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DISCUSSION PAPER

BETTER INFORMATION ON INTANGIBLES

WHICH IS THE BEST WAY TO GO?

[MONTH AND YEAR OF PUBLICATION]

This Discussion Paper is issued by the European Financial Reporting Advisory Group (‘EFRAG’),

DISCLAIMER

While encouraging debate on the issues presented in the paper, EFRAG does not express an~~any~~ opinion on the direction of possible future standard setting~~those matters~~ at this stage.

Copies of the Discussion Paper are available from the EFRAG website. A limited number of copies of the Discussion Paper will also be made available in printed form and can be obtained from EFRAG.

EFRAG welcomes comments on its proposals via the 'Questions to Constituents' at the end of each section. Such comments should be submitted through the EFRAG website by clicking [here-insert hyperlink] or should be sent by post to:

EFRAG
35 Square de Meeûs
B-1000 Brussels
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Comments should arrive no later than [Comment Deadline Date]. EFRAG will place all comments received on the public record unless confidentiality is requested.

EFRAG research activities~~Research Activities~~ in Europe

This paper is part of EFRAG's research work. EFRAG aims to influence future standard-setting developments by engaging with European and international constituents, and providing timely and effective input to early phases of the IASB's work. Four strategic aims underpin proactive work:

- engaging with European constituents to understand their issues and how financial reporting affects them;
- influencing the development of International Financial Reporting Standards ('IFRS Standards'), including through engaging with international constituents;
- providing thought leadership in developing the principles and practices that underpin financial reporting; and
- promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our research work and current projects is available on EFRAG's website.

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Executive summary~~Summary~~

ES1 This Discussion Paper has been prepared as part of EFRAG's project *Better Information on Intangibles*. Different approaches to obtain better information on intangibles are analysed, based on input from members of the EFRAG Advisory Panel on Intangibles. The Discussion Paper presents various alternatives and discusses their benefits and disadvantages without providing recommendations on the selection of a particular approach. The approaches presented address 'intangibles' with reference to intangible sources of possible economic benefits. This includes items that would not meet the definition of an asset in the IFRS literature. As further explained in Chapter 1, this Discussion Paper only considers information to be included in financial reports (financial statements (including the notes) and the management report). The approaches presented only deal with how to provide better information for intangibles that are used in the entity's operations (as opposed to those that are used as investment or for other purposes). The scope is also limited to cover only information that is useful for the primary users of financial reporting.

Issues with the current information

ES2 EFRAG's commissioned literature review, published in February 2020, identified academic studies showing that the value relevance of financial statements is decreasing and that this could be due to financial statements not reflecting information about intangibles, which has become more important for more entities than previously. Insufficient information on intangibles could affect the company's market value due to information asymmetry, result in an inefficient capital allocation in society and make assessment of the management's stewardship difficult.

ES3 The said review also underlined the difficulty for users to compare entities that grow organically with those growing by means of acquisition, as IFRSs currently generally require acquired intangibles to be recognised, while internally generated intangibles can only be recognised in specific circumstances.

ES4 As further explained Chapter 2, some consider that recognising more internally generated intangibles (and perhaps fewer intangible assets acquired in a business combination) would be a way to deal with the issue. However, in this scenario, all recognised internally generated intangibles would have to be measured, and both measurement at cost and at fair value of recognised intangible assets are problematic. In addition, not all intangibles would meet the definition of an asset.

ES5 The alternative scenario to require additional disclosures as the way forward also has some problems. Boundaries between different intangibles are not (well) defined and are interpreted differently. There are also no generally accepted ways on how to report on intangibles. Finally, additional information on intangibles may be commercially sensitive to provide.

Approaches for better information on intangibles

ES5 The Discussion Paper considers three approaches for better information on intangibles:

a) Recognition and measurement in the primary financial statements;

b) Information on specific intangibles in the notes to the financial statements or in the management report;

c) Information on expenses and risk/opportunity factors that may affect future performance in the notes to the financial statements or in the management report.

RECOGNITION AND MEASUREMENT IN THE PRIMARY FINANCIAL STATEMENTS

ES6 Accounting for intangible assets under IFRS does not have an overarching framework. This creates a lack of comparability for otherwise similar intangible assets. Intangibles are generally recognised only if acquired, either separately or as part of a business combination. Internally generated intangibles, other than development costs, are therefore not generally recognised as assets in the financial statements even though they may be the most important intangibles for entities. Accordingly, both costs related to the income of the current period and costs related to gaining income in the future are recognised in the statement of financial performance.

ES7 This makes it difficult to compare IFRS financial statements of an entity that has built (or builds) up substantial intangibles internally, with those of another entity that has purchased most of its intangible assets. To some extent, alternative performance measures currently provided voluntarily by some entities adjusting the results for the components of the purchase price allocation, attempt to facilitate the comparison of the financial performance of entities growing by acquisition with the performance of entities growing organically. However, relying on voluntary disclosures may not be the best way forward. In addition, those alternative performance measures would not enhance the comparability of the statements of financial position.

ES8 In order to enhance the comparability between entities that grow organically with entities that grow by acquisition, consideration could also be given to recognising less intangible assets separately from goodwill in a business combination. However, such an approach does not seem to have received wide support when the IASB recently consulted on this in its discussion paper *Business Combinations - Disclosures, Goodwill and Impairment*.

ES9 Chapter 3 considers alternative recognition (and measurement) requirements than those currently applied. In considering the recognition and measurement of (internally generated) intangibles, three questions are addressed:

- Which type(s) of intangibles should be considered for recognition (and measurement)?
- Under which circumstances should such intangibles be recognised? and
- Which measurement basis or bases should be considered?

ES10 On the question of which intangibles should be considered for recognition, the Discussion Paper states that it would be a radical approach to recognise intangibles that are not controlled by an entity. For the remaining discussion, Chapter 3 thus focuses on intangibles that meet the definition of an asset under the Conceptual Framework.

ES11 Chapter 3 presents four different approaches to recognition of intangible assets: (i) an approach under which all intangible assets are generally recognised, (ii) an approach under which intangible assets are recognised if certain criteria are met, (iii) an approach under which intangible assets are recognised when they meet certain criteria, and (iv) an approach under which no internally generated intangible assets are recognised. The advantages and disadvantages of these approaches are considered.

ES12 Intangibles that are recognised would necessarily also have to be measured. It would be possible to list many different methods for measurement. Chapter 3 focuses on the advantages and disadvantages of measurement at cost and fair value respectively without expressing a preference for any of them.

INFORMATION RELATING TO SPECIFIC INTANGIBLES

ES13 Chapter 4 discusses proposals to require disclosures that can provide information on a specific intangible to help users of financial reports assess the contribution of that intangible to the value/the value creation of the entity. As it appears from Chapter 3, the benefits of recognising more internally generated intangibles may be questionable and may not outweigh the associated costs. An alternative to providing better information on intangibles would thus be to provide better disclosures on specific intangibles. Disclosures on specific intangibles could also supplement recognition of (some) internally generated intangibles.

ES14 The intangibles, for which this chapter would propose the provision of information, are those that are key to an entity, in relation to its business model. Under the approach described in this chapter, when providing information relating to specific intangibles the first step would accordingly be to describe the entity's business model(s) and identify which intangibles are important for the entity's success following its business model(s).

ES15 Information relating to specific intangibles could be both qualitative and quantitative, or a mix of both.

ES16 Some of the advantages of information relating to specific intangibles would be that granular and detailed information on the intangibles that are key to an entity would be provided. The information could also be less subjective than recognising and/or measuring intangibles, less complex and hence less costly.

ES17 Some of the disadvantages of this approach are that in some cases it is difficult to determine the particular intangible the disclosures relate to, and the information would not provide a solution to the issue of distorted IFRS performance measures as described in paragraph 2.5 above. The latter would also mean that information is not provided on the value intangibles are creating together with other assets.

INFORMATION ON EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE PERFORMANCE

ES18 Chapter 5 discusses an approach under which information on intangibles is provided indirectly, (i) by communicating on the non-capitalised costs and (ii) requiring information about risk/opportunity factors that may affect future performance of an entity. As a result, the information provided under this approach does not provide a measure of 'the stock' of intangibles, but provides information to help users assess the future profitability/margins and/or projected future cash flows resulting from changes in the contribution of intangibles. Relevant information is thus information to assess whether the current margins can be maintained, enhanced or will decrease in future periods. That is, information on factors that change (the contribution of) intangibles, rather than information on the value of intangibles. Changes in how intangibles affect performance can arise from the entity's investments and disinvestments in intangibles and from risk/opportunity factors. Chapter 5 accordingly considers an approach under which an entity should provide information on:

- Costs of a period that are not capitalised but could be considered to relate to benefits that will materialise in future periods. This chapter discusses both an approach under which an entity provides information to help users in their assessments of what costs relates to future periods and an approach under which an entity's management provides its assessment on which non-capitalised costs that relate to future earnings.
- Factors that could affect (the contribution of) both recognised and unrecognised intangibles. Under the approach discussed in chapter 5, it is considered that sufficient information on risk/opportunity factors that could affect the contribution

of intangibles to the financial performance of an entity would generally be provided if entities disclose information on risk/opportunity factors that are material and specific to the entity.

ES19 One of the advantages of the approach is that a fixed terminology to be used to distinguish between different intangibles is not necessary for providing information on the costs of a period that are not capitalised. However, a fixed terminology for types of costs may be needed. Also, as the approach is based on the combined effect on earnings at entity level, the approach caters for the fact that often intangibles do not create much value on a stand-alone basis but together with other intangibles and assets.

ES20 Some of the disadvantages of the approach of providing information on uncapitalised costs are that information on the effectiveness of the investments are not reflected (and IFRS performance figures will still be distorted) and the information will thus not be so useful for assessing management's stewardship. However, other aspects of the management's stewardship will be provided by disclosing how the entity is dealing with risks and opportunity factors.

Challenges and issues for possible solutions

ES21 This Discussion Paper does not expressed any preferences on which of the above mentioned methods, or combination of the above mentioned methods, should be the way forward for providing better information on intangibles. Instead, the Discussion Paper asks for constituents' input on this. The Discussion Paper, however, states (in Chapter 6) that when considering how to provide better information on intangibles, consideration should also be given to:

- Whether it would be beneficial to establish a common terminology on intangibles;
- How to provide useful information but at the same time not require entities to disclose information that is commercially sensitive;
- Where the information should be provided - in the financial statements (including the notes), in the management report, or somewhere else;
- Whether it would be possible to audit the information and at a cost that would not outweigh the benefits of having the information audited;
- Whether the approach to providing information on intangibles could affect an entity's access to finance;
- Whether some of the current requirements can be removed.

~~ES1 [Text to be included].~~

QUESTIONS TO CONSTITUENTS

EFRAG invites comments on all matters in this Discussion Paper, particularly in relation to the questions set out below. Comments are more helpful if they:

- address the question as stated;
- indicate the specific paragraph reference to which the comments relate; and/or
- describe any alternative approaches that should be considered.

All comments should be received by [Submission date].

Question 1 Issues with the current information

Chapter 2 illustrates claimed issues with the current information on intangibles. Do you think issues exist that are not mentioned in the Chapter? If so, which?

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 and information for assessing how performance could be affected by changes in intangibles) and, within each approach, different alternatives to provide better information on intangibles.

Different approaches and different alternatives are listed in this Discussion Paper. 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 the different approaches 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.

If not, do~~Do~~ you think better information on intangibles should primarily be achieved by:

a) Amending existing recognition and measurement requirements for intangibles (see Chapter 3~~if so, please provide your responses to questions 3 – 7 and 11 below~~);

b) Providing disclosures~~Amending disclosure requirements for information~~ on specific intangibles (see Chapter 4); or

~~b)~~c) Providing disclosures on expenses~~if so, please provide your responses to questions 8~~ and risk/opportunity factors that may affect future performance (see Chapter 5)?~~11 below);~~

~~c) Amending disclosure requirements for information for assessing how performance could be affected by changes in intangibles (if so, please provide your responses to questions 9 - 11 below); or~~

~~d) A combination of the above (if so, please describe the combination and answer the questions below related to the approaches you would combine and Question 11)?~~

Question 3 Recognition and Measurement

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 should be amended to permit the recognition and measurement of certain internally generated intangible assets? ~~YES / NO~~ (Please explain your answer).~~)~~

Question 4 Possible scope for recognition

Paragraph 3.14 explains that IAS 38 currently include an explicit prohibition to recognise some types of internally generated intangibles such as internally developed brands, mastheads, publishing titles, customer lists and items similar, staff training, marketing.

Do you consider that the explicit prohibition to recognise some types of intangible that exists in IAS 38 should be removed and replaced by a principle-based approach? (Please explain your answer)

~~Yes/No(Please explain)~~

Question 5 Possible scope for recognition

Paragraphs 3.9 to 3.52 explore Four possible approaches regarding the recognition of internally generated intangibles. Which of the following approaches would you support?

a) Capitalise all costs associated with defined intangibles; with no specified conditions or thresholds;

b) Conditional capitalisation;

c) Threshold for capitalisation; ~~and~~

d) No recognition (that is,~~ie.~~ expensing all internally generated intangibles); and~~).~~

e) None of the above/others~~, Others~~ (please explain).

Please explain the reasons for your preferences.

Question 6 Possible recognition criteria

If you support recognition based on Threshold or conditional in the previous 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,~~i.e~~ 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 legal right and/or the ability to sell, transfer, licence, pledge ~~.~~.the asset);

e) All or a combination of the above depending on the nature of the intangibles (please explain);

f) Others (please specify).

Question 7 Possible measurement bases

Paragraph 3.53 to 3.70 consider possible measurement bases for internally generated intangibles without forming a final or suggesting a preferred approach. Which of the following suggested approach 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~~fair~~ value model);

d) Initial measurement at fair value (as deemed cost) and subsequent measurement at amortised cost with impairment ('IFRS 3 model'~~model~~)?

Question 8 Information relating to specific intangibles

Chapter 4 discusses the requirement to disclose information that directly relates to the contribution~~value~~ of an intangible to ~~. Direct information could relate to~~ the value of the entity. Information relating to specific intangibles could relate to (i) the contribution of the intangible itself to the value of the entity, or (ii)~~or~~ to items linked to the intangible that would help a user of financial reports assess the contribution of the intangible to the~~its~~ value of the entity. Preliminary feedback by some preparers and investors indicates that the disclosure of the fair value of unrecognised intangible assets would involve significant costs and that the information may not be relevant to users of financial reports. Therefore, the focus of the proposed ~~direct~~ information relating to specific intangibles alternative is on items linked to the key intangibles that would help users of financial reports assess the contribution of the key intangibles to the~~their~~ value of the entity.~~.~~ Examples of such~~these~~ items could be: for a pharmaceutical patent, information on the expiration date or on the targeted population; for a customer list the attrition rate.

1 Do you agree that ~~direct~~ information relating to specific~~on~~ intangibles should be limited to the key intangible assets of the entity? If not, why should it reach a broader scope?

~~2~~1 Do you agree that the disclosure of the fair value of an intangible is less helpful for users of financial reports and less feasible for preparers, as compared to the disclosure of quantitative and qualitative information on the value of the intangible itself or to items linked to the intangible?

