EFRAG Discussion Paper

Better Information on Intangibles – Which is the best way to go?

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EFRAG

European Financial Reporting Advisory Group

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Why this Discussion Paper?

2018 EFRAG Research Agenda Consultation

A project on intangibles is very important. Internally generated intangibles play an increasingly important role for the performance of an entity and are not reflected adequately (and differently from acquired) in financial statements.

2019 Initial interviews with various types of stakeholders

Currently insufficient information in financial reports – but different solutions suggested.

2020 Literature review

Not much was known about how users use information on intangibles.

2020 Advisory Panel on Intangibles

To ensure that proposals would be based on identified user needs.

2021 Publication of Discussion Paper

Scope

Does not present ‘the solution’

Presents different approaches and assesses their advantages and disadvantages and asks for input on the way forward (for example combination – different approach for different types of intangibles).

Considers ‘intangibles’

Broader scope than intangible assets.

Information to be presented in the financial report

EFRAG to further consider the interconnectivity with sustainability reporting.

Current issues

Some identified issues

- 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.

The three approaches considered

How to provide better information on intangibles

Chapter 3	Chapter 4	Chapter 5
Recognition and measurement in the primary financial statements	**Information related to specific intangibles** in the notes to the financial statements or in the management report	**Information on future-oriented expenses and risk/opportunity factors** in the notes to the financial statements or in the management report

Recognition and measurement

Three questions

Which types of (internally generated) intangibles should be considered for recognition?

Those meeting the definition of an asset.

Under which circumstances should such intangibles be recognised?

- Recognising all;
- Recognition if criteria are met (threshold for recognition);
- Recognition when criteria are met (conditional recognition);
- No internally generated intangible assets are recognised.

Which measurement basis or bases should be considered?

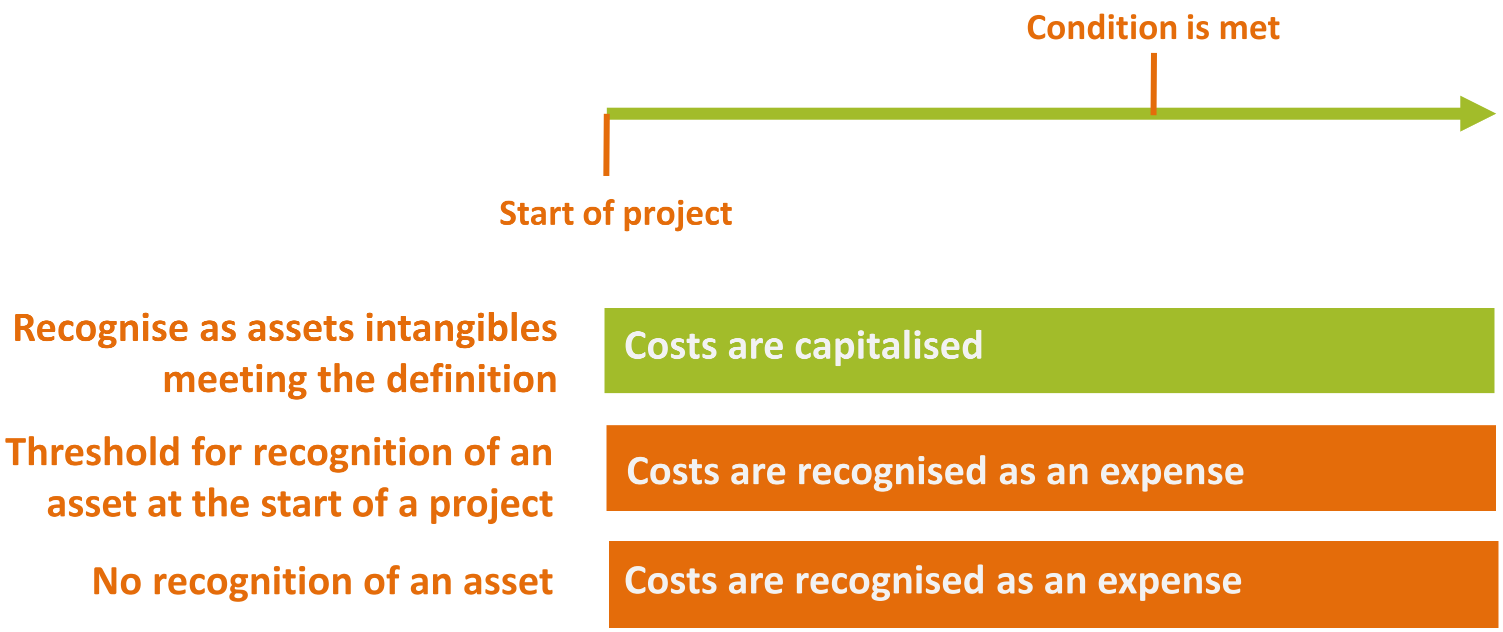
Problems with both cost and fair value measurement.

