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EFRAG's research on Better Information on Intangibles Cover Note

Objective of the session

- 1 The objective of this session is to provide an update on the EFRAG research project to EFRAG TEG including the input received from the EFRAG Advisory Panel on Intangibles and discuss the structure and content of our forthcoming Discussion Paper.

Background

- 2 The objectives of the EFRAG research project on intangibles are to:
 - (a) explain how entities, report on creating, maintaining and/or improving their value;
 - (b) explain how users, consume information on creating, maintaining and/or improving value, and the extent to which current financial reporting addresses their needs; and
 - (c) provide suggestions on how information on creating, maintaining and/or improving value can be provided in financial reports in a manner that is useful for decisions on providing resources to the entity.
- 3 In considering how an entity creates, maintains and improve its value, the project will focus on information on the entity's key intangibles. 'Intangibles' is to be consider broader than 'intangible assets' as it, for example, will include resources that are not controlled by the entity.

Previous discussions

- 4 In April 2019, EFRAG TEG and User Panel members agreed that the Project should not attempt to fill the gap between the company's equity book value and its market capitalisation.
- 5 At its September 2019 meeting, EFRAG TEG further clarified that the research:
 - (a) should focus on financial reporting and consider the financial aspects of value creation and the needs for the primary users of financial statements and management commentary, opposed to the creation of value to other stakeholders such as employees, environment and community/society (broader corporate reporting);

- (b) should consider recognition and measurement of assets in financial statements, narrative information in the notes to the financial statements and in the management commentary, reporting measures of value, including drivers of value creation and risk (e.g. customer attrition rates), disaggregation of expenses, or other performance measures;
 - (c) should aim to identify 'solutions' and good practices that would improve reporting on intangibles and better enable users to do their own assessments of intangibles; and
 - (d) should start by focusing on specific industries, rather than specific types of intangibles, covering more "intangible-intensive" industries, develop solutions and then consider if identified principles can be applied more broadly.
- 6 At its March 2020 joint meeting, EFRAG TEG and User Panel members discussed how to foster and optimise engagement with relevant stakeholders. Some EFRAG User Panel and EFRAG TEG members reiterated their view that the project was right in looking holistically at better information on how entities report on creating, maintaining and/or improving value rather than focusing only on the debate about capitalisation of expenses. They recommended providing more information in the financial report or management commentary as for example KPIs.
- 7 At its April 2020 meeting, EFRAG TEG received an update from the first meeting of the Advisory Panel on Intangibles discussed the tentative contents of a first discussion paper on problem definition ([Content of the first discussion paper: Identification of issues](#)), together with an updated scope of the project. EFRAG TEG members reiterated support for the project's objective to improve reporting on intangibles by looking at how to provide useful information to users about creation, maintenance and enhancement of value. Members noted the importance of the project for users and its interactions with other initiatives such as the revision of the Management Commentary Practice Statement.

Advisory Panel on Intangibles (API)

- 8 Since April 2020 four meetings of the API meetings were held. Several initiatives, including the following, were implemented in those meetings in line with the aims indicated above:
- (a) Share User/Preparer examples of (good) reporting practice and how information is being reported/consumed. Each Industry represented in the API (Pharma, Fast-moving Consumer Goods and IT/Media) was discussed based on members presentations (both users and preparers).
 - (b) Discuss whether and how current accounting framework could be improved.
 - (c) Discuss approaches on intangibles developed by other organisations
 - (d) Gathering API members views on questions included in the DP/2020/1 Business Combinations-Disclosures, Goodwill and Impairment.
- 9 The feedback received from the API is included in Agenda paper 03-02.

Published document (reminder)

- 10 In February 2020 EFRAG published a commissioned literature review ([the literature review](#)) on intangibles. The literature review provided further evidence that only a limited number of studies have addressed how investors, analysts, and other users consume the information about, particularly unrecognised, intangibles, and the information needs of the users in that regard. Some research papers have quantitatively looked at the way and frequency of information on intangibles

mentioned in analysts' reports. However, only few have reached out directly to users to learn about their needs.

Project deliverables and timeline

- 11 When EFRAG TEG discussed the project in April, members generally supported having two separate deliverables (on problems and on solutions) as it will give more visibility to the project and provide insight to respond to the forthcoming MCPS consultation. A few members expressed concerns of not having a proper public consultation on the first Discussion Paper. They suggested that flexibility should be considered to find ways to elicit feedback and comments on the first paper, while not having the burden (and delays) of a fully-fledged public consultation.
- 12 Since April the research activities have been focused in discussing the technical issues with the API in several collective discussions and individual interviews/surveys and in getting their inputs, in particular with reference to practical approaches that are put in place in their relevant experiences and to recent proposals exposed for comments by national standard setters.
- 13 In consideration of other competing projects that have absorbed and will continue to absorb resources and of the input obtained to date, EFRAG Secretariat considers that it would be more appropriate to include in a single discussion paper both a review of perceived issues with the information on intangibles in financial reports and an assessment of possible solutions. This paper will incorporate the feedback of the API on the identified solutions. Publication is expected to occur over the first half of 2021. Stakeholders would provide their input on the proposed possible solutions in the consultation to this DP.
- 14 EFRAG's research also provides an opportunity to gather input and insight that could be useful in responding to; and influencing future decisions on:
 - (a) the forthcoming consultation on the revision of the Management Commentary Practice Statement (now expected by May 2021);
 - (b) the IASB 2021 Agenda Consultation expected in March 2021 (in particular regarding the need for an IASB project on intangibles and its possible areas of focus).
- 15 Appendix 1 to this cover note summarises the possible interactions of EFRAG's research with other ongoing initiatives relating to non-financial information.