~~3~~1 Do you agree with the identified advantages and disadvantages of ~~direct ~~information relating to specific~~on~~ intangibles compared to recognition, as identified in Chapter 4? If not, which aspects do you disagree with and/or which additional advantages and disadvantages have you identified?

Question 9 Information on uncapitalised costs related to future benefits

Chapter 5~~4~~ proposes various information on costs of a period that are not capitalised, but could be considered to relate to benefits that will be recorded in future periods.

1 Do you consider that such information could be useful? If so:

(a) Should the information mainly complement information on specific intangibles (see Chapter 4) or should/could requirements on information for assessing how performance could be affected by changes in intangibles be introduced instead of requirements on information on specific intangibles?

(b) Should the information mainly:

(i) Reflect the views of the entity's management (for example,~~e.g.,~~ by disclosing the costs the management considers relate to the benefits of future periods)? Or

(ii) Help users perform their own assessments on the costs related to the benefits of future periods (for example,~~e.g.,~~ by providing further specifications and breakdown of the costs of a period)?

2 Do you agree with the identified advantages and disadvantages of information on uncapitalised costs related to future benefits identified in Chapter 5~~4~~? If not, which aspects do you disagree with and/or which additional advantages and disadvantages have you identified?

Question 10 Information on risk/opportunity factors affecting intangibles

Chapter 5~~4~~ proposes 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,~~e.g.,~~ 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 factors based on the probability of their occurrence and the expected magnitude of their negative impact.

Do you agree with this proposal? If not, what information on factors affecting intangibles should be provided?

Question 11 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?

Question 12 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. 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 and why?

~~Chapter 1:~~CHAPTER 2: BACKGROUND

This Discussion Paper has been prepared as part of EFRAG's project Better Information on Intangibles. *Different~~The Discussion Paper presents different~~ approaches to obtain~~get~~ better information on intangibles are analysed, based on input from members of the EFRAG Advisory Panel on Intangibles. The Discussion Paper presents various alternatives, and discusses their advantages and disadvantages without providing recommendations on the selection of a particular approach. The approaches presented address 'intangibles' with reference to~~The proposals are made for information on~~ intangible sources of possible economic benefits. This includes items that would not meet the definition of an asset in the IFRS literature. The Discussion Paper only considers information ~~(in the paper referred to as 'intangibles')~~ to be included in financial reports ~~(statements, the notes to the~~ financial statements (including the notes) and ~~in~~ the management report). The approaches presented only deal with how to provide better information for intangibles used in the entity's operations.~~.~~ The scope is limited to cover information that is useful for the primary users of financial reporting~~statements~~.*

Why this Discussion Paper?

~~1.1~~2.1 In 2018, following the input received from the EFRAG research agenda consultation, EFRAG decided to add a research project on better information on intangibles to its agenda.

2.2 Among the arguments provided to EFRAG for including a proactive research project on intangibles were the following:

~~1.2 There has been a lot of debate in recent decades 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.~~

~~1.3 Proponents of the research noted that:~~

a) Changes in the business landscape resulting from new technologies, digitalisation, software solutions and movements towards a service economy, mean that internally generated intangible assets play an increasingly important role for the performance of an entity, while not adequately reflected in the financial statements.

b) There has been increasing focus on the intangible drivers of value within companies, and how these act as indicators of the future value of a business. At the same time, concerns have been voiced that financial statements are losing their relevance as they do not reflect many of these intangible elements.

c) The discrepancies between the accounting treatment for acquired and internally generated intangibles need to be examined, being ~~as this is~~ a significant investor concern as it distorts key ratios and could lead to the misallocation of capital.

~~1.4~~2.3 As one of its~~the~~ first ~~steps of the~~ research steps, EFRAG commissioned an academic literature review to provide insights on primarily academic literature on information on intangibles. The~~, their relevance of financial reporting, company performance, market value and users.~~ ~~The~~ literature review was published in 2020. One of the insights provided by the literature review was that although much research exists in the area of intangibles, not much ~~research~~ exists on how the information is consumed~~used~~ by users of financial reporting,~~– and~~ hence there is not much direct research on what information on intangibles would be useful for users.

~~1.5~~2.4 EFRAG considered it important that suggestions on how to provide better information on intangibles would be based on identified information needs of users of financial reporting.~~.~~ EFRAG therefore conducted a limited number of interviews with users, academics and other types of stakeholders and established, in March 2020, the EFRAG Advisory Panel on Intangibles ('EFRAG API') to provide input to the project. The EFRAG API~~which~~ consisted of users~~ of financial statements~~, valuators and preparers of financial reports~~statements to provide input to the project~~.

Input received from stakeholders

~~1.6~~2.5 In order to develop proposals for how better~~identifying issues with current~~ information on intangibles can be provided, EFRAG's first aim was to identify the issues with the information currently included in financial reporting. In doing so, EFRAG ~~has~~ considered input ~~and feedback~~ from:

a) A limited outreach conducted in early 2019 with a range of stakeholders (including preparers, users, valuers, academics and other professionals);~~professional)~~

b) Several meetings of EFRAG API; and

c) Discussions of the EFRAG User Panel.

~~1.7~~2.6 The input ~~EFRAG has~~ received by EFRAG was~~has been~~ relatively consistent with regards to the views that:

a) The purpose of the financial statements is not to explain the market capitalisation of an entity by measuring all possible items at fair value.~~;.~~ Users providing input to the project, have stated that they are less~~were not so much~~ interested in the fair value of individual assets as assessed by management than in~~by~~ obtaining the information necessary to make their own assessment of the operation~~business(es)~~ of an entity as a whole.

b) The importance~~role~~ of intangibles has significantly grown ~~in importance~~ and ~~that~~ information provided about intangibles can be improved[1]. ~~(for this issue, the view has, however, also been expressed by a few that there is not much that can be done).~~

~~1.8~~2.7 However, a wide range of views were~~have been~~ expressed about whether and how to improve information on intangibles as a way to help users estimate the value of the entire entity and assess stewardship. These different views can be categorised as suggestions for~~from~~:

[1] This view was not shared by all stakeholders consulted. A few have expressed the view that there is not much that can be done to improve the information reported on intangibles.

a) improved~~Improved~~ narrative reporting, including metrics, to assist users of financial reporting~~statements~~ in assessing an entity's intang~~intangibles~~;

b) improved~~Improved~~ information about 'future-oriented' costs that are not recognised as assets; and

c) further~~Further~~ recognition of internally generated intangibles in the financial statements (or in a separate statement).

~~1.9~~2.8 Most differing~~different~~ views probably exist~~existed~~ in relation to the recognition of intangible assets. Some consider~~considered~~ that the current requirements are broadly right, while others consider~~considered~~ that the requirements of IAS 38 *Intangible Assets* could be revisited. Among those~~,~~ who consider~~considered~~ that there is room for improvement, the views expressed include the following~~included~~:

a) Currently, too many intangible assets are recognised separately from goodwill in a business combination. Preparers~~From preparers~~ of financial reports note~~statements it is noted~~ that it is very costly to account for these assets separately as~~ it~~, for example, it is necessary to assess whether the assets are impaired. Users note~~From users, it is noted~~ that in most instances~~many of~~ the only asset~~assets~~ recognised separately is~~are~~, in fact, ~~just ~~goodwill. Primarily~~Others, primarily~~ users also~~,~~ consider that the current requirements are appropriate, as it is useful to receive information on what intangible assets an entity considers it has acquired in a business combination.

b) The criteria for the recognition of (internally generated) intangible assets may not be appropriate and could be revisited. A~~Alternatives proposed included a~~ wide range of views were expressed in terms of proposed alternatives:

(i) all~~All~~ intangibles should be recognised (proposal from a user);

(ii) the~~The~~ recognition criteria of IFRS 3 could also be applied for internally generated intangible assets if they can be measured reliably and it is more likely than not that their value will be recovered (suggestion from a valuator);

(iii) internally~~Internally~~ generated intangibles should be recognised to the extent they can be sold and have a commercial value (suggestion from a preparer);

(iv) internally~~Internally~~ generated intangibles could be recognised to the extent they are identifiable within the entity's value creation process (suggestion from a user);

(v) internally~~Internally~~ generated intangibles should be recognised to the extent it is possible to sell them or they result from a contractual right and the cost can be measured reliably (suggestion from a user).

~~1.10~~2.9 Differing~~Different~~ views also exist~~existed~~ on how recognised intangibles should be measured. Some consider a fair value measurement to be most useful (measurement at fair value, initially and subsequently, was thus proposed in relation to the recognition approaches~~approach~~ mentioned above in paragraphs ~~-~~2.8b)(i), 2.8b)(ii)).~~)~~ while others suggest:

a) Measurement at cost, unless fair value can be determined more reliably. In that case measurement should be at fair value both initially and subsequently for a specific~~that~~ intangible (this was suggested in relation to the recognition approach mentioned above in paragraph 2.8b)(iii)).~~);~~

b) A mixed measurement approach consisting of cost, a measure reflecting the revenue the intangible will generate, and fair value (this was suggested in relation to the recognition approach mentioned above in paragraph 2.8b)(iv)).~~);~~

c) Measurement at cost (initially and subsequently) (this was suggested in relation to the recognition approach mentioned above in paragraph 2.8b)(v)).

2.10 The input received on recognition and measurement is~~has been~~ reflected in the analysis~~discussion~~ in Chapter 3 of this Discussion Paper.

~~1.11~~ In addition~~on whether and how amendments~~ to ~~the current~~ recognition and measurement,~~ requirements in IAS 38 could result in~~ better ~~information on intangibles.~~

~~1.12~~2.11 ~~Better~~ disclosures on intangibles is an approach to improve transparency~~another manner to provide better information on intangibles~~ that has been proposed. ~~Some noted that such information would improve transparency.~~ There are currently no prohibitions~~prohibition~~ for preparers to provide additional information on intangibles on a voluntary basis, but preparers seem reluctant to provide such~~additional~~ information. Many reasons can account for this reluctance. One of the reasons may be~~ including~~ the cost of providing the information – ~~(~~for example, it may be less costly to provide the information outside the financial reports. Another reason may be~~),~~ its commercial sensitivity, and the fact that entities may be judged negatively if, for example, they provide information on investment in intangibles (such as research costs~~cost for example~~) and the projects to which these investments relate are subsequently~~ be~~ abandoned.

~~1.13~~2.12 The proposals in Chapter 4 build on input received on how ~~direct~~ information on specific intangibles (that is,~~i.e.,~~ information useful for estimating the contribution~~value~~ of intangibles to the value of an entity) can be provided to make~~provide~~ better information on intangibles available.

~~1.14~~2.13 As an alternative to changing~~change~~ the recognition criteria and/or measurement of intangible assets and/or providing~~provide direct~~ information on specific intangibles, users have explained that better information to determine the 'steady-state' margins and possible changes to these should be provided. The proposals in Chapter 5 are based on this approach and the suggested information to be provided is accordingly presented in Chapter 5.

~~1.15~~2.14 Some users have also pointed out that sustainability-related~~ESG~~ disclosures (that is, disclosure of data explaining the~~a business's~~ impact and added value of a business with reference to~~in the areas:~~ environment, social and corporate governance aspects, as well as~~) and~~ other types of non-financial disclosures) are useful. However, other users have noted that only information that would have a significant impact on the entity should be disclosed, in order ~~to~~ not to make~~ the~~ financial reports less accessible for the primary users of those.

~~1.16~~2.15 Sustainability-related ~~Non-financial~~ information is considered in Chapters~~Chapter~~ 4 and ~~Chapter~~ 5 of this Discussion Paper to the extent it~~this information~~ is considered to be useful for the primary users of financial reporting, and~~reports, for example to the extent the information~~ can be considered pre-financial (that is, although not currently affecting the entity, it could be assumed that in the future, the factors for~~on~~ which information is provided, would be important for the entity's performance).

~~1.17~~2.16 As is apparent from the~~it appears~~ above, the preliminary input received for this Discussion Paper has pointed in different directions, both in relation to the question on the issues with current information and on how better information can be provided.~~direction.~~ The absence of a consensus on these issues~~which way to go~~ means that ~~there~~, even after decades of discussions, there is still a need to consider the topic – both in this Discussion Paper and by~~in~~ other related~~similar~~ initiatives. Different approaches on how to provide better information on intangibles have already been developed. Input is therefore~~With these different approaches already developed, input is~~ needed on which one (or combination of approaches) should be considered further.

~~1.18~~2.17 Accordingly, this Discussion Paper does not present 'one single model' to provide better information on intangibles but, instead, discusses the merits and limitations of various approaches.

Scope

~~1.19~~2.18 This Discussion Paper only considers information to be provided in the ~~primary~~ financial statements (including~~,~~ the notes)~~ to the financial statements~~ and in the management report. The scope is also limited to ~~only~~ cover information that is useful for the primary users of financial ~~reports. Information to meet the needs of stakeholders other than those defined as the primary users of financial~~ reporting as defined in the IASB's *Conceptual Framework for Financial Reporting* (the 'Conceptual Framework') (that is, existing and potential investors, lenders and other creditors). The purpose~~) is not part~~ of this Discussion Paper is not to consider how the book value of an entity should equal its market capitalisation~~research~~.

~~1.20~~2.19 The Discussion Paper considers information on intangible sources of possible economic benefits other than financial assets. Specifically~~That is~~, the intangible sources should have the potential to produce economic benefits on a stand-alone basis or together with other ~~intangible~~ sources of possible economic benefits (including assets).~~.~~ In this Discussion Paper these intangible sources of possible economic benefits are referred to as 'intangibles'.~~, as opposed to 'intangible assets'.~~ The ~~Discussion Paper thus uses the~~ term 'intangibles' is thus used to include a potentially wide range of assets and other factors that drive the creation of value in companies, whether or not they are currently recognised or reported in financial reports, and whether or not they would meet the accounting definition of an asset. The scope of this Discussion Paper is accordingly~~thus~~ broader than many other projects which only consider intangibles that would meet the definition of an asset.

~~1.21~~2.20 The focus is~~This Discussion Paper focuses~~ on intangibles in relation to providing information on how an entity creates, maintains, expands and/or preserves value. There are many other issues related to financial reporting of intangibles (including divergence in how (the scope of) IAS 38 is applied/interpreted). Such issues are not the main focus of this Discussion Paper. By focusing on how an entity creates, maintains, expends and/or preserves value, it follows that the intangibles considered in the Discussion Paper are those that are used in an entity's operations. Issues with intangibles that are held for investment purposes are accordingly outside the scope of this Discussion Paper. It is noted however that issues related to crypto-assets are considered in EFRAG's discussion paper *Accounting for Crypto-Assets (Liabilities).*

~~1.22 As it will appear, the purpose of this Discussion Paper is not to consider how the book value of an entity should equal its market capitalisation.~~

~~1.23~~2.21 The proposals in this Discussion Paper are only intended for material information about intangibles that are key for the value creation of an entity or, for the proposals in Chapter 5, entities for which intangibles are material.

