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EFRAG's 2018 research agenda consultation

Dear Jean-Paul

This letter sets out the comments of the UK Financial Reporting Council (FRC) in response to EFRAG's 2018 research agenda consultation.

We welcome this consultation as we consider proactive research to be an important part of EFRAG's activities, providing thought leadership and evidence to influence the work of the IASB.

We would like to highlight the following points:

- a. Utilising a range of research techniques, combining both quantitative and qualitative analysis, can provide high quality evidence to direct the focus of research projects as well as enabling better assessment of their impact on completion. We support the improvements that EFRAG has made in terms of diversifying its use of research techniques.
- b. We encourage EFRAG to collaborate with standard setters and academics where possible, to advance its research objectives effectively and efficiently. We would like to highlight that the FRC has active research projects on two of the topics that EFRAG is proposing to research: intangibles, and variable and contingent consideration. There may be opportunities to share ideas and coordinate research efforts in these areas.
- c. We also support the proposal to add a project on transaction-related costs to EFRAG's research agenda. However, we believe that this should be set within the wider context of examining the conceptual basis for historical cost accounting more generally so that this topic can be considered holistically, before considering narrowing the scope of the research to focus solely on transaction-related costs.

Our responses to the questions in the consultation paper are included in the Appendix to this letter.

If you would like to discuss these comments, please contact me or Rosalind Szentpéteri on 020 7492 2474.

Yours sincerely

A handwritten signature in black ink that reads "Paul George". The signature is written in a cursive style with a long, sweeping underline.

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Appendix: Questions to constituents on EFRAG's 2018 research agenda consultation

Question 1 – General questions

In paragraphs 4 to 17 below, EFRAG provides a high-level description of its research process.

- Q1.1** Do you have suggestions on how EFRAG could substantiate the influence of its Research activities in general, and individual projects in particular, on the IASB's work?
- Q1.2** What is your assessment on the use of evidence by EFRAG in its recent Research? Do you have suggestions on how to improve it?

In our view it is helpful that EFRAG is using a range of research techniques, including quantitative analysis. This analysis has proven useful in identifying systemic issues, measuring the impact of current accounting practices and reporting requirements and predicting the impact of changes to reporting requirements. Empirical studies can provide high quality evidence to better direct the focus of research, particularly when combined with investor views on priority areas for improving transparency, comparability, communication or the quality of disclosure content.

We encourage EFRAG to continue to collaborate with national standard setters and other organisations. Collaboration has many benefits, including wider stakeholder outreach, ensuring that the differences between markets and regulatory environments across Europe are adequately considered, and raising the profile, and thereby the influence, of the research projects. We note that two of EFRAG's proposed topics are the subject of current active FRC research projects, so we would welcome collaboration in these areas.

We also encourage EFRAG to engage with the academic community, which is increasingly utilising the capabilities of technology to analyse large datasets, thus developing more detailed, cost effective research methods that could be applied to EFRAG's research projects.

We agree with EFRAG that it is helpful to be able to demonstrate the impact of research projects where possible. There are many factors that influence changes in accounting practices and the IASB has stakeholders in many jurisdictions therefore the conclusions of EFRAG research will not always be reflected in changes to IFRS. However, the fact that topics and issues highlighted by EFRAG are considered and discussed by the IASB provides evidence of the influence of its research.

While not the subject of this consultation, we support the proposal to establish through EFRAG a European Corporate Reporting Lab. The FRC launched its Financial Reporting Lab in 2011 to provide a safe environment where investors and companies can come together to develop pragmatic solutions to today's reporting needs, independently of FRC policy objectives. The influence of the Lab's work has been substantial; for example, its report on disclosure of net debt was a precursor to the IASB making improvements to the disclosure requirements in IAS 7 *Statement of cash flows*. In our view, if a European Corporate Reporting Lab was established using a similar model, this could make a valuable contribution to innovation in corporate reporting at the European level.

Question 2 – List of potential topics

In paragraphs 26 to 70 below, EFRAG illustrates a list of potential topics to be added to its Research agenda.

Q2.1 For each of the projects listed above, you are kindly required to provide your recommendation based on the following criteria:

- (a) Is the project topic an important or urgent matter to European constituents?
- (b) Is the project likely to reach a useful conclusion in a reasonable time?
- (c) How would an EFRAG Research project interact with projects from other organisations, including (but not limited to) the IASB?

Q2.2 Are there other topics that you advise EFRAG to add to its Research agenda? If so, please provide a description of the topic and what the objective of an EFRAG Research project should be.

General observations

Paragraph 20 of EFRAG's research consultation paper states that EFRAG considers having its own separate research projects on topics that are the subject of IASB research would result in duplicated effort. We question whether this is always the case; sometimes specific, focused research from other organisations can supplement wider IASB projects in an effective manner. For example – as noted in the consultation paper – previous research by EFRAG, the ANC and the FRC was influential in driving the establishment of and focus areas for IASB's Disclosure Initiative. Similarly, recent FRC research on the statement of cash flows has assisted the IASB with scoping some aspects of its Primary Financial Statements research project. In addition, the IASB has recently stated its intention to research variable and contingent consideration and, in our view, this does not prevent EFRAG and others such as the FRC from making a useful contribution in this area, which may influence the IASB's subsequent work on the topic.

