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Comments on Discussion Paper “Better Information on Intangibles – Which is the Best Way to Go?”

Dear Madam, dear Sir,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Discussion Paper “Better Information on Intangibles – Which is the Best Way to Go?”. Principal authors of this comment letter were Christian Höllerschmid, Helmut Kerschbaumer, Ulf Kühle, Stefan Maxian, Otto Nowotny, Christoph Pelger, Gerhard Prachner, Georg Schneider, and Alfred Wagenhofer. In order to ensure a balanced Austrian view on the consultation, the professional background of these authors is diverse.

Best regards,  
Romuald Bertl  
Chairman

## **Comments on Discussion Paper “Better Information on Intangibles – Which is the best way to go?”**

### **General comments**

Accounting of and reporting on intangibles has been an important issue for a long time. We, therefore, welcome this Discussion Paper, which asks many fundamental questions about how to improve the existing accounting and reporting requirements.

As we explicate in detail below, we believe that some current requirements in IAS 38 do no longer serve the information needs of investors. We suggest to remove the strict requirements for the recognition of internally generated intangibles and to align more closely the recognition requirements in IAS 38 and in IFRS 3. We favour a conditional recognition with costs capitalized and fully impaired until it is probable that the expected future economic benefits will flow to the entity. In that case, previously recognised impairment losses should be reversed. We are strongly in favour of a measurement at cost and not at fair value or on another valuation basis.

We believe that disclosures are not a good substitute for recognition and measurement. Therefore, the disclosures concerning intangibles that are recognized and measured should be similar to those of other assets, whereas the disclosures for unrecognized intangibles should be expanded. For the latter, we favour a management approach (as in IFRS 7 and IFRS 8) rather than a creation of new terms, such as “intangibles that are key to the business model”, in order to formulate disclosure requirements. We do not support disclosures on future-oriented expenses.

As part of preparing this comment letter, we conducted a survey among Austrian investors and analysts to gain more insight into users’ perspective concerning the reporting on intangibles. We received more than 30 responses. The feedback provided by these investors and analysts informed our discussions and is incorporated in our responses to the specific questions below.

### **Specific comments**

#### **Question 1— Issues with the current information**

***Chapter 2 summarises issues put forward with the current information on intangibles. Do you think the issues listed are relevant and valid? Are there additional issues with the current information on intangibles that are not listed? If so, what are these issues?***

We agree with the characteristics of intangibles as described in Chapter 2, which clearly pose challenges for the financial reporting on intangibles, particularly regarding

- identifiability,
- demonstration of control by the entity,
- uncertainty of future benefits that are attributable to them, and
- difficulty to measure their costs.

We also agree that current IFRSs do not provide consistent guidance for the recognition, measurement, and disclosure of intangibles. This is especially decisive as the importance of intangibles for businesses has been increasing and will continue to grow.

Chapter 2 raises several concerns as to IAS 38, and we agree that this standard is becoming less adequate over time and requires a review, in particular, regarding the treatment of internally generated intangibles. We note that IFRS 3 includes very different requirements for intangibles acquired in a business combination than for internally generated intangibles, which leads to an unbalanced treatment of those intangibles that are acquired in a business combination versus those that are internally generated.

We are less concerned about the value relevance and performance measurement uses of financial reports. Most users have sufficient knowledge and use additional information about intangibles, rather than mechanically relying only on primary financial statement ratios to make their decisions.

We note that the connectivity between financial reporting and sustainability reporting will have to be considered when proposing changes to financial reporting requirements under IFRS.

### **Question 2— Which way to go?**

***Chapters 3, 4 and 5 present possible different approaches to provide better information on intangibles (namely recognition and measurement; disclosure of information on specific intangibles; information on future-oriented expenses and risk/opportunity factors) and, within each approach, different alternatives to provide better information on intangibles.***

***These different approaches represent different trade-offs between benefits and costs when considering the different needs of users of financial reports for better information on intangibles.***

***Do you think there is room for improvement regarding information on intangibles in financial reporting? If so:***

- a) Do you think the different approaches described could be combined in a manner that could meet (most of) the needs of users and for which the benefits would exceed the costs? If so, please describe such a combination.***
- b) If you do not think the different approaches described in the Discussion Paper could be combined in a manner that would meet (most of) the needs of users, which (if any) of the described approaches do you think could be worth investigating further with the objective of getting better information on intangibles:***
  - Amending existing recognition and measurement requirements for intangibles (see Chapter 3);***
  - Providing disclosures on specific intangibles (see Chapter 4);***
  - Providing disclosures on future-oriented expenses and risk/opportunity factors that may affect future performance (see Chapter 5); or***
  - An approach other than those described in the Discussion Paper (please explain this approach)?***

There is a need for improvement of IFRS regarding the financial reporting of intangibles, and there is certainly room for such an improvement.