Structure of the Discussion Paper

~~1.24~~2.22 The Discussion Paper considers approaches to better information on intangibles in relation to:

a) recognition~~Recognition~~ and measurement in the primary financial statements (Chapter 3);

b) information~~Information~~ on specific intangibles in the notes to the financial statements or in the management report~~commentary~~ (Chapter 4);

a) information on expenses and risk/opportunity factors (including risks related to sustainability and climate) that may affect future~~Information for assessing how~~ performance ~~could be affected by changes in intangibles~~ in the notes to the financial statements or in the management report~~commentary~~ (Chapter 5).

~~1.25~~2.23 Chapter 6 considers factors, primarily from the perspective of preparers, that will have to be considered when finding a solution to provide better information on intangibles.

~~1.26~~2.24 First, however, the following chapter, Chapter 2, summarises some of the issues with current information on intangibles.

~~Chapter 2:~~CHAPTER 3: ISSUES WITH THE CURRENT INFORMATION

EFRAG's commissioned literature review, published in February 2020, identified academic studies showing that the value relevance of financial statements is decreasing and that this could be due to financial statements not reflecting information about intangibles, which has become more important for more entities than previously. Insufficient information on intangibles could affect the company's market value ~~performance~~ due to information asymmetry, result in an inefficient capital allocation in society and make assessment of the management's stewardship difficult.

The said review also underlined the difficulty~~,~~ for users~~,~~ to compare entities that grow organically with those growing by means of acquisition, as current regulation generally requires acquired intangibles to be recognised, while internally generated intangibles can only be recognised in specific circumstances.

Some consider that recognising more internally generated intangibles~~assets~~ (and perhaps fewer intangible assets acquired in a business combination) would be a way~~manner~~ to deal with the issue. However, all recognised internally generated intangibles would have to be measured and both measurement at cost and at fair value of recognised intangible assets are~~is~~ problematic. In addition, not all intangibles would meet the definition of an asset.

Additional disclosures as the way forward also has~~have~~ some problems. Boundaries between different intangibles are not (well) defined and are interpreted differently. There are also no generally accepted ways~~manners~~ on how to report on intangibles. Finally, additional information on intangibles may be commercially~~commercial~~ sensitive ~~information~~ to provide.

What are the issues with the current information on intangibles?

~~2.1~~3.1 Intangibles are dissimilar in type. This~~, which~~ complicates finding ways~~manners on how~~ to account for them, as the approach chosen for one type might not be useful for another type.~~.~~ In addition, beyond lacking physical substance, many intangibles have specific characteristics ~~, in addition to lacking physical substance,~~ and economic features that can be a challenge for~~to~~ the conventional approach of financial reporting. Some of these characteristics are:

a) Investment in intangibles is generally associated with high levels of uncertainty about the expected future benefits. In addition, costs of developing an intangible are often sunk costs. The development costs cannot be recovered if the development is not satisfactorily finalised. If the investment fails there may not~~it cannot~~ even be any~~sold as~~ scrap value to it.

b) It can sometimes be difficult to demonstrate the control over intangibles when it is difficult to restrict access or protect the use by legal means.

c) On its own, the value of an intangible can be very low. ~~It is how it works in combination with other intangibles or other assets that makes it valuable.~~ The existence of synergies and network effects are an important feature of intangibles and most intangibles do not create value on their own but in conjunction with other assets. It is thus often how an intangible works in combination with other intangibles or other assets that makes it valuable. The ~~and the~~ existence of synergies can affect the~~their~~ value of intangibles and gives rise to difficulties, for example in relation to measurement.

d) Intangibles are~~It is~~ often scalable at low marginal costs. Scalability means that, unlike tangible assets, intangibles can be used repeatedly and in multiple places at the same time, with little or no reinvestment.

~~2.2~~3.2 To add to the complexity of the debate on the ~~current~~ information currently reported on intangibles, there are different views on what the issues are. For example, while some consider ~~that it is~~ an issue the fact that internally generated intangibles ~~assets~~ are not recognised, others point out that the omission of intangibles~~intangible assets~~ from the statement of financial position is not necessarily a deficiency, as the value of intangible (and other) assets can be ascertained from the statement of financial performance. In addition, not all intangibles ~~would~~ meet the definition of an asset (see ~~also~~ Chapter 3 for details).

~~2.3~~3.3 The purpose of this chapter is ~~thus~~ not to present a list of factual~~summarise general acknowledged~~ deficiencies with the ~~current~~ information currently reported.~~.~~ Instead, this chapter provides a summary of different views on the problems with the currently reported~~current~~ information.

~~2.4~~3.4 To the extent that insufficient~~Poor~~ information on intangibles is provided, it may affect:

a) the company's~~Company's~~ market value ~~performance~~ and financial position;

b) capital~~Capital~~ allocation and investment decisions;

c) access~~Access~~ to finance for investment in intangibles;

d) stewardship~~Stewardship~~ assessments (the accountability of management for actions/decisions in managing a firm's resources).

~~2.5~~3.5 Some academic studies show that the value relevance of financial statements is decreasing, and this could be due to financial statements not reflecting information about intangibles, which has now become more important for more entities than was previously the case. Some are concerned that many intangibles that would meet the definition of an intangible asset~~assets~~ are not recognised because of the additional recognition criteria in IAS 38 *Intangible Assets* for internally generated intangible assets. They argue that as a result:

a) Financial~~This means that financial~~ statements do not reflect the underpinning drivers of value for intangible intensive businesses (that is, return-generating intangibles are not recognised).~~.~~ In this regard it is noted that the importance of intangibles is growing in the global economy, with ~~where~~ intangible assets such as big data, customer relationships, brand, efficient business processes and/~~,~~ or the dynamic capability of a workforce being~~, are an~~ important parts~~part~~ of how businesses create value. It is also noted that IAS 38 does not require, but only encourages, entities to 'provide a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria'.

b) Performance~~It distorts performance~~ measures are distorted since~~as~~:

(i) Return on assets ratios do~~would~~ not provide useful information as the 'assets' part is~~would~~ not ~~be~~ properly reflected. One of the consequences is that it is ~~more~~ difficult to hold management accountable for use of the entity's resources and the return on these (stewardship aspect).~~.~~

(ii) As costs incurred to build an intangible are not capitalised, income of a period may not be correctly matched with the related expenses.

Accordingly profit margins calculated from the IFRS figures of a period do not say much about the 'real' profitability of the period and cannot be used to predict margins in the future.

(iii) The statement of performance is 'hit twice' in the same period if the entity acquires an intangible asset (which is capitalised and amortised) and replaces this over time with an internally generated asset which cannot be recognised and for which the costs are therefore recognised in the financial statement at the same time as the amortisation costs of the acquired intangible assets.

c) Comparability is adversely affected~~It reduces comparability~~ insofar as most intangible assets are not recognised if they are internally generated, but they are recognised if they are acquired. In addition, there may be a difference between whether intangible assets are acquired in a business combination or not, as under IAS 38 probability and reliability recognition criteria apply[2], whereas under IFRS 3 *Business Combinations* the criteria are always considered to be satisfied.

~~2.6~~3.6 The issue of reduced comparability as a result of internally generated intangible assets generally not ~~being~~ recognised, while acquired intangibles are~~being~~ recognised, means that it is difficult to compare entities that grow organically with entities that grow through~~by~~ acquisition[3]. Particularly in relation to business acquisitions, the view has also been presented that too many intangible assets are recognised (separately from goodwill). The reliability and relevance of some of the separately recognised intangibles acquired in a business combination is thus questioned by some (both users and preparers). However, as noted in paragraph 2.8 above, others~~Others, however,~~ consider that including intangible assets in goodwill, instead of recognising them separately, would reduce~~reduces~~ information on what the entity has acquired in a business combination.

~~2.7~~3.7 While some think that more internally generated assets should be recognised (and perhaps fewer intangible assets acquired in a business combination), it is also noted that not only the recognition, but also the measurement requirements of IAS 38, give rise to issues. ~~that results in some problems.~~

~~2.8~~3.8 Under IAS 38, intangible assets are generally measured at cost. There are two issues with measurement at cost. Firstly, for internally generated intangible assets, it may be difficult to identify/allocate internal costs. Secondly, the measurement does not reflect the value of the asset, if, for example, it is worth much more than its cost ~~price~~. This may particularly be an issue with some types of intangibles which increase in value with use~~as they are being used~~ (for example, some software platforms). On the other hand, measurement at fair value would also be problematic, particularly from a reliability/faithful representation perspective, as there is no active market for most intangibles. The~~Chapter 3 further discusses the~~ respective merits and limitations of the different possible measurement bases for intangibles are discussed further in Chapter 3.

[2] IAS 38 requires an entity to recognise an intangible asset if, and only if: 'a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and b) the cost of the asset can be measured reliably'.

[3] In its comment letter in response to the IASB's consultation on DP 2020/1 Business Combinations—Disclosures, Goodwill and Impairment, EFRAG invited the IASB to take~~takes~~ into account the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically and, as such, start a project on IAS 38. Pending such a broader project on IAS 38, EFRAG questioned the usefulness of considering unilateral changes to the existing provisions in IFRS 3 as to whether some separately recognised intangible assets should be subsumed in goodwill. Instead, EFRAG suggested a broader project on IAS 38 by the IASB.

~~2.9~~3.9 As an alternative to recognising more intangibles, additional disclosures could be provided. However, additional disclosures as the way forward also has associated issues.~~some problems.~~ Boundaries between different intangibles are not (well) defined and they are interpreted differently. There are also no generally accepted approaches on how to report on intangibles. Chapters 4 and 5 ~~further~~ discuss these issues further. Also~~. Finally~~, while additional information on intangibles may be useful, it could also mean that entities would have to provide information that is commercially sensitive. This issue is ~~further~~ discussed further in Chapter 6.

~~2.10~~3.10 Finally, regarding~~Finally, when it comes to the current issues related specifically to~~ intangibles that would meet the definition of an asset, there are also issues related to the current financial reporting standards, such as:

a) How to assess ‘control’ in relation to certain intangibles. For example, should control be assessed in relation to the right to be able to broadcast a given event (together with other broadcasting companies) or to holding the master broadcasting rights for a given event?

b) It is not always straightforward whether an asset should be accounted for under IAS 2 *Inventories* or IAS 38.~~;~~

c) It is not always clear~~straightforward~~ whether an asset is a pre-payment or an intangible asset. For example, whether an upfront payment to be able to broadcast a given event would be a pre-payment for a service or the purchase of an intangible right.~~;~~

d) It is not always straightforward whether/when a contract could be considered an intangible asset.

~~2.11~~3.11 Some additional issues ~~It is not a given that the most important intangibles~~ for the broader category of intangibles which~~an entity are those that~~ would not necessarily meet the definition of an asset, are the following~~. For the broader category of intangibles, some of the issues are~~:

a) Information on intangibles is difficult to compare and use as the boundaries between different intangibles are not (well) defined and are interpreted differently. Even for those that meet the definition of intangible assets there are different interpretations on what development costs are.

b) It is unclear what the unit of account is. This also applies for acquired intangible assets. For example, a movie picture includes many different types of rights such as author rights, music rights and graphical rights. It is unclear whether these rights are different intangible assets or the intangible asset on which information should be provided is the movie picture.

c) The information to be provided may be commercially~~commercial~~ sensitive (this issue is ~~further~~ considered further in Chapter 6).

~~2.12~~3.12 While this Discussion Paper~~discussion paper~~ focuses on the issues mentioned in paragraphs 3.5 - 3.8, the issues listed in paragraphs 3.9 - 3.11 are also considered important and are included in the assessments of the different approaches to provide better information on intangibles, when relevant.

~~Chapter 3:~~CHAPTER 4: RECOGNITION AND MEASUREMENT

Chapter 3~~This chapter~~ considers approaches to provide better information on~~whether and how internally generated~~ intangibles through recognition~~could be recognised~~ and measurement~~measured~~ in the financial statements. Several approaches are considered together with their~~ 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 on~~of~~ financial performance.

As explained in Chapter 2~~ Issues with the Current Information~~, accounting for intangible assets under IFRS does not have an overarching framework. This~~, which~~ creates a lack of comparability for otherwise similar intangible assets. Intangibles are generally recognised only if acquired, either separately or as part of a business combination. ~~Intangible assets that are generated internally are generally not recognised in financial statements.~~

Internally generated intangibles, other than development costs,~~ that may be the most important for entities~~ are therefore not generally recognised as assets in the financial statements even though they may be the most important intangibles for entities. Accordingly, both costs related ~~and accounting of many investments in intangible assets~~ to the income of the current period and costs related to gaining income in the future are recognised in the statement of financial performance.

This makes it ~~results in confusing earnings from current revenues with investments to gain future revenues. It is therefore~~ difficult to compare IFRS~~the~~ financial statements of an entity that has built up substantial intangibles~~intangible assets~~ internally, with those of another entity that has purchased most of its intangible assets. To some extent, alternative performance measures[4] (e.g. results adjusted for the components of the purchase price allocation) currently provided voluntarily by some entities attempt to facilitate the comparison of the financial performance of entities growing by acquisition with the performance of entities growing organically. However, relying on voluntary disclosures may not be the best way forward. In addition, those alternative performance measures would not enhance the comparability of the statements of financial position.

In order to enhance the comparability between entities that grow organically with entities that grow by acquisition, consideration could also be given to recognising less intangible assets separately from goodwill in a business combination. However, such an approach does not seem to have received wide support when the IASB consulted on this in its discussion paper Business Combinations – Disclosures, Goodwill and Impairment.

Chapter 3 considers alternative recognition (and measurement) requirements than those currently applied. In considering the recognition and measurement of (internally generated) intangibles, three questions need to be addressed:

- ~~*Which type(s) of intangibles are considered fit for recognition and measurement;*~~
- ~~*What are the recognition criteria for such intangibles; and*~~
- ~~Which measurement basis or bases should be considered?~~

[4] In its 2015 Guidelines, ESMA defines Alternative Performance Measures as 'financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework'

- Which type(s) of intangibles should be considered for recognition (and measurement)?
- Under which circumstances should such intangibles be recognised? and
- Which measurement basis or bases should be considered?

On the question of which intangibles should be considered for recognition, the Discussion Paper states that it would be a radical approach to recognise intangibles that are not controlled by an entity. For the remaining discussion, Chapter 3 thus focuses on intangibles that meet the definition of an asset in the Conceptual Framework.

Chapter 3 presents four different approaches to recognition of intangible assets: (i) an approach under which all intangible assets are generally recognised, (ii) an approach under which intangible assets are recognised if certain criteria are met, (iii) an approach under which intangible assets are recognised when they meet certain criteria, and (iv) an approach under which no internally generated intangible assets are recognised. The advantages and disadvantages of these approaches are considered.

Intangibles that are recognised would necessarily also have to be measured. It would be possible to list many different methods for measurement. Chapter 3 focuses on the advantages and disadvantages of measurement at cost and fair value respectively without expressing a preference for any of them.

Which type(s) of intangibles should be considered for recognition?

~~3.1~~4.1 Intangibles encompass a wide variety of items and when considering recognition and measurement for such items a classification of intangibles is necessary. A possible classification considered in this Discussion Paper[5] is related to the degree of difficulty of establishing ownership or control rights and more generally the difficulty of their measurement.

