EFRAG Research activities – Agenda consultation

Objective of the session

1 Some of the active EFRAG Research projects will be completed during 2018. EFRAG is therefore looking to add new Research projects to its agenda.

2 The objective of this session is to approve the Agenda consultation for publication. The Agenda consultation will be used to obtain feedback from constituents on the new projects that EFRAG should undertake.

Introduction

3 EFRAG undertakes proactive activities with four strategic aims:

(a) Engage with European constituents to ensure we understand their issues and how financial reporting affects them;

(b) Influence the development of global financial reporting standards;

(c) Provide thought leadership in developing the principles and practices that underpin financial reporting; and

(d) Promote solutions that improve the quality of information, are practical, and enhance transparency and accountability.

4 EFRAG conducted its prior Agenda consultation in 2015 at the same time of the IASB Agenda consultation. The current status of the projects that EFRAG undertook following the 2015 Agenda consultation and additional projects at request of the European Commission, is described in Appendix 1. Many of these projects have or will be reaching its final stage in 2018. EFRAG is therefore looking to add new Research projects to its agenda.

5 EFRAG agenda is necessarily dependent on, and wherever possible coordinated with, the IASB Research activities.

6 This Agenda consultation seeks views on ways to assess and improve the effectiveness of EFRAG's Research activities and new Research topics. We welcome views on any of the points addressed in the paper. Specific questions are given in the section 'Questions to constituents'.

7 Comments should be sent to commentletters@efrag.org by 1 June 2018. It will also be possible to submit input via an on-line questionnaire on EFRAG website. All replies received will be placed on public record, unless confidentiality is requested.

General questions

Assessing influence of EFRAG Research activities

8 One strategic aim of EFRAG in performing its Research activities is to influence the development of IFRS Standards. This encompasses both ensuring that the IASB gives priority to topics that are relevant to European constituents, and that it develops its projects considering the preferred (or at least acceptable) solutions for European constituents.

9 However, both EFRAG Research projects and the IASB standard-setting activities require time to be completed, and in some cases the amount of time is quite significant. Over time, the scope of projects may change and adapt. Therefore, a direct link is not always evident.

10 As an example, in 2009 EFRAG in partnership with the French and UK Standard Setters (ANC and FRC respectively) started a project on a Framework for Disclosure in the notes to the IFRS financial statements. The partners published a Discussion Paper (DP) in 2012, and in 2014 the IASB started its Disclosure Initiative. In 2017 the IASB published its discussion paper *Principles of Disclosures*, which addresses most of the topics in the EFRAG/ANC/FRC DP and follows some of its suggestions in its own proposals. However, the IASB has also drawn on input received from other parties in developing its discussion paper.

11 EFRAG is aware that some constituents claim to be unable to assess how successful EFRAG Research activities are in influencing the IASB. This point was raised in the course of the Fleishman Hillard report *Perception Audit of EFRAG*. More information on this can be found on page 12 of the report published on the EFRAG website (*add link)*.

Question to constituents

12 Do you have suggestions on how to substantiate the influence of EFRAG Research activities in general, and individual projects in particular, on the IASB's work?

Using evidence in EFRAG Research activities

13 There has been a consistent call for accounting research to be more evidence-based. EFRAG has been trying to accommodate this request both in developing its endorsement advice to the European Commission, in particular in its impact analyses, and its Research activities.

14 An example of quantitative analysis used in EFRAG's endorsement advice has been the study from an independent economic consultancy and its quantitative assessment of accounting impacts of *IFRS 16 Leases*.

15 An example of quantitative analysis used in EFRAG's Research activities include the quantitative study *What do we really know about goodwill and impairment?* published in 2016 and the report to the European Commission on the findings of the first phase (the assessment phase) of its investigation into the significance of investments in equity instruments and the possible effects on long-term investments of the new requirements in IFRS 9 *Financial Instruments*.

16 The sources of quantitative data in these EFRAG publications are aggregated selected data extracted from IFRS financial statements of preparers and public consultations. Both of these sources have some inherent limitations in assessing possible impacts of changes in accounting requirements – financial statements report information that relates to past periods (so they do not reflect the conditions at a future date) and constituents' participation in EFRAG consultations occurs on a voluntary basis and are often qualitative in nature.

17 Evidence of the impact of accounting requirements in academic studies is usually investigated by using statistical regression analysis between stock prices and specific line items. However, this approach may not be applied to proposed future changes, but only to IFRS Standards that have been effective for years; and even for these, isolating their effect from other factors (tax, prudential regulations, macroeconomic developments) is difficult and may be imprecise.

