ASAF meeting, December 2021
Agenda paper 1A

DISCUSSION PAPER

BETTER INFORMATION ON INTANGIBLES

WHICH IS THE BEST WAY TO GO?

August 2021

EFRAG
European Financial Reporting Advisory Group

This Discussion Paper is issued by the European Financial Reporting Advisory Group (‘EFRAG’).

DISCLAIMER

While encouraging debate on the issues presented in the paper, EFRAG does not express an opinion on the direction of possible future standard setting at this stage.

The Discussion Paper is available on the EFRAG website. A limited number of copies of the Discussion Paper will be available in printed form and can be obtained from EFRAG.

EFRAG welcomes comments on its proposals via the ‘Questions to Constituents’ at the end of each section. Comments should be submitted through the EFRAG website by clicking (open consultations) or should be sent by post to:

EFRAG
35 Square de Meeûs
B-1000 Brussels
Belgium

Comments should arrive no later than 30 June 2022. EFRAG will place all comments received on the public record unless confidentiality is requested.

EFRAG RESEARCH ACTIVITIES IN EUROPE

This Discussion Paper forms part of EFRAG's research work. EFRAG aims to influence future standard-setting developments by engaging with European and international constituents and providing timely and effective input to early phases of the IASB's work. Four strategic aims underpin EFRAG's proactive work:

- engaging with European constituents to understand their issues and how financial reporting affects them;
- influencing the development of International Financial Reporting Standards ('IFRS Standards'), including through engaging with international constituents;
- providing thought leadership in developing the principles and practices that underpin financial reporting; and
- promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our research work and current projects is available on EFRAG's website.

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EXECUTIVE SUMMARY

ES1 This Discussion Paper has been prepared as part of EFRAG's project *Better Information on Intangibles*. Different approaches to obtain better information on intangibles are analysed, based on input from members of the EFRAG Advisory Panel on Intangibles. The Discussion Paper presents various alternatives and discusses their benefits and disadvantages without providing recommendations on the selection of a particular approach. The approaches presented address 'intangibles' with reference to intangible sources of possible economic benefits. This includes items that would not meet the definition of an asset in the IFRS literature. As further explained in Chapter 1, this Discussion Paper only considers information to be included in financial reports. In this Discussion Paper, the term 'financial report' is used to refer to the primary financial statements, including the notes, and a management report similar to the type currently required in the European Union by implementation of Directive 2013/34/EU of the European Parliament and of the Council[1].

ES2 The approaches presented only deal with how to provide better information for intangibles that are used in an entity's operations (as opposed to those that are used as investment or for other purposes). The scope is also limited to cover only information that is useful for primary users of financial reports.

ES3 There are significant ongoing developments in requirements for sustainability reporting, both inside and outside the EU, that could have implications for the management report and could expand its role and remit. This Discussion Paper focuses on how intangibles affect an entity from a financial reporting perspective. A sustainability reporting perspective to the issue could have other/additional implications. While a sustainability reporting perspective to the issue would have resulted in proposals other than those included in this Discussion Paper, sustainability reporting and financial reporting are linked. An implication of this is that some of the information proposed in this Discussion Paper might, at a later stage, be considered to fit better with sustainability reporting, even though the information is also relevant for financial reporting. Accordingly, while the Discussion Paper does not elaborate further on the ongoing developments, EFRAG considers that connectivity between financial and sustainability information within the management report will be essential, as emphasised in the report of the EFRAG European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards. The topic of how to connect financial and sustainability reporting will be considered by EFRAG in future discussions.

ISSUES WITH THE CURRENT INFORMATION

ES4 EFRAG's commissioned literature review, published in February 2020, identified academic studies showing that the value relevance of financial statements is decreasing and that this could be due to financial statements not reflecting information about intangibles, which has become more important for more entities than previously. Insufficient information on intangibles could affect the company's market value due to information asymmetry, result in an inefficient capital allocation in society and make assessment of the management's stewardship difficult.

ES5 The review also underlined the difficulty for users to compare entities that grow organically with those growing by means of acquisition, as current IFRS Standards generally require acquired intangibles to be recognised, while internally generated intangibles can only be recognised in specific circumstances.

ES6 As further explained in Chapter 2, some consider that recognising more internally generated intangibles (and perhaps fewer intangible assets acquired in a business combination) would be a way to deal with the issue. However, in this scenario, all recognised internally generated intangibles would have to be measured, and both measurement at cost and at fair value are problematic. In addition, not all intangibles would meet the definition of an asset.

1 The management report is also known by various other names, including: management commentary, management's discussion and analysis (MD&A), operating and financial review and strategic report.

ES7 Instead of recognising and measuring intangibles in the statement of financial position, additional disclosures could be considered to provide better information on intangibles. This alternative, however, also has some problems. Boundaries between different intangibles are not (well) defined and are interpreted differently. There are also no generally accepted ways on how to report on intangibles. Finally, additional information on intangibles may be commercially sensitive to provide.

APPROACHES FOR BETTER INFORMATION ON INTANGIBLES

ES8 The Discussion Paper considers three approaches for better information on intangibles:

a) Recognition and measurement in the primary financial statements;

b) Information on specific intangibles in the notes to the financial statements or in the management report;

c) Information on future-oriented expenses and risk/opportunity factors that may affect future performance in the notes to the financial statements or in the management report.

Recognition and measurement in the primary financial statements

ES9 Accounting for intangible assets under IFRS can result in otherwise similar intangible assets being accounted for differently depending on whether they are acquired or internally generated. Intangibles are generally recognised only if acquired, either separately (individually or as part of the purchase of a group of assets) or as part of a business combination. Internally generated intangibles, other than development costs, are therefore not generally recognised as assets in the financial statements even though they may be the most important intangibles for entities. Accordingly, both costs related to the income of the current period and costs related to gaining income in the future are recognised as expenses in the statement of financial performance.

ES10 This makes it difficult to compare IFRS financial statements of an entity that has built (or builds) up substantial intangibles internally, with those of another entity that has purchased most of its intangible assets. To some extent, alternative performance measures, currently provided voluntarily by some entities adjusting the results for the components of the purchase price allocation, attempt to facilitate the comparison of the financial performance of entities growing by acquisition with the performance of entities growing organically. However, relying on voluntary disclosures may not be the best way forward. In addition, those alternative performance measures would not enhance the comparability of the statements of financial position.

ES11 In order to enhance the comparability between entities that grow organically with entities that grow by acquisition, consideration could also be given to recognising fewer intangible assets separately from goodwill in a business combination. However, such an approach was not widely supported when the IASB recently consulted on this in its discussion paper *Business Combinations - Disclosures, Goodwill and Impairment*.

ES12 Chapter 3 considers alternative recognition (and measurement) requirements to those currently applied. In considering the recognition and measurement of (internally generated) intangibles, three questions are addressed:

- Which type(s) of intangibles should be considered for recognition (and measurement)?
- Under which circumstances should such intangibles be recognised? and
- Which measurement basis or bases should be considered?

ES13 On the question of which intangibles should be considered for recognition, the Discussion Paper states that it would be a radical approach to recognise intangibles that are not controlled by an entity. For the remaining discussion, Chapter 3 thus focuses on intangibles that meet the definition of an asset under the Conceptual Framework for Financial Reporting ('the Conceptual Framework').

ES14 Chapter 3 presents four different approaches to recognition of intangible assets: (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.

ES15 Intangibles that are recognised would necessarily also have to be measured. It would be possible to list many different methods for measurement. Chapter 3 focuses on the advantages and disadvantages of measurement at cost and fair value respectively without expressing a preference for any of them.

Information relating to specific intangibles

ES16 Chapter 4 discusses proposals to require disclosures that can provide information on a specific intangible to help users of financial reports assess the contribution of that intangible to the value / the value creation of the entity. As it appears from Chapter 3, the benefits of recognising more internally generated intangibles may be questionable and may not outweigh the associated costs. An alternative would thus be to provide better disclosures on specific intangibles. Disclosures on specific intangibles could also supplement recognition of (some) internally generated intangibles.

ES17 The intangibles, for which this chapter would propose the provision of information, are those that are key to an entity's business model. Under the approach described in this chapter, when providing information relating to specific intangibles the first step would accordingly be to describe the entity's business model(s) and identify which intangibles are important for the entity's success following its business model(s).

ES18 Information relating to specific intangibles could be both qualitative and quantitative, or a mix of both.

ES19 Some of the advantages of information relating to specific intangibles would be that granular and detailed information, on the intangibles that are key to an entity, would be provided. The information could also be less subjective than recognising and/or measuring intangibles, less complex and hence less costly.

ES20 One of the disadvantages of this approach is that intangibles often create value with other intangibles and other assets. The most relevant disclosure may therefore sometimes not relate to a specific intangible. Also, the information would not provide a solution to the issue of distorted IFRS performance measures resulting from generally not recognising internally generated intangibles.

Information on future-oriented expenses and risk/opportunity factors that may affect future performance

ES21 Chapter 5 discusses an approach under which further information is provided on the expenses recognised in a period together with information on risk/opportunity factors that may affect future performance. Under the current requirements, some of the expenses recognised in a period might be considered to relate to benefits that will be recorded in future periods. Information on these expenses could help users assess the performance of the current period and make estimations of the performance in future periods.

ES22 Information on risk and opportunity factors could also help users of financial reports when estimating future performance. Under the approach discussed in Chapter 5, it is considered that sufficient information on risk/opportunity factors that could affect the contribution of intangibles to the financial performance of an entity would generally be provided if entities disclose information on risk/opportunity factors that are material and specific to the entity.

ES23 One of the advantages of the approach suggested in Chapter 5 is that a fixed terminology to be used to distinguish between different intangibles is not necessary for providing information on the recognised expenses of a period. Also, as the approach is based on the combined effect on earnings at entity level, the approach caters for the fact that often intangibles do not create much value on a stand-alone basis but together with other intangibles and assets.

ES24 One of the disadvantages of the approach of providing information on future-oriented expenses is that information on the effectiveness of the investments is not reflected (and IFRS performance figures will still be distorted) and the information will thus not be so useful for assessing management's stewardship. However, other aspects of the management's stewardship will be provided by disclosing how the entity is dealing with risks and opportunity factors.

CHALLENGES AND ISSUES FOR POSSIBLE SOLUTIONS

ES25 This Discussion Paper does not express any preferences on which of the above-mentioned methods, or on which combination of the above-mentioned methods, should be the way forward for providing better information on intangibles. Instead, the Discussion Paper asks for constituents' input on this. The Discussion Paper, however, states (in Chapter 6) that when considering how to provide better information on intangibles, consideration should also be given to:

- whether it would be beneficial to establish a common terminology on intangibles;
- how to provide useful information but at the same time not require entities to disclose information that is commercially sensitive;
- where the information should be provided – in the financial statements (including the notes), in the management report, or somewhere else;
- ensuring that requirements on information to be provided would result in relevant and comparable information;
- whether the approach to providing information on intangibles could affect an entity's access to finance;
- whether some of the current requirements can be removed.

QUESTIONS TO CONSTITUENTS

EFRAG invites comments on all matters in this Discussion Paper, particularly in relation to the questions set out below. Comments are more helpful if they:

- address the question as stated;
- indicate the specific paragraph reference to which the comments relate; and/or
- describe any alternative approaches that should be considered.

All comments should be received by 30 June 2022.

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?

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)?

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).

Please explain the reasons for your preferences.

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).

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')?

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?

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?

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?

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?

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?

CHAPTER 1: INTRODUCTION

This Discussion Paper has been prepared as part of EFRAG's project Better Information on Intangibles. Different approaches to obtain better information on intangibles are analysed, based on input from members of the EFRAG Advisory Panel on Intangibles. The Discussion Paper presents various alternatives and discusses their advantages and disadvantages without providing recommendations on the selection of a particular approach. The approaches presented address 'intangibles' with reference to intangible sources of possible economic benefits. This includes items that would not meet the definition of an asset in the IFRS literature. The Discussion Paper only considers information to be included in financial reports (financial statements (including the notes) and the management report). The approaches presented only deal with how to provide better information for intangibles used in the entity's operations. The scope is limited to cover information that is useful for the primary users of financial reports.

WHY THIS DISCUSSION PAPER?

1.1 In 2018, following the input received from the EFRAG research agenda consultation, EFRAG decided to add a research project on better information on intangibles to its agenda.

1.2 Among the arguments provided to EFRAG for including a proactive research project on intangibles were the following:

a) Changes in the business landscape resulting from new technologies, digitalisation, software solutions and movements towards a service economy, mean that internally generated intangible assets play an increasingly important role for the performance of an entity, while not adequately reflected in the financial statements.

b) There has been increasing focus on the intangible drivers of value within companies, and how these act as indicators of the future value of a business. At the same time, concerns have been voiced that financial statements are losing their relevance as they do not reflect many of these intangible elements.

c) The discrepancies between the accounting treatment for acquired and internally generated intangibles need to be examined, being a significant investor concern as it distorts key ratios and could lead to the misallocation of capital.

1.3 As one of its first research steps, EFRAG commissioned an academic literature review to provide insights on primarily academic literature on information on intangibles. The literature review (Zambon *et al.* 2020) was published in 2020. One of the insights provided by the literature review was that although much research exists in the area of intangibles, not much exists on how the information is consumed by users of financial reports, hence there is not much direct research on what information on intangibles would be useful for users.

1.4 EFRAG considered it important that suggestions on how to provide better information on intangibles would be based on identified information needs of users of financial reports. EFRAG therefore conducted a limited number of interviews with users, academics and other types of stakeholders and established, in March 2020, the EFRAG Advisory Panel on Intangibles ('EFRAG API') to provide input to the project. The EFRAG API consisted of users, valuators and preparers of financial reports.

Input received from stakeholders

1.5 In order to develop proposals for how better information on intangibles can be provided, EFRAG's first aim was to identify the issues with the information currently included in financial reporting. In doing so, EFRAG considered input from:

a) A limited outreach conducted in early 2019 with a range of stakeholders (including preparers, users, valuers, academics and other professionals);

b) Several meetings of EFRAG API; and

c) Discussions of the EFRAG User Panel.

1.6 The input received by EFRAG was relatively consistent with regards to the views that:

a) The purpose of the financial statements is not to explain the market capitalisation of an entity by measuring all possible items at fair value. Users providing input to the project, have stated that they are less interested in the fair value of individual assets as assessed by management compared to obtaining the information necessary to make their own assessment of the operation of an entity as a whole.

b) The importance of intangibles has grown significantly and information provided about intangibles can be improved[2].

1.7 However, a wide range of views were expressed about whether and how to improve information on intangibles as a way to help users estimate the value of the entire entity and assess stewardship. These different views can be categorised as suggestions for:

a) further recognition of internally generated intangibles in the financial statements (or in a separate statement)[3];

b) improved narrative reporting, including metrics, to assist users of financial reports in assessing an entity's intangibles; and

c) improved information about 'future-oriented' costs that are not recognised as assets (that is, 'future-oriented expenses').

1.8 Most differing views probably existed in relation to the recognition of intangible assets. Some consider that the current requirements are broadly right, while others consider that the requirements of IAS 38 *Intangible Assets* (and/or IFRS 3 *Business Combinations*) should be revisited. Among those who consider that there is room for improvement, the views expressed include the following:

a) Currently, too many intangible assets are recognised separately from goodwill in a business combination. Preparers of financial reports note that it is very costly to account for these assets separately as, for example, it is necessary to assess whether the assets are impaired. While some users similarly question the usefulness of recognising all types of acquired intangible assets separately from goodwill in a business combination, other users consider that the current requirements are appropriate, as it is useful to receive information on what intangible assets an entity considers it has acquired in a business combination.

b) The criteria for the recognition of (internally generated) intangible assets may not be appropriate. A wide range of views were expressed in terms of proposed alternatives:

(i) all intangibles should be recognised (proposal from a user);

(ii) the recognition criteria of IFRS 3 could also be applied for internally generated intangible assets if they can be measured reliably and it is more likely than not that their value will be recovered (suggestion from a valuator);

(iii) internally generated intangibles should be recognised to the extent they can be sold and have a commercial value (suggestion from a preparer);

2 This view was not shared by all stakeholders consulted. A few expressed the view that there is not much that can be done to improve the information reported on intangibles.

3 As it will be explained further in Chapter 2, the views have also been presented that fewer intangibles acquired in a business combination should be recognised and that changes to current requirements are not necessary.

(iv) internally generated intangibles could be recognised to the extent they are identifiable within the entity's value creation process (suggestion from a user);

(v) internally generated intangibles should be recognised to the extent it is possible to sell them or they result from a contractual right and the cost can be measured reliably (suggestion from a user).

1.9 Differing views also exist on how recognised intangibles should be measured. Some consider a fair value measurement to be most useful (measurement at fair value, initially and subsequently, was thus proposed in relation to the recognition approaches mentioned above in paragraphs 1.8b)(i) and 1.8b)(ii)), while others suggest:

a) Measurement at cost, unless fair value can be determined more reliably. In that case, measurement should be at fair value both initially and subsequently for a specific intangible (this was suggested in relation to the recognition approach mentioned above in paragraph 1.8b)(iii)).

b) A mixed measurement approach consisting of cost, a measure reflecting the revenue the intangible will generate, and fair value (this was suggested in relation to the recognition approach mentioned above in paragraph 1.8b)(iv)).

c) Measurement at cost (initially and subsequently) (this was suggested in relation to the recognition approach mentioned above in paragraph 1.8b)(v)).