- **Category A**: Intangibles that are controlled by an entity; for which property rights are relatively clear and for which markets exist (generally they can be bought and sold). Within this category, two types of intangibles can be distinguished: (i) assets~~Assets~~ such as patents, copyrights and trade names and (ii) business~~Business~~ agreements, licenses, enforceable contracts, and data bases.

- **Category B**: Intangibles that are controlled by the entity but for which well-defined and legally-protected property rights may not exist, and markets are weak or non-~~-~~existent. Examples are R&D in process, business secrets, proprietary management systems, and business processes.

- **Category C**: Intangibles for which the firm has few, if any, control rights and markets do not exist, and which are often tied to the people who work for the entity. Examples are human assets, structural (or organisational) assets, and relational assets, that is,~~i.e.~~ the components of intellectual capital.

~~3.2~~4.2 Control is a fundamental concept in the definition of any asset's recognition in IFRS and it does seem unrealistic, or at least difficult, to introduce an exception to recognise 'uncontrolled' intangibles without unintended consequences on other assets or undermining the general~~whole~~ principles of IFRS. Therefore, focusing on possible improvement to the accounting (that is, recognition and measurement) of intangibles in categories A and B seems the more promising and realistic approach.

[5] Classification suggested by Blair, M. M., & Wallman, S. M. H. (2000). Unseen wealth: Report of the Brookings task force on understanding intangibles sources of value.

4.3 In this regard, it is also noted that proponents of an expansion of the capitalisation of intangibles have generally not proposed a mechanical capitalisation of all intangibles. Instead, most recent research papers[6] proposed only a limited expansion consistent with the current definition of assets under condition or thresholds such as the ability to attribute benefits or the passing of specified technological or commercial feasibility tests.

~~3.3~~4.4 Before considering possible approaches for recognition and measurement of those internally generated intangibles as characterised above, the following section discusses a number of additional considerations specific to intangibles.

Existence of expenditures

~~3.4~~4.5 Some types of internally generated intangibles typically do not require explicit (nor have easily identifiable) expenditures. This may be the case for instance for organisational capital, social capital, reputation and~~,~~ customer fidelity.

~~3.5~~4.6 Although the IFRS definition of an asset does not state explicitly that an asset must stem from a direct or identifiable expenditure to be recognised, the absence of such direct or identifiable expenditure adds a layer of complexity to any recognition pattern: if the recognition of an intangible asset such as organisational capital, market power, customer loyalty, is proposed in absence of such any expenditure, the credit must be to equity, either directly to equity or ~~as income~~ through comprehensive income~~the statement of financial performance~~.

~~3.6~~4.7 Some consider that the nature of an accounting system is to report faithfully on the cash-to-cash cycle, and therefore recognise only assets arising from expenditures (including commitments for future expenditures that give rise to a liability).

~~3.7~~4.8 In this regard, it has to be noted that many promoters of the recognition of more internally generated assets[7] generally restrict the accounting for intangible assets to the capitalisation of expenditures as their focus is on the effects on earnings of such expenditures and avoiding confusing earnings from current revenues with investments to gain future revenues.

~~3.8~~4.9 These authors generally consider that limiting recognition to intangibles that have expenditure would be more helpful for users to measure return on investment and for the assessment of stewardship. Conversely, recognising assets with no expenditure could alter this information.

Under which circumstances should~~Possible approaches for the recognition of internally generated~~ intangibles be recognised?

~~3.9~~4.10 Conceptually four possible approaches to recognition of internally generated intangibles could be considered which all have benefits and limitations.

a) Capitalise all costs associated with defined intangibles; with no specified conditions or thresholds;

b) Conditional capitalisation;

c) Threshold for capitalisation; and

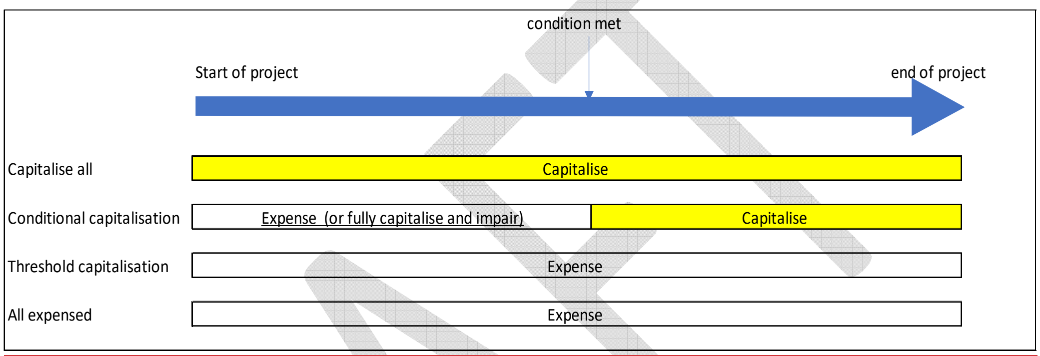
[6] Gu and Lev (2017); Barker and Penman (2017).

[7] For example, Lev and Srivastava 2020.

d) No recognition (that is,~~ie.~~ expensing all internally generated intangibles).

4.11 These approaches are illustrated below in Figure 3.1 and further explained in the following paragraphs. In the figure below ‘Conditional capitalisation’ is mentioned before ‘Threshold for capitalisation’ as the different approaches in Figure 3.1 are ranked according to how many intangibles would be recognised following the approach – other things being equal. However, as it may be easier to understand ‘conditional capitalisation’ after the ‘threshold for capitalisation’ approach has been explained, the ‘threshold for capitalisation’ approach is explained before ‘conditional capitalisation’ in the following text.

Figure 3.1 Possible approaches for recognising internally generated intangibles



4.12 For the reasons mentioned above in paragraph 4.2, the discussion below focuses on intangibles that would meet the definition of an asset in the Conceptual Framework. Amending the requirements for recognition of intangible assets might have to be supplemented by the approaches considered in Chapter 4 and Chapter 5 for intangibles that are not recognised (and for those that are recognised).

4.13 For the reasons mentioned above in paragraph 4.2, the discussion below will also not consider factors that reduces earnings (but not meting the definition of a liability (that is ‘negative intangibles’/’unrecognised intangible liabilities’)).

Capitalising all internally generated intangibles

4.14 There are arguments both in favour and against capitalising all internally generated intangible assets.

Arguments in favour of recognising all internally generated intangible assets

4.15 One argument in favour of~~Some may argue that~~ recognising all internally generated intangible assets would be that~~appropriate as~~ it would result in IFRS performance figures better reflecting of the costs that would be related to the income reported in a period (see also Chapter 5).

4.16 It could also be argued that recognising all internally generated intangible assets would be more~~be~~ consistent with the treatment of internally generated tangible assets (property, plant and equipment), which are generally recognised.

~~3.10~~ ~~. It has to be noted~~ IAS 16 *Property Plan Equipment*, similar to IAS 38, requires that assets can only be recognised if (a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity and (b) the cost of the asset can be measured reliably. In addition,

~~3.11~~4.17 ~~But the current definition of intangibles under~~ IAS 38 requires~~, in addition,~~ that intangible assets~~Intangibles~~ must be 'identifiable' before it is recognised. That~~that~~ is either:

a) Separable (capable of being separated and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract); or

b) Arise from contractual or other legal rights.

4.18 A tangible asset would be identifiable. Also, future economic benefits that are attributable to a tangible asset will generally flow to the entity from internally generated tangible assets. It may be that an internally developed tangible asset does not function as intended, but in that case, it would often be possible to sell different components of the tangible asset separately, for example as scrap.

4.19 The characteristics of internally developed tangible assets would therefore mean they would generally meet the stated criteria for recognition and hence be recognised.

4.20 It could therefore be argued that generally internally generated intangible assets should also generally be recognised. It could thus be argued that applying recognition criteria for intangible assets that would mirror those of tangible assets is inappropriate as it does not take into account that tangible and intangible assets are different.

4.21 A possible approach could therefore be to consider whether the guidance provided by IAS 38 to define 'identifiable' could be modified in a less restrictive/more inclusive manner.

4.22 The existing 'measurability' and 'probability of future economic benefits' conditions can also be an impediment to recognition of internally generated intangibles. It could likewise be considered to remove/relax these criteria. In this regard, it is noted that these conditions are assumed to be always met in the case an acquisition of intangibles in a business combination. The presumption that the 'reliable measurability' and 'probability of future economic benefits' conditions are always met for intangibles acquired in a business combination could be rebutted as the existence of a purchase price for a whole entity or business does not necessarily infer that the allocation to each identifiable intangible item would be more reliable than the measurement of internally generated intangibles.

Arguments against recognising all internally generated intangible assets

~~3.12~~4.23 Against the suggestion to remove or relax the identifiability criterion it could be argued that this criterion is necessary. To be recognised, an asset must have boundaries and identifiability may be seen as a reasonable condition to set such boundaries of an asset which by essence has no physical substance and therefore no physical boundaries.

~~3.13~~4.24 It could also~~has to~~ be noted that~~, without changing~~ the identifiability criterion is not the only cause that~~current requirements in IAS 38 some~~ internally generated intangibles, except ~~can already meet the conditions~~ for development costs, are not recognised~~recognition~~. Typically, intangibles in Category A would meet the identifiability criteria:

a) A self-developed brand can often be separated out (for example,~~e.g.,~~ sold or licenced).

b) Contractual customer relationships would meet the contractual-legal criterion, whereas customer loyalty or the entity's reputation would not meet either of the two identifiability~~Identifiability~~ criteria mentioned in paragraph 1.1 above.~~3.11.~~

~~3.14~~4.25 However, the above-mentioned intangibles are not currently recognised because IAS 38 includes specific prohibitions to recognise:

a) Internally developed brands, mastheads, publishing titles, customer lists and items similar, IAS 38 includes an explicit prohibition to recognise such items; and

b) Expenditure on training staff, selling and administration.

~~3.15~~4.26 Recognition of items in a) is prohibited on account of the fact that the cost of generating an intangible asset internally is 'often difficult to distinguish from the cost of maintaining or enhancing the entity's operations'. Recognition of items in b) is prohibited on account of the difficulty to demonstrate control.

~~3.16 A possible approach could therefore consist in removing the explicit prohibition and consider whether the guidance provided by IAS 38 to define 'identifiable' could be modified in a less restrictive/more inclusive way. That could be the topic of an IASB project in the context of its forthcoming agenda consultation.~~

4.27 ~~The existing 'measurability' and 'probability of future economic benefits' conditions can also be an impediment to recognition of internally generated intangibles.~~ It was noted above that there could be arguments for relaxing the 'measurability' and 'probability of future economic benefits' criteria. This could result in items listed in paragraph 4.25a) being recognised. However, there would also be arguments against such a change.

4.28 Firstly, removing the requirement that the cost of the asset can be measured reliably would seem to contradict the Conceptual Framework. According to this, '[r]ecognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or liability or by other factors'.

~~3.17~~ It thus ~~Such conditions are assumed to be always met in the case an acquisition of intangibles in a Business Combination.~~

~~3.18~~4.29 ~~However, it~~ seems difficult to remove~~suggest removing~~ such conditions, since recognising assets that cannot be measured reliably (even if a fair value model is applied, initial recognition would be at cost) or that are unlikely to generate future economic benefits is not deemed to result in useful information.

~~3.19~~4.30 In addition, asset recognition in the statement of financial position must be considered together with the effect on the statement of financial performance which materialise through amortisation and impairment. As discussed above, a feature is uncertainty about both the cost and the outcome of investments in intangibles and how that affects the usefulness of the information in particular in the statement of financial performance. In that respect, mismeasurement~~Mismeasurement~~ of intangibles at the entity level might have adverse subsequent impacts on the in the statement of financial performance. (including through impairment or restatements to the carrying amount) thus resulting in providing inadequate information. In the presence of high outcome uncertainty, there is statement of financial performance mismatching effects, either though arbitrary amortisation or subsequent impairment.

~~3.20~~4.31 Specific characteristics and economic features of internally generated intangibles contribute to that uncertainty can be a challenge to the conventional way of thinking about reporting and accounting because:

a) The expenditure associated with some internally generated intangibles is not always separable from other expenses or may not be easily identifiable when it is imbedded in transactions also involving current expenses.

b) The economic benefits expected to be derived from investment in intangibles can be hard to quantify as it is the nature of innovation that many projects will fail and be abandoned and provide little or no benefit to the entity. For investments in activities such as research and development (say) with no product as yet, the amount and timing of future revenues is very uncertain.

c) The absence of market for most of these assets can affect the reliability of their measurement. There are no markets generating visible prices for items such as intellectual capital, brands, or human capital to assist investors in correctly valuing intangibles-intensive companies. This can create difficulties under both a fair value or cost model as under the latter, intangibles would need to be tested for impairment.

d) The existence of synergies and network effects are also important features. Most intangible assets do not create income on their own but only in conjunction with other assets and the existence of synergies and network effects can affect their value. This can give rise to difficulties in connection to measurement ~~(~~be it for fair value purposes but also for the measurement of consumption or impairment of intangible assets (as the benefits from the synergies of intangibles with other assets may not necessarily be easy to allocate to the cash generating unit at which impairment is calculated~~which are reported at cost, and the determination of values on an asset standalone basis~~).

~~3.21~~4.32 In the ~~IFRS~~ Conceptual Framework, uncertainty about the existence of an asset or liability or a low probability of a flow of economic benefits is noted as circumstances when recognition of a particular asset or liability might not provide relevant information.

~~3.22~~4.33 As outlined by some[8], capitalising 'assets' with significant uncertainty aggregates them on the statement of financial position with assets with more certain outcomes thus blurring the overall information about future cash flows expectations. Capitalising investments in intangibles subsequently affects earnings as these recognised assets would be amortised against future earnings or subject to impairment. This in turn may affect the usefulness of the information provided by the statement of financial performance and the quality of users'~~Users'~~ analyses.

~~3.23~~4.34 Accordingly, some consider that the uncertainty feature suggests a solution that books an asset to the statement of financial position when an uncertainty threshold or condition is satisfied. As mentioned in paragraph 4.1, measurement uncertainties are lower for some categories of intangibles that are controlled by an entity; for which property rights are relatively clear and for which markets exist.

[8] Accounting for Intangible Assets - Suggested Solutions (Richard Barker, Andrew Lennard, Stephen Penman, Alan Teixeira) – September 2020.

Threshold for recognition

~~3.24~~ Instead of recognising all intangible assets, it could be considered to amend the current recognition thresholds. ~~However, it could be valuably argued that the same levels of measurement uncertainties exist in the case of Intangibles acquired in a business combination. The presumption that the 'reliable measurability' and 'probability of future economic benefits' conditions are always met for intangibles acquired in a business combination could be rebutted as the existence of a purchase price for a whole entity or business does not necessarily infer that the allocation to each identifiable intangible item would result in reliable and useful information.~~

~~Establishing a threshold for recognition~~

~~3.25~~4.35 Current IAS 38 actually contains a combination of recognition thresholds and explicit prohibitions (see paragraph 4.25) for some types of intangibles. Intangible assets are recognised if, in addition to meeting the definition of an asset:

a) They are 'identifiable' that is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged; or arise from contractual or other legal rights.

b) If it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

~~3.26~~4.36 Thresholds act as an in/out assessment made at inception when an entity starts the development of an intangible and incurring expenditure to recognition conditions (see next section) and not reassessed subsequently.

