Better Information on Intangible Assets
Scoping the project: Intangibles vs. Intangible Assets
Identification of Issues
Issues Paper

Objective

1 The objective of this paper is to ask EFRAG TEG members for their initial views on:

(a) the working definition of an intangible that the EFRAG Secretariat should consider as part of its research;

(b) the issues that could be considered by the research under the agreed definition.

Definitions and possible related issues to be considered

2 In the literature, there is a large spectrum of possible definitions of an intangible, ranging from a narrow concept i.e. intangible assets meeting criteria from a specific framework, to a broad notion of intangibles i.e. resources.

3 The issues, and their quantity, that could be considered in the EFRAG Project *Better Information on Intangibles* (the Project) will inevitably depend on whether EFRAG TEG decides to only consider intangible assets or rather to take a broader view of intangibles, and, if the latter, on how EFRAG TEG recommends that the term is defined.

Intangible asset

IAS 38 Intangible Assets

4 If EFRAG TEG prefers a relatively narrow scope, the project could focus, for example, on intangible assets as defined in IAS 38 *Intangible Assets.* IAS 38 defines an intangible asset as follows:

(a) an *asset* is a resource: (i) controlled by an entity as a result of past events; and (ii) from which future economic benefits are expected to flow to the entity.

(b) an *intangible asset* is an identifiable non-monetary asset without physical substance, that shall be recognised if, and only if (i) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and (ii) the cost of the asset can be measured reliably.

5 If such a scope is chosen, the project may focus on the following issues:

(a) Whether the current requirements result in inadequate information, including:

(i) providing insufficient information about intangible assets in notes or management commentary;

(ii) lack of comparability as a result of the inconsistent accounting treatment of internally generated intangible assets and purchased intangible assets;

(iii) costs related to internally generated intangible assets not being matched with the related revenue.

(b) To the extent that the existing requirements result in providing inadequate information, whether/how this could affect:

(i) misallocating the capital in society;

(ii) companies' access to finance;

(iii) innovation and investment disincentives due to the criteria for recognising internally generated intangible assets;

(iv) competition; and

(v) loss of relevance of financial reporting.

(c) Which characteristics of intangible assets pose challenges. In other words, the accounting issues related to intangible assets may arise not only because of an asset being intangible, but also because of other features of that asset, including:

(i) scalability at low marginal cost;

(ii) sunk development costs i.e. the development costs cannot be recovered if the development is not satisfactorily finalised;

(iii) control over the asset when it is difficult to restrict access or protect the use by legal means; and

(iv) the existence of synergies as the value of an intangible asset on its own can be very low.

Has selected an academic team to conduct a literature review. The literature review is expected to provide information on the topic.

(d) How information (both quantitative and qualitative) about unrecognised intangible assets could be provided in the notes or in the management commentary (for different types of intangible assets) and whether guidance should be mandatory or voluntary.

(e) Review of the requirements to recognise internally generated intangible assets i.e. assessing whether, and if so how, more intangible assets should be recognised.

(f) Measurement problems for internally generated intangibles i.e. measuring at cost may be considered not relevant for users and measuring at fair value may be not reliable.

(g) Interpretation issues of the requirements of IAS 38.

Conceptual Framework

6 The project could be made broader by considering the definition of an asset provided in the *Conceptual Framework for Financial Reporting* and, instead of the definition in IAS 38, which requires an asset to be a non-monetary asset without physical substance, and not requiring it to be identifiable.

7 According to the *Conceptual Framework for Financial Reporting*, an asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.

8 If the project scope is extended to consider such assets too, the additional issues to discuss could include whether it's reasonable to consider the definition in the *Conceptual Framework for Financial Reporting* instead IAS 38 when identifying intangible assets. It may also be logical to consider the high-level recognition guidance in the Conceptual Framework when reviewing the recognition requirements in IAS 38 regarding recognition of internally generated intangibles assets (see paragraph 5(e) above).

