

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG and User Panel. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG TEG or User Panel. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

EFRAG's Research on Better Information on Intangibles Fostering Engagement with Users and Preparers

Issues Paper

Objective

- 1 The objective of this paper is to inform the EFRAG User Panel and EFRAG TEG about the interactions with users (and preparers) considered for the research project and seek members' advice on how to foster and optimise engagement with relevant stakeholders (for the purpose of this paper particularly users).

Interactions with users and preparers

- 2 Interactions with users and preparers are expected to occur throughout the life of the project, including defining the issues, identifying possible solutions and testing them. Interactions with users and preparers are in particular expected to materialise during the following realised or planned activities:
 - (a) targeted outreach with users and preparers conducted over the first half of 2019 (see the cover note);
 - (b) meetings of the Intangible Advisory Panel (expected to be active by end-March 2020) offering selected users and preparers a forum for exchanging ideas on how to improve information on intangibles;
 - (c) roundtables on intangibles scheduled for 28 and 29 April 2020 in Brussels and London (see paragraphs 17 to 19);
 - (d) consultations with the EFRAG User Panel;
 - (e) (future) public consultations on EFRAG's Discussion Papers.
- 3 Each of the above future initiatives are further detailed in the following sections. For each, the EFRAG Secretariat is seeking advice from EFRAG TEG and EFRAG User Panel on how to best foster interactions with users and preparers.
- 4 The input collected as part of EFRAG's activities related to the intangibles project is also expected to be used by EFRAG when replying to the IASB's consultation on the revision to the Management Commentary Practice Statement and to the IASB's 2020 Agenda Consultation. It is expected that information about intangibles will be discussed as part of this project. The consultation will offer another opportunity for EFRAG to interact with its stakeholders and in particular users and preparers.

Intangibles Advisory Panel

- 5 In order to learn about what information investors need (but cannot find in the financial statements) and what information can be prepared on how an entity

creates, maintains, expands and/or preserves value, EFRAG is in the process of setting up the Intangibles Advisory Panel ('the Panel'). The Panel aims at facilitating dialogue, identifying the issues on the current guidance and helping practical solutions to emerge.

- 6 On 21 January 2020, EFRAG launched the call for candidates and the first meeting is expected to take place on 27 March 2020.
- 7 The Panel will initially focus on three intangible-intensive sectors (biotech/pharma; interactive media and software and fast-moving consumer goods - FMCG). These industries were selected following a discussion with EFRAG TEG. Based on the discussions on these sectors, proposals will be tested on other industries (to the extent they are not industry specific) and be published in the EFRAG discussion paper on problem definition for public consultation (see section *Future Consultations on EFRAG's Discussion Papers*).
- 8 The Panel could be used in a variety of ways to 'feed' EFRAG's research, for example by:
 - (a) Discussing real-life examples (selection of good practices) based on information reported in the financial reports about how an entity creates, maintains and enhances value in order to identify the principles that underpin them. Examples could be drawn for the members' entities or from third party reporting entity.
 - (b) Having open discussions, at least in the first meeting(s), to foster innovative thinking. The panel could, for example, consider how to distinguish intangibles, how to identify an entity's core intangibles, ways of reporting measures of value, drivers of value creation and risk (e.g. customer attrition rates); reporting KPIs and elementary data that the analysts would use as input to their models.
 - (c) Discussing possible solutions developed by the EFRAG Secretariat (based on the discussions of the Panel).
 - (d) Discussing, specific models or solutions 'developed' by EFRAG or other parties for instance:
 - (i) The KASB proposals on a 'Statement of Core Intangibles (see the appendix);
 - (ii) UK FRC suggestions from its consultation [Business Reporting of Intangibles: Realistic Proposals](#)) (see the appendix);
 - (iii) IASB's suggested approach in the revised Management Commentary Practice (see agenda paper 06-01).
- 9 The Panel could also consider the extent to which principles existing in IFRS Standards could be applied, by analogy, for information about unrecognised intangibles. For instance, the disclosure approach of IFRS 13 *Fair Value Measurement*, based on a fair value hierarchy and the level of observable input significant to the overall fair value, could be considered to identify useful disclosure requirements for unrecognised intangibles. Similarly, some of the concepts in IFRS 7 *Financial Instruments: Disclosures* could be explored (e.g. sensitivity analysis of each type of market risk to which unrecognised intangibles are exposed).
- 10 For the discussions the EFRAG Secretariat would prepare supporting documents (i.e. for the discussions mentioned in (b) and to some extent (c) in paragraph 8 above). For the preparation of these supporting documents, the EFRAG Secretariat, would like to draw on the EFRAG User Panel experience to identify how best to engage with the Panel (in particular regarding its 'users' component) and in particular how specific and detailed should the discussion be to maximise input and insight.