Question to constituents

18 What is your assessment on the use of evidence by EFRAG in its recent Research? Do you have suggestions on how to improve it?

List of potential topics for EFRAG Research

19 When identifying the topics, a number of factors have been considered:

(a) Where the topic currently sits on the IASB work plan;

(b) EFRAG publications in recent years;

(c) How the EFRAG Research could be used to influence the IASB work;

(d) Activities by and potential cooperation with other Standard Setters; and

(e) How evidence could be collected.

20 EFRAG has tentatively identified five possible new Agenda topics:

(a) Better information on intangible assets;

(b) Cryptocurrencies;

(c) Derecognition;

(d) Transaction-related costs; and

(e) Variable and contingent payments.

21 For each of the topics, this paper presents a brief description of the issues and objectives of undertaking a project. EFRAG considers that for each project ultimately selected, there should be an assessment of the specific information needs for users as well as some type of quantitative assessment.

22 EFRAG acknowledges that financial reporting issues are part of a more general debate of communication to the markets and other stakeholders, and there is an interplay with various external factors and discussions. This Agenda consultation is however written in consideration of EFRAG's current remit which extends to financial reporting and the content of financial statements.

23 Wider corporate reporting, including non-financial reporting, has drawn significant interest in Europe. There are multiple initiatives that address this topic. The EC published on 8 March its Action Plan on *Financing Sustainable Growth* and EFRAG is called upon in certain areas, including the establishment of a European Financial Reporting Lab. EFRAG is ready to support and contribute to the implementation of the EC's Action Plan in areas within its competence. However, any future activities arising of EFRAG relating to the EC's Action Plan, or to wider corporate reporting issues more generally, are outside the scope of this agenda consultation.

24 EFRAG is currently conducting a project on recycling and impairment for equity instruments designated at Fair Value through Other Comprehensive Income (see Appendix 1). In the EC Action Plan it is indicated, amongst other things, that the EC will ask EFRAG to explore potential alternative accounting treatments to fair value measurement for long-term investment portfolios of equity and equity-type instruments. EFRAG would add a specific project framed on the basis of the EC request.

Better information on intangible assets

What is the issue?

25 There has been a lot of debate lately about how financial reporting does not provide a full picture of the value drivers of businesses. Internally-generated intangibles such as know-how, market share, assembled workforce, research and so on play an ever-increasing role in the performance of entities, but are not recognised in the IFRS financial statements.

26 However, there are a number of challenges around recognition and measurement of these intangibles. Assessment of control is judgemental, especially at an early development stage, and future benefits are highly variable. Historical cost may have little relevance and current value would be mostly based on unobservable inputs, since there is little or no active market for intangibles (most intangibles) and they may be not tradeable separately.

27 EFRAG could start a Research project to develop alternatives to provide more relevant information on intangibles. The EFRAG Secretariat considers that a preliminary analysis of the gap between market valuations and accounting equity would provide good insights for the project – for instance, by providing evidence of whether this gap is more commonly found in specific industries. However, both EFRAG TEG and the EFRAG Board have already indicated that the project should not aim at proposing accounting requirements with the view to align the carrying amount of equity to market prices.

Objective of a Research project

28 The project could address a number of aspects in relation to internally-generated intangibles. First, it could consider and describe the different categories (marketing, technological, social and reputational) and how their different features are relevant in terms of financial reporting. .

29 A second aspect could be to investigate how to take into consideration uncertainties in relation to these elements, especially when they cannot be protected legally or they can be duplicated by competitors. Uncertainties can exist both in relation to the entity's ability to access future benefits, and their amount/timing.

30 A third aspect could be about developing metrics to express earnings potential and value. These metrics may not be fit as a measurement basis, but could be used to disclose information in the notes to the financial statements. .

31 A number of initiatives (Integrated Reporting, the World Intellectual Capital/Asset initiative….) have already taken steps to improve the reporting in this area. An important part of the Research project would be to investigate and leverage from these other initiatives for financial reporting.

Cryptocurrencies

What is the issue?

32 A cryptocurrency is a virtual or digital currency and refers to a form of exchange that does not exist in physical form. It is not linked to any physical currency, does not have a central repository nor is it typically backed by any government or central bankIt is generally held for capital appreciation or in limited cases (and in some jurisdictions) as a means for exchange.