~~3.27~~4.37 The identifiability criterion (which is embedded in the definition of intangible assets in IAS 38) de facto scopes out items such as customer service capability, presence in geographic markets or locations, strong labour relations, ongoing training or recruiting programs, knowledge capital, ecological attitudes, outstanding credit ratings and access to capital markets, or favourable government relations.

~~3.28~~4.38 As explained in paragraph 4.25, IAS 38 includes specific prohibitions to recognise: internally developed brands, mastheads, publishing titles, customer lists and items similar and expenditure on training staff, selling and administration.

~~3.29~~4.39 A possible option to consider could be to remove these explicit prohibitions and consider specific recognition thresholds that are not too high so as to cause investment expenditure to be expensed as incurred. The criterion of identifiability could also be removed from the definition of intangibles assets in IAS 38; considered as a threshold or condition for recognition and defined in a less restrictive way (see paragraph 4.21).

~~3.30~~4.40 Some have suggested that an alternative threshold could consist in the ability to determine, at inception of an investment the amortisation schedule that allocates the consumption of those assets to appropriate periods.

~~3.31~~4.41 More particularly, proponents of such an approach consider~~, considers~~ as possible alternative approach to recognise an asset only when:

a) Expenditure~~expenditure~~ has been incurred, that is separately identifiable from other transactions; and

b) The~~the~~ entity has the ability to establish and allocated the pattern of consumption of future benefits (that is to establish an ex-ante amortisation schedule) arising from that asset to appropriate periods.

~~3.32~~4.42 A limitation of such an approach is that it would not address the situation of intangibles with infinite (or indefinite) lives nor the situation of intangibles with no (identifiable) expenditure.

~~3.33~~4.43 Other possible recognition conditions of internally generated intangibles could encompass the following criteria (alone or in~~a~~ combination):

a) Intangibles with attributable benefits only (that is intangibles for~~-~~ which future benefit can be identified and separated from the other main business activities at inception of their development) that can be identified ~~-~~and estimated at inception of the development;

b) The ability to estimate, at inception of the development of an intangible, the expected expenditure related to that intangible (for example,~~e.g.~~ R&D, development of a customer database or brand);~~…);~~

c) Whether the cost associated with the development of the intangibles are, at inception of the development, expected to be recovered;

d) Whether the item is identifiable within the entity's value creation chain; that is, for instance the ability to attach a rate of return to the investment;

e) Whether the intangible can be sold or has a commercial value;

f) Whether monitoring for impairment can be established (that is,~~i.e.,~~ whether the recoverable amount can be determined).

~~3.34~~4.44 An option of the threshold approach could consist in considering the criteria for recognition set in IFRS 3 and recognise all internally generated intangible that would have been recognised if acquired separately. IFRS 3 allows the recognition of a broad range of intangibles that are separately identifiable including:

a) Marketing-related intangible (such as trademarks, trade names, internet domain names and non-competition agreements);

b) Customer-related intangible (such as customer lists, customer contracts and customer relationships);

c) Artistic-related intangible assets (such as books, pictures, musical works and audio-visual material);

d) Contract-based intangible assets (such as licensing agreements, servicing contracts, employment contracts and use rights).

~~3.35~~4.45 Separate presentation of expenditure not meeting the defined thresholds in the statement of income could also be considered (see~~See~~ Chapter 5).

4.46 An issue with a general threshold approach could be to establish the time at which the threshold should be considered. For development costs, which are currently capitalised, IAS 38 includes guidance on when the development phase begins. This makes it possible for entities to know when it should start capitalising development costs. However, for other types of intangibles, this could be difficult as there could be different stages in the development. For example, it may not be straight forward to determine when a brand is starting to being developed / at what stage costs should start being capitalised.

Conditional capitalisation

~~3.36~~4.47 Conditional capitalisation is a permutation of the 'Threshold for recognition'~~Thresholds'~~ approach under~~in~~ which a threshold is~~the thresholds are~~ not assessed once and for all at inception of the development of an asset. Instead~~ but on the contrary~~, as time evolves, an entity reconsiders if the threshold has been met and if it becomes likely that the investment will pay off, capitalisation will~~would~~ start at that point in time.

~~3.37~~4.48 Under this approach expenditures are expensed (or capitalised and~~ immediately~~ impaired) immediately to indicate their relative uncertainty, but presented in a separate line of the statement of financial performance so not to be confused with other operating expenses. When the threshold for recognition is met, an asset starts to be recognised and is then subsequently amortised.

~~3.38~~4.49 An illustration of 'conditional capitalisation' can be found in the pharmaceutical sector, where some companies have developed practice to start manufacturing inventory before the developed drugs are approved, in anticipation of receiving that approval (pre-approval inventory). Inventory is recognised as an asset under IAS 2, but its recoverable amount is assessed for impairment immediately. If the entity assesses that it is not probable, at the time of production, that it will recover the cost through sale the inventory is impaired to nil immediately. If (or when) the drug is approved, the impairment is reversed.

> ~~3.39~~a) ~~Another illustration of 'conditional capitalisation' can be found in the accounting of development costs. Such costs are expensed until the point in time when the project technical and commercial feasibility have been established.~~

~~3.40~~4.50 The practical solution, put in place by the pharma industry for inventories could be considered and extended to different forms of intangibles; including research cost, training cost and marketing expenses.

~~3.41~~1.1 ~~It has to be noted that IFRS permits recognition and immediate impairment of some assets and allows conditional capitalisation through the requirement to reverse impairments for all assets, including intangibles, except goodwill, if the recoverable amount increases.~~

~~3.42 Separate presentation in the statement of income of the expenditures that do not meet the condition for recognition can supplement this approach. See Chapter 4 and~~ Other examples~~5).~~

4.51 ~~An example~~ of 'conditional capitalisation'~~recognition~~ can be found:

a) In the accounting of development costs under IAS 38. Such costs are expensed until the point in time when the project technical and commercial feasibility have been established.

~~3.43~~b) In~~ in~~ the practices of the extractive industries. Under the so-called 'successful efforts' method used in the oil and gas industry to capitalise, for each individual exploratory well, costs associated with the location of new oil and gas reserves. Costs may be capitalised as wells-in-progress until there is additional information about the existence of future benefits and as soon as the additional information becomes available, these costs can either be charged to expense (if there are no future benefits) or reclassified as a fixed asset (if there are future benefits). In the latter case, these costs are amortised as production occurs, so that expenses offset revenues.

4.52 IFRS permits recognition and immediate impairment of some assets and allows conditional capitalisation through the requirement to reverse impairments for all assets, including intangibles, except goodwill, if the recoverable amount increases.

4.53 Separate presentation in the statement of income of the expenditures that do not meet the condition for recognition can supplement this approach. See Chapter 4 and Chapter 5).

4.54 Applying the conditional capitalisation approach, investments in intangibles such as research and development ~~cost~~ could be either:

a) Expensed as incurred ~~capitalised and impaired (or expensed)~~ until the condition is met and then further cost ~~specified conditions~~ are capitalised~~met~~ (for example outcomes of a research project are known and future economic benefits from the research become likely to flow to the entity). The capitalised amount~~amortisation expense~~ would then be recognised~~recognized~~ over the periods over which~~where~~ the benefits ~~from the R&D~~ materialise in revenue.

b) Capitalised and fully impaired until the specified conditions are met at which point the impairment loss would be reversed. The reversal of the impairment loss would indicate to users when the management has assessed that the intangible investment~~its R&D~~ would pay off.

~~3.44~~4.55 Compared with current IAS 38, which requires expensing research cost and provides high hurdles for capitalising development cost, the~~this~~ approach could be considered to better match revenue and expenses: although under approach (a) only a fraction of the total cost would be capitalised whereas only approach (b) would allow all costs associated with successful investment to be recognised and subsequently amortised against revenue).~~.~~

4.56 Another possible modality of ‘conditional capitalisation’ to explore, could be to account for the cost of the investment in intangibles as a component of other comprehensive income (‘OCI’) and ‘recycle’ the costs either as an intangible asset (if and when the condition is met) or as an expense if the projects is not successful. Applying the method, research costs incurred could be included in OCI until the research project meet the defined conditions. At that point in time, accumulated expenses could be reclassified from OCI to intangible asset and further expenditure would be capitalised into the asset leading to a capture of all costs associated with the development of the intangibles.

4.57 However, contrary to the approaches explored in paragraph 4.54 (a) and (b), an OCI accounting would not draw from existing principles and would create conceptual challenges.

4.58 Other comprehensive income includes items of income and expense that are not recognised in profit or loss in accordance with IFRS Standards. According to the Conceptual Framework;

a) The statement of profit or loss is the primary source of information about an entity’s financial performance for the period, all income and expenses are, in principle, included in that statement.

b) In ‘exceptional circumstances’, the IASB ‘*may decide that income or expenses arising from a change in the current value of an asset or liability are to be included in OCI when doing so would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity’s financial performance for that period’.*

4.59 Cost incurred to develop intangibles until the capitalisation condition is met do not result from a '*change in the current value of an asset or liability'* or a measurement mismatch between the statement of financial position and the statement of income. Accounting such costs in OCI would create a precedent (there are other costs which recovery is subject to measurement uncertainties and flows through the statement of income) and an accounting in OCI would not be justifiable without an extension in the 'definition' of OCI.

Expensing internally generated intangibles

~~3.45~~4.60 Recognising costs related to intangibles as an expense in the period~~This~~ is the default accounting when intangibles are not separately identifiable or do not meet the conditions in current IAS 38.

~~3.46~~4.61 The immediate expensing of investment in intangible assets to the statement of financial performance, as in much of current practice, upsets the income calculation, failing to differentiate expenditure that supports current revenues from that which is intended to generate future revenues (investment).

~~3.47~~4.62 However, separate presentation in the statement of financial performance could partly help address the issue by distinguishing expenses that relate to investments in intangibles form other operating expenses. See the discussion in Chapter 5. In addition, expanded disclosures about internally generated items that meet the definition of intangible asset but not the recognition criteria, might provide users with additional information to assist in analysing similar companies in industries in which intangible items are significant to future prospects.

4.63 This could address concerns raised by some that the benefits of recognising internally generated intangible assets on the statement of financial position do not justify the related financial reporting costs. Incremental disclosure could provide useful information at a reasonable cost.

~~3.48~~4.64 Disclosures~~It has to be noted that disclosures~~ about unrecognised intangible assets would not be unprecedented: IAS 38 already:

a) Requires entities to disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

b) Encourages, but do not require, to disclose '*a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before the version of IAS 38 Intangible Assets issued in 1998 was effective'*. [IAS 38 Par 128]

~~3.49~~4.65 The question arises as to whether mandatory and expanded disclosures would not be preferable to voluntary ones to achieve more comparability.

~~3.50~~4.66 In practice, given the general requirement in IAS 1 *Presentation of Financial Statements*, to provide any additional information (even if not required by a specific Standard) necessary for an understanding of the entity's performance and financial position, one would expect companies to disclose information on significant risk factors and managerial judgement relative to material levels of investments in intangibles, whether capitalised or not.

~~3.51~~4.67 The nature and extent of information to be disclosed in the notes would need to be specified, while balancing the desire for incremental disclosure from users with concerns of preparers about providing proprietary information.

Advantages and disadvantages of the four possible approaches

~~3.52~~4.68 The table below summarises the advantages and disadvantages of the four approaches discussed above for internally generated intangibles. Unless otherwise stated, the listed advantages and disadvantages relate to both the objectives of helping users of financial statements predicting future cash flows and assessing management's stewardship:~~pros and cons of the four approaches discussed in the Chapter:~~

	Advantages	Disadvantages
All capitalised	Comparability between acquired and self-developed intangibles (if fair value is used for initial measurement).~~.~~ Comparability between internally generated tangibles and intangibles. IFRS performance measures will not be distorted as a result of not all intangibles being recognised (for example the statement of profit or loss will not be 'hit twice' when acquired intangibles would be replaced with internally generated (see paragraph 3.5 above). For the assessment of stewardship, the resources available to the management will appear from the statement of financial position.	Difficult/impossible~~Difficulty/ impossibility~~ to separately identify and measure some intangibles. Due to ~~the~~ measurement uncertainty, possible mismatches affect the statement~~effects in Statement~~ of financial performance~~Financial Performance~~, either by arbitrary amortisation or subsequent impairment. Incompatibilities with the definition of an asset in the Conceptual Framework (if all intangibles and not only intangible assets would be recognised). Costly~~Possible incompatibilities with the conceptual framework (absence of control…)~~ ~~More costly of the 4 approaches~~ as preparers would be~~are~~ required to identify and measure all intangibles/intangible assets. Even if all intangibles would be recognised, disclosures relating to key specific intangibles (see Chapter 4) could provide more granular and detailed information.
Thresholds for capitalisation	Possible to limit~~Addresses~~ the impact on the primary financial statements resulting from uncertainties inherent int~~o~~ measurement of intangibles. Reduces distortion of IFRS performance measures to the extent that the criteria for ~~by considering~~ recognition are met.~~threshold.~~ ~~When threshold is met, reduces possible mismatches in the statement of income due to expensing expenditure on~~	Would ~~If too high capitalisation thresholds would~~ continue to exclude ~~most~~ internally ~~-~~generated intangibles ~~leading~~ to the extent the criteria for recognition are not met. In these cases, there will be no improvement to~~on~~ current accounting. Criteria for recognition are not reassessed even if they would subsequently be met. This results in fewer intangibles being recognised~~met leading to more~~

	Advantages	Disadvantages
	~~intangibles before revenue is recognised.~~	~~exclusions~~ than under the conditional capitalisation approach. Would increase costs of preparing financial statements to the extent that more intangible assets would be recognised than currently. Even if many intangibles would be recognised, disclosures relating to key specific intangibles could provide more granular and detailed information. ~~Does not fully address the lack of comparability with acquired intangibles if internally-generated intangibles are initially measured at cost not fair value like for IFRS 3 and as the scope of possible recognition of purchased intangibles under IFRS 3 would probably still be larger.~~ ~~Cost of implementation.~~
Condition for capitalisation	Possible to limit~~Addresses~~ the impact on the primary financial statements resulting from uncertainties inherent in~~to~~ measurement of intangibles ~~by considering recognition conditions~~. Reduces distortion~~When threshold is met, reduces mismatches in the statement~~ of IFRS performance measures~~income due~~ to the extent that the criteria~~expensing expenditure on intangibles before revenue is recognised.~~ ~~As conditions~~ for recognition are met. Other things being equal, more internally generated intangible assets are recognised than under a threshold approach.~~subsequently reassessed more IGAs can be captured.~~	Would continue to exclude ~~Does not fully address the lack of comparability with acquired intangibles if~~ internally~~-~~generated intangibles to the extent the criteria~~are initially measured at cost not fair value like~~ for ~~IFRS 3 and as the scope of possible~~ recognition are not met. In these cases, there will be no improvement to current accounting. Costs of preparing financial statements would increase and likely be higher than under a threshold approach as the entity would have to reassess the criteria for capitalisation and as the entity would have to keep track of costs that might subsequently qualify for capitalisation. Even if many intangibles would be recognised, disclosures relating to key specific~~of purchased~~ intangibles could provide more granular and detailed information.~~under IFRS 3 would probably still be larger. .~~ ~~Cost of implementation.~~

	Advantages	Disadvantages
All expensed	The primary financial statements will not be impacted by the uncertainties inherent in measuring intangibles. Would reduce costs of preparing financial statements~~Less costly of the 4 approaches for preparers.~~ ~~Avoid subsequent mismatching from amortisation or impairment due to uncertainty about future revenues.~~	Distorted IFRS performance measures. Internally generated~~Mismatches of expenses~~ and ~~future revenue.~~ ~~Lack of comparability with~~ acquired intangibles are accounted for differently. For the assessment of stewardship, all the resources available to the management will not appear from the statement of financial position. This also means that any impairment losses are not recognised and the return on assets, the management is creating, cannot be calculated.~~.~~

4.69 In the table above, some of the advantages and disadvantages mentioned, relate to the comparability between intangibles that are acquired (in a business combination) and intangibles that are internally developed. As noted above in paragraph 3.6, an alternative to recognise more internally developed intangibles, could be to recognise fewer intangibles separately from goodwill in a business combination. In this regard it is noted that some users spend resources to undo the effects of the purchase price allocation and entities spend resources providing alternative performance measures that do not take the effects of the purchase price allocation into account.