Factors to consider include:

- Whether an asset produces cash flows directly and could be sold independently;
- Whether the entity's business activities involve the use of several economic resources that produce cash flows indirectly by being used in combination.

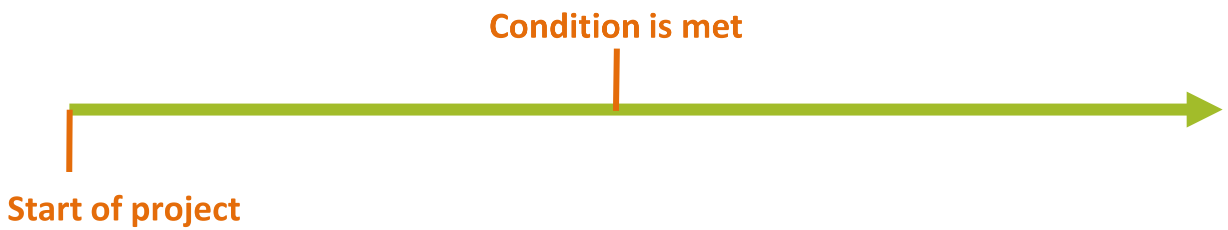
Recognition and measurement

Recognition approaches (1/2)



Recognition and measurement

Recognition approaches (2/2)



Conditional recognition of an asset:

a) Expensed in profit and loss until the condition is met	Costs are recognised as P/L expenses	Costs are capitalised from this point in time
	Reversal of impairments	
b) Capitalised and fully impaired until condition is met	Costs are capitalised and fully impaired	Costs are capitalised from this point in time
	Accumulated OCI expenses are capitalised	
c) Expensed in OCI until the condition is met	Costs are recognised as OCI expenses	Costs are capitalised from this point in time

Some advantages and disadvantages of conditional recognition

Advantages

- Possible to limit the impact on the primary financial statements resulting from uncertainties inherent in measurement of intangibles (judgements).
- Increases comparability with acquired intangible assets in the statement of financial position and in the income statement (in particular if the OCI approach is used).
- Reduces distortion of IFRS performance measures to the extent that the criteria for recognition are met.
- Other things being equal, more internally generated intangible assets are recognised than under a threshold approach.

Disadvantages

- Would continue to exclude internally generated intangibles to the extent the criteria for recognition are not met.
- Volatility of earnings (if impairment of capitalised cost and reversals are recognised in P&L (accounting in OCI might prevent that volatility)).
- Costs of preparing financial statements would increase.
- Even if many intangibles would be recognised, disclosures relating to key specific intangibles could provide more granular and detailed information.

Information relating to specific intangibles

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.

Information relating to specific intangibles

Examples of information

- For a patent held by a pharmaceutical company: expiration date, targeted population.
- For customer relationships: Customer attrition, change in number of customers, demographic mix of customers, customer concentration (see also information on risks and opportunities), market share, information on relationships with subscribers (if relevant), information on customer loyalty, customer feedback (including customer satisfaction and whether they would recommend the entity’s products/services).
- For employees: Employee satisfaction, mix between internal promotions and hiring of new employees, talent development, expertise of employees, changes in productivity, information about organisational culture, attrition rate (and development in this), number of accidents.
- Information on intangibles that need or do not need replacement and how they will be replaced (by external acquisition or internally/through operation).

Not suggested in the Discussion Paper

- Disclosure of the fair value of unrecognised intangible assets.

Information relating to specific intangibles

Advantages

- Provides granular and detailed information.
- Provides information on how an entity is creating value by linking the identification of key intangibles with the entity's business model.
- Could also include information on negative intangibles.
- Could be less subjective than disclosing the fair value of intangibles (or recognising and measuring intangibles at fair value).
- More useful for the assessment of stewardship than information on future-oriented expenses (as the intangibles are specified).
- Could be less costly than information on the fair value of intangibles or recognising more intangibles.
- Could lead to less concern from preparers than providing the fair value of intangible resources.

Information relating to specific intangibles

Disadvantages

- May be difficult to determine the particular intangible the disclosure would relate to.
- Identifying the key intangibles of an entity could be judgmental.
- Information could be commercially sensitive.
- Not a solution to the issue that acquired intangible assets are accounted for differently than internally generated.
- Not a solution to distorted IFRS performance measures.
- Information on specific intangibles might not reflect the value the intangible is creating for the entity in combination with other assets.

Information on future-oriented expenses

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).

Information on future-oriented expenses

Example of information if the distinction should be made by users

- Expenses related to patents;
- Marketing expenses (including information on spending on trademarks/brands);
- Staff training expenses (not included in research and development costs or sales and marketing costs).