- 11 On the one hand, the EFRAG Secretariat is searching for some general directions on how to report on how value is created, enhanced and maintained. On the other hand, it is the experience of the EFRAG Secretariat that users can provide more detailed comments, that can provide a deeper insight into the issues, by considering specific examples – but the comments may then be specific to the given circumstances. There seems to be (at least) these four dimensions to consider when describing how specific questions should be formulated:
- (a) what the information should be useful for;
 - (b) what the information is about;
 - (c) who is providing the information;
 - (d) the circumstances under which the information is provided.
- 12 For the project on intangibles, the first three dimensions could be illustrated with an example. In the hypothetical example, the EFRAG Secretariat would like to know whether a statement showing the fair values of an entity's core intangibles is useful. When discussing this issue, the following dimensions could be considered:
- (a) How specific would it be necessary to be regarding the use of the information? I.e. should it be specified whether the information is to be used for credit rating purposes, lending decisions, equity investments (buy side), equity investments (sell side) or stewardship assessment?
 - (b) How specific would it be necessary to be regarding the description of the intangible resource on which the information would be provided? I.e. could we, for example, just ask whether it generally would be useful to provide fair value information on intangible resources? Or should we for each of the specific intangibles that are considered most important in the industries to be examined initially¹ ask whether it would be useful to provide fair value information. These intangibles, would likely not be, but could hypothetically be:
 - Human resources
 - Patents
 - Brands
 - Reputation
 - R&D
 - ...
 - (c) How specific should the description of the entity providing the information be? For example:
 - (i) Would it be sufficient to ask whether a statement showing the fair value of core intangibles would be useful?
 - (ii) Would it be necessary/better to provide an example of a fictive entity in a particular industry?
 - (iii) Would it be necessary/better to provide an example of a real entity in a particular industry?
- 13 The EFRAG Secretariat, has made the following initial assumptions about the dimensions explained in paragraphs 11 and 12 above:

¹ Although the EFRAG Secretariat would initially ask separately about each of the most important intangibles identified for particular industries, it would subsequently try to see whether it is possible to make some general suggestions for useful information for categories of intangibles (yet to be determined how these will be defined) that could also be applied by entities in other industries.

- (a) When considering how to provide useful information on how an entity creates, enhances and maintains value, it would be the initial assumption of the EFRAG Secretariat that if the information needs of a buy side investor would be met, the information needs of lenders and other creditors² would also be met.
- (b) When discussing whether a particular information would be useful, it would be necessary to also specify the intangible or the group of intangibles on which the information would be provided. This is because intangibles can be very different in their nature. In other words, we cannot ask whether it would be useful to provide the fair value of the most important intangibles but would have to specify the intangibles on which the information is to be provided.
- (c) If it is assumed that a given intangible is material, it would not be necessary to provide specific information about the entity that would provide the information in order for users of the advisory panel to assess whether certain information about the intangible would be useful.
- (d) It would not be necessary to describe the situation under which the information is provided except that it is assumed that the reporting entity is a going concern and will continue in operation for the foreseeable future.