We believe that the different approaches described in the DP should be combined to meet the needs of users in the following way:

- Amending recognition and measurement, particularly in IAS 38, to align more closely the requirements for acquired and internally generated intangibles and those that are acquired in a business combination.
- Increasing accompanying disclosures on recognised intangibles in the notes.
- Increasing disclosures on unrecognised intangibles in the management report.

Our survey among investors and analysts in Austria supports changes to both, recognition/measurement and disclosure. In particular, the survey participants provided the following views.

- The different recognition requirements for acquired and internally generated intangibles hinder the comparability of financial statements. Many respondents advocate recognition of more internally generated intangibles, primarily of technology-based intangibles.
- Respondents strongly support additional disclosures on intangibles, preferably in the notes.

### Question 3— Recognition

***Chapter 3 considers whether and how internally generated intangibles could be recognised and measured in the financial statements and the benefits and limitations of the proposed approaches. In doing so, consideration is being given to the asset recognition in the statement of financial position but also to the effects in the statement of financial performance.***

***Do you consider that IAS 38 Intangible Assets should be amended to permit the recognition of certain internally generated intangible assets (in addition to development costs)? (Please explain your answer). If your answer to this question is 'yes', please also answer sub-questions 1 to 3 below.***

Yes, IAS 38 should be amended and updated as its current recognition requirements are too restrictive. This particularly applies to the recognition of internally generated intangibles.

Conceptually, we suggest to bring the recognition requirements of IAS 38 and IFRS 3 more closely together. While those of IAS 38 are too narrow, we consider some requirements of IFRS 3 as being too broad. While we agree that an acquisition is a strong indicator for the fact that the general recognition criteria are met, this is not directly applicable to a business combination because it does not include a market transaction of each individual asset.

***1. Paragraph 3.26 of this Discussion Paper explains that IAS 38 currently includes an explicit prohibition to recognise some types of internally generated intangible assets such as internally developed brands, mastheads, publishing titles, customer lists and similar items, staff training and marketing. Do you consider that the explicit prohibition to recognise some types of intangible assets that exists in IAS 38 should be removed? (Please explain your answer).***

Yes, this explicit prohibition should be removed because it is rule-based. It leads to a lack of comparability between companies that grow organically and companies that acquire intangibles individually or in a business combination. Instead, the recognition should be based on general criteria applicable to internally generated intangibles.

As explained above, we favour a close alignment of the recognition requirements with those applicable in a business acquisition. In particular, this procedure also entails meeting the definition of an intangible asset: identifiable, controlled by the entity, and future economic benefits are expected to flow to the entity, regardless of whether it is acquired or internally generated.

***2. Paragraphs 3.10 to 3.71 of this Discussion Paper explore four possible approaches regarding the recognition of internally generated intangibles. Which of the following approaches would you support?***

***a) Recognise (as an asset) all defined intangibles; with no specified conditions or thresholds (see paragraphs 3.15 - 3.35 of this Discussion Paper);***

***b) Threshold for recognition of an asset (see paragraphs 3.36 - 3.48 of this Discussion Paper);***

***c) Conditional recognition of an asset (see paragraphs 3.49 - 3.59 of this Discussion Paper); if you prefer this approach, would you prefer an approach under which:***

- (i) Costs are expensed in profit and loss until the condition is met;***
  - (ii) Costs are capitalised and fully impaired until the condition is met, at which point in time the impairment losses are reversed;***
  - (iii) Costs are expensed in other comprehensive income until the condition is met, at which point in time the expenses are 'recycled' and capitalised.***
  - d) No recognition (that is, expensing all internally generated intangibles) (see paragraphs 3.60 - 3.67 of this Discussion Paper); and***
  - e) None of the above or other suggestions (please explain).***
- Please explain the reasons for your preferences.***

We prefer the approach under c) ii), that is, a conditional recognition with capitalised and fully impaired costs until it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity. If all conditions are met, previously recognised impairment losses are reversed. Under this approach, the recognition as an intangible asset still requires that the definition of an intangible asset is met (identifiability, control, future economic benefits) and that the costs can be measured reliably.