1.10 The input received on recognition and measurement is reflected in the analysis in Chapter 3 of this Discussion Paper.

1.11 In addition to recognition and measurement, better disclosures on intangibles in financial reports is an approach to improve transparency that has been proposed. There are currently no prohibitions for preparers to provide additional information on intangibles on a voluntary basis in financial reports, but preparers seem reluctant to provide such information. Many reasons can account for this reluctance. One of the reasons may be the cost of providing the information in the financial reports – for example, it may be less costly to provide the information outside the financial reports. Another reason may be its commercial sensitivity, and the fact that entities may be judged negatively if, for example, they provide information on investment in intangibles (such as research costs) and the projects to which these investments relate are subsequently abandoned.

1.12 The proposals in Chapter 4 build on input received on how information on specific intangibles (that is, information useful for estimating the contribution of intangibles to the value of an entity) can be provided to make better information on intangibles available.

1.13 As an alternative to changing the recognition criteria and/or measurement of intangible assets and/or providing information on specific intangibles, users have explained that better information to determine the 'steady-state' margins and possible changes to these should be provided. The proposals in Chapter 5 on 'future-oriented expenses' are based on this approach and the suggested information to be provided is accordingly presented in Chapter 5.

1.14 Some users have also pointed out that sustainability-related disclosures (that is, disclosure of data explaining the impact and added value of a business with reference to environment, social and corporate governance aspects, as well as other types of non-financial disclosures) are useful. However, other users have noted that only information that would have a significant impact on the entity should be disclosed, in order not to make financial reports less accessible for the primary users of those.

1.15 Sustainability-related information is considered in Chapters 4 and 5 of this Discussion Paper to the extent it is considered to be useful for the primary users of financial reports, and can be considered pre-financial (that is, although not currently affecting the entity, it could be assumed that in the future, the factors for which information is provided, would be important for the entity's performance).

1.16 As is apparent from the above, the preliminary input received for this Discussion Paper has pointed in different directions, both in relation to the issues with current information and on how better information can be provided. The absence of a consensus on these issues means that, even after decades of discussions, there is still a need to consider the topic – both in this Discussion Paper and by other related initiatives. Different approaches on how to provide better information on intangibles have already been developed. Input is therefore needed on which one (or which combination of approaches) should be considered further.

1.17 Accordingly, this Discussion Paper does not present 'one single model' to provide better information on intangibles but, instead, discusses the merits and limitations of various approaches.

SCOPE

1.18 This Discussion Paper only considers information to be provided in the 'financial reports', which in this Discussion Paper is used to refer to the primary financial statements, including the notes, and a management report[4] of the type currently required in Chapter 5 of the EU Accounting Directive (Directive 2013/34/EU of the European Parliament and of the Council).

1.19 There are significant ongoing developments in requirements for sustainability reporting, both inside and outside the EU, that could have implications for the management report and could expand its role and remit. This Discussion Paper focuses on how intangibles affect an entity. A sustainability reporting perspective to the issue could have other/ additional implications. While a sustainability reporting perspective to the issue would have resulted in proposals other than those included in this Discussion Paper, sustainability reporting and financial reporting are linked. An implication of this is that some of the information proposed in this Discussion Paper might, at a later stage, be considered to fit better with sustainability reporting, even though the information is also relevant for financial reporting. Accordingly, while the Discussion Paper does not elaborate further on the ongoing developments, EFRAG considers that connectivity between financial and sustainability information within the management report will be essential, as emphasised in the report of the EFRAG European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards. The topic of how to connect financial and sustainability reporting is therefore not covered in this Discussion Paper and will be considered by EFRAG in future discussions.

1.20 The scope is also limited to cover information that is useful for the primary users of financial reports as defined in the IASB's *Conceptual Framework for Financial Reporting* (the 'Conceptual Framework') (that is, existing and potential investors, lenders and other creditors). The purpose of this Discussion Paper is not to consider how the book value of an entity should equal its market capitalisation.

1.21 The Discussion Paper considers information on intangible sources of possible economic benefits other than financial assets. Specifically, the intangible sources should have the potential to produce economic benefits on a stand-alone basis or together with other sources of possible economic benefits (including assets). In this Discussion Paper, these intangible sources of possible economic benefits are referred to as 'intangibles'. The term 'intangibles' is thus used to include a potentially wide range of assets and other factors that drive the creation of value in companies, whether or not they are currently recognised or reported in financial reports, and whether or not they would meet the accounting definition of an asset. The scope of this Discussion Paper is accordingly broader than many other projects which only consider intangibles that would meet the definition of an asset.

1.22 The focus is on intangibles in relation to providing information on how an entity creates, maintains and/or enhance value. There are many other issues related to financial reporting of intangibles (including divergence in how (the scope of) IAS 38 is applied/interpreted). Such issues are not the main focus of this Discussion Paper. By focusing on how an entity creates, maintains and/or enhance value, it follows that the intangibles considered in the Discussion Paper are those that are used in an entity's operations. Issues with intangibles that are held for investment purposes are accordingly outside the scope of this Discussion Paper. It is noted, however, that issues related to crypto-assets are considered in EFRAG's discussion paper *Accounting for Crypto-Assets (Liabilities)*.

1.23 The proposals in this Discussion Paper are only intended for material information about intangibles that are key for the value creation of an entity or, for the proposals in Chapter 5, entities for which intangibles are material.

4 The management report is also known by various other names, including: management commentary, management's discussion and analysis (MD&A), operating and financial review and strategic report.

STRUCTURE OF THE DISCUSSION PAPER

1.24 The Discussion Paper considers approaches to better information on intangibles in relation to:

a) recognition and measurement in the primary financial statements (Chapter 3);

b) information on specific intangibles in the notes to the financial statements or in the management report (Chapter 4);

c) information on future-oriented expenses and risk/opportunity factors (including risks related to sustainability and climate) that may affect future performance in the notes to the financial statements or in the management report (Chapter 5).

1.25 Chapter 6 considers factors, primarily from the perspective of preparers, that will have to be considered when finding a solution to provide better information on intangibles.

1.26 First, however, the following chapter, Chapter 2, summarises some of the issues with current information on intangibles.

CHAPTER 2: ISSUES WITH THE CURRENT INFORMATION

EFRAG's commissioned literature review, published in February 2020, identified academic studies showing that the value relevance of financial statements is decreasing and that this could be due to financial statements not reflecting information about intangibles, which has become more important for more entities than previously. Insufficient information on intangibles could affect the company's market value due to information asymmetry, result in an inefficient capital allocation in society and make assessment of the management's stewardship difficult.

The current accounting requirements could also make it difficult for users to compare entities that grow organically with those growing by means of acquisition, as current regulation generally requires acquired intangibles to be recognised, while internally generated intangibles can only be recognised in specific circumstances.

Some consider that recognising more internally generated intangibles (and perhaps fewer intangible assets acquired in a business combination) would be a way to deal with the issue. However, all recognised internally generated intangibles would have to be measured and both measurement at cost and at fair value of recognised intangible assets are problematic. In addition, not all intangibles would meet the definition of an asset.

Additional disclosures as the way forward also have some problems. Boundaries between different intangibles are not (well) defined and are interpreted differently. There are also no generally accepted ways on how to report on intangibles. Finally, additional information on intangibles may be commercially sensitive to provide.

WHAT ARE THE ISSUES WITH THE CURRENT INFORMATION ON INTANGIBLES?

2.1 Intangibles are dissimilar in type. This complicates finding ways to account for them, as the approach chosen for one type might not be useful for another type. In addition, beyond lacking physical substance, many intangibles have specific characteristics and economic features that can be a challenge for the conventional approach of financial reporting. Some of these characteristics are:

a) Investment in intangibles is generally associated with high levels of uncertainty about the expected future benefits. In addition, costs of developing an intangible are often sunk costs. The development costs cannot be recovered if the development is not satisfactorily finalised. If the investment fails, there may not even be any scrap value to it.

b) It can sometimes be difficult to demonstrate the control over intangibles when it is difficult to restrict access or protect the use by legal means.

c) On its own, the value of an intangible can be very low. The existence of synergies and network effects are an important feature of intangibles and most intangibles do not create value on their own but in conjunction with other assets. It is thus often how an intangible works in combination with other intangibles or other assets that makes it valuable. The existence of synergies can affect the value of intangibles and gives rise to difficulties, for example in relation to measurement.

d) Intangibles are often scalable at low marginal costs. Scalability means that, unlike tangible assets, intangibles can be used repeatedly and in multiple places at the same time, with little or no additional investment.

2.2 To add to the complexity of the debate on the information currently reported on intangibles, there are different views on what the issues are. For example, while some consider an issue the fact that internally generated intangibles are not recognised, others point out that the omission of intangibles from the statement of financial position is not necessarily a deficiency, as the value of intangible (and other) assets can be ascertained from the statement of financial performance[5]. In addition, not all intangibles meet the definition of an asset (see Chapter 3 for details).

5 See, for example, Zambon *et al.* (2020) for references to academic literature presenting these views.

2.3 The purpose of this chapter is not to present a list of factual deficiencies with the information currently reported. Instead, this chapter provides a summary of different views on the problems with the currently reported information.

2.4 To the extent that insufficient information on intangibles is provided, it may affect:

a) the company's market value and financial position;

b) capital allocation and investment decisions;

c) access to finance;

d) stewardship assessments (the accountability of management for actions/decisions in managing a firm's resources).

2.5 Some studies[6] show that the value relevance of financial statements is decreasing, and this could be due to financial statements not reflecting information about intangibles, which have now become more important for more entities than was previously the case. Some are concerned that many intangibles that would meet the definition of an intangible asset are not recognised because of the additional recognition criteria in IAS 38 *Intangible Assets* for internally generated intangible assets. They argue that as a result:

a) Financial statements do not reflect the underpinning drivers of value for intangible intensive businesses (that is, return-generating intangibles are not recognised). In this regard, it is noted that the importance of intangibles is growing in the global economy, with intangible assets such as big data, customer relationships, brand, efficient business processes and/or the dynamic capability of a workforce being important parts of how businesses create value. It is also noted that IAS 38 does not require, but only encourages, entities to provide 'a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria'.

b) Performance measures are distorted since:

(i) Return on assets ratios do not provide useful information as the 'assets' part is not properly reflected. One of the consequences is that it is difficult to hold management accountable for the use of the entity's unrecognised resources and the return on these (stewardship aspect).

(ii) As costs incurred to build an intangible are not capitalised, income of a period may not be correctly matched with the related expenses. Accordingly, profit margins calculated from the IFRS figures of a period do not portray the 'real' profitability of the period and cannot be used to predict margins in the future.

(iii) The statement of performance is 'hit twice' in the same period if an entity acquires an intangible asset (which is capitalised and amortised) and replaces this over time with an internally generated asset which cannot be recognised and for which the costs are therefore recognised in the financial statement at the same time as the amortisation costs of the acquired intangible assets.

c) Comparability is adversely affected insofar as most intangible assets are not recognised if they are internally generated, but they are recognised if they are acquired. In addition, there may be a difference between whether intangible assets are acquired in a business combination or not, as under IAS 38 probability and reliability recognition criteria apply[7], whereas under IFRS 3 the criteria are always considered to be satisfied.

2.6 The issue of reduced comparability as a result of internally generated intangible assets generally not being recognised, while acquired intangibles are recognised, means that it is difficult to compare entities that grow organically with entities

6 See, for example, Zambon *et al.* (2020) for references.

7 IAS 38 requires an entity to recognise an intangible asset if, and only if: 'a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and b) the cost of the asset can be measured reliably'.

that grow through acquisition[8]. Particularly in relation to business acquisitions, the view has also been presented that too many intangible assets are recognised (separately from goodwill). The reliability and relevance of some of the separately recognised intangibles acquired in a business combination is thus questioned by some (both users and preparers). However, as noted in paragraph 1.8 above, others consider that including intangible assets in goodwill, instead of recognising them separately, would reduce information on what the entity has acquired in a business combination.

2.7 While some think that more internally generated assets should be recognised (and perhaps fewer intangible assets acquired in a business combination should be recognised), it is also noted that not only the recognition, but also the measurement requirements of IAS 38, give rise to issues.

2.8 Under IAS 38, intangible assets are generally measured at cost. There are two issues with measurement at cost. Firstly, for internally generated intangible assets, it may be difficult to identify/allocate internal costs. Secondly, the measurement does not reflect the value of the asset, if, for example, it is worth much more than its cost. This may particularly be an issue with some types of intangibles which increase in value with use (for example, some software platforms such as social media). On the other hand, measurement at fair value would also be problematic, particularly from a reliability/faithful representation perspective, as there is no active market for most intangibles. The respective merits and limitations of the different possible measurement bases for intangibles are discussed further in Chapter 3.

2.9 As an alternative to recognising more intangibles, additional disclosures could be provided. However, additional disclosures as the way forward also have associated issues. Boundaries between different intangibles are not (well) defined and they are interpreted differently. There are also no generally accepted approaches on how to report on intangibles. Chapters 4 and 5 discuss these issues further. Also, while additional information on intangibles may be useful, it could also mean that entities would have to provide information that is commercially sensitive. This issue is discussed further in Chapter 6.

2.10 Finally, regarding intangibles that would meet the definition of an asset, there are also issues related to the current financial reporting standards, such as:

a) How to assess 'control' in relation to certain intangibles. For example, should control be assessed in relation to the right to be able to broadcast a given event (together with other broadcasting companies) or to holding the master broadcasting rights for a given event?

b) It is not always straightforward whether an asset should be accounted for under IAS 2 *Inventories* or IAS 38.

c) It is not always clear whether an asset is a pre-payment or an intangible asset. For example, whether an upfront payment to be able to broadcast a given event would be a pre-payment for a service or the purchase of an intangible right.

d) It is not always straightforward whether/when a contract could be considered an intangible asset.

e) Difficulties with allocating the total transaction price for intangible assets acquired in a bundle (outside a business combination).

2.11 Some additional issues for the broader category of intangibles which would not necessarily meet the definition of an asset, are the following:

a) Information on intangibles is difficult to compare and use as the boundaries between different intangibles are not (well) defined and are interpreted differently. Even for those that meet the definition of intangible assets there are different interpretations on what development costs are (see also paragraph 2.9 above).

8 In its comment letter in response to the IASB's consultation on *DP 2020/1 Business Combinations—Disclosures, Goodwill and Impairment*, EFRAG invited the IASB to take into account the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically and, as such, start a project on IAS 38. Pending such a broader project on IAS 38, EFRAG questioned the usefulness of considering unilateral changes to the existing provisions in IFRS 3 as to whether some separately recognised intangible assets should be subsumed in goodwill. Instead, EFRAG suggested a broader project on IAS 38 by the IASB.

b) It is unclear what the unit of account is. This also applies for acquired intangible assets. For example, a movie picture includes many different types of rights such as author rights, music rights and graphical rights. It is unclear whether these rights are different intangible assets or the intangible asset on which information should be provided is the movie picture.

c) The information to be provided may be commercially sensitive (this issue is considered further in Chapter 6).

2.12 While this Discussion Paper focuses on the issues mentioned in paragraphs 2.5–2.9, the issues listed in paragraphs 2.10–2.11 are also considered important and are included in the assessments of the different approaches to provide better information on intangibles, when relevant.

CHAPTER 3: RECOGNITION AND MEASUREMENT

Chapter 3 considers approaches to provide better information on intangibles through recognition and measurement in the financial statements. Several approaches are considered together with their benefits and limitations. In doing so, consideration is given both to the asset recognition in the statement of financial position and to the effects in the statement on financial performance.

As explained in Chapter 2, the current IFRS requirements can result in otherwise similar intangible assets being accounted for differently depending on whether they are acquired or internally generated. Except for development costs, intangibles are generally recognised only if acquired, either separately (individually or as part of the purchase of a group of assets[9]) or as part of a business combination. Internally generated intangibles, other than development costs, are therefore not generally recognised as assets in the financial statements even though they may be the most important intangibles for entities. Accordingly, both costs related to the income of the current period and costs related to gaining income in the future are recognised as expenses in the statement of financial performance.

This makes it difficult to compare IFRS financial statements of an entity that has built up substantial intangibles internally, with those of another entity that has purchased most of its intangible assets. To some extent, alternative performance measures[10] (for example, results adjusted for the components of the purchase price allocation) currently provided voluntarily by some entities attempt to facilitate the comparison of the financial performance of entities growing by acquisition with the performance of entities growing organically. However, relying on voluntary disclosures may not be the best way forward. In addition, those alternative performance measures would not enhance the comparability of the statements of financial position.

In order to enhance the comparability between entities that grow organically with entities that grow by acquisition, consideration could also be given to recognising fewer intangible assets separately from goodwill in a business combination. However, such an approach does not seem to have received wide support when the IASB consulted on this in its discussion paper Business Combinations – Disclosures, Goodwill and Impairment.

