EFRAG Research Project
Better Information on Intangible Assets
Users' Information Needs on Intangible Assets

Objective

1 The objective of this session is to provide an update on the EFRAG Secretariat interviews with a number of stakeholders in the context of its research project *Better Information on Intangible Assets* and ask EFRAG TEG and EFRAG User Panel for their views about users' information needs regarding intangible assets.

Feedback from the interviews

2 In accordance with the work plan, the initial phase for the project has included interviews in order to understand the current trends in the contribution of intangibles to the performance and reporting of intangible assets. A total of 16 interviews have been performed so far with academics, preparers, users, valuers and other professionals. These interviews were not focused on the accounting treatment of intangibles but had a broader objective to discuss whether there was an information gap and how this gap could be addressed.

3 Mixed views have been expressed during the interviews, however, there was a degree of consensus that the role of intangibles has significantly grown in importance and that information about these intangibles is lacking in primary financial statements. However, preparers may also be reluctant to provide more information on intangibles.

4 The main messages received included the following:

(a) Some suggested that the requirements of IAS 38 *Intangible Assets* could be amended to allow for recognition of more internally-generated intangibles such as research and development in the balance sheet.

(b) Some in thought that this should be the case when the cost may result in a technological product. However, others suggested that more of research and development costs should be capitalised in the statement of financial position.

(c) One academic recommended capitalising all the internally generated intangibles in the statement of financial position in order to match costs and revenue.

(d) Providing comparable information on purchased and internally generated intangible assets seems challenging; moreover, it is complex to provide a correct fair value of intangibles, due to volatility of the economic environment.

(e) One user commented that for some internally generated intangible assets, like brands and customer relationship, the solution would be to provide more relevant mandatory information in the disclosure. This would improve transparency. The user also commented that there are no real constraints for preparers to provide this information. However, preparers may be reluctant to provide expanded information on expenditure on research and development, because they fear being judged negatively if those projects were to be abandoned.

(f) Some interviewees suggested alternatives such as expanded disclosures about unrecognised intangibles or providing information on 'strategic' intangibles in a separate "intangibles' statement".

(g) Lastly, some interviewees suggested that the research analysis should focus on different types on intangibles (see Appendix 1), rather than on different sectors, because the different types of intangible assets have different characteristics. On the other hand, some said that the research project should only focus on the industries (e.g. technological) where the issue is most relevant. One preparer commented that there are some sectors (e.g. pharmaceutical sector) where the companies due the regulation must provide relevant information of such assets.

Items for discussion

Need for better information

5 The interviews have given an indication that, at least some stakeholders consider that something could be improved in the manner information is provided about intangibles in the financial statements. This corroborates the feedback from EFRAG's last research agenda consultation. In particular some outlined that it would be worthwhile to further examine the conceptual basis for the discrepancies between the accounting treatment for acquired and internally generated intangibles. This may be a significant investors' concern as it possibly distorts key ratios and may lead to misallocating the capital.

6 Interviewees had a wide range of views about whether and how to improve information about intangibles from improved narrative reporting including metrics to assist users of financial statements in assessing an entity's intangibles (either in the notes or other reports); improved information about 'future-oriented' expenses that are not recognised as assets (i.e. those relating to future growth); further recognition of internally generated intangibles in the financial statements (or in an separate ad hoc statement).

Questions for EFRAG TEG/User Panel

7 Do EFRAG TEG/User Panel have comments on the above feedback?

8 What are your views on the information needs of users about intangible assets (in particular unrecognised ones)?

9 What are the main sources of information (financial statements, other report, direct engagement with preparers,) that users typically rely on?

Challenges associated with intangibles

10 A number of interviewees have referred to the specific characteristics and economic features of internally generated intangibles can be a challenge to the conventional way of thinking about reporting and accounting.

11 First, 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.

12 The costs of developing intangible assets are generally sunk. This is the result of the need for high upfront investment – with software or databases or movies for

instance – and then very low marginal cost. The absence of market for most of these assets can affect the reliability of their measurement. There are no markets generating visible prices for items such intellectual capital, brands, or human capital to assist investors in correctly valuing intangibles-intensive companies.

13 The existence of synergies and network effects are also 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. The value of intangibles taken together is often greater than the sum of the parts. This can give rise difficulties in connection to measurement (be it for fair value purposes but also for the measurement of consumption or impairment of intangible assets which are reported at cost, and the determination of values on an asset standalone basis.

14 Lastly, intangibles often also have spillovers in particular for knowledge-based assets. Despite best efforts to protect intellectual property and keep the results secret, the new knowledge developed in a company's research programme often leaks out, benefitting other companies and society at large in ways that the originating firm can't benefit from.

15 Appendix 1 provides an analysis of how the different characteristics described above may apply to different categories of internally generally intangibles. This table provided for background only, was contained in the European Commission 2017 Discussion Paper Unlocking investment in intangible assets.

Questions for EFRAG TEG/User Panel Members

16 What are EFRAG TEG/ User Panel views on the identification of the main challenges associated with reporting on intangibles?

17 What are your initial views on how the characteristics described in paragraphs 10 to 15 should be considered as part of the EFRAG Research?

Technology-related Intangibles

18 The interviews indicated that the issue could be most important in technological industry and digital companies. The feedback from EFRAG's last research agenda consultation indicated that changes in the business landscape resulting mostly from new technologies, digitalisation and software solutions, meant that internally generated intangible assets played an increasingly important role for the performance of an entity while not adequately reflected in the financial statements.

Questions for EFRAG TEG/User Panel

19 What are the EFRAG TEG/User Panel view on whether there are specific types of businesses or types of intangibles where better information should be provided (specific sectors or asset types, stages in the entity's life cycle, specific business models etc)?

Appendix 1: Characteristics of intangibles per asset type

20 The table below is provided for background only and is based on an external source. It doesn't represent EFRAG Secretariat analysis.

		Specific effects on competition			**Risks, sunk costs, uncertainty**	**Synergies, complementarity**
		Appropriability, Excludability, Separability, Transferability	*Non-rivalry, Scalability, Network-externalities*	*Spill-overs*		
Computerised Information	Computer software	Partly excludable, transferable	Fully non-rival, scalable, network-external	High (codified)	High	Potentially high
	Computerised Databases	Partly excludable, transferable	Fully non-rival, scalable, network	High (codified)	High	Potentially high
Innovative Properties	Scientific R&D	Partly excludable separable/transfer e.g. as patents	Fully non-rival, scalable, network-external.	For "published" results high, partly otherwise	Very high	High
	Copyright and creative property	Partly excludable (depending on IPR), transferable	Fully non-rival, scalable	High (codified)	High	Potentially High
	Design	Low excludability for visible, transferable (IPR)	Fully non-rival, scalable	High for visible products, partly otherwise	Potentially High	Potentially High
Economic Competencies	Brand equity	High excludability, non-separable, transfer via M&A	Largely rival, scalable	Low/firm-specific	High	Potentially High
	Firm-Specific human capital	High excludability, non-separable, transfer though staff mobility	Largely rival, scalable	Partly, large if high staff mobility	Very High	Very High
	Organisational Capital	Partly excludable, non-separable, transferable	Largely rival, scalable	Partly	High	Potentially High
	Market research	High excludability (if non-disclosure), separable, transferable	Largely rival, scalable	Partly	High	High

Source: European Commission. Discussion Paper May 2017: "Unlocking investment in intangible assets".