Questions for EFRAG TEG

- 16 Do EFRAG TEG members have comments or suggestion on the project background, approach or timeline?

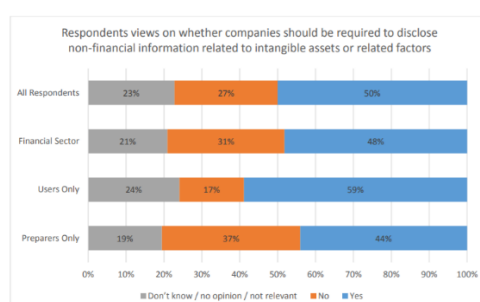
Agenda Papers

- 17 In addition to this cover note, the following agenda paper have been provided for this session
 - (a) Agenda Paper 03-02 – Issues Paper *EFRAG research on Intangibles: Status update and contents of the Discussion Paper*.

Appendix 1 - Interactions with Other projects

Revision of the Non-Financial Reporting Directive

- 18 The public consultation on the review of the Non-Financial Reporting Directive (NFRD) included a question asking whether companies should be required to disclose additional nonfinancial information regarding intangible assets or related factors, such as intellectual property, software, customer retention, and human capital.



- 19 Half of the respondents stated that companies should be required to disclose non-financial information on intangible assets. This view is stronger among users of non-financial information (59%).
- 20 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.
- 21 Moreover, reporting on assets like companies' human capital or customer base may provide information very valuable to understand the companies' sustainability profile. Some preparers consider that these issues are not mature enough to be included in the legislation, and that issuers should disclose non-financial information regarding intangible assets on a voluntary basis.
- 22 As a consequence, it is expected that the proposed revision of the NFRD (to be issued in Q1 2020) will include proposals for such a requirement although the exact terms of the guidance are not known for now.

EFRAG's European Lab activities

- 23 The European Lab has two ongoing projects that will touch upon the matter of intangibles to some degree.

Reporting of non-financial risks and opportunities and linkage to the business model

- 24 The Project Task Force (PTF-RNFRO) aims at identifying and promoting good reporting practices on non-financial risks and opportunities and how that information is linked to the business of the entity, not developing standards. Information about intangible resource (and the risks and opportunities thereto) would be an important part of the analysis. We have agreed that the examples of good practices that the PTF- RNFRO might identify would be discussed by EFRAG's Advisory Panel on Intangibles. The exchange will be beneficial to both projects as Identifying and discussing the principles underpinning the good practices could help consider how reporting requirements could be changed to improve information on intangibles.
- 25 The PTF- RNFRO is expected to complete its work and publish a report in February 2020.

Preparatory work for the elaboration of possible EU non-financial reporting standards

- 26 The Project Task Force (PTF-NFRS) will consider in one of its work streams the inter-connections between financial and non-financial information; discuss the limitations of financial information and possible evolution. Typically , information about intangibles is at the crossing of financial and non-financial information Although the objective of the PTF-NFRS is not to develop guidance but explore whether and how such guidance could be developed, the discussion about the limitations of financial information and possible changes could also feed into our research project .
- 27 The PTF-NFRS is expected to complete its work and submit its recommendations to the EC by the end of January 2021.

Management Commentary Practice Statement

- 28 EFRAG's research on reporting on intangibles provides an opportunity to gather input and insight that will be useful in responding to the forthcoming MCPS consultation (now expected in May 2021) and influencing future decisions.
- 29 It is expected that greater emphasis on information about intangible resources. The IASB has clarified that the MCPS will remain a principle-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 primary users' understanding of the nature and importance of those resources and relationships (and their continued availability) to the future operation of the business.
- 30 To support that principle, the MCPS is expected to provide high-level guidance and identify 'commonly held' resources and relationships 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.
- 31 EFRAG Research could help assessing whether the high-level guidance suggested in the forthcoming MCPS would be likely to help meet the information needs of users (for instance whether the identified 'commonly held resources and intangibles are appropriate, whether the guidance strikes a right balance between historic and forward-looking information, between quantitative and qualitative information).The proposed guidance, when available, will be discussed with the Intangible Advisory Panel at a future meeting.

Overview of the Timeline of the different initiatives