Chapter 3 considers alternative recognition (and measurement) requirements to those currently applied. In considering the recognition and measurement of (internally generated) intangibles, three questions need to be addressed:

- *Which type(s) of intangibles should be considered for recognition (and measurement)?*
- *Under which circumstances should such intangibles be recognised? and*
- *Which measurement basis or bases should be considered?*

On the question on which intangibles should be considered for recognition, the Discussion Paper states that it would be a radical approach to recognise intangibles that are not controlled by an entity. For the remaining discussion, Chapter 3 thus focuses on intangibles that meet the definition of an asset in the Conceptual Framework.

Chapter 3 presents four different approaches to recognition of intangible assets: (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.

9 When a group of assets and liabilities is purchased that does not constitute a business, paragraph 2(b) of IFRS 3 requires the purchaser to allocate the cost of purchase to the individual assets and liabilities on the basis of their relative fair values at the date of purchase.

10 In its 2015 Guidelines, ESMA defines Alternative Performance Measures as 'financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework'.

Intangibles that are recognised would necessarily also have to be measured. It would be possible to list many different methods for measurement. Chapter 3 focuses on the advantages and disadvantages of measurement at cost and fair value respectively without expressing a preference for any of them.

WHICH TYPE(S) OF INTANGIBLES SHOULD BE CONSIDERED FOR RECOGNITION?

3.1 Intangibles encompass a wide variety of items and when considering recognition and measurement for such items a classification of intangibles is necessary. A possible classification considered in this Discussion Paper[11] is related to the degree of difficulty of establishing ownership or control rights and more generally the difficulty of their measurement.

- **Category A:** Intangibles that are controlled by an entity; for which ownership rights are relatively clear and for which markets exist (generally they can be bought and sold). Within this category, two types of intangibles can be distinguished: (i) marketing-related intangibles such as trademarks and brand names and (ii) technology-based intangible assets such as patented technology, computer software, databases, internet domain names and film copyrights.
- **Category B:** Intangibles that are controlled by the entity but for which well-defined and legally-protected ownership rights may not exist, and markets are weak or non-existent. Examples include R&D in process, non-patented technology or trade secrets.
- **Category C:** Intangibles for which the firm has few, if any, control rights and markets do not exist. Within this category two types of intangibles can be distinguished: (i) those related to the people who work for the entity (examples include, assembled workforce, skills and experience, staff loyalty and training) and (ii) those related to relationship capital (for example, relationships, including reputation, with customers, suppliers, partners and government).

3.2 Control is a fundamental concept in the definition of any asset in IFRS and it does seem unrealistic, or at least difficult, to introduce an exception to recognise 'uncontrolled' intangibles as assets without unintended consequences on other assets or undermining the general principles of IFRS. Therefore, focusing on possible improvement to the accounting (that is, recognition and measurement) of intangibles in categories A and B seems the more promising and realistic approach.

3.3 In this regard, it is also noted that proponents of an expansion of the recognition of intangibles have generally not proposed a mechanical recognition of all intangibles. Instead, most recent research papers[12] propose only a limited expansion consistent with the current definition of assets under conditions or thresholds such as the ability to attribute benefits or the passing of specified technological or commercial feasibility tests.

3.4 Before considering possible approaches for recognition and measurement of those internally generated intangibles as characterised above, the following section discusses a number of additional considerations specific to intangibles.

Existence of expenditures as a precondition for asset recognition

3.5 Some types of internally generated intangibles typically do not require explicit (nor have easily identifiable) expenditures. This may be the case for instance for organisational capital, social capital, reputation and customer fidelity.

3.6 Although the IFRS definition of an asset does not state explicitly that an asset must stem from a direct or identifiable expenditure to be recognised, the absence of such direct or identifiable expenditure adds a layer of complexity to any recognition pattern: if the recognition of an intangible asset such as organisational capital, market power, customer loyalty, is proposed in absence of such any expenditure, the credit must be to equity, either directly to equity or through comprehensive income.

11 Classification suggested by Blair, M.M., & Wallman, S.M.H (2000).

12 Gu and Lev (2016); Barker and Penman (2017); The Financial Reporting Council Limited (2019).

3.7 Some consider that the nature of an accounting system is to report faithfully on the cash-to-cash cycle, and therefore recognise only assets arising from expenditures (including commitments for future expenditures that give rise to a liability).

3.8 Promoters of the recognition of more internally generated assets referred to in paragraph 3.3 above, generally suggest restricting the accounting for intangible assets to the intangibles with expenditures as their focus is on the effects on earnings of such expenditures and avoiding confusing earnings from current revenues with investments to gain future revenues.

3.9 These authors generally consider that limiting recognition to intangibles that have expenditure would be more helpful for users to measure return on investment and for the assessment of stewardship. Conversely, recognising assets with no expenditure could alter this information.

UNDER WHICH CIRCUMSTANCES SHOULD INTANGIBLES BE RECOGNISED?

3.10 This section considers different accounting approaches for the expenditure related to internally generated intangibles. The considerations apply to an accounting under a cost model but would also apply to the initial measurement of intangibles, at cost, under a revaluation model.

3.11 Conceptually four possible approaches[13] can be considered which all have benefits and limitations.

a) Recognise as assets all intangibles meeting the definition; with no specified conditions or thresholds;

b) A threshold for recognition of an asset (that is, recognising an asset **if specified conditions are met at the start of the project**, with no subsequent reassessment of the conditions);

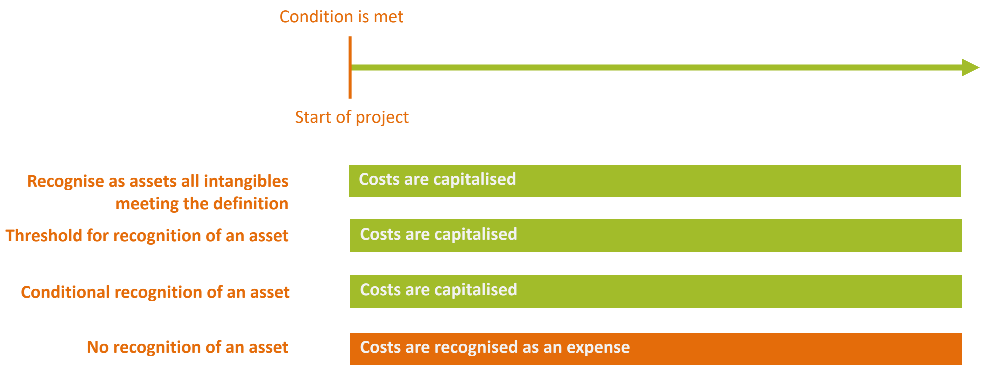
c) Conditional recognition of an asset (that is, recognising an asset **when specified conditions are met**); and

d) No recognition of internally generated intangibles (that is, expensing as incurred all investments related to internally generated intangibles).

3.12 These approaches are illustrated below in Figure 3.1 and further explained in the following paragraphs.

Figure 3.1 Possible approaches for recognising internally generated intangibles

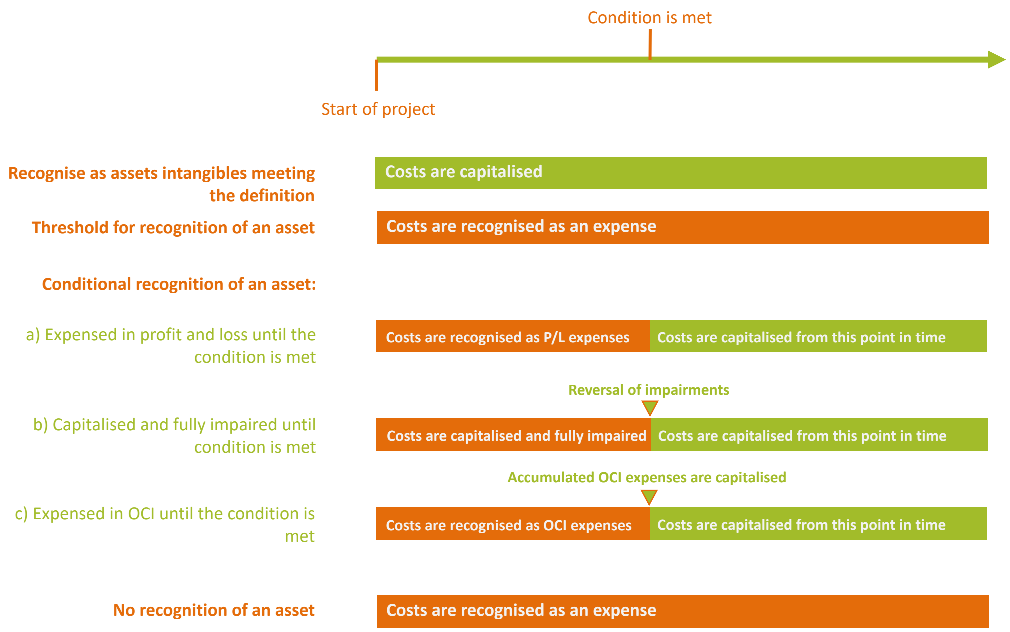
Case 1 - the condition for recognition is met at the start of the project



When the condition to recognise an asset is met at the beginning of the project, the first three approaches have the same outcome.

13 See also Barker *et al.* (2020).

Case 2 - the condition for recognition is met at a later point in the project



3.13 For the reasons mentioned above in paragraph 3.2, the discussion below focuses on intangibles that would meet the definition of an asset in the Conceptual Framework. Amending the requirements for recognition of intangible assets might have to be supplemented by the approaches considered in Chapter 4 and Chapter 5 for intangibles that are not recognised (and for those that are recognised).

3.14 For the reasons mentioned above in paragraph 3.2, the discussion below will also not consider factors that reduce earnings (but not meeting the definition of a liability (that is 'negative intangibles'/'unrecognised intangible liabilities')).

Recognising all internally generated intangibles

3.15 There are arguments both in favour and against recognising all internally generated intangible assets.

Arguments in favour of recognising all internally generated intangible assets

3.16 One argument in favour of recognising all internally generated intangible assets would be that it would result in IFRS performance figures better reflecting the costs that would be related to the income reported in a period (see also Chapter 5).

3.17 It could also be argued that recognising all internally generated intangible assets would be more consistent with the treatment of internally generated tangible assets (for example, property, plant and equipment), which are generally recognised.

3.18 IAS 16 *Property Plan Equipment*, similar to IAS 38, requires that assets can only be recognised if (a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity and (b) the cost of the asset can be measured reliably. In addition, the definition of an intangible asset in IAS 38 requires that intangible assets must be 'identifiable'. That is either:

a) Separable (capable of being separated and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract); or

b) Arise from contractual or other legal rights.

3.19 A tangible asset would be identifiable. Also, future economic benefits that are attributable to a tangible asset will generally flow to the entity from internally generated tangible assets. It may be that an internally developed tangible asset does not function as intended, but in that case, it would often be possible to sell different components of the tangible asset separately, for example as scrap.

3.20 The characteristics of internally developed tangible assets would therefore mean that they would generally meet the stated criteria for recognition and hence be recognised.

3.21 As internally generated tangible assets are generally recognised, it could be argued that internally generated intangible assets should also generally be recognised. It could thus be argued that applying recognition criteria for intangible assets that would mirror those of tangible assets is inappropriate as it does not take into account that tangible and intangible assets are different and hence would result in some types of intangible assets not being recognised.

3.22 A possible approach could therefore be to consider whether the guidance provided by IAS 38 to define 'identifiable' could be modified in a less restrictive/more inclusive manner.

3.23 The existing 'measurability' and 'probability of future economic benefits' conditions can also be an impediment to recognition of internally generated intangibles. It could likewise be considered to remove/relax these criteria. In this regard, it is noted that these conditions are assumed to always be met in the case an acquisition of intangibles in a business combination. The presumption that the 'reliable measurability' and 'probability of future economic benefits' conditions are always met for intangibles acquired in a business combination could be rebutted. This is because the existence of a purchase price for a whole entity or business does not necessarily infer that the allocation to each identifiable intangible item would be more reliable than the measurement of internally generated intangibles.

Arguments against recognising all internally generated intangible assets

3.24 Against the suggestion to remove or relax the identifiability criterion it could be argued that the identifiability criterion is necessary. An asset must have boundaries in order to be recognised, and identifiability may be seen as a reasonable condition to set such boundaries of an asset which by essence has no physical substance and therefore no physical boundaries.

3.25 It could also be noted that the identifiability criterion is not the only cause that internally generated intangibles, except for development costs, are not recognised. Typically, intangibles in Category A (see paragraph 3.1 above) would meet the identifiability criteria. A self-developed brand can often be separated out (for example, sold or licenced). Similarly, contractual customer relationships would meet the contractual-legal criterion. On the other hand, customer loyalty or the entity's reputation would not meet either of the two identifiability criteria mentioned in paragraph 3.18 above.

3.26 Although a self-developed brand or customer relationships would meet the identifiability criterion, they are, however, not currently recognised because IAS 38 includes specific prohibitions to recognise:

a) Internally developed brands, mastheads, publishing titles, customer lists and items similar, IAS 38 includes an explicit prohibition to recognise such items; and

b) Expenditure on training staff, selling and administration.

3.27 Recognition of items in a) is prohibited on account of the fact that the cost of generating an intangible asset internally is 'often difficult to distinguish from the cost of maintaining or enhancing the entity's operations'. Recognition of items in b) is prohibited on account of the difficulty to demonstrate control.

3.28 It was noted above in paragraph 3.23 that there could be arguments for relaxing the 'measurability' and 'probability of future economic benefits' criteria. This could result in items listed in paragraph 3.26a) being recognised. However, there would also be arguments against such a change.

3.29 Firstly, removing the requirement that it should be possible to measure reliably the cost of an asset would seem to contradict the Conceptual Framework (paragraph 5.18). According to this, '[r]ecognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or liability or by other factors'.

3.30 It thus seems difficult to remove such conditions, since recognising assets that cannot be measured reliably is not deemed to result in useful information.

3.31 In addition, asset recognition in the statement of financial position must be considered together with the effect on the statement of financial performance which materialise through amortisation and impairment. As discussed above, when a cost method is used, a feature is uncertainty about both the cost and the outcome of investments in intangibles and how that affects the usefulness of the information in particular in the statement of financial performance.

3.32 In that respect, mismeasurement of intangibles might have adverse subsequent impacts on the information in the statement of financial performance (including through impairment or restatements to the carrying amount if cost estimates are subsequently re-assessed). In the presence of high outcome uncertainty, financial performance mismatching effects may occur either though arbitrary amortisation or subsequent impairment.

3.33 Specific characteristics and economic features of internally generated intangibles that contribute to measurement uncertainty can be a challenge to the conventional way of thinking about reporting and accounting because:

a) The expenditures associated with some internally generated intangibles are not always separable from other expenditures or may not be easily identifiable when they are imbedded in transactions also involving current expenses.

b) The economic benefits expected to be derived from investment in intangibles can be hard to quantify as it is the nature of innovation that many projects will fail and be abandoned and provide little or no benefit to the entity. For investments in activities such as research and development not related to current product or service, the amount and timing of future revenues is very uncertain.

c) The absence of a market for most of these assets can affect the reliability of their measurement. There are no markets generating visible prices for items such as intellectual capital, brands, or human capital to assist investors in correctly valuing intangibles-intensive companies. This can create difficulties under both a fair value and cost model as under the latter, intangibles would need to be tested for impairment.

d) The existence of synergies and network effects are important features. Most intangible assets do not create income on their own but only in conjunction with other assets and the existence of synergies and network effects can affect their value. This can give rise to difficulties in the measurement of fair value for intangible assets measured at fair value and for the measurement of consumption or impairment for intangible assets measured at cost, as the benefits from the synergies of intangibles with other assets may not necessarily be easy to allocate to the cash generating unit at which impairment is calculated.

3.34 As outlined by some[14], capitalising 'assets' with significant uncertainty aggregates them on the statement of financial position with assets with more certain outcomes thus blurring the overall information about future cash flows expectations. Capitalising investments in intangibles subsequently affects earnings as these recognised assets would be amortised against future earnings or subject to impairment. This in turn may affect the usefulness of the information provided by the statement of financial performance and the quality of users' analyses.

3.35 Accordingly, some consider that the uncertainty feature suggests a solution that books an asset to the statement of financial position when an uncertainty threshold or condition is satisfied. Thresholds and conditions for recognition are considered in the following paragraphs.

Threshold for recognition

3.36 Instead of recognising all intangible assets, it could be considered to amend the current recognition thresholds. IAS 38 currently contains a combination of recognition thresholds and explicit prohibitions (see paragraph 3.26) for some types of intangibles.

14 Accounting for Intangible Assets - Suggested Solutions (Richard Barker, Andrew Lennard, Stephen Penman, Alan Teixeira) – September 2020.

3.37 The definition of intangible assets implies that they are 'identifiable', that is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged; or arise from contractual or other legal rights. In addition, for an intangible asset to be recognised, it must be probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

3.38 Thresholds act as an 'in/out assessment' to be made at inception when an entity starts the development of an intangible and is incurring expenditures. Contrary to recognition conditions (see next section) the criteria are not reassessed subsequently.