Questions for EFRAG TEG and EFRAG User Panel

- 14 Does the EFRAG User Panel agree with the initial assumptions made by EFRAG Secretariat in paragraph 13?
- 15 The EFRAG Secretariat is uncertain about whether the information needs on intangibles would be similar if the objective is to assess management's stewardship or it is to estimate future cash flows. Would the EFRAG User Panel assess that in its discussions with the members of the Panel, it would be useful to distinguish between information useful for the two different objectives, or would the EFRAG User Panel assess that the overlap of the information needs on this issue is so significant, that it would not be necessary to distinguish between the two objectives?
- 16 Do EFRAG TEG and the EFRAG User Panel have any other advice for how to run the meetings of the Panel (including how the EFRAG Secretariat could stimulate the discussions and maximising the input received or what topics should be discussed)?

Organisation of Roundtables on Intangibles

- 17 In collaboration with the UK FRC, EFRAG is setting up two joint roundtables ('Perspectives on the financial reporting of intangibles) held respectively in Brussels (on 28 April 2020), and in London (on 29 April 2020) and aiming at enabling dialogue between different stakeholders such as auditors, preparers, users, academics, standard setters.
- 18 The objective of the roundtables, which will last around 6 hours, is to have a discussion with some stakeholders from a variety of backgrounds to foster ideas on the issues on the reporting on intangibles and how the information could be improved.
- 19 Participation to the roundtable will be limited to around 15 - 20 people to foster in-depth discussions and interactions and open to public attendance. Selected

² The IASB's *Conceptual Framework for Financial Reporting* specifies that the objective of general purpose financial is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

participants will briefly introduce each session with the bulk of the time for highly interactive discussion on the following matters:

- (a) What are the issues with information on intangibles in financial statements?
- (b) What information do investors need (including how to balance the need for entity specific information (e.g. linked to the business model and identified risks) and comparability (e.g. by providing prescribed measures for the industry)?
- (c) How could information be provided (including what should be recognised and what should be disclosed) – and what are the constraints? The KASB could present its 'Statement of Core Intangibles' (see paragraph 8e) as part of this section.
- (d) What contributions could be made by other participants in the financial reporting environment than preparers and standard setters?

Questions for EFRAG TEG and User Panel

- 20 Do EFRAG TEG and EFRAG User Panel have comments on the roundtable programme at the two events (including any recommendations on how to foster an interactive dialogue between the participants and which more detailed questions could be raised)?

Consultations with EFRAG User Panel

- 21 The EFRAG Secretariat intends to associate the EFRAG User Panel with the development of this project and consult it whenever necessary. Besides the updates provided at the April 2019 and February 2020 meetings, the EFRAG Secretariat considers that, in the future, it could be useful to share some of the outcome of the discussions of the Panel with the User Panel in particular to:
- (a) ensure that the users' perspective is appropriately reflected,
 - (b) ensure that any developed 'solutions' result in information that is useful for decision making;
 - (c) help assess and test the validity of some ideas developed from the discussions of the Panel.

Questions for EFRAG TEG and User Panel

- 22 Do EFRAG TEG and EFRAG User Panel have recommendation on how the Panel and the EFRAG User Panel should interact?

Appendix - Specific solutions or suggested approaches 'developed' by other parties

- 23 Following there are two specific solution or model developed by other parties that could be discussed by the Advisory Panel on Intangibles.

The KASB proposal 'Statement of Core Intangibles'

- 24 The KASB proposes a statement of core intangibles. The statement would include the intangibles that are not recognised in the statement of financial position to the extent they are the main drivers of an entity's value (hence 'core'). The intangibles included in the statement of core intangibles would be measured at fair value.
- 25 Core intangibles are intangible factors that are important to an entity in its creation of value (regardless of whether they are internal developed or externally acquired). Core intangibles do not need to be secured by legal means and do not need to meet the definition of an asset. It is not the intention that the statement of core intangibles should be subject to an external audit. Main assumptions related to the statement, including the measurement, should be disclosed.
- 26 The statement should include comparative information in respect of the preceding periods for the fair value of core intangibles. According to the proposal this is in order to make the figures more credible.