33 The accounting treatment of cryptocurrencies under IFRS Standards is unclear. They may not qualify as financial assets, as they neither represent a right to receive cash or other financial instruments, nor a contract to exchange assets. They may qualify as intangible assets, but they are not legally protected and have no useful life. It is also debatable that the measurement requirements in IAS 38 would provide relevant information – and the impairment issue would need to be addressed.

34 Cryptocurrencies make it easier to transfer funds between two parties in a transaction and are typically based on the blockchain technology. They are initially 'mined' but could subsequently be bought, exchanged, awarded, or granted. Mining cryptocurrencies is a specialised activity and the accounting for such activities warrant further research. There are a number of potential options to account for them and diversity has already emerged in practice under different GAAP's and potentially under IFRS.

35 Cryptocurrencies including initial coin offerings (ICO's) are undergoing rapid growth and developments, although they are also subject to extreme price volatility. ICO's are gaining increasing attention from investors, businesses and regulators, and are popular because of the ease with which they can be used to obtain public funding with less complexity and greater speed than traditional methods.

36 In December 2017, the Accounting Standards Board of Japan issued for public comment an exposure draft on the accounting for virtual currencies under local Japanese GAAP. A final Standard is expected to be issued in the first half of 2018. The Canadian Securities Exchange (CSE) announced in February 2018 the launch of a securities clearing and settlement platform based on the Ethereum Blockchain that allows companies to raise capital with security tokens. Some established exchanges have launched bitcoin futures.

37 Some European countries have discussed initiatives to facilitate the blockchain technology. However, there is also a view that global cryptocurrency regulation is necessary. Some claim that cryptocurrencies appear as a threat to the long-term financial stability. This topic is scheduled to be discussed at the forthcoming G20 meeting.

Objective of a Research project

38 The objective of the project would be to assess whether the current IFRS Standards could be used to account for cryptocurrencies or whether a new accounting model should be developed to cater for the specific characteristics of this type of virtual currency.

39 Another aspect could be to assess whether the measurement basis should be the same for all cryptocurrencies held or whether different bases may be justified based on the business model or purpose and based whether an active market exists,

40 A third aspect could be to investigate the accounting implications, including disclosure, of specific activities linked to cryptocurrencies such as held by an entity on its own behalf versus on behalf of others cryptocurrency mining and Initial Coin Offerings.

Derecognition

What is the issue?

41 The Conceptual Framework includes a lengthy discussion on the recognition criteria for assets and liabilities. Many IFRS Standards, such as IFRS 15 *Revenues from Contracts with Customers* and IFRS 16 *Leases* have added guidance to assess the conditions to recognise an item.

42 Less attention has been given on derecognition. Only IFRS 9 *Financial Instruments* includes detailed guidance to assess when an entity can achieve derecognition of financial assets (and to less extent, financial liabilities).

43 Derecognition brings along significant financial impacts. In many cases, it triggers recognition of gains, and less frequently losses. Certain items can or must be recycled out of Other Comprehensive Income (OCI) through profit or loss and others may be transferred within equity.

44 It may be argued that there is no need for specific guidance because recognition criteria can be used in a mirroring approach. However, this may not be the case in some IFRS Standards. In IFRS 16, the IASB maintained the distinction between finance and operating leases in lessor accounting: operating leases result in the lessee recognising a right to use, but the lessor does not derecognise any portion of the underlying asset.

45 In IFRS 9, transfer of substantially all risks and rewards results in derecognition of financial assets, while control acts as a fallback test. This is different from the approach in IFRS 15, where control is the condition to assess performance completion and transfer of risks and rewards is used as an indicator.

46 There are a number of different aspects around derecognition. The first aspect would be to discuss if and under what circumstances recognition and derecognition may or should not be fully symmetrical.

47 The second could be to how to distinguish between termination and modification of a transaction. Modification is generally treated differently, but in certain cases issues were raised about the distinction.

48 A third aspect concerns features such as put and call options, repurchase agreements or guarantees, and how they should impact derecognition of an asset/liability or of a gain/loss.

49 A fourth aspect concerns the use of a full or partial derecognition approach for transactions like a sale-and-leaseback or a partial settlement. The use of either method may be more appropriate based no specific characteristics and has an impact on the amounts recognised in profit or loss.

Objective of a Research project

50 The project would start with a comparative analysis of how derecognition is assessed in different IFRS Standards and what are the accounting implications. It could then examine the aspects mentioned in paragraphs 46 to 49, and other relevant aspects, and develop a common definition and conceptual approach for derecognition. This would be relevant also to assess when a gain/loss is considered to be ‘realised’.