3.39 The identifiability criterion (which is embedded in the definition of intangible assets in IAS 38) de facto scopes out items such as customer service capability, presence in geographic markets or locations, strong labour relations, ongoing training or recruiting programs, knowledge capital, ecological attitudes, outstanding credit ratings and access to capital markets and favourable government relations.

3.40 As explained in paragraph 3.26, IAS 38 includes specific prohibitions to recognise: internally developed brands, mastheads, publishing titles, customer lists and items similar and expenditure on training staff, selling and administration.

3.41 A possible option to consider could be to remove these explicit prohibitions and consider specific recognition thresholds that would not cause investment expenditures related to internally generated intangible assets to be expensed as incurred. The criterion of identifiability could also be removed from the definition of intangibles assets in IAS 38. Instead, a less restrictive version of this criterion (see paragraph 3.22 above) could be considered as a threshold or condition for recognition.

3.42 Some have suggested that an alternative threshold could be the ability to determine, at inception of an investment, the amortisation schedule that allocates the consumption of those assets to appropriate periods.

3.43 More particularly, proponents of such an approach consider an approach under which an asset would only be recognised when:

a) An expenditure has been incurred, that is separately identifiable from other transactions; and

b) The entity has the ability to establish and allocate the pattern of consumption of future benefits (that is to establish an ex-ante amortisation schedule) arising from that asset to appropriate periods.

3.44 A limitation of such an approach is that it would not address intangible assets with infinite (or indefinite) lives nor intangible assets with no (identifiable) expenditure.

3.45 Other possible recognition conditions of internally generated intangibles could encompass the following criteria (alone or in combination):

a) Only to recognised intangibles for which future benefit can be identified and separated from the other main business activities at inception of their development;

b) Only to recognise intangibles (for example, R&D, development of a customer database or brand) for which the expected expenditures can be estimated at the inception of the development of the intangible asset;

c) Only to recognise intangibles, for which the cost associated with the development are, at inception of the development, expected to be recovered;

d) Only to recognise intangibles that are identifiable within the entity's value creation chain; that is, for instance the ability to attach a rate of return to the investment;

e) Only to recognise intangibles that can be sold or have a commercial value;

f) Only to recognise intangibles that can be monitored for impairment (that is, intangibles for which the recoverable amount can be determined).

3.46 Another variation of the threshold approach could be to use the criteria for recognition set in IFRS 3 and recognise all internally generated intangible that would have been recognised if acquired separately. IFRS 3 allows the recognition of a broad range of intangibles that are separately identifiable including:

a) Marketing-related intangible (such as trademarks, trade names, internet domain names and non-competition agreements);

b) Customer-related intangible (such as customer lists, customer contracts and customer relationships);

c) Artistic-related intangible assets (such as books, pictures, musical works and audio-visual material);

d) Contract-based intangible assets (such as licensing agreements, servicing contracts, employment contracts and use rights).

3.47 Separate presentation of expenditures not meeting the defined thresholds in the statement of income could also be considered (see Chapter 5).

3.48 An issue with a general threshold approach could be to establish the time at which the threshold should be considered. For development expenditures, which are currently capitalised, IAS 38 includes guidance on when the development phase begins. This makes it possible for entities to know when it should start capitalising development expenditures. However, for other types of intangibles, this could be difficult as there could be different stages in the development. For example, it may not be straightforward to determine when a brand is starting to being developed / at what stage expenditures should start being capitalised.

Conditional recognition

3.49 Conditional recognition of an asset is a variation of the 'Threshold for recognition' approach under which a threshold is not assessed once and for all at inception of the development of an asset. Instead, an entity continuously assesses whether the recognition criteria are met. When the criteria are met, an asset will be recognised. Under a conditional recognition approach, expenditures related to investments in an intangible asset, can be either:

a) Expensed in profit or loss as incurred until the recognition criteria are met. When/if the recognition criteria are met, further expenditures are capitalised. The capitalised amount would then be recognised as an expense over the intangible's amortisation period.

b) Capitalised and fully impaired until the recognition criteria are met at which point the impairment loss would be reversed. Unlike the approach mentioned in a) above, this approach would mean that not only the expenditures incurred after the recognition criteria are met would be capitalised. This would also be the case for the expenditures incurred before the recognition criteria are met. The reversal of the impairment loss would indicate to users when the recognition criteria are met.

c) Expensed in other comprehensive income ('OCI') as incurred and 'recycled' as an intangible asset when/if the recognition criteria are met, or as an expense in profit or loss if the project is not successful/would never meet the criteria for recognition.

3.50 Under the conditional recognition approach, expenditures that are expensed (or capitalised and impaired) immediately could be presented in a separate line of the statement of financial performance so they are not confused with other operating expenses. When the threshold for recognition is met, an asset starts to be recognised and is then subsequently amortised.

3.51 An illustration of 'conditional capitalisation' can be found in the pharmaceutical sector, where some companies have developed a practice to start manufacturing inventory before the developed drugs are approved, in anticipation of receiving that approval (pre-approval inventory). Inventory is recognised as an asset under IAS 2 *Inventories*, but its recoverable amount is assessed for impairment immediately. If the entity assesses that it is not probable, at the time of production, that it will recover the cost through sale, the inventory is impaired to nil immediately. If (or when) the drug is approved, the impairment is reversed.

3.52 The practical solution, put in place by the pharma industry for inventories, could be considered and extended to different forms of intangibles; including research cost, training cost and marketing expenses.

3.53 Other examples of 'conditional capitalisation' can be found:

a) In the accounting of development costs under IAS 38. Such costs are expensed until the point in time when the project technical and commercial feasibility have been established.

b) In the practices of the extractive industries. Under the so-called 'successful efforts' method used in the oil and gas industry to capitalise, for each individual exploratory well, expenditures associated with the location of new oil and gas reserves. Expenditures may be capitalised as wells-in-progress until there is additional information about the existence of future benefits and as soon as the additional information becomes available, these costs can either be charged to expense (if there are no future benefits) or reclassified as a fixed asset (if there are future benefits). In the latter case, these costs are amortised as production occurs, so that expenses offset revenues.

3.54 It follows from the examples that recognition and immediate impairment of some assets can take place under current IFRS requirements. Current IFRS requirements allows conditional capitalisation through the requirement to reverse impairment losses for all assets, including intangibles, except goodwill, if the recoverable amount increases.

3.55 Separate presentation, in the statement of financial performance, of the expenditures that do not meet the condition for recognition can supplement this approach (see Chapter 5).

3.56 Compared with current IAS 38, which requires expensing research cost and provides high hurdles for capitalising development expenditures, the approach could be considered to better match revenue and expenses. Under the approach mentioned in a) only a fraction of the total cost would be capitalised whereas approach b) and c) in paragraph 3.49 would allow all expenditures associated with a successful investment to be recognised and subsequently amortised. Under the approach mentioned in c) in paragraph 3.49, research costs incurred could be included in OCI until the research project meet the defined recognition criteria. At that point in time, accumulated expenses could be reclassified from OCI to intangible asset and further expenditures would be capitalised so that all costs associated with the development of the intangible asset will be reflected in the recognised asset.

3.57 However, contrary to the approaches explored in paragraph 3.49 a) and b), an OCI accounting approach would not draw from existing principles and would create conceptual challenges.

3.58 Other comprehensive income includes items of income and expense that are not recognised in profit or loss in accordance with IFRS Standards. According to the Conceptual Framework:

a) The statement of profit or loss is the primary source of information about an entity's financial performance for the period, all income and expenses are, in principle, included in that statement.

b) In 'exceptional circumstances', the IASB 'may decide that income or expenses arising from a change in the current value of an asset or liability are to be included in OCI when doing so would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that period'.

3.59 Expenditures incurred to develop intangibles until the recognition criteria are met do not result from a '*change in the current value of an asset or liability*' or a measurement mismatch between the statement of financial position and the statement of income. Including such costs in OCI would create a precedent (there are other costs which recovery is subject to measurement uncertainties and flows through the statement of income) and an accounting in OCI would not be justifiable without an extension of the 'definition' of OCI.

Expensing internally generated intangibles

3.60 Recognising expenditures related to intangibles as an expense in the period is the default accounting when intangibles are not separately identifiable or do not meet the conditions in current IAS 38.

3.61 The immediate expensing of investments in internally generated intangible assets in the statement of financial performance distorts the income calculation, failing to differentiate expenditure that supports current revenues from that which is intended to generate future revenues (investment).

3.62 However, separate presentation in the statement of financial performance could partly help address the issue by distinguishing recognised expenses that relate to investments in intangibles from other operating expenses. See the discussion in Chapter 5. In addition, expanded disclosures about internally generated items that meet the definition of intangible asset but not the recognition criteria, might provide users with additional information to assist in analysing similar companies in industries in which intangible items are significant to future prospects.

3.63 This could address concerns raised by some that the benefits of recognising internally generated intangible assets on the statement of financial position do not justify the related financial reporting costs. Incremental disclosure could provide useful information at a reasonable cost.

3.64 Disclosures about unrecognised intangible assets would not be unprecedented. IAS 38 already:

a) Requires entities to 'disclose the aggregate amount of research and development expenditure recognised as an expense during the period' (IAS 38 paragraph 126).

b) Encourages, but do not require 'a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before the version of IAS 38 *Intangible Assets* issued in 1998 was effective' (IAS 38 paragraph 128).

3.65 The question arises as to whether mandatory and expanded disclosures would not be preferable to voluntary ones to achieve more comparability.

3.66 In practice, given the general requirement in IAS 1 *Presentation of Financial Statements*, to provide any additional information (even if not required by a specific IFRS Standard) necessary for an understanding of the entity's performance and financial position, one would expect companies to disclose information on significant risk factors and managerial judgement relative to material levels of investments in intangibles, whether capitalised or not.

3.67 The nature and extent of information to be disclosed in the notes would need to be specified, while balancing the desire for incremental disclosure from users with concerns of preparers about providing proprietary information.

Advantages and disadvantages of the four possible approaches

3.68 The table below summarises the advantages and disadvantages of the four approaches discussed above for internally generated intangibles. Unless otherwise stated, the listed advantages and disadvantages relate to both the objectives of helping users of financial reports predicting future cash flows and assessing management's stewardship:

	ADVANTAGES	DISADVANTAGES
All recognised	• Comparability between acquired and self-developed intangibles. • Comparability between internally generated tangibles and intangibles. • IFRS performance measures will not be distorted as a result of not all intangibles being recognised (for example the statement of profit or loss will not be 'hit twice' when acquired intangibles would be replaced with internally generated intangibles (see paragraph 2.5 above)). • For the assessment of stewardship, the resources available to the management will appear from the statement of financial position.	• Difficult/impossible to separately identify and measure some intangibles. • Due to measurement uncertainty, possible mismatches affect the statement of financial performance, either by arbitrary amortisation or subsequent impairment. • Incompatibilities with the definition of an asset in the Conceptual Framework (if all intangibles and not only intangible assets would be recognised – see scope restriction in paragraph 3.13 above). • Costly as preparers would be required to identify and measure all intangibles/intangible assets. • Even if all intangibles would be recognised, disclosures relating to key specific intangibles (see Chapter 4) could provide more granular and detailed information.
Threshold for recognition of an asset	• Possible to limit the impact on the primary financial statements resulting from uncertainties inherent in measurement of intangibles. • Reduces distortion of IFRS performance measures to the extent that the criteria for recognition are met.	• Would continue to exclude internally generated intangibles to the extent the criteria for recognition are not met. In these cases, there will be no improvement to current accounting. • Criteria for recognition are not reassessed even if they would subsequently be met. This results in fewer intangibles being recognised than under the conditional capitalisation approach. • Would increase costs of preparing financial statements to the extent that more intangible assets would be recognised than currently. • Even if many intangibles would be recognised, disclosures relating to key specific intangibles could provide more granular and detailed information.
Conditional recognition of an asset	• 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.	• Would continue to exclude internally generated intangibles to the extent the criteria for recognition are not met. In these cases, there will be no improvement to current accounting. • 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 and likely be higher than under a threshold approach as the entity would have to reassess the criteria for capitalisation and as the entity would have to keep track of costs that might subsequently qualify for capitalisation. • Even if many intangibles would be recognised, disclosures relating to key specific intangibles could provide more granular and detailed information.
All expensed	• The primary financial statements will not be impacted by the uncertainties inherent in measuring intangibles. • Would reduce costs of preparing financial statements.	• Distorted IFRS performance measures. • Internally generated and acquired intangibles are accounted for differently. • For the assessment of stewardship, all the resources available to the management will not appear from the statement of financial position. This also means that any impairment losses are not recognised and the return on assets, the management is creating, cannot be calculated.

3.69 In the table above, some of the advantages and disadvantages mentioned, relate to the comparability between intangibles that are acquired (either in a business combination, in the separate acquisition of intangible assets or a group of assets that does not constitute a business and contains intangibles) and intangibles that are internally developed. As noted above in paragraph 2.6, an alternative to recognise more internally developed intangibles, could be to recognise fewer intangibles separately from goodwill in a business combination. In this regard, it is noted that some users spend resources to undo the effects of the purchase price allocation and entities spend resources providing alternative performance measures that do not take the effects of the purchase price allocation into account.

3.70 As it will be further noted below such an approach could also moderate issues with measurement uncertainty related to the separately identified intangibles acquired in a business combination (or the acquisition of a group of assets that does not constitute a business and contains intangibles). Also, it could reduce the costs of preparers related to account for these separately identified intangibles, including testing these for impairment.

3.71 However, when the IASB consulted on whether to include in goodwill some separately identifiable intangibles assets recognised in a business combination, most respondents disagreed with such a proposal. They noted that the separate recognition of these intangible assets provides useful information, and they did not see a need for change[15]. In addition, in consultations done in relation to this Discussion Paper, some users have noted that it is not the purpose of the financial statements to make the corrections, some users, for their own analyses, would make to the financial statements.

WHICH MEASUREMENT BASIS OR BASES SHOULD BE CONSIDERED?

3.72 IAS 38 requires recognised intangible assets to be initially measured at cost but allows such assets to be subsequently measured either:

a) At cost less any accumulated amortisation and impairment; or

b) Under a revaluation model under which the intangible asset is carried at the asset's fair value, less any subsequent accumulated amortisation and impairment losses. The revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from fair value at the end of the reporting period.

3.73 IAS 38 does not state that any of the measurement options is preferred to the other and does not explain in its basis for conclusion when each of the approaches would provide more relevant information and/or result in a more faithful representation. IAS 38 notes, however, that the revaluation method can only be used if fair value can be determined by reference to an active market which is expected to be uncommon for intangible assets. Examples mentioned in IAS 38 where an active market might exist include production quotas, fishing licences and taxi licences.

3.74 Should additional intangibles be recognised, an option could be to apply the same measurement requirements for these. That is, they should be measured at cost less any accumulated amortisation and impairment unless their fair value can be determined by reference to an active market. In the latter case, they could also be measured under a revaluation model. However, such an approach may be less suitable for internally generated intangible assets given the number and significance of internally generated intangible assets that do not:

a) have directly attributable costs;

b) generate cash flows in isolation but do so in combination with other assets.

3.75 It may therefore be that another measurement approach would have to be developed, should additional internally generated intangibles be recognised. When considering such an approach, a key issue related to reporting on intangibles in general would have to be taken into account. As noted in the concluding remarks of the literature review of the reporting of intangibles (Zambon *et al.* 2020), a key issue about reporting on intangibles is uncertainty:

15 See, for example, paragraph 47 of IASB Agenda Paper 18A for the May 2021 IASB meeting.

'Investment in intangibles is associated with high levels of uncertainty. Further, while there is evidence that investment in intangibles leads to innovation and tangible investment, there is a time lag between intangible investments and economic benefits (intangible investment occurs early in the product life cycle)';

'the more the system is grounded on intangibles, the more vulnerable it becomes because intangibles are more uncertain, unstable and risky. The challenge we accountants face is to learn how to manage and report on these 'invisible' resources for a better understanding of organisations' financial performance and their resilience'.

3.76 In that regard, it is noted that measurement at both cost and at fair value may be problematic:

a) For fair value measurement, an issue is that there is no active market for most intangibles.

b) For measurement at cost, the issue is that it can be difficulty to identify / allocate internal cost.

3.77 Additional complexity may also exist for of intangibles acquired as part of the purchase of a group of assets and liabilities that does not constitute a business. For such transactions, IFRS 3 (paragraph 2(b)) requires an entity to:

a) identify and recognise the individual identifiable assets acquired and liabilities assumed; and

b) allocate the cost of the group to the individual identifiable assets and liabilities based on their relative fair values at the date of the acquisition.

3.78 Even if such intangibles are carried at cost, the fair value of the identifiable intangibles acquired would have to be determined for cost allocation purposes.