UK FRC suggestions from its consultation *Business Reporting of Intangibles: Realistic Proposals*

- 27 The consultation was structured as follows:
- (a) Section 2 discussed the implications of the Conceptual Framework for the reporting of intangibles. It related its conclusions to the economic features of intangibles that are identified in the literature.
 - (b) Section 3 considered possible improvements to the reporting of expenses incurred to develop intangibles that cannot be capitalised in financial statements but are expected to benefit future periods ('future-oriented intangibles').
 - (c) Section 4 discussed how narrative reporting, including the use of metrics, might be used to provide better information for investors on intangibles.
 - (d) Section 5 noted that further consideration is required of the implementation of the suggestions made in the consultation and the role of preparers, investors, and standard setters in that process.

Section 2

- 28 The consultation suggested that capitalisation of an intangible asset at cost is appropriate only where:
- (a) the costs to be incurred on development of an intangible asset can be estimated at the time when a project to develop an intangible is undertaken. The amount capitalised should not exceed these estimated costs in view of the difficulty of establishing the future economic benefits; and
 - (b) the economic benefits to be derived from the intangible can be specified when the costs are first incurred, and hence a relevant method of amortisation or monitoring for impairment can be established.
- 29 It was noted that these proposals might more easily be met for purchased intangibles than for those that are internally generated. A consequence would be that similar intangibles would be reported differently depending on how they were

acquired, detracting from comparability. It suggested that there was no clear solution to this issue.

- 30 The consultations concluded that “for many intangibles, the measurement uncertainty of fair value is so great as to call into question whether it could provide a representationally faithful depiction”. In reaching this conclusion, the consultation considered the three valuation techniques suggested by IFRS 13 *Fair Value Measurement* (market approach, cost approach, income approach).

Section 3

- 31 The consultation noted that, resulting from the conclusions in Section 2 many intangibles will not be recognised in financial statements as they fail to meet the definition of an asset or the recognition criteria. Examples include staff training, and brand-building through advertising. As no asset is recognised as a result of expenditure on such activities, it will be reported as an expense, even though it is undertaken with a view to enhancing the financial returns in subsequent accounting periods. As a result:

- (a) reported net income is reduced in the period in which the expenditure is made; and
- (b) the higher financial returns achieved in subsequent accounting periods appear unusually large, as the costs incurred to achieve those returns have already been written off.

- 32 The consultation therefore suggested separate disclosure (perhaps as a separate line item) for expenditure on ‘future-oriented intangibles’, that is expenditure which is incurred with a view to benefitting future periods, but is written off as a matter of accounting policy because it does not result in an item that meets the definition of an asset or fulfil the recognition criteria. It acknowledged that determining which expenditure is ‘future-oriented’ will inevitably be subjective and judgemental.
- 33 The consultation also suggested disclosure (perhaps in a note to the financial statements) of the cumulative amount of expenditure on future-oriented intangibles that was still expected to benefit future periods.

Section 4

- 34 The consultation used the term ‘narrative reporting’ to include reports with titles such as ‘Management Commentary’ or ‘Strategic Report’, and also those reports, such as Preliminary Earnings Announcements, that are primarily aimed at investors.
- 35 As it would not be practicable to suggest that all intangibles are addressed in narrative reporting, management should select those intangibles that are most important for the value-added activities of the business (that is, those that play a key role in the business model). Management should discuss the reasons for their selection.
- 36 The consultation suggested that the usefulness and credibility of narrative information may be enhanced by the inclusion of metrics, i.e. numerical measures that are relevant to an assessment of the entity’s intangibles.

Section 5

- 37 The Discussion Paper closed by noting that there were opportunities for all involved in financial reporting to contribute to implementation of its proposals. In particular, it notes that endorsement by accounting standard-setters might enhance the status of non-mandatory guidance that seeks to set out best practice.