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))

Information on future-oriented expenses

Advantages

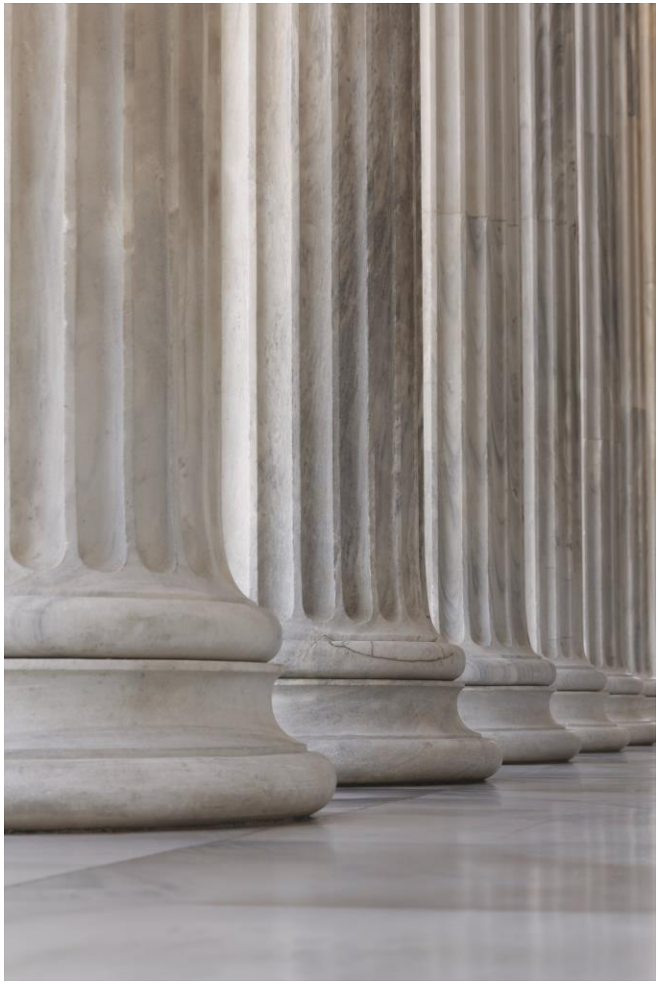
- A fixed terminology to be used to distinguish between different intangibles is not necessary.
- Can take into account that intangibles often do not create much value on a stand-alone basis but together with other intangibles or other assets.
- Does not require specific intangibles to be identified and measured. Issues with measurement of intangibles would be avoided.
- Generally, it could be assumed to be less costly to provide than recognising intangibles or providing information on specific intangibles.

Information on future-oriented expenses

Disadvantages

- No information on which specific intangibles that are key for the entity’s business model.
- The effectiveness of investments in intangibles is not taken into account.
- Difficult to ‘match’ revenue with previous future-oriented expenses.
- Less useful for assessment of stewardship.
- Less granular information on intangibles.
- Information could be commercially sensitive.
- Would not provide information on ‘negative intangibles’. Information on risks and opportunities could, however, capture some of this information.
- Would require guidance on different types of recognised expenses.
- If the entity is splitting recognised expenses related to the current period and to future periods, the information will be quite subjective.
- Not provide a solution to the issue that acquired intangible assets and internally generated intangible assets are accounted for differently.
- Could be more costly to prepare than information on specific intangibles.
- IFRS performance measures will still be distorted.

Information on risk/opportunity factors



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 of risk/opportunity factors on which information could be provided (if relevant)

- 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

Way forward, challenges and issues for possible solutions

Which is the best way to go?

Which, if any, of the approaches should be further considered?
How could the approaches be combined in a cost/benefit effective manner?

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?

Where should the information be provided?

Which information would be best placed in the notes to the financial statements and which information should be in the management report?

Access to finance

Could the approaches affect an entity's access to finance?

Removal of some current requirements

Can some of the current requirements be removed?

Questions for constituents

Issues with current information

- Are the issues listed in the Discussion Paper relevant and valid?
- Are there additional issues?

Which is the best way to go?

- Which, if any, of the approaches should be further considered?
- How could the approaches be combined in a cost/benefit effective manner?

Recognition and measurement

- Which, if any, of the recognition approaches for internally generated intangibles should be considered and what should the criteria for recognition be?
- How should internally generated intangibles be measured?

Information on specific intangibles

- Should the information be limited to the intangibles that are key to an entity's business model?
- Do you agree with the advantages/disadvantages identified?

Information on future-oriented expenses and risk/opportunity factors

- Would information on future-oriented expenses be useful, and if so, should it be based on the management's distinction or not?
- Do you agree with the advantages/disadvantages identified?
- Do you agree with the risk/opportunity factors to be disclosed?

Issues to be considered

- Where should the information be provided?
- Are there additional issues than those identified that should be taken into account?

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Thank you for your attention –
We are looking forward to receiving your input

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