3.79 Conceptually, four measurement options can be considered for the sake of the discussion:

a) Internally generated intangibles are initially and subsequently measured at cost consistent with the current 'cost model' of IAS 38. Under this approach amortisation and/or impairment losses are recognised in profit or loss.

b) Internally generated intangibles are initially measured at fair value which becomes their deemed cost and subsequently subject to amortisation and impairment (consistent with the accounting of separately identifiable assets and liabilities in a business combination under IFRS 3). Under this approach amortisation and/or impairment losses are recognised in profit or loss.

c) Internally generated intangibles are initially measured at cost and subsequently measured at fair value, consistent with the current 'revaluation model' under IAS 38. Under this approach increases in fair value are reported in other comprehensive income and amortisation and/or impairment losses in profit or loss[16].

d) Internally generated intangibles are measured at fair value both initially and subsequently. Under this approach, fair value changes are reported in profit or loss.

3.80 The following discussion will mainly focus on alternatives a) and d). Generally, the advantages and disadvantages identified for alternative a) will also apply for alternative b) and the advantages and disadvantages identified for alternative d) will also apply for alternative c).

Factors to consider in selecting a measurement basis

3.81 The Conceptual Framework includes some guidance to consider when selecting a measurement basis for a particular type of intangibles.

3.82 According to the Conceptual Framework, the information provided by a measurement basis must be relevant and it must faithfully represent what it purports to represent.

16 The effect of increases in the carrying amount of an asset as a result of revaluation is included in other comprehensive income. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss. Similarly, a decrease in the carrying amount following a revaluation shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset.

3.83 Although a high level of measurement uncertainty does not render a particular measurement basis necessarily irrelevant, a balance must be achieved between relevance and faithful representation and the Conceptual Framework states that for some estimates, a high level of measurement uncertainty may outweigh other factors to such an extent that the resulting information may not be particularly useful.

3.84 The Conceptual Framework also states that the characteristics of the asset or liability and how it contributes to future cash flows are two of the factors that can affect whether a particular measurement basis provides relevant information. In particular:

a) Whether an asset produces cash flows directly and could be sold independently without a significant business disruption. In such case, a current value measurement such as fair value is likely to provide the most relevant information that incorporates current estimates of the amount, timing and uncertainty of the future cash flows.

b) Conversely, if the entity's business activities involve the use of several economic resources (including intangibles) that produce cash flows indirectly by being used in combination, information about value changes may not always provide predictive value or confirmatory value to users of financial reports.

3.85 Regarding faithful representation, the Conceptual Framework notes that:

a) The level of measurement uncertainty may affect whether information provided by that measurement basis provides a faithful representation of an entity's financial position and financial performance. In some cases, this level of measurement uncertainty is so high that it might not provide a sufficiently faithful representation. In such cases, it is appropriate to consider selecting a different measurement basis that would also result in relevant information.

b) Using the same measurement basis for related assets and liabilities may provide users of financial reports with information that is more useful than using different measurement bases.

3.86 Although the Conceptual Framework does not preclude the use of different measurement bases in the statement of financial position and in the related statement of financial performance, it notes that in most cases, using the same measurement basis in both statements would provide the most useful information.

3.87 It follows from the guidance in the Conceptual Framework[17] that measurement at cost may result in the most useful information (both for assessing future cash flows and for assessing management's stewardship) for the internally generated intangible assets that are used in an entity's operation and are mainly producing cash flows indirectly, together with other assets. An exception to this could be when it is difficult to determine the cost (and/or amortisation period) of such an intangible asset reliably and a fair value of the intangible asset can be determined reliably.

3.88 The following paragraphs discuss the benefits and disadvantages of cost or fair value measurement by considering other input than the guidance in the Conceptual Framework as well as cost/benefit considerations. The discussion is thus not suggesting a preferred approach.

Arguments for and against cost

3.89 Arguments in favour of initially and subsequently measuring internally generated intangible assets at cost rather than fair value include that it is more consistent with the treatment of internally generated tangible property, plant and equipment. Furthermore, some argue that it is more consistent with IFRS 3 principles because IFRS 3 uses fair value only as a surrogate for cost for allocation purposes (see, for example, paragraph 33 of IAS 38).

3.90 Given the users' general focus on cash flows (and hence on the cost basis), fair value measurement of internally generated intangible assets for financial reporting purposes is considered by some as unnecessary. Financial analysts often see their role as determining value and therefore a fair value asserted by an entity's management is not particularly helpful other than as a point of comparison.

17 IASB (2018). Conceptual Framework for Financial Reporting, paragraphs 6.43 to 6.82.

3.91 In outreach conducted during the development of this Discussion Paper, some users indicated that recognition at cost would be a helpful measure to calculate return on investment. Others considered that recognition of intangible items at cost does not result in providing useful measures of the benefits a company will receive from those expenditures.

3.92 Measurement of an intangible asset at cost is more appropriate when the costs to be incurred on development of an intangible asset can be identified and estimated reliably. This may be a particularly acute issue as expenditures on intangibles to generate future earnings are often made together with those for current earnings: For example, advertising can generate future sales (brand building) as well as current sales.

3.93 Lastly, measurement at cost is generally understood to be less costly to produce than fair value measurement, as well as less subjective. It is seen as a cost-effective way of measuring internally generated intangible assets and relies on traditional recognition triggers (incurrence of cost), rather than effectively using the reporting date as a recognition trigger. Subsequently, subjecting those assets to impairment testing only when there is an indication of an impairment is also more cost-effective than a periodic valuation-based model.

Arguments for and against fair value

3.94 Arguments in favour of measuring internally generated intangible assets at fair value include that fair value provides more relevant information for predicting future cash flows by capturing the expectations of future cash flows generated by an asset. Fair value also results in a consistent treatment of the same kind of assets acquired in a business combination under IFRS 3. However, assets acquired in a business combination are not subsequently remeasured at fair value.

3.95 Fair value may also be the only option available when no expenditures are incurred (or are identifiable) for a specific nature of intangibles. Under a fair value measurement, it is also not necessary to identify and allocate cost to recognised assets which can be judgemental and burdensome.

3.96 Although fair value may not capture many entity-specific synergies, it may be more prone to capture the synergies between assets than measurement at cost.

3.97 Measurement at fair value, may, when fair value is estimated, result in a risk of double counting certain items, when the effect of synergies starts materialising in the statement of performance. However, that effect would be mitigated if intangibles are initially measured at fair value but subsequently measured at cost (as explained in paragraph 3.79b) as the asset would be amortised when the synergies start materialising.

3.98 For some items, fair value may result in more relevant information than historical cost but, in the case of intangibles, fair value would be mostly based on unobservable inputs, since there are few, or none, active markets for intangibles (most intangibles) and they may be not tradeable separately. Under these conditions, fair value measurement would imply more subjectivity and expose financial reporting to a higher degree of uncertainty. For many intangibles, the measurement uncertainty of fair value could call into question whether it could provide a faithful representation.

3.99 Differences in how fair value is estimated may reduce comparability between items even though they would all be measured at ‘fair value’. Fair value may also create volatility in profit or equity that would not be predictive of (the variability of) future cash flows and the variability may also not be useful for assessing the management’s stewardship following the entity’s business model.

3.100 Fair value measurement may also be more costly to apply than measurement at cost (all the more if intangibles are subsequently measured at fair value at the end of each accounting period). Also separate initial measurement of identifiable intangibles acquired in a business combination at fair value has received criticisms for being costly and resulting in information that is not always used by users.

CHAPTER 4: INFORMATION RELATING TO SPECIFIC INTANGIBLES

Chapter 4 discusses proposals to require disclosures that can provide information on a specific intangible to help users of financial reports assess the contribution of that intangible to the value of the entity. As it appears from Chapter 3, the benefits of recognising more internally generated intangibles may be questionable and may not outweigh the associated costs. An alternative to recognising and measure internally generated intangibles would be to provide better disclosures on specific intangibles. Such information could be less subjective than recognition, less complex and hence less costly. Also, disclosures on specific intangibles could supplement recognition of (some) internally generated intangibles.

The intangibles, for which this chapter would propose the provision of information, are those that are key to an entity, in relation to its business model. Under the approach described in this chapter, when providing information relating to specific intangibles the first step would accordingly be to describe the entity's business model(s) and identify which intangibles are important for the entity's success following its business model(s).

Information relating to specific intangibles could be both qualitative and quantitative, or a mix of both.

Some of the advantages of information relating to specific intangibles would be that granular and detailed information on the intangibles that are key to an entity will be provided. The information could also be less subjective than recognising and/or measuring intangibles.

Some of the disadvantages of this approach are that in some cases it is difficult to determine the particular intangible that the disclosures relate to, and the information would not provide a solution to the issue of distorted IFRS performance measures as described in paragraph 2.5 above. The latter would also mean that information is not provided on the value intangibles are creating together with other assets.

INFORMATION RELATING TO SPECIFIC INTANGIBLES

4.1 Recognition of intangibles is not the only way to provide useful information to users of financial reports on intangibles. In practice, some entities, particularly in intangible-intensive sectors, voluntarily disclose qualitative and quantitative information that helps users develop their own estimates of present value of the cash flows expected to be generated from the entity from internally generated intangibles.

4.2 This chapter discusses requirements to disclose information on those intangibles identified by an entity to be key for its business model. The information encompasses information directly linked to a specific intangible, be it recognised in the financial statements or not. This information could be with regard to:

a) the contribution of the intangible to the value of the entity; or

b) factors related to the intangible that would help a third party assess the contribution of the intangible to the value of the entity.

4.3 Disclosures related to a specific intangible include, for example, the type of the intangible; KPIs related to the intangible; the economic life of the intangible (if relevant); the selling price of products developed based on the intangible; whether it would need to be replaced; whether it is maintained through the operation of the entity; and whether it tends to increase in value when being used by customers.

4.4 Information relating to specific intangibles may take the form of qualitative information and/or quantitative information. Examples of elements of qualitative and quantitative information on specific intangibles are provided in paragraph 4.19 below.

WHY INFORMATION RELATING TO SPECIFIC INTANGIBLES IS USEFUL

4.5 Intangibles are increasingly acknowledged as significant value drivers for the strategy and business model of an entity. Providing information related to specific intangibles that are important for an entity's business model, allows users of financial reports to understand the intangible in relation to the entity's value creation process. Such an understanding might not be achieved by means of recognition of more internally generated intangibles in the statement of financial position.

4.6 The need for this information is also apparent from the results of the European Commission's consultation for the revision of the EU Non-Financial Reporting Directive[18] (NFRD). In response to this consultation, half of the respondents took the position that companies should be required to disclose additional non-financial information regarding intangible assets or related factors. This view was stronger amongst users (59%). In addition, some financial authorities pointed out that intangibles provide essential information about an issuer's value creation potential and the lack of disclosure surrounding intangible assets creates an information gap between information available to issuers and that available to investors.

4.7 The importance and usefulness of information on intangibles was also analysed in the report of the multistakeholder Task Force (the 'Task Force') established by EFRAG to undertake preparatory work for possible EU non-financial reporting standards in a revised NFRD (European Reporting Lab @EFRAG 2021)[19]. The Task Force observed that the role of intangibles which are not reflected through financial reporting, and which are key to the development of businesses and to their processes of sustainable value creation, should be emphasised in sustainability information provided by entities. The Task Force noted that sustainability information tends to eventually lead to financial consequences meeting recognition criteria for inclusion in the financial statements over time. This makes the connectivity between sustainability information and financial information particularly relevant for users to monitor the reporting entity's value creation.

4.8 To understand value creation at company level, additional information is essential. This is illustrated by the increasing disconnect between financial reporting 'book values' and market values of companies, as expressed by financial markets through transactions. This situation explains why in the EU a majority of financial stakeholders support the idea of developing disclosures that foster a better understanding of intangibles. Information relating to specific intangibles is important in order to provide users the information about unrecognised intangibles as value drivers. This is particularly true for intangible-intensive sectors.

4.9 The above views are reflected in the European Commission's proposal for a Corporate Sustainability Reporting Directive (proposal for the revision of the NFRD) published on 21 April 2021. The Commission's proposal acknowledges that information on intangibles, including internally generated intangibles (for example, human capital, brand, and intellectual property and intangibles related to research and development), is under-reported, even though these intangibles represent the majority of private sector investment in advanced economies. The Commission's proposal therefore introduces a new requirement for companies to provide information about their intangibles, other than intangible assets recognised in the balance sheet, including: intellectual capital; human capital, including skills development; and social and relationship capital, including reputation capital.

4.10 According to the Commission's proposal, information on intangibles should also include information related to research and development, and how companies have identified the information they report on intangibles. The objective of the Commission's proposal in respect of intangibles is to require adequate reporting on intangibles, to enable investors to better understand the increasing gap between the accounting book value of many undertakings and their market

18 https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Fina/public-consultation.

19 Proposals for a relevant and dynamic EU sustainability reporting standard-setting, European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards (February 2021).

valuation, which is observed in many sectors of the economy. The definition provided in the Commission's proposal for 'intangibles' is non-physical resources that contribute to the undertaking's value creation.

PROPOSALS FOR INFORMATION RELATING TO SPECIFIC INTANGIBLES

4.11 The approach described in this chapter suggests that information on specific intangibles would be most useful if it focuses on the intangibles that are key for an entity's business model. Also, the information is considered more useful when it is linked with financial performance measures.

4.12 To enhance the usefulness of current IFRS requirements, some IFRS preparers in the more intangible-intensive industries (for example, biotech, pharmaceuticals and health care; entertainment, interactive media and software; fast moving consumer goods and luxury goods) have developed practical ways to provide information related to intangibles. This information, however, is currently, to a large extent, only included in the non-financial section of the annual reports (outside the financial statements), in presentations to investors and in press releases. The information is therefore generally not audited. In addition, despite some market discipline that helps to achieve some degree of comparability within the same industry, the information provided is generally not comparable across entities and across industries. Some companies also provide additional information, on a voluntary basis, on intangibles that contribute to the value creation process in the financial reports. However, this information is not provided by all entities and the way entities provide the information is not standardised.

4.13 Accordingly, in the following paragraphs, a possible approach to provide better information on intangibles is presented. By introducing requirements to provide information linked to intangibles that would help users assess their contribution to the value of the entity, such information would be provided by all entities and would be comparable across entities and across segments.

Suggestions on information relating to specific intangibles to be provided

Identification of key intangibles

4.14 The starting point with respect to the approach for providing information relating to specific intangibles described in this chapter, would be for an entity to identify its key intangibles. Key intangibles would be those that are critical to the business model of an entity, and that are the main driver for an entity's value creation.

4.15 These identified intangibles would then be those for which required qualitative disclosures and key standardised intangible-related metrics should be provided, supplemented by entity-specific metrics. The fact that entities would be required to provide similar information for the same key intangibles would facilitate comparisons by users in respect of entities operating similar business models.

Useful disclosures

4.16 As it appears from paragraph 4.15, information related to specific intangibles can be in the form of both qualitative and quantitative information.

4.17 Information is generally deemed more useful if it is linked with quantitative financial performance measures. However, for intangibles that have an indirect impact on performance, or are future oriented, it may be difficult, unreliable or commercially sensitive to provide information linking the resource to performance measures. Qualitative information is therefore important to supplement quantitative information and allow users a more complete understanding on the linkage with financial performance and how an intangible contributes to an entity's value. There could also be situations where only qualitative information is available because the quantitative information is very preliminary or imprecise, especially in the early stages of new projects.

4.18 Entities should, to the extent possible, provide an integration between qualitative information and quantitatively expressed information through key performance indicators. Disclosures should be provided over several periods, to enable users to compare entities over time and to assess trends.

Elements of information relating to specific intangibles

4.19 The tables below provide details on the information that could be provided for certain intangibles when these are identified as key intangibles by an entity. The details provided below are by no means exhaustive and are provided only by way of illustration of possible information relating to specific intangibles.

GENERAL INFORMATION	
QUALITATIVE INFORMATION RELATING TO SPECIFIC INTANGIBLES	**QUANTITATIVE INFORMATION RELATING TO SPECIFIC INTANGIBLES**
BUSINESS MODEL	
• Information about the entity's business model and its value drivers.	• Indicators that would help substantiate assertions in the qualitative information provided.
INFORMATION ABOUT SPECIFIC KEY INTANGIBLES	
• A description of the intangible, how it is related to the entity's value creation and linkage with financial performance. • Information on whether intangible assets recognised in the statement for financial position have been acquired or are internally developed. • Information on whether the intangible would need to be replaced by the acquisition of another asset in the future or the asset is updated and/or maintained through the entity's operation. • Information about whether the intangible is (mostly) related to products or services or to customers. • Information about legal and contractual rights associated with intangibles, including whether an intangible is (legally) owned by an entity.	• Linkage with (elements of) intangibles recognised in the statement of financial position and profit or loss or cash-flows. • Information on the remaining useful life of the intangible (if relevant). • Disclosure of standardised intangible-related metrics (for example, license ratio by geographic area, number of product recalls), supplemented by entity-specific metrics (for example, job leaving ratio, number of active patents).
• If the value of an intangible resource would be provided on a voluntary basis (either in the notes or in the statement of financial position): information on the valuation method, including key assumptions used in the estimation and key inputs (similar to requirements in IFRS 13).	