Better information on intangible assets

We agree that intangibles are subject to substantial stakeholder focus and warrant further research and we support EFRAG's proposal to establish a research project on this topic. We believe that the topic is highly relevant for European constituents and that progress can be made within a reasonable timeframe. The FRC has an active research project on intangibles and has recently presented a preliminary paper on the topic to EFRAG TEG and at IFASS. As noted in our response to Question 1 of this consultation, in our view it may be helpful for the FRC and EFRAG to share ideas in this research area. The FRC project considers intangibles in the broader sense, rather than only those that meet the definition of an asset.

EFRAG's research consultation paper highlights the difference between the net book value and the market valuation of a company. We agree with the EFRAG Board that the aim of research in this area should not be to align the carrying amount of equity to market prices given that depicting a market valuation of the company is not the objective of financial reporting. With this in mind, we are not persuaded that the suggestion in the consultation paper

to seek evidence of whether this gap is more commonly found in certain industries is the right starting place for further research. In our view, it may be more helpful to focus on identifying specific information that would help investors to analyse intangibles, which is not available from financial statements currently.

The interaction between the recognition, measurement and disclosure of intangibles, the IASB's research project on Goodwill and Impairment and its forthcoming project on Management Commentary should also be considered. For example, better communication of value drivers related to unrecognised intangible assets may be achieved through management commentary and disclosure of key assumptions or targets supporting the purchase consideration in a business combination.

We also agree with EFRAG that it would be worthwhile to examine further the conceptual basis for the discrepancies between the accounting treatment for acquired and internally generated intangibles. This is a significant investor concern due to the fact that it distorts key ratios and can lead to the misallocation of capital.

Cryptocurrencies

In our view, it would be helpful to properly assess the materiality of cryptocurrencies to European preparers prior to committing to a research project. We suggest that EFRAG collates data on the characteristics of the types of cryptocurrencies held by European preparers, current accounting practices and the extent to which European companies invest or transact in cryptocurrencies before deciding if or how best to proceed with detailed research. We also suggest that EFRAG engages with experts in this field to explore these issues further given that this is an emerging area.

Derecognition

We agree that there are inconsistencies in the accounting requirements for derecognition that could benefit from further investigation and analysis. However, the magnitude of issues arising from such discrepancies in terms of its impact on comparability and investor understanding and analysis is not clear. Moreover, there may be conceptual reasons for differences in the accounting treatment applied to derecognition in different contexts. We encourage EFRAG to engage with investors and establish the extent of the impact of these issues prior to commencing a research project.

Transaction-related costs

We support EFRAG's proposal to research this topic. We agree that this is a pervasive issue, impacting the accounting requirements in many IFRSs as set out in EFRAG's research consultation paper. However, we believe that it would be beneficial to consider the conceptual basis for historical cost accounting holistically as an initial step, before narrowing the research to focus on specific issues such as transaction-related costs.

Clarity around the purpose of the historical cost measurement basis and what it aims to depict may help to establish a more consistent conceptual basis for the specific requirements in various IFRSs. We recognise that this would be a larger undertaking than the project proposed in the consultation paper, but we believe this would be the most logical approach and likely to be more productive in terms of improving consistency across a broader range of accounting issues.

Variable and contingent payments

The FRC has an active research project on variable and contingent consideration and we support EFRAG's proposal to research this topic. As noted in our covering letter, we believe that it would be beneficial for EFRAG and the FRC to share ideas as our respective projects develop. We also note that the IASB has announced recently its intention to perform its own research on variable and contingent consideration. This presents an opportunity for current research from the FRC, EFRAG and others to provide insight to the IASB and assist them with determining the scope and direction of their planned project.

We broadly agree with the issues that EFRAG has identified in paragraphs 64 to 67 of its consultation paper and the objectives set out in paragraph 70. That said, narrowing the scope of the project from the outset to consider only variable and contingent payments (rather than consideration) and to exclude certain classes of transactions may be unhelpful. The issues around variable and contingent consideration are so pervasive, impacting a large number of IFRSs, that in our view the full range of relevant classes of transactions should be evaluated.

While we agree with EFRAG that certain classes of transactions (such as post-retirement benefits, long-term bonuses and share-based payments with vesting conditions) pose specific issues, we believe that to obtain completeness of understanding of the conceptual issues such transactions need to be examined. Even if principles developed through the project need modification for certain cases or exceptions to their application are accepted; valid conceptual reasons for this may be identified during the research. The FRC has performed some initial research analysing the various accounting treatments and rationales for current practice which may be of interest to EFRAG when considering this topic further.