This approach allows de facto to defer the recognition of the costs of an intangible asset, which future economic benefits are not yet probable, to that period in which they become probable. We regard this approach as a suitable compromise between the differing requirements in IAS 38 and IFRS 3. Currently, under IAS 38, the recognition of development costs begins at the time when the future economic benefits are probable. This often leads to the recognition of only a small portion of the total development costs, which is not very informative. Reversing an impairment loss, when the condition of probable economic benefits is met, brings these costs onto the balance sheet in a more timely and substantial manner. This approach is more cautious than IFRS 3, which does not require the probability recognition criterion but requires the recognition of any acquired intangible assets.

A potential issue with this approach is that some analysts rely on EBITDA performance measures. Under our favoured approach of conditional recognition, the costs for generating an intangible before it is recognised are written down as an impairment, which is part of the "DA" in EBITDA, and are not deducted in the calculation of EBITDA. When an impairment is reversed, the costs will be depreciated subsequently, which is also outside of EBITDA. An additional disclosure of such impairments may be a remedy.

We do not favour the other approaches.

- a) Recognising all intangible assets (that satisfy the conditions as explicated in the Conceptual Framework) would be most in line with the requirements of IFRS 3, but different from a business combination, as there is no underlying third-party transaction relating to internally generated intangibles. Therefore, this approach is not sufficiently reliable. To be clear, intangibles must meet the definition of an asset in the Conceptual Framework to be recognized.
- b) An approach that defines thresholds for recognition as an asset is related to our favoured approach c) ii) as it contains elements of a threshold in the form of those that are addressed in IFRS 3 (see para. 3.46 of the Discussion Paper).
- c) i) This approach is apparently used for development costs under IAS 38. We do not favour this approach because it expenses such costs until the condition is met, and they cannot be recovered subsequently when the condition is eventually met.
- c) iii) Expensing costs in OCI until the condition is met creates another item in OCI. In our view, OCI contains a number of conceptually very diverse items and seems to be used, if the IASB is undecided about how to deal with the respective items. Thus, OCI items fail to follow a common principle, and therefore we do not support another item in OCI.

- d) Not recognising internally generated intangibles is close to the current requirements in IAS 38, and we already noted that we do not support this approach.
3. ***If you support 'Conditional recognition of an asset' or 'Threshold for recognition of an asset' in the previous sub-question, which criteria would you consider for recognition:***
- a) ***Criteria based on the level of (un)certainty about the outcome of the intangibles (that is, the probability of expected benefit and the pattern of consumption of these future benefits);***
  - b) ***Criteria based on the identifiability of the expenditure related to the intangibles;***
  - c) ***Criteria based on the technical or commercial feasibility of the intangibles considered at inception of the development;***
  - d) ***Criteria based on separability of the assets, that is, the existence of a legal right and/or the ability to sell, transfer, licence or pledge the asset;***
  - e) ***All or a combination of the above depending on the nature of the intangibles (please explain);***
  - f) ***Other suggestions (please specify).***

As noted in our response to earlier questions, we support the following thresholds for recognition as an asset:

- Identifiability,
- control,
- reliable measurement of the costs, and
- (as a condition for reversal of impairment) the probability of expected future benefits.

#### **Question 4— Possible measurement bases**

***Paragraphs 3.72 to 3.100 of this Discussion Paper consider possible measurement bases for internally generated intangibles without suggesting a preferred approach. If you think that IAS 38 should be amended to permit the recognition of certain internally generated intangible assets (in addition to development costs), which of the following suggested measurement approaches would you support:***

- 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');***

We strongly support the cost model, that is, a) initial and subsequent measurement at amortised cost with impairment.

This approach is consistent with the measurement of other internally generated (tangible) assets and with current requirements of IAS 38. These requirements include an option between the cost model and the revaluation model, whereby the latter is restricted to intangibles for which an active market exists (IAS 38.75). We believe that the latter is an exception in case of intangibles. Thus, the revaluation model in practice is rarely used for the measurement of intangibles.

We believe that any fair value measurement (except if the recoverable amount of an impaired intangible equals fair value less costs of disposal) is inappropriate for intangibles without an active market, especially for internally generated intangibles, due to the typically high uncertainty of the future expected cash flows, which leads to a substantial measurement uncertainty.