SPECIFIC INFORMATION FOR CERTAIN TYPES OF INTANGIBLES	
QUALITATIVE INFORMATION	**QUANTITATIVE INFORMATION**
CUSTOMER RELATIONSHIPS (AND SIMILAR)	
• Information about customer loyalty. • Information on relationships with subscribers (if relevant).	• Customer attrition. • (Increase/decrease in) number of customers. • Demographic mix of customers (and related variations). • Customer concentration. • Market share.
• Customer feedback, including customer satisfaction and whether they would recommend the entity's product/service to others.	
RELATIONSHIPS WITH SUPPLIERS	
• Information on whether supplies are paid on time. • How suppliers are dealing with sustainability issues. • Information about the behaviour of providers of funding.	• Lead time (and changes in this).
• Supplier satisfaction. • Information about the quality of the products/services the suppliers are delivering to the entity.	
EMPLOYEES	
• Employee satisfaction. • Mix between internal promotions and hiring of new employees. • Information about organisational culture. • Talent development. • Expertise of employees.	• Attrition rate (and development in this). • Number of accidents.
• Employee training (see also Example 4.4 below). • Changes in productivity.	
RESEARCH AND DEVELOPMENT	
• Information on what is included in capitalised development costs. For example, it would be useful to present resulting patents, technologies or other intangibles separately, to allow comparability with information presented if the patent would have been acquired.	• R&D costs incurred (recognised in the profit and loss account) broken down by business type. • Ratio of R&D costs by total operating expenses and R&D costs by total sales. • Details on capitalised development expenditures including expected economic life. • The capitalised expenditures related to each component of development costs – for example, the capitalised expenditure related to a patent. • Headcount related to R&D.
INTELLECTUAL RIGHTS/PATENTS	
	• Number of patents with economically meaningful remaining terms. • Expected economic life of patents. • Information on patent expiration.

SPECIFIC INFORMATION FOR CERTAIN TYPES OF INTANGIBLES	
QUALITATIVE INFORMATION	**QUANTITATIVE INFORMATION**
INTERNALLY DEVELOPED PRODUCTS OR SERVICES	
• Information on internally developed products or services: target population; countries in which it has been marketed/approved; selling price; competing products (existing and under development); jurisdiction-specific opportunities or limitations; safety information (where applicable); market share and projections on market share; lifecycle plans, including prolongation; and return on investment.	• Indicators that would help substantiate assertions in the qualitative information provided.
INFORMATION RELATED TO BRANDS	
	• Disclosure on development in brand value, including the costs necessary to maintain the brand value. • Revenue related to each trade name.

4.20 In addition to the identification of the entity's key intangibles and providing qualitative disclosures and key intangible-related metrics, an entity might provide its own assessment of how the key intangibles contribute to the value of the entity. For certain intangibles, this could be made by providing the entity's expectations of the market share associated to products and services related to those intangibles.

NON-FINANCIAL INFORMATION RELATING TO SPECIFIC INTANGIBLES

4.21 Financial information relating to specific intangibles can be complemented by non-financial qualitative and quantitative information (or sustainability information), such as narrative explanations and metrics that would provide contextual information about the role and contribution of the specific intangible to the broader entity value creation strategy.

4.22 The objective of this Discussion Paper is to focus on financial reporting and consider the value creation aspects and the needs for the primary users of financial reports. As a result, non-financial information is considered only to the extent that it is relevant to and can have an impact on the primary users of financial reports. In this respect, non-financial information is only considered from a financial materiality (outside-in) perspective.

4.23 It is, however, becoming more and more difficult to identify a clear dividing line between financial information and sustainability information. This is because information needs of investors are evolving rapidly with the macrotrend of responsible and sustainable investments. The growing attention to responsible investment has resulted in increasing demand by primary users of financial reports for more sustainability disclosures, including better information about how an entity interacts with the external environment, the broader society and its labour force; and how this affects the creation and maintenance of its economic value, in particular in the long term, and its sustainability. The longer the investor's perspective, the more likely it is that some sustainability risks and opportunities translate into financial impacts and, thus, more non-financial information is needed to make informed investment decisions. In addition, for responsible investors, their understanding of the entity's strategy, processes and operations in dealing with sustainability factors is an integral part of their financial decision to invest or divest.

4.24 The report *Embankment Project for Inclusive Capitalism (EPIC)* of the Coalition for Inclusive Capitalism (The Embankment Project for Inclusive Capitalism 2018) notes 'In this 21st century business environment, intangible assets like human capital, organizational culture, customer loyalty and trust are more important than ever. They have become such important determinants of a business's success that, globally, intangible assets now represent on average over 50% of a company's market value – and up to 80% in some industries, such as advertising and technology. The problem is that standard accounting practices show the costs associated with these intangible assets, such as the cost of training employees or investing in innovation. But they still do not reflect the vast majority of their value.'

4.25 With the current economy focussing on services rather than manufacturing, tangible assets have become less important and have been surpassed by innovation, and other intellectual property as the most important value drivers: value creation is now driven by automation, superior technology as well as customer loyalty and human capital. Further evidence is that the ten largest companies by market capitalisation[20] include one oil company, a reinsurance conglomerate and a healthcare and consumer product conglomerate, with the remaining seven representing technology, internet platforms or internet-related offerings.

4.26 In the European Commission consultation for the revision of the EU Non-Financial Reporting Directive[21], it was noted that reporting on assets like companies' human capital or customer base may provide information very valuable to understand the companies' sustainability profile.

EXAMPLES OF DISCLOSURES ON INFORMATION RELATING TO SPECIFIC INTANGIBLES CURRENTLY PROVIDED BY LISTED COMPANIES

4.27 To the extent that the disclosures currently required by IFRS Standards focus on intangible assets as defined by IAS 38, certain intangibles that either do not meet the definition of an asset or, while being assets, do not meet the criteria for recognition are not required to be disclosed. The only requirement related to unrecognised intangible assets is the requirement to disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

4.28 Some companies find that this is insufficient to communicate their value creation potential. Therefore, similarly to the approach described in this chapter, they provide additional information on a voluntary basis, on intangibles that are significant value creation sources. An example of an entity identifying the key intangible resources that are significant value creation sources is provided below from the SAP 2020 Integrated Report[22]. As noted in paragraph 4.12 and 4.13 above the information illustrated in the following examples would be (more) useful to the extent it can be compared with peers.

Example 4.1 Extract SAP 2020 Integrated Report[23]

'The (intangible) resources that are the basis for our current as well as future success do not appear in the Consolidated Financial Statements [...] These resources include customer capital (our customer base and customer relations); employees and their knowledge and skills; our ecosystem of partners; internally developed software; our ability to innovate; the brands we have built up, in particular, the SAP brand itself; and our organization.'

4.29 As indicated above, information relating to specific intangibles could be in the form of qualitative information, quantitative information, or both complementing each other. An example of qualitative information on a drug that prevents some effects of COVID-19 can be found in the 2020 Annual Report of Merck Group.

Example 4.2 Extract Merck Group 2020 Annual Report[24]

'In June, the U.S. Food and Drug Administration (FDA) cleared our investigational new drug application (IND) for M5049 for the potential treatment of patients with Covid-19 pneumonia. The first patient was dosed in the Phase II trial at end of July. M5049 is a potentially first-in-class small molecule that blocks the activation of Toll-like receptor (TLR)7 and TLR8, two innate immune sensors that detect single-stranded RNA from viruses such as SARS-CoV-2, the virus responsible for Covid-19. The aim of the study is to investigate if M5049 intervention at a critical point in the course of Covid-19 disease may prevent or ameliorate the hyperinflammatory response in patients with Covid-19 pneumonia and prevent progression to 'cytokine storm'. Successful intervention with the investigational drug may reduce life-threatening

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20 https://www.statista.com/statistics/263264/top-companies-in-the-world-by-market-capitalization/.

21 https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Fina/public-consultation.

22 As indicated in paragraph 2.5, the purpose of this Discussion Paper is not to consider how the book value of an entity should equal its market capitalisation.

23 For illustration purposes, we only include an extract of Financial Performance: Review and Analysis section of SAP 2020 Integrated Report. The complete section is included in the SAP 2020 Integrated Report, which is publicly available at SAP website.

24 For illustration purposes, only the extract of Research and Development section of Merck Group 2020 Annual Report is included. The complete section is included in the Merck Group 2020 Annual Report, which is publicly available at Merck Group website.

complications of Covid-19, including severe respiratory symptoms that often necessitate further medical interventions such as mechanical ventilation.'

4.30 An example of quantitative information complementing qualitative information on the customer satisfaction is provided below from the SAP 2020 Integrated report.

Example 4.3 Extract SAP 2020 Integrated Report - Customers[25]

'In early 2020, SAP brought together customer-facing teams into one organization known as Customer Success. This move enables customer-facing groups to work more closely in unison, providing the foundation for SAP to deliver on the value and experience customers require to be successful. Additionally, we have introduced our new operating model, which aligns sales, services, and customer engagement activities for a seamless experience across customer interactions. Over the next three years, we will roll out this operating model with the aim of improving customers' adoption and consumption of our solutions and ultimately their business outcomes[...]

We use the Customer NPS[26] *as one feedback mechanism to measure customer loyalty. This allows us to directly understand what our customers are thinking and identify key pain points for action. Because of the importance of customers to SAP, Customer NPS is one of our main KPIs. In 2020, our Customer NPS increased 10 points year over year to 4 (2019: –6), strongly exceeding our target of –3 to –1. Using Qualtrics technology has enabled us to listen more closely to our customers and take action on the things that matter to them. We aim to continue to increase our Customer NPS to a range of 5 to 10 points in 2021. Further, we aim to increase the score steadily in the medium term. Beginning in 2020, Customer NPS has been included as a KPI in Executive Board remuneration as part of the short-term incentive component. For more information about executive compensation, see the Compensation Report section. For more information about the Customer NPS, see the Performance Management System section.'*

4.31 An example of quantitative information related to employees from Vivendi's annual report – universal registration document 2020 is provided in Figure 4.4.

Example 4.4 Extract from Vivendi's annual report – universal registration document 2020

***78%** of employees **(1)** attended at least one training course in 2020*

OTHER INITIATIVES

4.32 Disclosure related to specific intangibles has been discussed by other initiatives such as that of the Korean Accounting Standards Board (KASB), the World Intellectual Capital Initiative (WICI) and the UK Financial Reporting Council (FRC).

4.33 A specific proposal for direct information on core intangibles has been put forward by the KASB. The idea is that there would be a definition of 'core intangibles' – those intangibles that are the main driver of the company's value. These intangibles should be valued at fair value and presented in a separate statement to be provided in the notes to the financial statements: the 'Statement of Core Intangibles' (SCI). The SCI would provide monetary valuation of core intangibles in a separate report, including information on the basis of preparation; main assumptions; key valuation inputs and assumptions.

4.34 Core intangibles were tentatively defined by the KASB as intangible factors that are important to an entity in its creation of value, whether or not they are secured by legal means and whether or not they meet the current accounting definition of 'assets'. These are important intangibles that could affect the market as it continues to generate excess profits in relation to the reporting company's (value creation) primary operating activities, and if the information is (important)

25 For illustration purposes, only an extract of Customers section of SAP 2020 Integrated Report is included. The complete section is included in the SAP 2020 Integrated Report, which is publicly available at SAP website.

26 Customer Net Promoter Score as defined by SAP in its 2020 Integrated Report.

omitted or misrepresented, it effects information user's decision making (for example, description on gap between market value and book value).

4.35 EFRAG has identified both positive and negative aspects of the proposal. The main concern is the relevance and reliability of the fair value information and the cost associated with measuring some unrecognised intangibles at fair value. It can also be questioned whether it is the objective of the financial statements to provide such forward-looking information as this could be in conflict with local regulations prohibiting the provision of such information or even triggering possible legal issues (for example, if the intangible is finally sold to a materially different price). Furthermore, as it may not be easy to identify the boundaries of specific intangibles, there is a risk of double counting the value of some intangible resources.

4.36 However, although management's valuation of individual assets may not be information to be presented in the financial reports, the narrative information about both the value development/maintenance process and information about the model, assumptions and inputs could be valuable information for users to develop their own models.

4.37 In the description of information on specific intangibles above (paragraphs 4.1–4.26), disclosures of the fair value of intangibles were not proposed, as it was assessed that the benefits to the primary users of the financial report would not outweigh the costs that would be incurred by preparing this information. However, both the identification of key intangibles and the qualitative aspects whereby they add value were considered a positive aspect of the KASB initiative and have been considered in the alternative.

4.38 In 2019, staff of the UK Financial Reporting Council ('the FRC'), in the discussion paper '*Business Reporting of Intangibles: Realistic proposals*' explored the reasons why intangibles cannot be fully reflected in financial statements without radical change and developed practical proposals for improvement in business reporting that could be implemented in the shorter term. The paper considered how financial statements might provide better information about expenditures on intangibles that are not recognised as assets and addressed the business reporting of intangibles outside of the financial statements, for example in narrative reporting.

4.39 According to the proposal, management should select the intangibles that are discussed in narrative reporting by reference to those that are most relevant to the entity's business model. The narrative reporting should include metrics and they should be reported for several reporting periods to enable trend analyses. Rather than attempting to provide a value in narrative reporting, the entity should provide information that enables investors to make their own assessment of intangibles and their impact on financial performance. For example, rather than attempting to quantify the value of customer loyalty, metrics that are relevant to it could be disclosed. Management should comment on the factors that have caused metrics to change and compare the reported metrics with their realistic targets and the metrics could be standardised within specific industries.

4.40 The FRC discussion paper also suggests that an entity should disclose the cumulative amount of future-oriented expenditure that is expected to benefit future periods, and movements in this amount. To the extent that it would be possible to relate the information on the cumulative amount of future-oriented expenditures to specific intangibles, this information could be covered by the discussion in this chapter. The FRC's proposal on future-oriented expenditure is further considered in Chapter 5.

4.41 The World Intellectual Capital/Assets initiative (WICI) has developed a principles-based framework which establishes that organisations should, to the extent possible, provide an integration between narrative information and quantitatively expressed information through key performance indicators. According to WICI, intangible reporting information should be based on the reporting framework's principles of materiality, connectivity, conciseness, comparability and future-oriented. The WICI framework provides three levels of KPIs; general KPIs or those that may be relevant for most organisations across industries, industry-specific KPIs and organisation-specific KPIs.

4.42 Although the metrics or quantitative information complement the qualitative information as noted in the FRC staff's proposal and WICI, in the proposal in this Discussion Paper, it is emphasised that there might be situations, as illustrated in Example 4.1 above, where qualitative information provides relevant information on its own with respect to potential value creation. In cases where the quantitative information is very preliminary or imprecise, especially in the early stages of new projects, the provision of qualitative information is useful for primary users of financial reports.

4.43 The review of the IASB's Management Commentary Practice Statement (MCPS) is expected to place greater emphasis on information about intangible resources. The IASB clarified that the MCPS will remain principles-based and will not provide detailed reporting requirements or suggest KPIs. Instead, it is expected that the MCPS will set as a principle that, when management identifies resources and relationships that the entity depends on for its long-term success, it would need to provide qualitative and quantitative information necessary for the primary users' understanding of the nature and importance of those resources and relationships (and their continued availability) to the future operation of the business. To support that principle, the MCPS is expected to provide high-level guidance for identifying the resources and relationships involved but is not expected to provide an exhaustive list of such items nor a list of related disclosures, as these would be specific to entities and circumstances.

IDENTIFIED ADVANTAGES AND DISADVANTAGES OF INFORMATION RELATING TO SPECIFIC INTANGIBLES

4.44 The table below includes some advantages and disadvantages of information relating to specific intangibles compared with recognition (see Chapter 3), disclosure of fair value (as suggested in the KASB papers) and information on future-oriented expenses (see Chapter 5). Some of the below listed advantages and disadvantages are further explained after the table.

ADVANTAGES OF INFORMATION RELATING TO SPECIFIC INTANGIBLES

- Provides more granular and detailed information than information on future-oriented expenses and compared to disclosing the fair value of intangibles and recognising intangibles.
- Provides information on how an entity is creating value by linking the identification of key intangibles with the entity's business model and providing information on these intangibles. Such a link is not (necessarily) provided under the recognition approach and the future-oriented expenses approach.
- The disclosures could also include information that would have a negative impact on the entity's earnings, that is 'negative intangibles' / 'intangible liabilities'. For example, if customers are dissatisfied with the entity.
- Generally 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).
- Generally, it could be assumed to be less costly to provide than the fair value of intangibles or recognising more intangibles on the statement of financial position. Depending on the information to be provided (including KPIs) information could be less costly to prepare than information on future-oriented expenses.
- Could lead to less concern from preparers than providing the fair value of intangible resources. Providing such forward-looking information could be in conflict with local regulations or even give rise to possible legal issues (for example, if the intangible is finally sold to a materially different price).

