BMW
GROUP

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

Dear Mr. Gauzès,

We would like to thank EFRAG for publishing the Discussion Paper "Better Information on Intangibles – Which is the best way to go?" in August 2021 and giving us the opportunity to comment.

Please find attached is the response of BMW Group to the nine questions raised in the Discussion Paper in the appendix below.

If you would like to discuss our comments further, please do not hesitate to contact us.

BMW Group

Jonathan Townend
Group Reporting, Taxes
Senior Vice President

APPENDIX

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?

Answer:

We generally agree with the issues raised in the DP. However, we want to point out that it does not necessarily lie in the responsibility of financial statements to better reduce any gaps between market and book values of entities, because only this would substantially mitigate the mentioned problem that the asset side of the balance sheet does not depict all important value drivers/return generating assets of a company. A substantial increase of recognition of internally generated intangibles raises the question of how to properly measure those assets. The answer to this question is important, because it picks up the other mentioned issue of lacking comparability between companies. For financial statements to depict the substantial value drivers of an entity, a fair value accounting of the intangibles would suit best, however, fair value estimation of intangibles is very often highly problematic and could, in the end, result in worse comparability of financial statements between different entities. Furthermore, items shown on the balance sheet should not lose even further their connection to direct cashflows. Such an accounting leads to even greater management judgement, potentially more subjective influence and therefore embodies the inherent risk of overevaluation (management might have an interest in high fair value calculations in order to increase its remuneration given the direct link in most remuneration systems to the annual reported profit). Therefore, we are not of the opinion that proposing fair value accounting of (almost) all intangible value drivers of a company should be the result of EFRAG´s work.

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)?

Answer:

a) *A combination of different approaches would in our opinion only be appropriate, if amending the existing recognition and measurement requirements for intangibles would be supported. Such an amendment leading to an increase in recognized intangibles in the balance sheet could then be supported by additional information related to specific assets. However, we are not of the opinion that recognizing substantially more intangibles would lead to more useful information provided by financial statements (see under b)).*

b) *It might be argued that the additional, cumulative requirements in IAS 38 to recognize expenses during development phase should be updated in order to keep up with technological progress. The purpose of IFRS – providing useful information – however, is not served by amending IAS 38 in the way that it will result in a significant increase in recognized intangibles. The asset side of a balance sheet should enable the primary users of financial statements to assess possible future cash inflows to the entity. Intangibles, however, will regularly not fulfill the criterion of probable future economic benefits as project success often underlies high uncertainty. And given the speed of technological progress a differentiation between asset and maintenance of that asset as well as a reliable estimation of useful life are becoming increasingly difficult. In conjunction with limited reliability of their measurement, non-recognition of the intangibles is regularly more appropriate.*

   We are not of the opinion that providing disclosures regarding specific, single intangibles results in more useful information being provided. On the contrary, information on future-

oriented expenses under a holistic approach might be an appropriate method to better support users of financial statements in assessing the inflows of future economic benefits to the entity and management´s stewardship. However, in our opinion, reporting standards that focus on a conclusive and coherent corporate reporting which includes the interconnectivity of financial and nonfinancial information would suit the information needs of users best and allow the users of the statements to make their own conclusions. EFRAG should also consider the development of European Sustainability Reporting Standards in conjunction with any improvements in reporting of intangibles. In addition, such an integrated approach would mitigate the problem of repeating the same information both in the IFRS financial statements and the management report. Explanations of risks and chances (including intangibles) are already part of management reporting requirements. Setting additional requirements for communicating the risks and chances connected to the company´s intangibles are, thus, not necessary. An approach that interconnects financial and nonfinancial information would also eliminate the need to communicate separate, additional information about future-oriented expenses, because users would be able to better evaluate the company´s future performance and value generating resources via an integrated and interconnected financial and nonfinancial reporting.

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) Recognize (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) 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).

Answer:

In our opinion, weakening the general recognition requirements (reliable measurement and probable economic benefits) should not be done as this would decrease both fundamental qualitative characteristics – faithful representation and relevance – in the reporting of information on intangibles. It could be appropriate to update the additional cumulative recognition criteria in IAS 38. High emphasis for recognition should be put on the probability criterion, as this criterion is highly judgmental, but also of high importance for communicating useful information via recognition of intangibles in the balance sheet.

