement?

Information relating to specific intangibles

Discussion Paper

Intangibles considered

Intangibles that are key to an entity's business model.

Type of information

- Qualitative and/or quantitative.
- Information about the contribution of the key intangibles to the value of the entity.

Examples of information

- For a patent for a pharmaceutical company: expiration date, targeted population.
- For a customer list: the attrition rate.
- Information on intangibles that need or do not need replacement and how they will be replaced (by external acquisition or internally/through operation).
- Disclosure of the fair value of unrecognised intangible assets(?)

Advantages and disadvantages included in DP

E.g.

- Not related to a specific intangible.
- Limited information on effectiveness of investment.

Input received

Key to the entity's business model

- Many thought it was a good idea to limit.
- Other views included to consider it from a materiality perspective or focus on what the management look at.

Information on fair value

- Many supported that the fair values of intangibles should generally not be provided.

Advantages and disadvantages

- General agreement with the identified advantages and disadvantages, but also some comments - including:
  - Distorted IFRS performance figures is not a problem.
  - Challenges around verifiability and auditability.

Suggestions on information to be provided

- General information.
- Information on specific types of intangibles.

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received on information relating to specific intangibles?

Information on future-oriented expenses

Discussion Paper

Purpose

Not to assess the value of individual assets, but to assess the financial performance of a period and for predicting future financial performance.

Information

- Information on whether the costs of the period have been incurred to generate income in the period or in future periods.

Distinction

- By an entity’s management or
- By users – based on more granular information in the notes on recognised expenses for the period.

Additional information to understand an entity’s business model

- Provide additional contextual information about costs (e.g. number of employees and employee costs per function, per segment and region).

Discussion Paper

Example of how the information could be presented

	Cost of sales	Marketing and distribution expenses		Administrative expenses	Research and development expenses		Total
		Marketing expenses	Distribution expenses		Patent expenses	Other researchand development expenses	
Depreciation expenses							
Employee benefit expenses (not capitalised)							
Fees to consultants (not capitalised)							
Legal fees (not capitalised)							
Fees to providers of staff training (not capitalised)							
...							
Total							

Presentation form may not be useful if there are many empty cells (and cost of providing the information should be considered (see later slide))

Input received

Useful information

Some support for the information – but also some reservations (similar to identified disadvantages in the DP).

Management's assessment or enabling users to make their own assessments?

A combination was most popular in polls (or enabling users to make their own assessments).

Concerns with enabling users to make their own assessments: Would require extensive amount of information / how can users make the distinction?

Advantages and disadvantages

Many agreed with identified advantages and disadvantages. One respondent thought that the identified disadvantages could be overcome by adopting an approach including basic mandatory disclosures and basic guidance in separating future-oriented expenses from current expenses – and then leave flexibility.

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received on information on future-oriented expenses?

Information on risks/opportunity factors affecting intangibles

Discussion Paper

Approach suggested

- Limited to information that is material and specific to the entity.
- Limited to information material for the primary users of financial reports.
- Include a description of the risk/opportunity factors that could affect (the contribution of) both recognised and unrecognised intangibles, how it affects the entity (would also require the entity to describe its business model) relevant measures if relevant and how the risk/opportunity is managed and mitigated or taken advantage of.
- Possible location: management commentary.
- Anchor point to the sustainability reporting.
- Examples:
    - Environmental impact/dependence
    - Ability to attract people with the right skills
    - Functioning of management control systems
    - Customer concentration
    - Supplier relationships
    - Quality of work of oversight committees
    - Respect for human rights
    - Anti-corruption and bribery

Input received

Many agreed with the proposals – but some noted that:

- Information on risks and opportunities related to intangibles should not be considered separately from other risk and opportunity factors.
- The information should reflect what risks and opportunities the management is managing (the DP proposed risk and opportunity factors that could affect (the contribution of) both recognised and unrecognised intangibles that are material and specific to the entity).
- The information should also reflect risks/opportunities that are general for the industry?

One respondent thought it should be voluntary to provide information on opportunities.

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received on risks/opportunity factors affecting intangibles?

Issues to be considered

Discussion Paper

The Discussion Paper, in Chapter 6, discusses the challenges and issues to be considered when finding a manner to provide better information on intangibles. Among other, it requested information on the following:

Common terminology

Would it be beneficial to establish a common terminology on intangibles?

Sensitive information

How can useful information be provided that would not require entities to disclose information that is commercially sensitive?

Additional issues

Are there any additional issues to be considered?

Input received

COMMON TERMINOLOGY

The vast majority of respondents agreed that it would be useful to introduce a common terminology.
Standarisation over different frameworks should enhance comparability.

SENSITIVE INFORMATION

The vast majority of respondents agreed that the preparers should not be required to disclose commercially sensitive information.

ADDITIONAL ISSUES

The existing process of drafting new European Sustainability Reporting Standards, the work of ISSB and IFRS Sustainability Disclosure Standards, and sustainability reporting in general, should be considered when improving information on intangibles.

Asymmetric treatment of intangible assets between IFRS framework and the prudential framework should be considered.

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received?

Placement of the information

Discussion Paper

The DP presents an approach under which disclosures would be placed in the notes to the financial statements if the information is related to an item that meets the definition of an asset or to an item recognised in the statement of financial performance. In other cases, the information would be placed in the management report. However, it is noted that such an approach would result in information about intangibles to be spread between the notes to the financial statements and the management report.

Input received

PLACEMENT OF THE INFORMATION

Some respondents agreed that information on recognised intangibles should be placed in the notes, whereas information on unrecognised intangibles should be part of the management report.

However, various modifications and/or alternatives to the model were proposed.

Questions for EFRAG FR TEG

Do you have any questions on the summary of input received?

Suggestions – Matters to consider

Input received

Some respondents provided additional suggestions and comments. These included:

- Consider the connectivity with sustainability reporting.
- Further research of the cost/benefit balance of the suggestions is needed together with field tests of the proposals.
- Further research of the application of measurement at cost of internally generated intangibles (including determining the amortisation period, the impairment test and how to account for subsequent expenditures).
- The criteria for when something is ‘development’ should be reviewed as the criteria included in IAS 38 do not reflect current development processes.
- Requirements for internally generated software should be reviewed.
- The role of prudence/conservatism in accounting should be discussed.
- The concept of ‘control’ in the IASB’s Conceptual Framework’ should be reviewed – in particularly when applied to intangibles.
- The concept of ‘economic benefits’ in the definition of an asset should be clarified.
- Consider challenges in relation to auditing the information.
- Consider need for amending IFRS 6 and SIC 32.
- Consider how to account for intangibles acquired in exchange for variable consideration.
- There is a need for cooperation between standard setters and with other professionals such as auditors.

Questions for EFRAG FR TEG

Do you have any questions on the list of matters suggested by respondents/ participants for further consideration?

EFRAG TEG discussion

Questions for EFRAG FR TEG

After considering the feedback received What are your initial thoughts on which recommendations could be made to the IASB in EFRAG's forthcoming feedback statement on how to get better information on intangibles based on the input received?

Do members have initial views on how EFRAG's recommendations could be structured in the forthcoming feedback statement? Should EFRAG:

- Follow the order of the proposed approaches as presented in the successive Chapters its DP; or
- Present its recommendations following the possible staged approach as discussed by the IASB (see summary of the IASB's decisions in the cover note 05-01) to make their project more manageable; or
- Follow another structure (please specify which one?).

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