DISADVANTAGES OF INFORMATION RELATING TO SPECIFIC INTANGIBLES

- In some cases, it is difficult to determine the particular intangible that the disclosures relate to (intangibles are often interrelated).
- Identifying the key intangibles of an entity could be judgemental.
- Information could be commercially sensitive (affecting both the entity's competitive position and the risk of litigation).
- It would not provide a solution to the issue that acquired intangible assets are accounted for differently than internally generated.
- IFRS performance measures will continue to be distorted as not all intangibles are recognised (see paragraph 2.5 above).
- Information on specific intangibles might not reflect the value the intangible is creating for the entity in combination with other assets. While this would also be the case if intangibles would be recognised, the recognition, to the extent that a reliable measurement could be provided, could mean that the value created by the combination of assets would appear from IFRS performance measures.

Subjectivity

4.45 Information on specific intangibles may be less subjective than disclosing the fair value of intangibles (or recognising and measuring intangibles at fair value).

4.46 Some users note that they are not as interested in the management's valuation of individual assets as in receiving information to determine the entity's value based on their own models. They consider that the entity's own valuation of the intangibles implies a high element of subjectivity and might be biased.

4.47 There is also a lack of measurement systems for most of the internally generated intangible assets, as well as value assessment methodologies to avoid overestimation or duplication in the valuation calculations. As noted in Chapter 3, it is not only measurement at fair value of recognised intangible assets that could be a problem, but also measurement at cost.

Identifying key intangibles

4.48 For many entities it should be possible to identify key intangibles based on the entity's business model. Similar entities in the same sector would identify similar key intangibles and investors would already be asking for information about these. There may, however, be entities that consider it more challenging to identify their key intangibles. For these entities, the identification may therefore be more judgemental. In order to operationalise the approach described in this chapter, it should accordingly also be considered whether guidance could be provided to help entities in identifying their key intangibles. Such guidance could refer to what is generally considered to be relevant in the communication with users of financial reports in a given sector and what is monitored by the board of directors. Reference may also be made to the term 'key resources' in the IASB's project on the MCPS.

Granularity

4.49 Information on specific intangibles can be more granular than information resulting from other approaches.

4.50 Sufficiently detailed and granular information related to the value of intangible assets enables primary users of financial reports to assess how intangibles contribute to the value of an entity using their own models. For example, to know how a marketing plan has been designed and implemented, when it started, in which forms it was pursued, how many clients/households were involved, etc. could help users to estimate the value of a customer list or a brand.

4.51 This provides more detailed information about an intangible than the valuation of the intangible itself, which is an ultimate outcome that users would not generally find very useful, due to the subjectivity involved. It also produces more in-depth information on intangibles than information on future-oriented expenses, which may provide valuable information on the income statement but serves to draw conclusions on the company as a whole rather than on individual intangible assets. The information provided should be material from the perspective outlined in paragraph 4.22 above. Otherwise, highly granular information could impact the understandability of financial statements as immaterial information may obscures material information.

Stewardship

4.52 Information on specific intangibles may provide better information for the assessment of stewardship than information on future-oriented expenses.

4.53 The disclosure of meaningful KPIs on key intangibles allows users to have more tools at their disposal to assess the performance of the management. For this to be effective, KPIs must be clearly defined and consistent over time.

Definitions and identifiability

4.54 Information relating to specific intangibles requires specific intangibles to be identified and there is no common definition nor common understanding on the categories of internally generated intangible assets. As explained in Chapter 2, different terms are used for the same types of intangibles and some intangibles are overlapping (for example, reputation versus brand value), which can make it complex to provide information relating to specific intangibles. In addition, certain KPIs are not necessarily related to a single intangible as they might reflect the value of more than one intangible.

Cost

4.55 Providing information relating to specific intangibles as suggested in this chapter could generally be assumed to be less costly than recognising additional intangibles. It would be less costly than recognition as entities would not have to account for additional intangibles (including performing impairment tests or estimating fair value).

4.56 Whether providing information relating to specific intangibles would be more or less costly than providing information on future-oriented expenses, would likely depend on the specific circumstances. When providing information relating to specific intangibles, entities would have to identify the various key intangibles and prepare information for each of those. As discussed in Chapter 5, to provide information on future-oriented expenses, an entity might on the other hand have to provide more detailed information on its expenses than currently.

4.57 Some entities already provide information related to key specific intangibles in internal reports prepared for managerial purposes, which means that the cost of disclosing this information would be limited for these entities.

CHAPTER 5: INFORMATION ON FUTURE-ORIENTED EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE PERFORMANCE

Chapter 5 discusses an approach under which information on intangibles is provided indirectly, by communicating on the expenses recognised for a period that are expected to benefit future periods and risk/opportunity factors that may affect future performance of an entity. As a result, the information provided under this approach does not provide a measure of 'the stock' of intangibles but provides information to help users assess the future profitability/margins and/or projected future cash flows resulting from changes in the contribution of intangibles. Relevant information is thus information to assess whether the current margins can be maintained, enhanced or will decrease in future periods. Changes in how intangibles affect performance can arise from the entity's investments and disinvestments in intangibles and from risk/opportunity factors. Chapter 5 accordingly considers an approach under which an entity should provide information on:

- *Expenses recognised in a period that could be considered to relate to benefits that will be recorded in future periods. This chapter discusses both an approach under which an entity provides information to help users in their assessments of which recognised expenses relate to future periods and an approach under which an entity's management provides its assessment on which recognised expenses that relate to future earnings.*
- *Risk and opportunity factors that could affect (the contribution of) both recognised and unrecognised intangibles. Under the approach discussed in this chapter, it is considered that sufficient information on risk/opportunity factors that could affect the contribution of intangibles to the financial performance of an entity would generally be provided if entities disclose information on risk/opportunity factors that are material and specific to the entity.*

One of the advantages of the approach is that a fixed terminology to be used to distinguish between different intangibles is not necessary for providing additional information on the expenses of a period. However, a fixed terminology for types of expenses may be needed. Also, as the approach is based on the combined effect on earnings at entity level, the approach caters for the fact that often intangibles do not create much value on a stand-alone basis but together with other intangibles and assets.

One of the disadvantages of the approach of providing additional information on the expenses of a period is that information on the effectiveness of the investments is not reflected (and IFRS performance figures will still be distorted). The information will thus not be so useful for assessing management's stewardship. However, other aspects of the management's stewardship will be provided by disclosing how the entity is dealing with risks and opportunity factors.

WHY CONSIDER INFORMATION ON FUTURE-ORIENTED EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE PERFORMANCE?

5.1 Academic research indicates that professional investors consider the statement of financial performance to be relevant for their investment decisions and for the assessment of stewardship[27]. It could thus be assumed that information that would enable financial statement users to further assess the financial performance of a period and for predicting future financial performance would be useful.

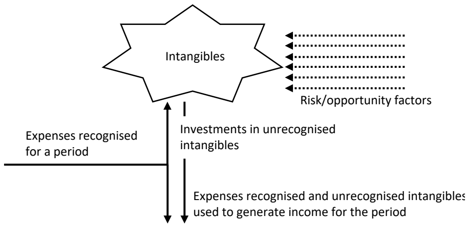
5.2 As it appeared from Chapter 3, there could be some issues with recognising all types of intangibles that could affect the performance of future periods. Accordingly, some of the expenses recognised[28] in a period could relate to the income in future periods. These recognised expenses thus represent investments in (or maintenance of) unrecognised intangibles. This is illustrated in Figure 5.1 below. The figure also shows that (the financial contribution to the entity of) these unrecognised intangibles are affected by risk/opportunity factors. Finally, the figure shows that the entity's performance of the current period is affected by the use of this pool of unrecognised intangibles. That is, future performance (including

27 See, for example, Cascino *et al.* (2016).

28 This Discussion Paper uses the terms 'recognised expenses' and 'expenses recognised' to refer to the expenses that would be recognised in a period in accordance with accounting requirements. Some of these expenses may economically relate to benefits that will be achieved in future periods. These expenses are termed 'future-oriented expenses'.

future margins) will be affected by how the pool of unrecognised intangibles can contribute to the financial performance (together with other assets of the entity) in the future. Accordingly, if the effect of an entity's investment in the pool of unrecognised intangibles in a period would outweigh the decline in the pool's income generating capacity in the period, the entity may be able to generate more income/better margins in the future periods than in the current period (unless the intangibles are affected adversely by risk factors).

Figure 5.1 Information on recognised expenses and risk/opportunity factors



5.3 By receiving more granular information about recognised expenses and risk/opportunity factors, users of financial reports would thus have information that would be useful for predicting future performance compared to current performance[29].

5.4 For example, if users would receive information that an entity has reduced its marketing expenses related to a particular line of products (a decrease in non-capitalised costs related to the future), this could signal a lower level of revenue in the future as a result of a lower awareness of the entity's products. Similarly, if the public would be focused on what entities do to prevent money laundering (a risk factor), information about what the entity is doing in this regard could help users of financial reports forming expectations about the entity's future revenue (affected through changes in intangibles such as reputation and brand) as well as assessing the management's stewardship.

5.5 Information for assessing how current and future performance is affected by risk/opportunity factors and future-oriented expenses, could be provided without specifying the particular intangible for which the financial contribution will be affected. The information could thus be provided as either complementary or alternative information to the information on specific intangibles discussed in Chapter 4 or the recognition and measurement of intangibles discussed in Chapter 3.

USEFUL INFORMATION ON RECOGNISED EXPENSES AND RISK/OPPORTUNITY FACTORS

5.6 It follows from paragraph 5.2 and Figure 5.1 that information for assessing how performance could be affected by recognised expenses/non-capitalised expenditures and risk/opportunity factors can be categorised into:

a) Future-oriented expenses (that is, information on investments in unrecognised intangibles expenses used to generate income for the period (expenses of the period));

b) Information on the use of unrecognised intangibles;

c) Risk/opportunity factors affecting intangibles.

5.7 These types of information are further explained and exemplified below. In the following paragraphs it is proposed that information on future-oriented expenses and information on the use of unrecognised intangibles is provided in the notes to the financial statements.

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29 Instead of providing information on future-oriented expenses, it could be considered to provide information on cash outflows that affect future periods. However, starting from the accrual-accounting-based statement of financial performance would provide a short-cut to information on cash outflows that affect future periods. An approach based on the cash outflows in a period is accordingly not considered further in this Discussion Paper.

5.8 This chapter, however, does not include any suggestions on whether information on risk/opportunity factors affecting intangibles should be included in the notes to the financial statements or in the management report. Proposals on this are included in Chapter 6.

Information on future-oriented expenses

5.9 As noted above, for users of financial reports to be able to make projections on future profitability and cash-flows, it would be useful to have information on whether the expenses recognised for the period have been incurred to generate income in the current (or past) period or in future periods.

5.10 There are two general manners in which this information can be provided. Either:

a) Entities can be asked to present separately, in the notes to the financial statements, expenses that according to the management relate to the current (and past) period earnings and those incurred to generate earnings in future periods (alternatively this information can be provided on the face of the statement of the financial position, see Chapter 3); or

b) Entities can be asked to provide information that would help users of financial reports to make a distinction between recognised expenses relating to the current period earnings and future periods respectively.

5.11 As an alternative to the two general manners, entities can be asked to provide information that would help users of financial reports to make the distinction, but at the same time disclose if there are significant and unusual expenses that relate to future periods.

5.12 The two approaches mentioned in paragraph 5.10 above are further described and considered below. In addition, it is considered how information can be provided to help understand the entity's business model when, as mentioned in paragraph 5.5 above, the information provided is not linked to identified specific intangibles. Finally, it is noted that when using current margins and profitability to predict future earnings under the suggested approach, information on the amortisation expenses of acquired intangibles could be useful.

Split made by the entity's management

5.13 Asking the entity to split the recognised expenses relating to the current (and past) and future periods has the potential to result in more accurate information, than if users should make their own split, due to the entity's access to detailed information. When the management is making the split, it would also be possible to require entities to provide additional information on the recognised expenses considered relating to the future. This could include information about the management's estimates on when material future-oriented expenses are expected to result in benefits (when it would be possible to make a reliable estimate, as it might be difficult for some types of expenses, such as research expenses).

5.14 Should entities be required to do the split, guidance on which recognised expenses would relate to the future might need to be provided. This guidance could be based on what expenses would have been necessary in a no-growth scenario.

Split made by the user of the financial report

5.15 Although asking the entity to split the recognised expenses could result in the most accurate information, users may be critical about such information received from an entity as the information would always involve some level of subjectivity. Users may accordingly want to make their own split.

5.16 Entities could help users of financial reports making their own estimates of the future-oriented expenses. This could be done by providing more granular information on the expenses recognised for a period. The entity could thus be required to provide information on specific expenses recognised (in addition to the current requirement in IAS 38 to disclose the aggregate amount of research and development expenditure recognised as an expense during the period), to the extent the expenses would be material. The list of specific expenses of the period could include, but not be limited to, for example:

a) Expenses related to patents;

b) Marketing expenses (including information on spending on trademarks/brands);

c) Staff training expenses (not included in research and development costs or sales and marketing costs).

5.17 Often, at least a part of those listed expenses could affect future earnings. Users could thus assess whether the expenses recognised in a period could affect future earnings positively or negatively (for example, if the expenses are lower than in previous periods).

5.18 To assess how the future-oriented recognised expenses affect current margins, it would be necessary to link the specified recognised expenses with the line items in which they are included in the statement of financial performance. This could, for example, be done in a matrix similar to that illustrated in Figure 5.2. In the example, an entity is presenting 'Costs of sales', 'Marketing and distribution expenses', 'Administrative expenses' and 'Research and development expenses' on the face of its statement of financial performance and provides further information on these expenses in the matrix included in the notes to the financial statements.

Figure 5.2 Specification of recognised expenses matrix

	Cost of sales	Marketing and distribution expenses		Administrative expenses	Research and development expenses		Total
		Marketing expenses	Distribution expenses		Patent expenses	Other research and 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							

5.19 If many of the cells would be empty in a matrix similar to that illustrated above, a list could be a more appropriate manner of disclosing the information.

Information to understand the entity's business model

5.20 Users seem to consider line items in the financial statements to be most useful when they provide information about the underlying business model and when they help forecast firm activities or evaluate managerial performance[30]. It may be reasonable to expect that the same would apply to financial information in the notes of the financial statements. It will follow below that information on future-oriented expenses may not be as useful as information on specific intangibles to understand the entity's business model and strategy. This is because information on future-oriented expenses does not directly identify the intangibles that are important for an entity. However, information on which areas an entity is using/spending its resources/costs could provide some information on its business model.

5.21 For this purpose, it could be considered to require information such as:

a) Granular information on expenses (see paragraph 5.16 above);

b) Number of employees and employee costs per function, per segment and region (if segments are not based on regions);

c) Marketing expenses per market and brand (see also paragraph 5.16b).

5.22 Figure 5.3 below shows a presentation of the distribution of research and development costs of a company.

30 Cascino, S. *et al.* (2021).

Figure 5.3 Illustration on the distribution of research and development cost in a current financial report

Research and Development Costs

€ million	2020	2019	Change € million	Change %
Healthcare	1,640	1,666	-26	-1.5%
Life Science	313	276	37	13.3%
Performance Materials	274	267	6	2.4%
Corporate and Other	62	59	3	4.3%
Total	**2,288**	**2,268**	**20**	**0.9%**

The ratio of research expenditure to Group sales was 13.0% (2019: 14.0%). The decline is due to the positive sales development.

Source: 2020 financial report of Merck Group.

Amortisation expenses related to acquired intangibles

5.23 Finally, amortisation expenses related to acquired intangible assets recognised in the statement on financial position should be disclosed separately in the notes to the financial statements. When an intangible asset has been acquired (and hence recognised in the statement of financial position) and is replaced automatically by internally generated assets (that is, non-capitalised costs), the statement of financial performance is 'hit twice' until the acquired asset is fully amortised. Until the asset is fully amortised, both the amortisation expenses and the non-capitalised cost used to replace the asset would affect the statement of financial performance. Users may therefore want to be able to exclude the amortisation expenses related to acquired intangible assets when calculating margins to be used for the projection of future profitability.

Information on the use of unrecognised intangibles

5.24 For users of financial reports to project future cash flows, it is useful to know what happens when an intangible is used to generate income. Unlike (most) tangible resources, some intangibles may become more valuable and are hence able to generate more income in the future the more they are used. This could, for example, apply to some IT platforms (for example, social media) that would increase in value the more content users put on them. On the other hand, similar to (most) tangible assets, some intangibles would need to be 'replaced' at one point in time which could involve significant costs (for example, intangibles resulting from a marketing campaign). Finally, while needing 'replacement' some intangibles are maintained 'automatically' through the operation of the business. This would, for example, normally be the case for a customer list.

5.25 The proposed information on specific intangibles (presented in Chapter 4) on whether an intangible would need to be replaced by the acquisition of another asset in the future or the asset is updated and/or maintained through the entity's operation could be useful. For intangibles that would require costly replacements, it could be useful for users of financial reports to receive information on the replacement period and cost of replacement for predicting future cash flows.

5.26 A possible useful information would be the disclosure of information on unrecognised intangibles used to generate income for a period. That is, the future-oriented expenses of a previous period, that are used to generate the income of the current period. However, unless preparers of financial information would be required to provide information on (or at least keep track of) the cumulative amount of expenditures that relate to the future and are not capitalised, it would not be possible to provide exact information on unrecognised intangibles used to generate income for a period.