#### **Question 5— Information relating to specific intangibles**

**Chapter 4 discusses an approach under which information on specific intangibles, that are key to an entity's business model, is provided to help users assess the contribution of the intangible to the value of the entity.**

- 1. To the extent that information relating to specific intangibles should be provided, do you agree that the information should be limited to the intangibles that are key to an entity's business model? If not, why?**

We do not support introducing a new terminology of "intangibles that are key to an entity's business model" because it requires to define the business model and what is "key" to the business model.

IFRS contain other concepts that can be used to determine the scope of such disclosures.

- IFRS 7 and IFRS 8 use the "management approach", that is, intangibles that are internally reported to the CODM and thus used internally. The advantage is that this reflects the view through the eyes of the management and no additional costs are incurred for generating the information that should be disclosed.
- A general concept of IFRS (e.g., in IAS 1) is materiality that applies to all IFRS requirements, including disclosures. Materiality for disclosures about intangibles could be applied for each intangible and for all intangibles together.

- 2. Preliminary feedback received from some users of financial reports indicates that an entity's fair value estimate of a specific intangible would generally not be particularly relevant information. Do you agree that disclosing the fair value of an intangible is less helpful for users than disclosure of quantitative and qualitative information that could assist them in forming their own views on the value for an entity of the specific intangible?**

We agree. In our response to the question about the measurement base, we stated that fair values are generally not verifiable due to the high uncertainty that is inherent in most intangibles. Therefore, disclosure of quantitative and qualitative information to help users to form their own views is strictly preferable.

- 3. Do you agree with the advantages and disadvantages of information relating to specific intangibles as identified in Chapter 4 compared to recognition and measurement (see Chapter 3) and information on future-oriented expenses (see Chapter 5)? If not, which aspects do you disagree with and/or which additional advantages and disadvantages have you identified?**

We support the conditional recognition approach (see our response to questions on Chapter 3), which implies that intangibles that satisfy the conditions are recognised. For such intangibles, we support additional information in the notes, as is required for other assets. This includes quantitative and qualitative information.

For intangibles that do not meet the criteria of an asset and cannot be recognised, we support additional disclosures, if those are important for understanding the business of the entity. Such disclosures should be part of the management report and should follow the principles set out for the management report. Disclosures are likely to include, among others, human capital, skills, brands, relationship and reputation capitals, and also risks and opportunities. In addition, as also noted in the Discussion Paper, such disclosures should cover the outside-in perspective (para. 4.22).

We expect sustainability reports to require disclosures of such intangibles as well and additional information from an inside-out perspective. It is very likely that both financial accounting standards and sustainability

standards will require many overlapping disclosures, and we believe that it is of utmost importance that standard setters coordinate their approaches about information related to intangibles.

The Discussion Paper summarizes advantages and disadvantages of information relating to specific intangibles in para. 4.44. We broadly agree with these, but we think that it is important to distinguish whether disclosures pertain to recognised or unrecognised intangibles and whether the intangibles relate to financial or sustainability issues.

The Discussion Paper also includes several examples of disclosures about intangibles that are voluntarily provided by companies. While we encourage to experiment with ways how to provide effective information about intangibles, disclosure standards include mandatory requirements and should be based on a trade-off between costs and benefits that apply to all companies. Entities can, of course, always provide additional voluntary disclosures to serve their specific users' information needs.

#### **Question 6— Information on future-oriented expenses**

***Chapter 5 proposes various elements of information on expenses recognised in a period that could be considered to relate to benefits that will be recorded in future periods ('future-oriented expenses').***

- 1. Do you consider that requiring such information could be useful? If so:**
  - a) Should the information mainly complement information on specific intangibles (see Chapter 4) or should requirements on future-oriented expenses be introduced instead of requirements on information on specific intangibles?**
  - b) Should the information mainly:**
    - (i) Reflect the views of the entity's management by disclosing the recognised expenses the management considers relate to the benefits of future periods)? Or**
    - (ii) Help users perform their own assessments on the recognised expenses that relate to benefits of future periods, by providing further specifications and breakdown of the expenses of a period?**

In our response to previous questions, we have argued that we suggest to differentiate the disclosures for intangibles that are recognised and those that are not. For recognised intangibles, additional information is not necessary, as the future orientation of these investments is immediately apparent (following the recognition criterion of probable future economic benefits).

