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Ref: Discussion Paper *Better Information on Intangibles- Which is the best way to go?*

Dear Jean- Paul,

In the present letter the Instituto de Contabilidad y Auditoría de Cuentas (ICAC) gives its view on Discussion Paper *Better Information on Intangibles*, issued by the EFRAG on 27 August 2021 (the "DP").

The ICAC welcomes EFRAG's initiative to analyse how the reporting of intangibles could be improved. The ICAC shares the view that intangibles play an increasingly important role as drivers of value creation for entities, while financial statements do not reflect many of these intangible resources. The debate on how to improve the reporting of intangibles is complex due to multiple factors. These include: the high levels of uncertainty about the payback associated with intangibles, the difficulty in demonstrating control over intangibles, the possibility that intangibles do not create value on their own but in combination with other assets, and the scalability that is often associated with intangibles. We are also concerned that this issue creates a lack of a level playing field between companies that grow organic and those who grow through acquisitions

The ICAC shares the view that this project is a key matter that needs to be addressed in order to provide information on intangibles in a more effective way. Nevertheless, we are aware that

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improving the intangibles accounting model will require a long debate and caution should be exercised when introducing changes to current regulations.

Our responses to the questions to constituents contained in the Discussion Paper are explained below.

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?

The ICAC agrees with the issues identified by EFRAG in relation to the information currently provided on intangibles.

The importance of intangibles is growing in the global economy, with assets such as big data, customer relationships, brands, etc. being drivers of value creation for more and more companies. To the extent that these assets are generated internally, they are not recognised in the financial statements. There are also no requirements to report significant intangibles for the entity that have not been recognised as assets. These circumstances result in the financial statements not adequately reflecting information on intangibles and the relevance of the financial statements is decreasing.

In addition, the ICAC shares the doubts that arise when assessing whether "control" exists in determining whether an intangible meets the definition of an asset.

The ICAC notes that the link with sustainability reporting has not been explored in depth. The continuation of the project should therefore study an integrated reporting framework on intangibles.

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 (Chapter 3);

• Providing disclosures on specific intangibles (Chapter 4);

• Providing disclosures on future-oriented expenses and risk/opportunity factors that may affect future performance (Chapter 5); or

• An approach other than those described in the Discussion Paper (please explain this approach)?

We believe that the principal achievement of this project should be the improvement of the recognition and measurement criteria of the current accounting model to better reflect the value of intangible assets, especially those that are internally generated, but obviously this issue is not an easy task

The current recognition criteria is not suitable for the management practices performed nowadays, for example in relation to software, brand names, market position and the relationship with the stakeholders. This is one of the causes of the difference between the value of the companies that buy intangibles in the market or grow through business combinations and those that generate intangibles internally. Furthermore, some intangibles are eligible for recognition when acquired separately or as part of a business combination but not when these intangibles are internally generated.

Although it could be useful to improve the quality of the information disclosed, it is also true that limiting the scope of the project to just the information to be disclosed on intangibles could have a very limited impact in the fair presentation of the annual accounts. In case that the requirements of information should be extended, these improvements should be developed in dialogue with the users of the financial statements to ensure that the information will really add value.

Therefore, the ICAC considers that a possible option for improving financial reporting of intangibles would be to combine the approaches described in Chapters 3 and 4.

Recognition of certain internally generated intangible assets would improve comparability between those entities that have purchased the majority of their intangible assets and those that have internally generated their intangible assets. On the other hand, disclosing information on intangibles that may not have been recognised as intangibles but are key to the entity's business model would complement the recognition of some internally generated intangibles in a way that is less complex for preparers and therefore less costly.

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.

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).

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).

The ICAC considers that certain internally generated intangible assets (for instance, brands or customer lists) could be allowed to be recognised, if they meet the definition of an asset in the conceptual framework and there are identifiable expenses associated with those assets.

A problem difficult to tackle is that commonly companies do not have control of certain intangibles (for instance the value of a customer relationship intangibles) and therefore they do not meet the definition of an asset. However, these intangibles can be one of the most important values for the company project. For this reason, resources should be located to analyse in deep the concept of control within the conceptual framework.