4.70 As it will be further noted below such an approach could also moderate issues with measurement uncertainty related to the separately identified intangibles acquired in a business combination. Also, it could reduce the costs of preparers related to account for these separately identified intangibles, including testing these for impairment.

4.71 However, when the IASB consulted on whether to include in goodwill some separately identifiable intangibles assets recognised in a business combination, most respondents disagreed with such a proposal. They noted that the separate recognition of these intangible assets provides useful information, and they did not see a need for change[9]. In addition, in consultations done in relation to this Discussion Paper, some users have noted that it is not the purpose of the financial statements to make the corrections, some users, for their own analyses, would make to the financial statements.

Which measurement basis or bases should be considered?

4.72 IAS 38 requires recognised intangible assets to be initially measured at cost but allows such assets to be subsequently measured at either:

a) Cost less any accumulated amortisation and impairment; or

[9] See, for example, paragraph 47 of IASB Agenda Paper 18A for the May 2021 IASB meeting.

b) Under a revaluation model under which the intangible asset is carried at the asset's fair value, less any subsequent accumulated amortisation and impairment losses. The revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from fair value at the end of the reporting period.

4.73 IAS 38 does not state that any of the measurement options is preferred to the other and does not explain in its basis for conclusion when each of the approaches would provide more relevant information and/or more faithful representation. The Standard notes, however, that the revaluation method can only be used if fair value can be determined by reference to an active market which is expected to be uncommon for intangible assets. Examples mentioned in the Standard where an active market might exist include production quotas, fishing licences and taxi licences.

4.74 Should additional intangibles be recognised, an option could be to apply the same measurement requirements for these. That is, they should be measured at cost less any accumulated amortisation and impairment unless their fair value can be determined by reference to an active market. In the latter case, they could also be measured under a revaluation model. However, such an approach may be less suitable for internally generated intangible assets given the number and significance of internally generated intangible assets that do not:

a) Have directly attributable costs;

b) Generate cash flows in isolation but in combination with other assets.

It may therefore be that another measurement approach would have to be developed, should additional internally generated intangibles be recognised. When considering such an approach, a key issue related to reporting on intangibles in general would have to be taken into account. As noted in the~~*Which measurement basis or bases should be considered?*~~

~~3.53 One of the factors to be considered when selecting a measurement basis is the degree of measurement uncertainty. The Conceptual Framework states that for some estimates, a high level of measurement uncertainty may outweigh other factors to such an extent that the resulting information may have little relevance.~~

~~3.54~~4.75 ~~The~~ concluding remarks of the Academic Literature on Intangibles issued by EFRAG[10], in 2020 identified that a key issue about reporting on intangibles is uncertainty:

'Investment in intangibles is associated with high levels of uncertainty. Further, while there is evidence that investment in intangibles leads to innovation and tangible investment, there is a time lag between intangible investments and economic benefits (intangible investment occurs early in the product life cycle)';

'the more the system is grounded on intangibles, the more vulnerable it becomes because intangibles are more uncertain, unstable and risky. The challenge we accountants face is to learn how to manage and report on these 'invisible' resources for a better understanding of organisations' financial performance and their resilience'.

[10] A Literature Review on the Reporting of Intangibles – February 2020 (here).

~~3.55 Some may argue that it is not necessary to answer the cost/fair value question for internally generated intangible assets, since current IAS 38 allows intangibles to be subsequently accounted for at either cost or fair value (through equity).~~

~~3.56 However, retaining the choice between cost and fair value has greater implications in the context of internally generated intangible assets than for most other asset classes given the number and significance of internally generated intangible assets that do not have directly attributable costs. Therefore, the absence of a specified measurement basis (i.e. the option between cost or fair may give rise to an even greater lack of comparability than is the case today where internally generated intangibles are generally not recognised.~~

~~3.57~~4.76 In that regard, it is noted that measurement at both cost and at fair value may be problematic:

a) For fair value measurement, an issue is that there is no active market for most intangibles.

b) For measurement at cost, the issue is that it can be difficulty to identify / allocate internal cost.

4.77 Conceptually, four measurement options can be considered for the sake of the discussion:

a) Internally generated intangibles are initially and subsequently measured at cost consistent with the current 'cost model' of IAS 38. Under this approach amortisation and/or impairment losses are recognised in profit or loss.

b) Internally generated intangibles are initially measured at fair value which becomes their deemed cost and subsequently subject to amortisation and impairment (consistent with the accounting of separately identifiable assets and liabilities in a business combination under IFRS 3). Under this approach amortisation and/or impairment losses are recognised in profit or loss.

c) Internally generated intangibles are initially measured at cost and subsequently measured at fair value, consistent with the current 'revaluation model' under IAS 38. Under this approach increases in fair value are reported in other comprehensive income and amortisation and/or impairment losses in profit or loss.[11]

d) Internally generated intangibles are measured at fair value both initially and subsequently. Under this approach, fair value changes are reported in profit or loss.

4.78 The following discussion will mainly focus on alternatives a) and d). Generally, the advantages and disadvantages identified for alternative a) will also apply for alternative b) and the advantages and disadvantages identified for alternative d) will also apply for alternative c).

[11] The effect of increases in the carrying amount of an asset as a result of revaluation is included in other comprehensive income. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss. Similarly, a decrease in the carrying amount following a revaluation shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset.

Factors to consider in selecting a measurement basis

4.79 The Conceptual Framework includes some guidance to consider when selecting a measurement basis for a particular type of intangibles.

4.80 According to the Conceptual Framework, the information provided by a measurement basis must be relevant and it must faithfully represent what it purports to represent.

4.81 Although a high level of measurement uncertainty does not render a particular measurement basis necessarily irrelevant, a balance must be achieved between relevance and faithful representation and the Conceptual Framework states that, for some estimates, a high level of measurement uncertainty may outweigh other factors to such an extent that the resulting information may have little relevance.

4.82 The Conceptual Framework also states that the characteristics of the asset or liability and how it contributes to future cash flows are two of the factors that can affect whether a particular measurement basis provides relevant information. In particular:

a) Whether an asset produces cash flows directly and could be sold independently without a significant business disruption. In such case, a current value measurement such as fair value is likely to provide the most relevant information that incorporates current estimates of the amount, timing and uncertainty of the future cash flows.

b) Conversely, if the entity's business activities involve the use of several economic resources (including intangibles) that produce cash flows indirectly by being used in combination, information about value changes may not always provide predictive value or confirmatory value to users of financial statements.

4.83 Regarding faithful representation, the Conceptual Framework notes that:

a) The level of measurement uncertainty may affect whether information provided by that measurement basis provides a faithful representation of an entity's financial position and financial performance. In some cases, this level of measurement uncertainty is so high that it might not provide a sufficiently faithful representation. In such cases, it is appropriate to consider selecting a different measurement basis that would also result in relevant information.

b) Using the same measurement basis for related assets and liabilities may provide users of financial statements with information that is more useful than using different measurement bases.

4.84 Although the Conceptual Framework does not preclude the use of different measurement bases in the statement of financial position and in the related statement of financial performance, it notes that in most cases, using the same measurement basis in both statements would provide the most useful information.

4.85 It follows from the guidance in the Conceptual Framework that measurement at cost may result in the most useful information (both for assessing future cash flows and for assessing management’s stewardship) for the internally generated intangible assets that are used in an entity’s operation and is mainly producing cash flows indirectly, together with other assets. An exception to this could be when it is difficult to determine the cost of an intangible reliably and a fair value of the intangible can be determined reliably.

~~3.58~~4.86 The following paragraphs discuss the benefits~~pros~~ and disadvantages~~cons~~ of cost or fair value measurement by considering other input than the guidance in the Conceptual Framework as well as cost/benefit considerations. The discussion is thus not~~without~~ forming a final or suggesting a preferred approach.

Arguments for and against cost

~~3.59~~4.87 Arguments in favour of initially and subsequently measuring internally generated intangible assets at cost rather than fair value include that it is more consistent with the treatment of internally generated tangible property, plant and equipment. Furthermore, some argue that it is more consistent with IFRS 3 principles because IFRS 3 uses fair value only as a surrogate for cost for allocation purposes (see for example paragraph 33 of IAS 38).

~~3.60~~4.88 Given the users' general focus on cash flows (and hence on the cost basis), fair value measurement of internally generated intangible assets for financial reporting purposes is considered by some as unnecessary. Financial analysts often see their role as determining value and therefore a fair value asserted by an entity's management is not particularly helpful other than as a point of comparison.

~~3.61~~4.89 In outreach conducted during the development of this Discussion Paper, some users have indicated that recognition at cost would be a helpful measure to calculate return on investment. Others have considered that recognition of intangible items at cost does not result in providing useful measures of the benefit a company will receive from those expenditures.

~~3.62~~4.90 Capitalisation of an intangible asset at cost is appropriate only where the costs to be incurred on development of an intangible asset can be identified and estimated reliably. This may be a particularly acute issue as expenditure on intangibles to generate future earnings are often made together with those for current earnings: For instance, a bonus to employees may represent investing in human capital and/or an incentive to stay with the firm and/or wages for past service. Advertising can generate future sales (brand building) as well as current sales.

~~3.63~~4.91 Lastly, measurement at cost is generally understood to be less costly to produce than fair value measurement, as well as less subjective. It is seen as a cost-effective way of measuring internally generated intangible assets and relies on traditional recognition triggers (incurrence of cost), rather than effectively using the reporting date as a recognition trigger. Subsequently, subjecting those assets to impairment testing only when there is an indication of an~~where~~ impairment~~ indicators exist indicated~~ is also more cost-effective than a periodic valuation-based model.

Arguments for and against fair value

~~3.64~~4.92 Arguments in favour of measuring internally generated intangible assets, at fair value include that fair value provides more relevant information for predicting future cash flows by capturing the expectations of future cash flows generated by an asset and results in a consistent treatment of the same kind of assets acquired in a business combination under IFRS 3. However, assets acquired in a business combination are not subsequently remeasured at fair value.

~~3.65~~1.1 ~~Conceptually, four measurement options can be considered for the sake of the discussion:~~

a) ~~Internally generated intangibles are initially and subsequently measured at cost consistent with the current 'cost model' of IAS 38~~

~~b) Internally generated intangibles are initially measured at cost and subsequently measured at fair value, consistent with the current 'revaluation model under IAS 38).~~

~~c) Internally generated intangibles are initially measured at fair value which becomes their deemed cost and subsequently subject to amortisation and impairment (consistent with the accounting of separately identifiable assets and liabilities in a business combination under IFRS 3).~~

~~d) Internally generated intangibles are measured at fair value both initially and subsequently.~~

~~3.66~~4.93 Fair value may also be the only option available when no expenditure is incurred (or is identifiable) for a specific nature of intangibles. A fair value measurement also avoids the need to identify and allocate cost to recognised assets which can be judgemental and burdensome.

4.94 Although fair value may not capture many entity-specific synergies, it may be~~Fair value is also~~ more prone to capture the synergies between assets~~intangibles~~ than measurement at cost.

~~3.67~~4.95 Measurement at fair value, may, when fair value is estimated, result in ~~accounting, as it is future-oriented insofar it encompasses expected future cash flows. However, this can be a double-edged sword with~~ a risk of double counting of certain items, when the effect of synergies starts materialising in the statement of performance. ~~income.~~ However, that effect would be mitigated if intangibles are initially measured at fair value but subsequently measured at cost (as explained in paragraph 4.77b) as the asset would be amortised when the synergies start materialising.

~~3.68~~4.96 For some items, fair~~Fair~~ value may result in~~have~~ more relevant information~~relevance~~ than historical cost ~~for users~~ but, in the case of intangibles, fair value ~~it~~ 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. Under~~In~~ these conditions, fair value measurement would imply more subjectivity and expose financial reporting to a higher degree of uncertainty. For many intangibles, the measurement uncertainty of fair value could call into question whether it could provide a representationally faithful depiction.

~~3.69~~4.97 Differences~~A lack of consistency~~ in how fair value is estimated~~the valuation methods and models adopted (for example proprietary models developed)~~ may reduce~~lead to lack of~~ comparability between items even though they would all be measured at 'fair value'.~~).~~ Fair value may also create volatility in profit or equity that would not be predictive of (the variability of) future cash flows and ~~. Absent arm's length transactions for internally generated intangible assets, this will leave no basis for recognition other than~~ the variability may also not be useful for assessing ~~application of~~ the management's stewardship following the entity's business model. ~~cost method.~~

~~3.70~~4.98 Fair value measurement may also~~however~~ be more costly to apply than measurement at cost (all the more if intangibles are subsequently measured at fair value at the end of each accounting periods). ~~) that cost accounting and more difficult to justify on cost-benefit grounds and it may be questionable whether the benefits will always outweigh the costs incurred by the entity in determining fair value.~~ Also separate initial measurement of identifiable intangibles acquired in a business combination at fair value has received criticisms for being costly and resulting in information that is not always used by users.