Other definitions of intangible assets

9 Although the EFRAG Secretariat has not identified any benefits of doing so, EFRAG TEG could also choose another definition of intangible assets for the project. When doing so, EFRAG TEG could consider how intangible assets have been defined by others:

(a) The Accounting Standard Codification 350 (ASC 350) issued by the Financial Accounting Standards Board (FASB) defines an intangible asset as an asset, other than a financial asset, that lacks physical substance.

(b) During the interviews performed by the EFRAG Secretariat, Baruch Lev defined an intangible asset as a non-physical asset under which expected benefits are owned or controlled by the company and for which it is possible to identify and measure the expenditures incurred in its creation and development. He defined control as effectively preventing others from appropriating the benefits of the intangible asset which he understood as enhancements of cash flows or reductions of enterprise costs.

(c) The International Glossary of Business Valuation Terms (IGBVT) defines intangible assets as non-physical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

(d) The Organisation for Economic Co-operation and Development (OECD) defines an intangible asset as a non-physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances.

(e) The International Public Sector Accounting Standard (IPSAS) defines an intangible asset as an identifiable non-monetary asset without physical substance.

Broader consideration of intangibles

10 EFRAG TEG could decide to broaden the scope of the project to include intangibles that do not meet the definition of an asset.

11 The purpose of such an approach could be to develop guidance on how to report on resources that are critical for an entity's profit-generation abilities but would not necessarily satisfy the definition of an asset. This could, for example, include customer loyalty, employees' skills, or business model.

12 Such critical resources would need to have the potential to produce economic benefits. However, they would not necessarily need to be controlled by the entity or have the potential to produce for the entity economic benefits beyond the economic benefits available to all other parties. They would also not need to result from a past event.

13 Intangibles could therefore, for example, be defined as a present economic resource without physical substance. An economic resource could be defined as in the *Conceptual Framework for Financial Reporting* as a right that has a potential to produce economic benefits.

14 Alternatively, an economic resource could be defined as something that has the potential to produce economic benefits.

15 The 'working definition' applied by the FRC in its research *Business Reporting of Intangibles: Realistic Proposals* could also be considered. According to that research, intangibles are factors that are important to an entity in its value creation, whether or not they are secured by legal means and whether or not they meet the current definition of assets.

16 In any case the number of items to be considered would be almost infinite. It would therefore be necessary to focus on some that are most important for an entity (as in the FRC's 'working definition').

17 In principle, all the issues identified in paragraphs 5 and 8 above could also be considered in a project on intangibles. However, as many intangibles would not be assets, it may be less relevant to consider the requirements in IAS 38, and instead the project could focus on how to provide information (other than by recognition and measurement in the financial statements) on intangibles in corporate reporting.

18 In addition to the issues identified in paragraphs 5 and 8 above, other issues could include:

(a) Whether currently there is insufficient publicly available information about intangibles, that are not intangible assets but are critical to the entity's business model and value creation;

(b) How information (both quantitative and qualitative) about intangibles could be provided in the notes, in the management commentary or somewhere else and whether guidance should be mandatory or voluntary.

(c) Identification of (important) intangibles. This would include identification of the source of future benefits. For example, an entity may in the future have the right to use a highway being constructed close to its distribution centre. This right is not controlled by the entity. Are benefits resulting from future lower transportation cost arising from this right, or from the plot of land the entity owns (next to the future highway)?

(d) Whether the calculation of earnings reflects the true costs of the generated revenue.

Question to EFRAG TEG members

19 In the view of EFRAG TEG members, which of the definitions discussed above should be considered by the EFRAG Secretariat in the Project?

20 Do EFRAG TEG members consider that there are additional issues that could be addressed in the Project other than those listed in paragraphs 5, 8 and 18 for the various definitions of intangible assets and intangibles? Should any of the issues in paragraphs 5, 8 and 18 not be considered further?