5.27 To some extent, however, users might be able to work around that for the prediction of future cash flows if they, based on the information on future-oriented expenses of a year would be able to assess steady-state margins and would then be able to predict how the future would deviate from a steady-state. This prediction could be based on whether future-oriented expenses (that is, 'investments') increase or decrease.

Risk/opportunity factors affecting intangibles

5.28 A list of factors that could affect an entity's intangibles could be very long. Although this Discussion Paper only focuses on information that is useful for the primary users of financial reports, issues that might currently only be considered useful for other groups of financial report users than the primary users, could end up having a significant impact on, for example, the entity's brands. The same could be the case for information about sustainability and climate. Accordingly, the information could also become useful for the primary users of the financial reports. An example was provided in paragraph 5.4 above.

5.29 Requiring entities to provide long lists of possible factors that could affect its intangibles might not be realistic or cost/benefit effective. Similarly, requiring all types of, for example, sustainability information in financial reports could make the financial reports less accessible for their primary users.

5.30 This chapter accordingly presents an approach under which a requirement to disclose risk/opportunity factors would be limited to information that is material and specific to the entity – that is, 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/opportunity is managed and mitigated or taken advantage of. The factors should be limited to those that are material for the primary users of financial reports. The information 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. Each of the risk/opportunity factor should be described, explaining how it affects the entity. This approach would also require the entity to describe its business model (see Chapter 4).

5.31 In some jurisdictions, entities are already required (either in the financial statements or in, for example, listing documents) to disclose similar information for risks in general or for specific types of risks (for example, related to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters). Figure 5.4 provides an example of how such information is currently provided.

Figure 5.4 Illustration on how information on risks related to intangibles is currently provided

Performance	Associated KPIs	Associated risks
•••		
We have continued to reallocate investment towards our best opportunities for future growth and increased profitability, which has driven a 17% increase in R&D and S&M expenditure on products categorised as "Invest".	– Research and development reallocation – Sales and marketing reallocation	– Inability to attract skills and resources – Poor resource allocation – Inadequate processes and systems

Identify	Evaluate	Analyse	Mitigate
Operational risks			
•••			
Skills and resources We do not have or cannot attract and retain the required skills and resources for strategic and business delivery	↓	– Potential to create key person dependencies – Capacity issues and inability to focus sufficient management attention where required – Inability to execute strategy and achieve business deliverables	– Talent management, skills attraction and recruitment processes in place – Resource allocation processes in place

Source: Extracts from the Sage 2014 annual report.

5.32 Users may also consider general market information (for example, market growth and price development) to be useful. For example, if the market is growing this could increase the value of an entity's brand. However, as general market information could be retrieved by users from other sources, the approach presented in this chapter does not introduce requirements for companies to disclose such information.

INITIATIVES CONSIDERING INFORMATION ON FUTURE-ORIENTED EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE PERFORMANCE

5.33 The idea that some recognised expenses of a period are an investment in future periods (which could be both successful and unsuccessful) and that information about this could be useful, is not new. In its 2001 proposal for a new agenda project 'Disclosure of Information about Intangible Assets not Recognised in Financial Statements', the FASB, for example, noted that information to be provided on intangible assets (not recognised) could involve 'expenditures to develop and maintain them'.

5.34 Academic research has, similarly, examined, for example, whether investments in intangibles, that are included in operating expenses should be measured and separated from operating expenses[31].

5.35 In 2019, the staff of the UK Financial Reporting Council ('the FRC'), in the discussion paper *Business Reporting of Intangibles: Realistic proposals* (see paragraph 4.38 above) proposed specific disclosure requirements of the amount and nature of investments in unrecognised intangibles that are treated as an expense in the period, particularly those that are incurred with a view to generating benefit in subsequent accounting periods ('future-oriented intangibles'). These should be clearly differentiated from expenses that unambiguously relate to the period. However, the proposal went further than the approach presented in this chapter, as it also suggested that the cumulative amount of future-oriented expenditure that is expected to benefit future periods, and movements in it, should be disclosed.

5.36 The proposals of the FRC staff were based on the approach that the entity should present directly which recognised expenses it considers relate to future periods.

5.37 The views of respondents commenting on the proposals were divided. The main concern of those who did not support the proposals was the inherently subjective nature of the allocation of costs between current period expenses and expenditure on future-oriented intangibles. Many respondents believed that this could not be done in a consistent and non-arbitrary manner. There were also concerns that it would be open to manipulation by management, with a view to presenting a more favourable view of current period earnings.

5.38 As noted above, this chapter presents an alternative to having the management splitting recognised expenses between current period expenses and costs related to 'investments'.

5.39 As mentioned in paragraph 5.31 above, information about certain risks is already required in many jurisdictions. Examples of EU legislation include: Regulation (EU) 2017/1129 (on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market) and the related Delegated Regulation (EU) 2019/980. The proposals in this Discussion Paper would also require information on opportunities.

IDENTIFIED ADVANTAGES AND DISADVANTAGES OF INFORMATION ON FUTURE-ORIENTED EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE PERFORMANCE

5.40 The table below includes some advantages and disadvantages of information on expenses and risk/opportunity factors compared with information on specific intangibles and recognition/measurement of intangibles. The advantages and disadvantages are considered further after the table.

31 See, for example: Kanodia *et al.* (2004) and Enache and Srivastava (2018).

ADVANTAGES OF INFORMATION ON FUTURE-ORIENTED EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE PERFORMANCE

- A fixed terminology to be used to distinguish between different intangibles is not necessary for providing information on future-oriented expenses.
- As the approach is based on the combined effect on earnings at entity level, it 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. It is thus not a problem when providing the information that intangibles are interrelated.
- 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 (see paragraphs 4.56 and 5.48 – 5.49).

DISADVANTAGES OF INFORMATION ON FUTURE-ORIENTED EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE PERFORMANCE

- Users would not receive information on specific key intangibles for the entity's business model.
- The effectiveness of investments in intangibles is not taken into account.
- Difficult to 'match' revenue with future-oriented expenses of a previous period.
- Less useful for assessment of stewardship.
- Not useful for assessing returns of an entity as the value of intangibles would not appear.
- Less granular information on intangibles compared with information relating to specific intangibles and recognition.
- The information could be commercially sensitive.
- Information on future-oriented expenses would not provide information on 'negative intangibles'/'intangible liabilities'. Information on risks and opportunities could, however, capture some of this information.
- Would require guidance on what different types of recognised expenses should include.
- To the extent the entity is splitting recognised expenses related to the current period and to future periods (see paragraph 5.10 above), the information will be quite subjective. If, instead, information is provided to help users perform their own split, the information will be less subjective.
- It would not provide a solution to the issue that intangible assets are accounted for differently if they have been acquired versus if they have been internally generated.
- IFRS performance measures will be distorted as not all intangibles are recognised (see paragraph 2.5 above).

Identifying intangibles

5.41 Information on future-oriented expenses and risk/opportunity factors does not require specific intangibles to be identified. As explained in Chapter 2, different terms are used for the same types of intangibles and some intangibles are overlapping (for example, reputation versus brand value), which can make it complex to provide information on specific intangibles.

5.42 On the other hand, information on future-oriented expenses and risk/opportunity factors would require more guidance on how to classify and split different types of recognised expenses in order for the information to be comparable and reduce the possibility of the different categories of expenses to be used opportunistically by management (for example, guidance should be provided on what should be included in research expenses, in marketing expenses, in expenses on patents and in staff training expenses).

5.43 Also, when intangibles are not identified, it may be more difficult for users of financial reports to understand the specific intangibles that are vital for the entity and the entity's business model.

5.44 Only providing information on (or to help the users assess) future-oriented expenses (that is, 'investments'), does not inform on how well these investments perform. In some cases, it may be possible for users to assess the effectiveness of the costs spent by calculating (to the extent information is available) and comparing, for example, the costs an entity spends on establishing a new customer relationship. However, this may often not be possible. For example, an entity can spend a lot of money on training staff in a new computer system which is then scrapped before it is taken into use. This failed investment will not appear directly from the financial statements (for example, in the form of an impairment loss). Similarly, it can be that an entity is decreasing its marketing costs, but if the money is just spent more wisely, this decrease may not mean that the intangibles related to the customer's perception and knowledge of a product/ entity would decrease. Qualitative information related to future-oriented expenses, for example, explanations of changes compared with last year may help users understand the management's intentions and expectations related to the changes. However, it may not be possible to subsequently check whether the management's expectations were realised. Information on future-oriented expenses may accordingly not be as good as information on specific intangibles for assessing the management's stewardship.

Measurement of intangibles

5.45 As information for assessing how performance could be affected by changes in intangibles does not include measurement of intangibles at either cost or fair value, the issues related to the uncertainty of such measurement could be avoided.

Use of investments

5.46 As previously noted, and unlike other proposals[32], this chapter does not propose that preparers would be required to register and keep track of the cumulative amount of uncapitalised costs that relate to 'investments'. The input on which this Discussion Paper is built, did not identify, as a user need, information on the cumulative amounts of uncapitalised costs related to future earnings. This also means that users of financial reports will not be able to receive information on when the 'investments' are used and hence determine the 'correct' margins by matching the income of a period with the related expenses. In addition, it means that the calculated returns will not be comparable between entities that have acquired intangibles and entities that have developed intangibles internally (under circumstances where the costs could not be capitalised).

5.47 To the extent that the management provides an assessment of future-oriented expenses, the suggested disclosures on when the recognised expenses are expected to result in benefits could be used to estimate the unrecognised 'investments' and the use of it. However, this would require users to keep records of the 'investments' of previous periods and when the benefits of these were expected to incur. This may be less of an issue as financial information is digitalised. Users would, nevertheless, not receive information in advance if the 'investment' is no longer expected to result in benefits or if the time period for the benefits has changed.

Costs of preparing the information

5.48 Providing information for assessing how performance could be affected by changes in intangibles as that suggested in this chapter could generally be assumed to be less costly than the costs of recognising additional intangibles. It would be less costly than recognition as entities would not have to account for additional intangibles (including performing impairment tests or estimating fair value). It may be less costly than information on specific intangibles, as entities would not have to identify the various intangibles and prepare information for each of those. However, in order to provide information on expenses relating to future performance, the entity may have to register costs and expenses more granularly than currently done. This would increase the costs for preparers.

5.49 To the extent that information on expenses related to future performance is used to supplement information on specific intangibles, any cost-saving benefits would diminish or disappear completely.

32 For example, the proposal of the FRC staff mentioned in paragraph 5.35.

CHAPTER 6: WAY FORWARD, CHALLENGES AND ISSUES FOR POSSIBLE SOLUTIONS

When considering how to provide better information on intangibles, consideration should also be given to:

- *whether it would be beneficial to establish a common terminology on intangibles;*
- *how to provide useful information but at the same time not require entities to disclose information that is commercially sensitive;*
- *where the information should be provided – in the financial statements (including the notes), in the management report, or somewhere else;*
- *ensuring that requirements on information to be provided would result in relevant and comparable information;*
- *whether the approach to providing information on intangibles could affect an entity's access to finance;*
- *whether some of the current requirements can be removed.*

WHICH WAY FORWARD?

6.1 This Discussion Paper identifies different approaches for better information on intangibles. It considers that better information on intangibles could be achieved by:

a) Approach 1: Amending recognition and measurement requirements for intangibles (Chapter 3 provides different ways in which this could be done);

b) Approach 2: Providing information on specific intangibles (Chapter 4 provides examples of information on specific intangibles that could be useful);

c) Approach 3: Providing information on future-oriented expenses and risk/opportunity factors that may affect future performance (Chapter 5 discusses different approaches in this respect and provides examples of information that could be useful).

6.2 For each of the identified approaches, information on risk/opportunity factors affecting intangibles would be useful.

6.3 Some of the approaches could be combined or different approaches could be used for different types of intangibles (for example, one approach could be used for intangibles that meet the definition of an asset and another approach could be used for intangibles that would not meet the definition of an asset). Approaches 1 and 2 mentioned in paragraph 6.1 above could thus be combined. Approach 3 could in principle also be combined with Approach 2, however, many of the (cost) advantages of providing information on future-oriented expenses would then disappear.

SOME ADDITIONAL FACTORS TO CONSIDER

6.4 When considering possible solutions for better information on intangibles, there are some other factors to consider. The previous chapters have already mentioned some of the following factors.

Terminology

6.5 There is no fixed terminology when it comes to describing intangibles. Different words can accordingly be used for the same intangible, and the boundaries of what is included in a particular term can differ. The introduction of a common terminology could therefore be considered as something that could be useful for the reporting of intangibles. If information on intangibles would be based on information on future-oriented expenses (see Chapter 5), a common terminology on intangibles might be less necessary than if information on specific intangibles would be provided or if more intangibles would be recognised in the financial statements. However, in that case, it may be beneficial to provide more guidance on how to classify different types of expenses.

6.6 The introduction of a common terminology might also clarify how different intangibles may be overlapping.

Sensitivity of the information provided

6.7 Another factor that was mentioned in previous chapters, is that some of the information proposed could result in entities having to disclose information they consider commercially sensitive. It would therefore be necessary to allow entities not to present certain information if it would be highly commercially sensitive. When this would be the case, it should be considered whether alternative information could be presented (a type of 'comply or disclose alternative information' approach).

Placement of information

6.8 This Discussion Paper only considers information that could be presented in the financial reports (the financial statements, including the notes, and the management report). The discussions in Chapter 4 and Chapter 5 about information on specific intangibles and information on expenses and risk/opportunity factors related to the future, do not generally consider what information would be best placed in the notes to the financial statements and what information would be better placed in the management report. Similarly, this Discussion Paper does not consider whether some of the proposed information might be better provided outside of the financial reports. Currently some preparers communicate additional information on intangibles that is useful for the primary users of financial reports outside financial reports. This, for example, happens when it would be very costly or not possible to have the same type of internal scrutiny and control of the information as is applied for the information provided in the financial reports.

6.9 Besides discussing what information is to be provided, it would also be relevant to discuss where the information should be provided.

6.10 Whether the information considered in Chapters 4 and 5 would be best provided in the notes to the financial statements or in the management report could depend on the type of the information and which role is assigned to the notes to the financial statements under the IFRS framework.

6.11 As suggested in the IASB's Exposure Draft *General Presentation and Disclosures*, the role of the notes could be to:

a) provide further information necessary for users of financial reports to understand the items included in the primary financial statements; and

b) supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.

6.12 A possible interpretation of this suggested guidance could be that information related to specific intangibles (the approach considered in Chapter 4) should generally be placed in the notes to the financial statements to the extent the specific intangible, to which the information is related, would meet the definition of an asset[33]. Information related to intangibles that would not meet the definition of an asset should, on the other hand, be disclosed in the management report. For the approach suggested in Chapter 5 it would mean that additional information about future-oriented expenses would be included in the notes to the financial statements. The disclosures about the specific risk/opportunity factors affecting intangibles, would, on the other hand, be included in the management report to the extent they are not directly related to items that would meet the definition of an asset.

6.13 An argument against the approach outlined in paragraph 6.12 above could, however, be that it would result in users of financial reports having to consult two different sources (or parts of the financial report) to find the relevant information

33 This is because the objective of financial statements, as stated in the Conceptual Framework, is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial reports in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources. The described approach also seems to be reflected in paragraph 128 of IAS 38, which encourages entities to disclose intangible assets controlled by the entity that do not meet the recognition criteria.

on intangibles. In addition, there would currently be practical issues with requiring information to be presented in the management report, as the IFRS guidance on this issue is not binding and the content of the management report and whether or not entities should prepare a management report depend on local requirements. This might impact international comparability.

Relevant and comparable information

6.14 There is a trade-off in standard setting between setting specific requirements that would promote comparability and leaving to the entity sufficient space to present entity-specific information. Some entities currently provide information on intangibles in addition to what is required. As the entity can decide on what additional information to provide, it is likely that the information presented will have some relevance for the entity. However, the information might be biased and may be difficult to compare with other entities. Providing additional reporting requirements on intangibles could make the information more balanced and comparable. However, standard-setting may be complicated by the fact that it can be challenging to make requirements that would result in both comparable information and information that is relevant for a particular entity.

Potential effects on the ability to receive finance

6.15 The extent to which presenting information in a particular way could impact an entity's ability to receive finance should be taken into account. For example, when considering what assets should be recognised in the statement of financial position (including which assets should be recognised separately from goodwill), consideration should be given to whether recognising these assets could affect an entity's ability to receive finance. This is due to the fact that assets such as research and development in pipeline, brand reputation and customer loyalty might be accepted as collateral, whereas goodwill would not[34].

Removal of some of the current requirements

6.16 The previous chapters have mainly considered how additional information can be provided on intangibles. However, when addressing how to provide better information on intangibles (because 'better' is not the same as 'more'), it would also be appropriate to assess whether some of the current requirements, for example those related to how to account for intangibles acquired in a business combination, which can be costly for preparers to comply with, could be removed/amended without reducing the usefulness of the information provided to users.

34 See, for example, Thum-Thysen *et al.* (2017).

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