~~3.71 The table below summarises the possible effects of the measurement options considered in this Chapter on the statement of financial performance:~~

	~~**Initial measurement**~~	~~**Subsequent measurement**~~	~~**Changes in FV**~~	~~**Amortisation Impairment**~~
~~**Cost model**~~	~~Cost~~	~~Cost~~	~~N/A~~	~~P&L~~
~~**Fair Value Model**~~	~~FV~~	~~FV~~	~~P&L~~	~~N/A~~
~~**IFRS 3 model**~~	~~FV~~	~~Cost~~	~~N/A~~	~~P&L~~
~~**Revaluation mode**~~	~~Cost~~	~~FV~~	~~OCI~~	~~P&L[12]~~

~~Conclusion for Chapter 3~~

~~3.72~~1.1 Proponents ~~of an expansion of the capitalisation of intangibles have generally not proposed a mechanical capitalisation of all intangibles. Instead, most recent research papers[13] proposed only a limited expansion consistent with the current definition of assets under condition or thresholds such as the ability to attribute benefits or the passing of specified technological or commercial feasibility tests.~~

~~3.73 It is likely that, within the confines of the current definition of assets in IFRS, many intangibles identified as Category A in paragraph 3.1 could be made eligible for recognition under specified thresholds or condition. For other types of intangibles (identified as categories B and C in paragraph 3.1) alternatives to (or supplement to) capitalisation are being considered.~~

~~3.74 This Discussion Paper does not express a preference for a cost or fair value model for the initial and subsequent measurement of internally generated intangibles. As explained paragraph 3.59 to 3.70 both methods have their merits and limitations and this Discussion Paper is asking input from constituents on the matter.~~

~~[12] The effect of increase in carrying amount of an asset as a result of revaluation is included in other comprehensive income (OCI), but the decrease and impairment losses impact P/L. However, increase will be included in P/L to the extent of previous decreases and impairment losses and, similarly, decreases are included in OCI to the extent of previous accumulated increases.~~

~~[13] Gu and Lev (2017); Barker and Penman (2017).~~

~~Chapter 4:~~CHAPTER 5: INFORMATION RELATING TO SPECIFIC INTANGIBLES

Chapter 4~~This chapter~~ discusses proposals~~the proposal~~ to require disclosures that can provide ~~the disclosure of~~ information *on a specific ~~that directly relates to the value of an~~* intangible *to ~~or items linked to the intangible that would~~* help *users~~a user~~* of financial reports assess the *~~value of that intangible, also referred to as 'direct information'.~~* ~~Intangibles are increasingly acknowledged as significant value drivers for the strategy and business model of an entity.~~ *contribution of that intangible to the value of the entity. As it appears from Chapter 3, the ~~The~~* benefits of recognising *more internally generated* intangibles may be questionable and may not outweigh the *associated* costs*. An alternative to~~, particularly if there is no single recognition method that satisfies the needs of users. Thus,~~* providing *better* information *on intangibles would thus be to provide better disclosures on specific intangibles. Such information could be less subjective than recognition, less complex and hence less costly. Also, disclosures on specific intangibles could supplement recognition of (some) internally generated intangibles.*

The intangibles, for which this chapter would propose the provision of information, are those that are key to an entity, in relation to its business model. Under the approach described in this chapter, when providing information ~~disclosures~~ relating to specific intangibles *the first step ~~allows an entity to identify and provide the necessary and useful information on its key intangibles using fewer assumptions compared to recognition, while keeping the process less costly and avoiding the complexities of recognition. Since the disclosure of the fair value of unrecognised intangibles would involve significant costs and judgement (similar to their recognition at fair value) and the information may not be reliable due to measurement uncertainty, the focus of the direct information alternative is on items linked to intangibles, that~~* would *accordingly be to describe the entity's business model(s) and identify which intangibles are important for the entity's success following its business model(s).*

~~help users of financial reports assess their value.~~ Information relating to specific intangibles could be both~~follow a~~ qualitative and~~approach, a~~ quantitative, ~~approach~~ or a mix of both.

Some of the advantages of information relating to specific intangibles would be that granular and detailed information on the intangibles that are key to an entity will be provided. The information could also be less subjective than recognising and/or measuring intangibles.

Some of the disadvantages of this approach are that in some cases it is difficult to determine the particular intangible the disclosures relate to, and the information would not provide a solution to the issue of distorted IFRS performance measures as described in paragraph 3.5 above. The latter would also mean that information is not provided on the value intangibles are creating together with other assets.

Information relation to specific intangibles

~~Direct information on intangibles~~

~~4.1~~5.1 Recognition of intangibles is not the only way to provide useful information to users of financial~~corporate~~ reports on intangibles. In practice entities, particularly in intangible-intense sectors, voluntarily disclose qualitative and quantitative information that helps users develop their own estimates of present value of the cash flows expected to be generated from the entity from internally generated intangibles.

~~4.2~~5.2 This chapter discusses the alternative of a requirement to disclose information relating to a specific intangible, with respect to~~also described as 'direct information', for~~ those intangibles identified by an entity to be its key intangibles. The~~Direct~~ information encompasses information directly linked to a specific intangible, be it recognised in the financial statements or not. This information could be with regard to:

a) The contribution of the intangible to the value of the entity~~intangible~~; or

b) Factors related~~Items linked~~ to the intangible that would help a third party assess the contribution of the intangible to the~~its~~ value of the entity.

~~4.3~~5.3 Disclosures ~~directly~~ related to a specific~~particular~~ intangible include, for example, the economic life of the intangible (if relevant); the selling price of products developed based on the intangible; the type of the intangible; ~~(~~whether it would need to be replaced; whether it is maintained through the operation of the entity and~~;~~ whether it tends to increase in value when being used by customers.~~).~~

~~4.4~~5.4 Information relating to specific intangibles may take the form of qualitative information and/or~~as well as~~ quantitative information~~, which can be complementary~~. Examples of elements of qualitative and quantitative information on specific intangibles are provided in paragraph 5.18 below.

Why information relating to specific intangibles is useful

~~4.5~~5.5 Intangibles are increasingly acknowledged as significant value drivers for the strategy and business model of an entity. Providing information related~~Intangibles are a crucial element of valuation, and are increasingly acknowledged as significant value drivers for the strategy and business model of an entity. Information relating~~ to specific intangibles that are important for an entity's business model, allows users of financial reports to understand the intangible in relation to the entity's value creation process. Such an understanding might not be achieved by means of recognition~~aspects~~ of more internally generated intangibles in the statement of financial position. ~~.~~

~~4.6~~5.6 The need for this information is also apparent from the results of ~~In~~ the European Commission's~~Commission~~ consultation for the revision of the EU Non-Financial Reporting Directive[14]. In response to this consultation, half of the respondents took the position that companies should be required to disclose additional non-financial information regarding intangible assets or related factors. This view was stronger amongst users (59%). In addition, 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.

[14] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Fina/public-consultation.

~~4.7~~5.7 The importance and usefulness of information on intangibles was also~~is~~ analysed in the report of the multistakeholder Task Force (the 'Task Force') established by EFRAG to undertake preparatory work for possible EU non-financial reporting standards in a revised NFRD[15]. The Task Force observed~~observes~~ that the role of intangibles which are not reflected through financial reporting, and which are key to the development of businesses and to their processes of sustainable value creation, should be emphasised in sustainability information provided by entities. The Task Force noted~~notes~~ that sustainability information tends to eventually lead to financial consequences meeting recognition criteria for inclusion in the financial statements over time. This makes the connectivity between sustainability information and financial information particularly relevant for users to monitor the reporting entity's value creation.

~~4.8~~5.8 To understand value creation at company level, additional information is essential. This is illustrated by the increasing disconnect between financial reporting 'book values' and market values of companies, as expressed by financial markets through transactions. This situation explains why in the EU a majority of financial stakeholders support the idea of developing disclosures that foster a better understanding of intangibles. Information relating to specific intangibles is important in order to provide users the information about unrecognised intangibles as value drivers. This is particularly true for intangible-intensive sectors.

Proposals for information relating to specific intangibles

~~4.9~~5.9 The approach described in this chapter suggests that information~~Information~~ on the key intangibles of an entity can better serve the needs of users, if it relates to the entity's business model and is linked with financial performance measures.

~~4.10~~5.10 To overcome the limits of current IFRS requirements, some IFRS preparers in the more intangible-intensive industries (for example,~~segments (e.g.,~~ biotech, pharmaceuticals and health care~~ equipment & supplies~~; interactive media and software; fast moving consumer goods~~household products, personal products, textiles~~ and ~~apparel &~~ luxury goods) have developed practical ways to provide ~~integrate the~~ information related to intangibles.~~required by users.~~ This ~~direct~~ information, however, is currently and often to a large extent, only~~mainly~~ included in presentations to investors (outside the ~~and press releases, not captured by~~ financial reports) and in press releases. The information is also therefore~~,~~ not audited. In addition~~ and~~, despite some market discipline that helps to achieve some degree of comparability within the same industry~~segment~~, the information provided is generally not comparable across entities and across industries. Some companies also provide additional information, on a voluntary basis, on intangibles that contribute to the value creation process in the financial reports. However, this information is not provided by all entities and the way entities provide the information is not standardized~~segments~~.

Accordingly, in ~~Suggestions on direct information to be provided~~

~~4.11~~5.11 ~~In~~ the following paragraphs, ~~this paper presents~~ a possible approach to provide better information on intangibles is presented. By introducing requirements to provide information linked to intangibles that would help users assess their contribution to the value of the entity, such information would be provided by all entities and would be comparable across entities and across segments.~~, requiring the disclosure of direct information about key intangibles.~~

[15] Proposals for a relevant and dynamic EU sustainability reporting standard-setting, European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards (February 2021).

Suggestions on information relating to specific intangibles to be provided

Identification of key intangibles

~~4.12~~5.12 The starting point with respect to the approach for providing information relating to specific intangibles described in this chapter, would be for an entity to identify its key intangibles. Key intangibles would be those that are critical to the business model of an entity, and that are the main driver for an entity's value creation.

~~4.13~~5.13 These identified intangibles would then be those for which required qualitative disclosures and key standardised intangible-related metrics would be required, supplemented by entity-specific metrics. The fact that entities would be required to provide similar information for the same key intangibles would facilitate comparisons by users in respect of entities operating similar business models.

~~*Location of direct information*~~

~~4.14 Information on key intangibles would be presented either in the notes to the financial statements, or in a dedicated section in the management report.~~

~~4.15 By including the information in the management report, such information would not be subject to a full scope audit as required if it were included in the notes to the financial statements, but would be subject to the same level of independent assurance as other information contained therein. In addition, an IFRS requirement to present the information in the notes to the financial statements would make the requirement enforceable. The enforceability of a presentation in the management report would vary depending on whether or not it is also required by the relevant local applicable regulation; this would impact international comparability.~~

~~4.16 Other factors to be considered in deciding the location of the information include the management and forward-looking nature of the information, as opposed to accounting and retrospective.~~

Useful disclosures

~~4.17~~5.14 As it appears from paragraph 5.13, information related to specific~~Direct information on~~ intangibles can be in the form of both qualitative and quantitative information.

~~4.18~~5.15 Information is generally deemed more useful if it is linked with quantitative financial performance measures. However, for intangibles that have an indirect impact on performance, or are future oriented, it may be difficult, uncertain or commercially sensitive to provide information linking the resource to performance measures. Qualitative information is therefore important to supplement quantitative information and allow users a more complete understanding. There could also be situations where only qualitative information is available because the quantitative information is very preliminary or imprecise, especially in the early stages of new projects.

~~4.19~~5.16 Ideally, quantitative aspects should complement qualitative disclosures as the existence of quantitative aspects alongside qualitative aspects allows users to have more information to assess the contribution~~value~~ of an entity's ~~the company and its~~ key intangibles to its value.

~~4.20~~5.17 Entities should, to the extent possible, provide an integration between qualitative information and quantitatively expressed information through key performance indicators. Disclosures should be provided over several periods, to enable users to compare entities over time and assess trends.

Elements of ~~direct~~ information relating to specific intangibles

~~4.21~~5.18 The tables below provide details on the information that could be provided for certain intangibles, when these are identified as key intangibles by an entity. The details provided below are by no means exhaustive and are provided only by way of illustration of possible ~~direct~~ information relating to specific intangibles.

General information	
Qualitative ~~direct~~ information relating to specific intangibles	**Quantitative ~~direct~~ information relating to specific intangibles**
Business model	
• Information about the entity's business model and its value drivers. • Information about organisational culture with relevance to specific key intangibles. • Information about customer loyalty and trust. • ~~Information about related forward-looking tax planning activities.~~	• Indicators that would help substantiate assertions in the qualitative information provided.
Information about specific key intangibles	
• Information on whether the intangible would need to be replaced (for example, ~~e.g.,~~ software development) or updated (for example, ~~e.g.~~ a customer database) or maintained (for example, ~~e.g.~~ brand awareness). A split between those acquired and those internally developed could sometimes be a proxy for this, but it would not work in all cases. • Information about whether the intangible is (mostly) related to products or to customers. • Information about legal and contractual rights associated with intangibles, including whether an intangible is (legally) owned by an entity. • Information on benefits from specific intangible-related talent and expertise of employees. • Information about the behaviour of providers of funding, collaborators or public authorities with relevance to a specific intangible.	• Linkage with (elements of) intangibles recognised in the statement of financial position and profit or loss or cash-flows. • Disclosure of standardised intangible-related metrics (for example, ~~e.g.~~ license ratio by geographic area, number of product recalls), supplemented by entity-specific metrics (for example, ~~e.g.~~ job leaving ratio, number of active patents). • Information on the remaining useful life of the intangible (if relevant).
• ~~Information on the remaining useful life of the intangible (if relevant).~~ • If the value of an intangible resource is provided (either in the notes or on the statement of financial position): information on the valuation method, including key assumptions used in the estimation and key inputs.	

<table>
<tr><th colspan="2">Specific information for certain types of intangibles</th></tr>
<tr><th>Qualitative ~~direct~~ information</th><th>Quantitative ~~direct~~ information</th></tr>
<tr><th colspan="2">Customer relationships (and similar)</th></tr>
<tr><td>• ~~Customer feedback.~~
• Information on relationships with subscribers.</td><td>• Customer attrition.
• (Increase/decrease in) number of customers.
• Demographic mix of customers (and related variations).
• Customer concentration.
• Market share.</td></tr>
<tr><td colspan="2">• Customer feedback, including customer satisfaction and whether they would recommend the entity's product/service to others.</td></tr>
<tr><th colspan="2">Relationships with suppliers</th></tr>
<tr><td>• Information on whether supplies are paid on time.
• How suppliers are dealing with sustainability issues.</td><td>• Lead time (and changes in this).</td></tr>
<tr><td colspan="2">• Supplier satisfaction.
• Information about the quality of the products/services the suppliers are delivering to the entity.</td></tr>
<tr><th colspan="2">Relationships with employees</th></tr>
<tr><td>• Employee satisfaction.
• Mix between internal promotions and hiring of new employees.</td><td>• Attrition rate (and development in this).
• Number of accidents.</td></tr>
<tr><td colspan="2">• Employee training (see also Figure 4.5 below).
• Changes in productivity.</td></tr>
<tr><th colspan="2">Development costs (recognised on the statement of financial position)</th></tr>
<tr><td>• Information on what is included in capitalised development costs. For example, it would be useful to present resulting patents, technologies or other intangibles separately, to allow comparability with information presented if the patent would have been acquired.</td><td>• R&D costs incurred (recognised in the profit and loss account) broken down by business type.
• Ratio of R&D costs by total operating expenses and R&D costs by total sales.
• Details on capitalised development costs including expected economic life.
• Headcount related to R&D.</td></tr>
<tr><th colspan="2">Intellectual rights/patents</th></tr>
<tr><td>• ~~Information on patent expiration.~~</td><td>• Number of patents with economically meaningful remaining terms.
• Expected economic life of patents.
• Information on patent expiration.</td></tr>
<tr><th colspan="2">Internally developed products</th></tr>
</table>

• Information on internally developed products: target population; countries in which it has been marketed/approved; selling price; competing products existing and under development); jurisdiction-specific opportunities or limitations; safety information (where applicable); market share and projections on market share; lifecycle plans, including prolongation; return on investment.	• Indicators that would help substantiate assertions in the qualitative information provided.
Information related to brands	
	• Disclosure on development in brand value, including the costs necessary to maintain the brand value. • Revenue related to each trade name.