51 The project could also consider the accounting for business combinations realised in stages, which in substance requires derecognition and remeasurement of previously held interests when control is lost or gained.

52 The project would not necessarily lead to recommending changes in existing IFRS Standards but it would be useful to assess the degree of coherence across Standards and whether different treatments are justified.

Transaction-related costs

What is the issue?

53 When an entity acquires an asset, a business, a contract, a liability or an equity instrument it generally incurs costs associated with the acquisition. IFRS Standards use different terms to refer to these costs, such as directly attributable costs, acquisition-related costs, incremental costs and transaction costs. This paper refers to this type of costs as acquisition-related costs. Depending on the applicable IFRS Standard, acquisition-related will either be capitalised (generally added to or deducted from the amount initially recognised as an asset or a liability), expensed or recognised in equity.

54 From a conceptual perspective, it is not always clear why IFRS Standards require different accounting for acquisition-related costs. A second issue is which costs qualify for capitalisation when an IFRS Standard requires capitalisation. As already mentioned above, a third issue is one of terminology, as IFRS Standards use different terms to describe similar type of costs. Examples of IFRS Standards that refer to acquisition-related costs and similar costs include:

(a) IAS 16 *Property, Plant and Equipment* (PPE) require that **directly attributable costs** required to bring the asset to its location and condition necessary for its intended use, are capitalised as part of the cost of an item of PPE. Although IAS 16 provides examples of directly attributable costs, in practice questions still arise about which costs qualify for capitalisation.

(b) IFRS 3 *Business Combinations* requires an entity to account for **acquisition-related costs** as expenses in the periods in which the costs are incurred and the services are received. Acquisition-related costs are not considered to be part of the exchange transaction between the acquirer and the acquiree (or its former owners).

(c) IFRS 9 *Financial Instruments* requires **transaction costs** to be included in the initial measurement of financial assets and liabilities unless they are carried at fair value through profit or loss, in which case the transaction costs are expensed immediately. Transaction costs include only those costs that are directly attributable to the acquisition or origination of a financial asset or issue of a financial liability.

(d) IAS 32 *Financial Instruments: Presentation* requires that **incremental costs** which are directly attributable to equity transactions (such as issuing new shares or buying back own shares) are recognised in equity. Costs which are not considered as 'incremental' should be expensed as they are incurred.

(e) IFRS 15 *Revenue from Contracts with Customers* requires an entity to recognise as an asset the **incremental costs** of obtaining a contract with a customer if the entity expects to recover those costs. Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained are recognised as an expense.

(f) IFRS 16 *Leases* requires any **initial direct costs** incurred by a lessee to be included in the initial measurement of the right-of use asset. For a lessor, initial direct costs, other than those incurred by manufacturer or dealer lessors, are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term.

(g) IFRS 17 Insurance contracts also provides guidance on **directly attributable acquisition costs** and allows an insurer to immediately expense such costs in certain cases (when the coverage period is less than one year) and requires capitalisation in other cases.

55 There are a number of different aspects about acquisition-related costs. One aspect is that the accounting for such costs is a key difference[1] between the accounting for asset acquisitions and business combinations for which there is no clear conceptual basis.

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[1] The main differences are the treatment of acquisition-related costs, contingent consideration and deferred taxation.

56 Another aspect is that some argue that there is a tension between recognising share issuance costs in equity and including them in the initial measurement of a financial asset and financial liability that is measured at amortised cost. Furthermore, it is not always clear which costs quality for recognition in equity and which ones should be included in the measurement of a financial asset or financial liability.

57 Acquisition-related costs may also be relevant in selecting a measurement basis. A number of Standards, including IFRS 5 *Non-current Assets held for Sale and Discontinued Operations* or IAS 36 *Impairment of Assets* refer to the fair value less costs of disposal. There is little or no guidance on costs of disposal, and whether these should be measured consistently with acquisition-related costs.

Objective of a Research project

58 A Research project would start with an analysis of how transaction-related costs are treated in different IFRS Standards and which costs are considered 'qualifying costs'.

59 The project would examine whether acquisition-related costs should be accounted for similarly, and if so, seek to develop a common principle to account for acquisition-related costs under IFRS. This would enhance consistency in IFRS reporting and help to reduce (or justify) the tensions in existing IFRS Standards caused by the different accounting treatments, such as making the distinction between an asset acquisition and a business combination and accounting for share issuance costs versus costs to issue a financial liability or acquire a financial asset.

