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Discussions on intangibles in relation to the IASB 2020 Agenda Consultation Update paper for background

Objective

- 1 This paper provides an update on discussions of the IFRS Interpretations Committee (IFRS IC) and the Accounting Standards Advisory Forum (ASAF).

Discussions of the IFRS IC

- 2 On 26 November 2019, the IFRS IC discussed the 2020 IASB Agenda Consultation.
- 3 The 2020 Agenda Consultation will include a Request for Information (RFI) which will be published in September 2020. The RFI will include a description of potential projects for the IASB's future work plan.
- 4 The objective of the 26 November 2019 session was for Committee members to provide input to identify and develop a description of those potential projects.
- 5 One of the potential projects for the IASB's future work plan is intangibles. In advance on the meeting, IFRS IC members had provided the following comments on a project on intangibles:
 - (a) IAS 38 is an old standard which is inconsistent on several subjects such as intellectual property licensing acquired—IAS 38 deals with the right to use a licence, but not the right to receive access to a licence, notably on the cloud. It is also inconsistent with IFRS 15 where this distinction does exist for IP licenses sold. There is a long-standing inconsistency in accounting between the separate acquisition of intangibles (IAS 38) and intangibles acquired in a business combination (IFRS 3). Should cover all intangibles, whether assets or working capital, eg advance payment within a service contract. Should lead to a reduction in recognised (capitalised) intangibles.
 - (b) With the technological changes that are happening in a variety of industries, this Standard is used more and more often. We've referred to it in our discussions on: crypto currency, software scoped out of leases, software in the cloud, etc. In the automotive and transportation industry, emissions trading schemes (that are increasingly coming into effect globally) all seem to end up in IAS 38 and, in nearly all cases that we have personally encountered, IAS 38 is deficient in providing any framework and/or guidance on how to account for these different topics. Affects most entities given the prevalence of technology developments.
 - (c) Would be a large project to rewrite IAS 38. IAS 38 has been overtaken by changing economic and technological environments. As these assets become more complex and diverse, the Standard is increasingly challenged. IAS 38 often functions as a residual standard. Recognition and measurement may

not always reflect the economic characteristics or complexity of contractual arrangements. Need to address scope (eg crypto assets; software as service arrangements; interaction with IFRS 16 lessees). Definition of control may no longer be appropriate eg whether run on own servers or hosted. Variable payments may also make initial cost difficult to establish. Thought needs to be given to subsequent measurement eg is FV through P&L appropriate? A large project.

- (d) Consider how better information about intangible assets could be provided through financial reporting as part of the Board’s work on Better Communications.
- (e) Intangibles are a major factor in driving value creation in the current global economy. Due to the age of IAS 38 there are concerns about adequacy when identifying, recognising and measuring internally generated assets. Important interrelationship with IAS 36. Increased use of digital/ cryptocurrency assets. Intangibles need as stable a platform as tangible assets. Given the rate of change in technology this topic will become increasingly relevant.

6 At the meeting IFRS IC members noted that a fundamental overhaul of the Standard was necessary. However, warnings were also expressed on what the IASB could achieve.

Discussions at ASAF

7 In the agenda papers for the December 2019 ASAF meeting, a potential project on intangibles is described as:

Problem definition, why important and stakeholders affected	Potential solutions
<p>Recognition of, or disclosure for, intangible assets not currently recognized in IAS 38. We think that IAS 38 Intangible Assets needs to be modernized to provide information about unrecognized internally generated intangible assets, such as:</p> <ul style="list-style-type: none"> - Human capital (e.g., workforce culture and employee competencies) that drive towards higher productivity and innovation; - Organizational capital (e.g., innovation, business processes, data, systems and software) that contribute to maintaining competitive advantage; and - Relationship capital (e.g., brand and reputation) with key external stakeholders such as customers and suppliers to ensure future business sustainability. <p>Problem:</p> <p>The current guidance in IAS 38 Intangible Assets does not:</p> <ul style="list-style-type: none"> a) permit the recognition or measurement of certain internally generated intangible assets; or b) require disclosure about an entities unrecognized internally generated intangible assets or value creation activities <p>We think that this topic is important as an entity’s value creation activities are increasingly more intangible in nature. Additionally, we continue to observe a shift in the global economy where intangible assets such as big data, customer relationships, brand, efficient business processes, or the dynamic capability of a workforce, are an important part of how businesses create value. Therefore, we think that information about unrecognized internally generated intangible assets and an entity’s other value creation activities is important to users as it provides insight into a company’s ability to generate future profits and cash flows.</p>	<p>There are several potential solutions that would provide users with decision-relevant information pertaining to an entity’s unrecognized internally generated intangible assets. These include, but are not limited to:</p> <ul style="list-style-type: none"> a) permit the recognition of some or all internally generated intangible assets (including those that would be recognized if they were acquired separately or through a business combination); or b) require enhanced disclosure or disaggregation of information about an entity’s value creation activities.

Furthermore, users in our jurisdiction shared a preference to have more information about those activities that an entity has expensed in a period that would impact future profits and cash flows (e.g. research and development costs, training costs, advertising costs). Overall, several members of our User Advisory Council think that some investors consider these costs as investments in future profits and cash flows.

Intangibles (whether meeting the definition of an asset or not)

Although there are some promising ideas under consideration within the IASB's project on Management Commentary, there remains much more that could be considered to improve the quality of information on the generation and maintenance of source of future value. This is probably best approached by supplementing the existing thinking rather than through radical change.

Some argue that:

- there is insufficient recognition of internally generated intangible assets – are the recognition criteria outdated and too restrictive?
- there is too much separate recognition of intangibles on business combination – are they all capable of reliable measurement in practice?

Relevant research

- FRC Discussion Paper 'Business Reporting of Intangibles: Realistic Proposals' (2019)
 - Other relevant research is currently being carried out by, for example, EFRAG, ICAS and others.
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Under the new economic environment, more and more enterprises show the characteristics of asset-light. Whether and how to recognize assets without physical form such as customer relationships, human resources, internal brands and client lists etc has become a problem to be solved in practice, which also causes the excessive value of goodwill in mergers and acquisitions to some extent.

To revise the standard

Stakeholders affected: Preparers, users and regulators

Review of requirement for intangible assets. The suggesting IASB's User Advisory Committee noted in particular the consideration of more consistent and comparable disclosure of unrecognised intangible assets.

IAS 38 is an old standard with a conservative approach to asset recognition and measurements. Yet intangibles have a growing significance in most businesses. Therefore, users are probably obtaining their information on intangible assets from sources other than IFRS-compliant financial statements. That may be fine; however, it would be useful to research where users are getting that information from and the types of information about intangible assets they find most helpful.

Research and possible selected additional disclosures

Given the struggle standard setters have had in developing requirements on intangible assets that are more progressive than the current standards, instead of a fundamental revision of IAS 38, it may be possible to identify key disclosures that could facilitate users' use of information on intangible assets that is sourced outside financial statements. This is particularly the case since the information in the financial statements has credibility through the audit process, which may be lacking in users' other sources of information.