1. *In our view, the explicit recognition exceptions in IAS 38 should not be removed, because the separation of these kind of intangibles from internally generated goodwill is highly judgmental and regularly not possible.*

2. *A threshold approach would result in too many intangibles not being recognized and is an approach that is generally not known from other standards. When specific recognition criteria are met at a specific point in time, e.g. probability criterion, the corresponding expenses should be recognized in the balance sheet.*

   Therefore, we support keeping a conditional approach as under current IAS 38. This approach should be based on different criteria, especially with a focus on the probability/certainty of future economic benefits, because this criterion is in line with the general recognition requirements of an asset and is the most important one in order to interpret the asset side of the balance sheet as an aggregation/overview of an entity´s resources that are capable of generating future economic benefits flowing to the entity. Before the conditions are met, any costs should be expensed in P&L. The recognition of all costs in conjunction with immediate impairment and a reversal of an impairment after the recognition criteria are met, would result in high risks of facilitating profit volatility (and probably confuse the average user of financial statements). Furthermore, an approach that expenses costs in OCI instead of P&L does not completely resolve the problem of volatility in earnings. On the one hand, the research phase underlies high uncertainty with respect to the technical and economical feasibility of the project, bearing the risk of recycling costs incurred in this phase in P&L. On the other hand, capitalizing costs incurred during research phase increases impairment risks during subsequent measurement, as intangible assets generally bear higher uncertainty of generating future economic benefits. Such an approach also lacks understandability, as impairments generally have a negative connotation and are accordingly interpreted as a *correction of wrong investment decisions. Under this approach, however, impairments are made for other purposes.*

3. *See answers above; focus should be put on probability of expected benefits flowing to the entity.*

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')?

Answer:

We clearly recommend the cost model as only this measurement approach can guarantee a faithful representation of intangibles in the balance sheet. Moreover, only initial and subsequent measurement at cost is justifiable under a cost/benefit analysis. Fair value measurement, on the contrary, might often lead to a spurious accuracy, because measurement of intangibles generally underlies a relative high level of uncertainty and subjectivity (management judgement) which ultimately reduce comparability between companies.

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?

Answer:

1. *Yes, in order to mitigate an information overload, only intangibles that are key to an entity´s business should be subject to the disclosure requirements. However, we do not support this approach in general (see answer to question 2).*

2. *Yes, in our opinion, disclosure of fair values of intangibles has a high risk of being less reliable and thus, does not in general result in a faithful representation. In addition, fair value accounting results in substantially increased complexity and costs for preparers of financial statements and challenges for the auditor.*

3. *Providing information with respect to key intangibles might have a positive impact on the capability of assessing stewardship. As the information requirements do not include fair value disclosure, they are not as subjective as other approaches presented in the DP. However, we are not of the opinion that separate information regarding individual assets will lead to a substantial improvement of disclosure quality and meet the needs of primary users. Please refer to our answer to question 2.*

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?

Answer:

1. *Information about future-oriented expenses could be seen as useful for the primary users of financial statements as they could be integrated in the users´ decision making processes.*

   a. *Information about future oriented expenses should potentially be presented instead of information about single intangibles. We do not think that it serves the primary users´ information needs to communicate detailed information about single material intangibles instead of providing information on intangibles via a more holistic approach. The latter one is more suitable for giving the primary users more insights into the entity´s future capability of generating cash inflows.*
   b. *Supporting users in making their own assessments would decrease subjectivity of the information reported and, therefore, increase comparability of information between different entities. However, having the obligation to provide a large set of different qualitative and/or quantitative information will most likely lead to an information overload and does not seem appropriate under a cost/benefit perspective. Thus, we have the opinion that it should lie in the responsibility of the entity´s management to decide which information about future oriented expenses should be provided in order to better understand future performance of the entity.*

2. *Basically, we agree with the advantages/disadvantages identified in chapter 5. High subjectivity of the information, especially the substantial judgment required to determine, which expenses are capable of affecting future economic performance of the entity, should be considered, if EFRAG decides to progress with this proposed approach. This approach also bears the risk that current period earnings of the entity might be presented in a too favourable way. It is also encompassed by very high complexity, leading to high costs for preparers. In the light of these substantial disadvantages, we prefer an approach set out in our answer to question 2.*

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?

Answer:

Information on risks/opportunities associated with the business of an entity are already an integral part of management reporting in many jurisdictions. We are also not of the opinion that separate descriptions on risk/opportunity factors regarding intangibles are useful for primary users. Risks and opportunities arising from intangibles should be presented in conjunction with the business model and should not be highlighted by separating this information from the presentation of other risks/opportunities that the entity faces and by obliging the entity to provide specific information with respect to intangibles. Please also refer to our answer to question 2, where we prefer an interconnection between financial and nonfinancial information in the management report. This would avoid doubling the same information about intangibles and their accompanying risks and chances.

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?

Answer:

1. *No, because this is not necessary under approach 3 (future oriented expenses).*

2. *Yes, we agree.*

3. *Standard setting should take into account aspects of information overload, the auditability of the requirements and introduce new reporting requirements if, and only if, those requirements clearly satisfy information needs of primary users. It should also consider increased financial reporting costs and complexity.*

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?

Answer:

Information on specific intangibles should – according to the proposal set out in chapter 4 – be provided with respect to the key intangibles. Thus, they must be explained in conjunction with the business model of the entity. Pursuant to chapter 5, explanations about future oriented expenses follow a holistic approach, under which prospective information should be communicated. Because disclosures about the business model as well as prospective disclosures abstracting from individual assets are placed in the management report, the proposed information should be placed in the management report.