60 The project would seek to develop a common definition for all types of acquisition-related costs and a common principle to help determine which costs quality for capitalisation or recognition in equity. A common practice issue is deciding whether internal costs quality for this treatment. The project could also address this issue.

Variable and contingent payments

What is the issue?

61 The issue of variable and contingent payments has been raised in different IFRS Standards recently. Both IFRS 15 and IFRS 16 include guidance on recognition and measurement. However, the guidance is not fully consistent.

62 The IFRS Interpretations Committee (IFRS IC) had a long-standing project on variable payments for tangible and intangible assets, with the objective being to address initial recognition and subsequent measurement. The project was put on hold pending completion of IFRS 16, which was expected to provide relevant guidance; however, the IFRS IC eventually did not agree to extend similar requirements to tangible and intangible assets and dropped the project.

63 There are a number of different aspects about variable and contingent payments (V&CP). The first is the moment of initial recognition. This could occur when the underlying transaction is initially recognised; when their likelihood exceeds a defined recognition threshold; or when they become due under the terms of the underlying transaction.

64 The second is the measurement basis. If these payments are recognised before they become due, then they need to be measured at an estimated amount. The basis for measurement could be fair value, expected outcome, or a single outcome (such as most likely outcome). If a probability threshold is included in the recognition criteria, the implications for the measurement basis should be assessed.

65 The third aspect is how the re-assessment should be accounted for. When these payments are related to the purchase of assets, the question arises if changes in subsequent measurement should affect the carrying amount of the asset or be charged to profit or loss.

66 A fourth aspect is whether all variable and contingent payments should be accounted for similarly. Payments could vary or be conditional on different factors: performance or output of the asset, changes in market prices and other events. Some of these factors are under the control of the management and others are not.

Objective of a Research project

67 One important aspect would be the scope definition. A fixed selling price per unit results in a total amount variable upon the number of units sold. This would not qualify for the scope of the project, however the distinction may not always be clear.

68 Also, it may be useful to define a scope with reference to only certain classes of transactions. For instance, variable and contingent employee benefits (long-term bonus, post-retirement benefits, share-based payments with vesting conditions) pose specific issues.

69 The objective of the Research would be to:

(a) Identify the accounting issues around V&CP;

(b) Assess to the extent possible the frequency, magnitude and nature of V&CP used in practice;

(c) Summarise and compare the guidance across different IFRS Standards and assess the rationale (or lack thereof) for difference in the requirements;

(d) Develop accounting alternatives and illustrate the relevant strengths and limitations for each alternative; and

(e) Consider improvements in presentation and disclosure.

Questions for constituents

70 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?

71 Are there other topics that you advice 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.

APPENDIX 1 – ACTIVE EFRAG RESEARCH AGENDA

Project title	Goodwill Impairment and Amortisation
Key research question	Subsequent accounting treatment of goodwill
Current status	EFRAG published its Feedback Statement on comments from respondents on the EFRAG Discussion Paper *Goodwill Impairment test: can it be improved?* No additional activity is planned on the topic.

Project title	Equity instruments – Impairment and Recycling
Key research question	Recycling of disposal gains and losses and recognition of impairment losses for equity instruments designated at Fair Value through Other Comprehensive Income under IFRS 9 *Financial Instruments.*
Current status	EFRAG completed the first phase of the project (assessment phase) and in January it published its report to the European Commission on the findings. EFRAG has now started the second phase of the project (possible solutions phase) with a view to finalise its technical advice to the European Commission by mid-2018. In March, EFRAG published a Discussion Paper to gather constituents' views. The comment deadline is 25 May.

Project title	Transactions other than Exchanges of Equal Value
Key research question	Considering a specific accounting approach for transactions with the following characteristics: • non-voluntary transactions whereby the entity does not have the discretion to decide whether to enter into the transaction; or • voluntary transactions where the intended benefits are not primarily to maximise the proprietary benefits to the resource provider. These transactions frequently involve Government entities acting in their capacity. Examples of the transactions are indirect taxes, grants and donations.

Current status	EFRAG expects to complete its deliberations by Q2 2018.

Project title	Pension Plans
Key research question	Accounting treatment for plans with a return-based promise.
Current status	EFRAG expects to publish a Discussion Paper by the end of 2018.

Project title	Discounting with current interest rates
Key research question	Considering whether negative and ultra-low interest rates have accounting implications.
Current status	EFRAG has commissioned academic research on the topic. EFRAG expects to publish the findings in H2 2018.