For intangibles that fail to meet the criteria for recognition, a disclosure of recognised future-oriented expenses and risk/opportunity factors may be helpful to users to assess the entity's prospects, if these disclosures relate to important value drivers of the entity.

We favour the application of the management approach (as used in IFRS 7 and IFRS 8) in order to determine what are important value drivers and what information about them is provided internally.

We do not support the requirement of a breakdown of specific expenses in a particular format.

We are concerned about the verifiability of a categorisation into future-oriented and not future-oriented expenses. Conceptually, future-oriented expenditures should be considered for recognition (which we argue) and, if they are not recognized, there is little benefit of disclosures in financial reporting. For many expenses, the distinction between future-oriented and not future-oriented is difficult to draw, including the question about the period the "future" shall cover – should it apply to benefits that are expected to accrue in the first quarter following the financial year, or several years later?



2. ***Do you agree with the advantages and disadvantages of information on future-oriented expenses identified in Chapter 5? If not, which aspects do you disagree with and/or which additional advantages and disadvantages have you identified?***

We broadly agree with the summary of advantages and disadvantages in para. 5.40 and note that there seem to be many more disadvantages than advantages.

#### **Question 7— Information on risk/opportunity factors affecting intangibles**

***Chapter 5 proposes that information included in the financial reports on factors affecting intangibles should be limited to disclosing risk/opportunity factors linked to the key intangibles (whether or not specified) according to the entity's business model. The disclosure should include a description of the risk/opportunity, relevant measures reflecting the risk/opportunity, if relevant (for example, KPI's used to measure it), and how the risk is managed and mitigated. It should include an assessment of the materiality of the risk/opportunity factors based on the probability of their occurrence and the expected magnitude of their impact.***

***Do you agree with this proposal? If not, what information on risk/opportunity factors affecting intangibles should be provided?***

IFRS 7 includes detailed requirements on the disclosure of risks related to financial instruments. Information on risk/opportunity factors affecting intangibles is more difficult to determine, particularly as it is often infeasible to quantify these risks or opportunities.

IFRS 7 does not include any disclosures of the opportunities. Hence, we do not support a requirement for the disclosure of opportunity factors. Opportunities-related information may be encouraged, but should not be required.

Principally, we favour to apply the management approach (as used in IFRS 7 and IFRS 8) to determine the disclosures of risks (and opportunities) of intangibles. We do not support linking disclosures to “key intangibles” as this term is difficult to interpret.

Such disclosures should be in the notes if they pertain to recognised intangibles, and they should be in the management report if they pertain to unrecognised intangibles.

#### **Question 8— Issues to be considered**

***Chapter 6 discusses challenges and issues to be considered when finding a manner to provide better information on intangibles. It mentions that it could be beneficial to introduce a common terminology on intangibles and that preparers of financial statements should not be required to disclose information on intangibles that would be (very) commercially sensitive.***

1. ***Do you consider that it would be useful to introduce a common terminology on intangibles?***

We believe that it is useful to consider providing a non-binding guidance as to the categories of intangibles. An example for such guidance is the list in IFRS 3.IE16-44.

2. ***Do you agree that preparers of financial statements should not be required to disclose information on intangibles that would be (very) commercially sensitive?***

Yes, we agree. However, it is necessary to have sufficient guidance as to how to determine what is (very) commercially sensitive. Moreover, guidance is needed whether the disclosure exception relates to the intangible itself or only to particular information about the intangible.

**3. Are there additional issues than those listed in Chapter 6 you think should be taken into account when considering how to provide better information on intangibles?**

We reiterate the need to consider further disclosure requirements in light of those that (will) arise from sustainability reporting requirements.

**Question 9— Placement of the information**

***Chapter 6 presents an approach under which information discussed in Chapter 4 and Chapter 5 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.***

***Where do you think the different types of information that would follow from the approaches discussed in Chapter 4 and Chapter 5 should be placed? Should they be placed all in the same section or in different sections of the financial report and why?***

We agree that information on recognised intangibles should be placed in the notes, whereas information on unrecognised intangibles should be part of the management report. The location of such information is also important because different auditing requirements apply.

The draft of the CSRD requires that sustainability information is placed in the management report and audited with limited, and later reasonable, assurance. We believe that disclosures on unrecognised intangibles should be placed close to the sustainability report.