As regards the second question raised, the ICAC believes that the most appropriate approach would be the one described in (c) “Conditional recognition of an asset" and within this approach it considers that costs should be expensed in profit and loss until the condition is met. As part of the conditions that could be established to recognise an internally generated intangible, the ICAC believes that they should include:

(a) Criteria based on the identifiability of expenses related to intangibles.

(b) Criteria based on probability of expected future benefits.

(c) Criteria based on the technical and commercial viability of intangibles.

This approach is similar to the current development recognition criteria, allowing entities to assess over the life of a project whether the condition is met, which would result in more internally generated intangible assets being recognised subject to conditions of certainty. It would lead to an increase in comparability as already mentioned in the answer to question 2.

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’)

Given that for most intangibles there is little or no active market, valuation at fair value would involve greater subjectivity and give rise to a higher degree of uncertainty in the financial statements. Therefore, provided that there are expenses that can be reliably identified, within the valuation bases proposed for internally generated intangibles, the ICAC considers that the most appropriate would be the "cost model", in which both the initial and subsequent valuation would be at cost, with amortisation and/or impairment losses recognised in the income statement.

Recognition at cost would be a useful measure for calculating the return on investment. It would also be the least costly option for preparers at both initial and subsequent measurement, as these assets would be tested for impairment only when there are indications of impairment. Finally, as mentioned above, the ICAC considers that it would be a less subjective measure than fair value measurement.

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?

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?

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?

The ICAC agrees that the information provided should be limited to intangibles that are key to the entity's business model.

We suggest including a definition of "key specific intangibles" to facilitate the understanding of the preparers about the information to disclose.

One option could be following the example of the Corporate Sustainability Reporting Directive that is proposing to define "key intangible resources" as resources without physical substance on which the business model of the undertaking fundamentally depends and that are a source of creation of the value of the undertaking'.

We also consider that reporting should be based on a common classification to improve comparability.

The ICAC shares the view that quantitative and qualitative information would be more useful for users to make their own assessments of the value that a specific intangible brings to the entity.

We agree with the advantages and disadvantages identified for the approach proposed in Chapter 4 of the DP.

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?

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 believe that the DP does not describe the third approach with sufficient clarity and depth. Therefore, with the current analysis the ICAC considers that the disadvantages of requiring this information from entities outweigh the possible advantages. In particular, one of the main advantages of this approach is the cost saving but this would disappear if combined with the information on key intangibles (Chapter 4) which the ICAC supports and considers more useful.

Consequently, it does not consider it appropriate to require information on information on future-oriented expenses.

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?

The ICAC supports the DP's proposal in relation to the risk/opportunity factors affecting intangibles. This information should be limited to key intangibles in accordance with the entity's business model, including a description of the risk/opportunity, relevant measures reflecting the risk/opportunity if relevant (for example, KPI's used to measure it), how the risk is managed and mitigated or the opportunity is taken advantage of.

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?

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

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?

The ICAC believes that it would be useful to introduce a common terminology for intangibles to avoid different terms being used for the same intangible and also to clarify how different intangibles may overlap. In combination to a common terminology we believe that a categorisation of intangibles should be included.

Finally, we share the view that it would be necessary to allow entities not to present information that is very commercially sensitive and to analyse what alternative information could be requested if this were the case.

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?

Although some intangible resources are intrinsic to sustainability matters and will be part of sustainability reporting (for example employees loyalty and motivation or the quality of the relationship with the customers) we are of the view that it would be more useful for the users of the financial statements to find the complete information of intangibles inside the notes.

Otherwise, the information would be split in two parts (the notes and the sustainability information inside the management report) and would not facilitate a comprehensive understanding for the users of the primary financial statements.

Nevertheless, we would like to insist on the link to sustainability reporting, because future reporting on intangibles and value creation is a key area for connecting financial and sustainability reporting.

Finally, we would like to point out that this Discussion Paper could also serve to push the debate on IASB Project Goodwill and Impairment as a way of improving the comparability between entities growing organically and those growing through acquisitions.

Please, don´t hesitate to contact us if you would like to clarify any point of this letter.

Yours sincerely,

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Chairman of ICAC