5.19 In addition to the identification of the entity's key intangibles and providing qualitative disclosures and key intangible-related metrics, an entity might provide its own assessment of how the key intangibles contribute to the value of the entity. For certain intangibles, this could be made by providing the entity's expectations of the market share associated to products related to those intangibles.

Non-financial information relating to specific intangibles

~~4.22~~5.20 Financial information relating to specific intangibles can be complemented by non-financial qualitative and quantitative information (or sustainability~~ESG~~ information), such as narrative explanations and metrics that would provide contextual information about the role and contribution of the specific intangible to the broader entity~~entity's~~ value creation strategy.

~~4.23~~5.21 The objective of this Discussion Paper is to focus on financial reporting and consider the ~~financial aspects of~~ value creation aspects and the needs for the primary users of financial statements and management report~~commentary~~. As a result, non-financial information is considered only to the extent that it is relevant to and can have an impact on the primary users. In this respect, non-financial information is only considered from a financial materiality (outside-in) perspective.

~~4.24~~5.22 It is,~~We note~~ however,~~ that it is~~ becoming more and more difficult to identify a clear dividing line between financial information and sustainability~~ESG~~ information. This is because information needs of investors are evolving rapidly with the macrotrend of responsible and sustainable~~ESG~~ investments. The growing attention to responsible investment has resulted in increasing demand by primary users of financial statements for more sustainability disclosures~~ESG disclosure~~, including better information about how an entity interacts with the external environment, the broader society and its labour force; and how this affects the creation and maintenance of its economic value, in particular in the long term, and its sustainability. The longer the investor's perspective, the more likely it is that some sustainability~~ESG~~ risks and opportunities translate into financial impacts and, thus, more non-financial information is needed to make informed investment decisions. In addition, for responsible investors, their understanding of the entity's strategy, processes and operations in dealing with sustainability~~ESG~~ factors is an integral part of their financial decision to invest or divest.

~~4.25~~5.23 The report *Embankment Project for Inclusive Capitalism (EPIC)* of the Coalition for Inclusive Capitalism notes 'In this 21st century business environment, intangible assets like human capital, organizational culture, customer loyalty and trust are more important than ever. They have become such important determinants of a business's success that, globally, intangible assets now represent on average over 50% of a company's market value – and up to 80% in some industries, such as advertising and technology. The problem is that standard accounting practices show the costs associated with these intangible assets, such as the cost of training employees or investing in innovation. But they still do not reflect the vast majority of their value.'

~~4.26~~5.24 With the current economy focussing on services rather than manufacturing, tangible assets have become less important and have been surpassed by innovation, and other intellectual property as the most important value drivers: value creation is now driven by automation, superior technology as well as customer loyalty and human capital. Further evidence is that the ten largest companies by market capitalisation[16] include one oil company, a reinsurance conglomerate and a healthcare and consumer product conglomerate, with the remaining seven representing technology, internet platforms or internet-related offerings.

~~4.27~~5.25 In the European Commission consultation for the revision of the EU Non-Financial Reporting Directive[17], it was noted that reporting on assets like companies' human capital or customer base may provide information very valuable to understand the companies' sustainability profile.

Examples of disclosures on information relating to specific intangibles currently provided by listed companies

~~4.28~~5.26 To the extent that the disclosures currently required by IFRS standards focus on intangible assets as defined by IAS 38, certain intangibles that either do not meet the definition of an asset or, while being assets, do not meet the criteria for recognition are not required to be disclosed. The only requirement related to unrecognised intangible assets is the requirement to disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

~~4.29~~5.27 Some~~To some~~ companies find that this is insufficient to communicate their value creation potential. Therefore, similarly to the approach described in this chapter, they provide additional information~~,~~ on a voluntary basis, on intangibles that are significant value creation sources. ~~Accordingly, this Discussion Paper proposes to require the disclosure of information on the key (or core) intangibles, derived from the entity's business model.~~ An example of an entity identifying the key intangible resources that are significant value creation sources~~how similar information is currently disclosed~~ is provided below from the SAP 2020 Integrated Report[18]. As noted in paragraph 5.10 and 0 above the information illustrated in the following examples would be (more) useful to the extent it can be compared with peers.~~:~~

Figure 4.1 Extract SAP 2020 Integrated Report[19]

[16] https://www.statista.com/statistics/263264/top-companies-in-the-world-by-market-capitalization/.

[17] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Fina/public-consultation.

[18] As indicated in paragraph 2.5 the purpose of this discussion paper is not to consider how the book value of an entity should equal its market capitalisation.

[19] For illustration purposes, we only include an extract of Financial Performance: Review and Analysis section of SAP 2020 Integrated Report. The complete section is included in the SAP 2020 Integrated Report, which is publicly available at SAP website.

‘The (intangible) resources that are the basis for our current as well as future success do not appear in the Consolidated Financial Statements [...]~~. This is apparent from a comparison of the market capitalization of SAP SE (based on all issued shares), which was €131.7 billion at the end of 2020 (2019: €147.8 billion), with the book value of our equity in the Consolidated Financial Statements, which was €29.9 billion (2019: €30.8 billion)…The difference is mainly due to certain internally generated intangible resources that the applicable accounting standards do not allow to be recorded (at all or at fair value) in the Consolidated Financial Statements.~~ These resources include customer capital (our customer base and customer relations); employees and their knowledge and skills; our ecosystem of partners; internally developed software; our ability to innovate; the brands we have built up, in particular, the SAP brand itself; and our organization.’

~~4.30~~5.28 As indicated above,~~in the previous section, the proposed alternative to disclose direct~~ information relating to specific intangibles could be in the form of qualitative information,~~ or through~~ quantitative information, ~~(~~or both complementing each other.~~).~~ An example of qualitative information on a drug that prevents some effects of COVID-19 can be found in the 2020 Annual Report of Merck Group.

Figure 4.2 Extract Merck Group 2020 Annual Report[20]

‘In June, the U.S. Food and Drug Administration (FDA) cleared our investigational new drug application (IND) for M5049 for the potential treatment of patients with Covid-19 pneumonia. The first patient was dosed in the Phase II trial at end of July. M5049 is a potentially first-in-class small molecule that blocks the activation of Toll-like receptor (TLR)7 and TLR8, two innate immune sensors that detect single-stranded RNA from viruses such as SARS-CoV-2, the virus responsible for Covid-19. The aim of the study is to investigate if M5049 intervention at a critical point in the course of Covid-19 disease may prevent or ameliorate the hyperinflammatory response in patients with Covid-19 pneumonia and prevent progression to ‘cytokine storm’. Successful intervention with the investigational drug may reduce life-threatening complications of Covid-19, including severe respiratory symptoms that often necessitate further medical interventions such as mechanical ventilation.’

~~4.31~~5.29 ~~As previously indicated, quantitative information can complement qualitative information. In this sense, although it is not always possible to provide both sorts of disclosure on key intangibles, the existence of quantitative aspects alongside qualitative aspects allows users of financial information to have more information to assess the value of the company and its key intangibles.~~ An example of quantitative information complementing qualitative information~~one~~ on the customer satisfaction is provided below from~~could be found in~~ the SAP 2020 Integrated report.

Figure 4.3 Extract SAP 2020 Integrated Report - Customers[21]

[20] For illustration purposes, only the extract of Research and Development section of Merck Group 2020 Annual Report is included. The complete section is included in the Merck Group 2020 Annual Report, which is publicly available at Merck Group website.

[21] For illustration purposes, only an extract of Customers section of SAP 2020 Integrated Report is included. The complete section is included in the SAP 2020 Integrated Report, which is publicly available at SAP website.

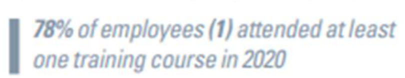
‘In early 2020, SAP brought together customer-facing teams into one organization known as Customer Success. This move enables customer-facing groups to work more closely in unison, providing the foundation for SAP to deliver on the value and experience customers require to be successful. Additionally, we have introduced our new operating model, which aligns sales, services, and customer engagement activities for a seamless experience across customer interactions. Over the next three years, we will roll out this operating model with the aim of improving customers’ adoption and consumption of our solutions and ultimately their business outcomes…

~~*SAP has implemented numerous global initiatives to ensure our focus on customers remains paramount. This includes improvements in the way we work with and care for our customers, taking measures to provide a consistent, end-to-end experience. Through a focus on empathy, we aim to be a company that listens and responds to its customers. We want customers to experience an SAP that is continuously improving. Through this approach, we aim to improve customer loyalty, as measured by the Customer Net Promoter Score (Customer NPS).*~~

We use the Customer NPS[22] as one feedback mechanism to measure customer loyalty. This allows us to directly understand what our customers are thinking and identify key pain points for action. Because of the importance of customers to SAP, Customer NPS is one of our main KPIs. In 2020, our Customer NPS increased 10 points year over year to 4 (2019: –6), strongly exceeding our target of –3 to –1. Using Qualtrics technology has enabled us to listen more closely to our customers and take action on the things that matter to them. We aim to continue to increase our Customer NPS to a range of 5 to 10 points in 2021. Further, we aim to increase the score steadily in the medium term. Beginning in 2020, Customer NPS has been included as a KPI in Executive Board remuneration as part of the short-term incentive component. For more information about executive compensation, see the Compensation Report section. For more information about the Customer NPS, see the Performance Management System section.’

5.30 An example of quantitative information related to employees from Vivendi’s annual report – universal registration document 2020 is provided in Figure 4.4.

5.31 Figure 4.4 Extract from Vivendi’s annual report – universal registration document 2020


78% of employees (1) attended at least one training course in 2020

Other initiatives

~~4.32~~5.32 Disclosure related to specific~~The disclosure of~~ intangibles has been discussed by other initiatives such as that of the Korean Accounting Standards Board (KASB), the World Intellectual Capital~~Capital~~ Initiative (WICI) and the UK Financial Reporting Council (FRC).

[22] Customer Net Promoter Score as defined by SAP in its 2020 Integrated Report.

~~4.33~~5.33 A specific proposal for direct information on core intangibles has been put forward by the KASB. The idea is that there would be a definition of ‘core intangibles’ – those intangibles that are the main driver of the company’s value. These intangibles should be valued at fair value and presented in a separate statement to be provided in the notes to the financial statements: the ‘Statement of Core Intangibles’ (SCI). The SCI would provide monetary valuation of core intangibles in a separate report, including information on the basis of preparation; main assumptions; key valuation inputs and assumptions.

~~4.34~~5.34 Core intangibles were tentatively defined by the KASB as intangible factors that are important to an entity in its creation of value, whether or not they are secured by legal means and whether or not they meet the current accounting definition of ‘assets’. These are important intangibles that could affect the market as it continues to generate excess profits in relation to the reporting company's (value creation) primary operating activities, and if the information is (important) omitted or misrepresented, it effects information user’s decision making (for example,~~e.g.,~~ description on gap between market value and book value).

~~4.35~~5.35 EFRAG has identified both positive and negative aspects of the proposal. The main concern is the relevance and reliability of the fair value information and the cost associated with measuring some unrecognised intangibles at fair value. It can also be questioned whether it is the objective of the financial statements to provide such forward-looking information as this could be in conflict with local regulations prohibiting the provision of such information or even triggering possible legal issues (for example,~~e.g.,~~ if the intangible is finally sold to a materially different price). Furthermore, as it may not be easy to identify the boundaries of specific intangibles, there is a risk of double counting the value of some intangible resources.

~~4.36~~5.36 However, although management’s valuation of individual assets may not be information to be presented in the financial reports, the narrative information about both the value development/maintenance process and information about the model, assumptions and inputs could be valuable information for users to develop their own models.

~~4.37~~5.37 In the alternative proposed above (paragraphs 5.1–5.25),~~,~~ disclosures of the fair value of intangibles ~~-~~are not proposed as the benefits to the primary users of the financial statements would not outweigh the costs that would be incurred. However, both the identification of key intangibles and the qualitative aspects whereby they add value were considered a positive aspect of the KASB initiative and have been considered in the alternative.

~~4.38~~5.38 In 2019, staff of the UK Financial Reporting Council (‘the FRC’), in the discussion paper ‘*Business Reporting of Intangibles: Realistic proposals*’ explored~~explores~~ the reasons why intangibles cannot be fully reflected in financial statements without radical change and developed~~develops~~ practical proposals for improvement in business reporting that could~~can be expected to~~ be implemented in the shorter term. The~~near future. This~~ paper considered~~considers~~ how financial statements might provide better information about expenditures~~expenditure~~ on intangibles that are not recognised as assets and addressed~~address~~ the business reporting of intangibles outside of the financial statements, for example in narrative reporting. ~~While disclosure of expenditure on intangibles relates to information for assessing how performance could be affected by changes in intangibles and is accordingly discussed in chapter 5, the narrative reporting section relates to direct information.~~

~~4.39~~5.39 According to the proposal, management should select the intangibles that are discussed in narrative reporting by reference to those that are most relevant to the entity's business model. The narrative reporting should include metrics and they should be reported for several reporting periods to enable trend analyses. Rather than attempting to provide a value in narrative reporting, the entity should provide information that enables investors to make their own assessment of intangibles and their impact on financial performance. For example, rather than attempting~~attempt~~ to quantify the value of customer loyalty, metrics that are relevant to it could be disclosed. Management should comment on the factors that have caused metrics to change and compare the reported metrics with their realistic targets and the metrics could be standardised within specific industries. The FRC discussion paper also suggests that an entity should disclose the cumulative amount of future-oriented expenditure that is expected to benefit future periods, and movements in this amount. To the extent that it would be possible to relate this information to specific intangibles, this information could be covered by the discussion in this chapter. The FRC's proposal on this information is further considered in Chapter 5.

~~4.40~~5.40 The World Intellectual Capital/Assets initiative (WICI) has developed a principles-based framework which establishes~~establish~~ that organisations should, to the extent possible, provide an integration between narrative information and quantitatively expressed information through key performance indicators. According to WICI, intangible reporting information should be based on the reporting framework's~~frameworks~~ principles of materiality, connectivity, conciseness, comparability and future-oriented. The WICI framework provides three levels of KPIs; general KPIs or those that may be relevant for most organisations across industries, industry-specific KPIs and organisation-specific KPIs.

~~4.41~~5.41 Although the metrics or quantitative information complement the qualitative information as noted in~~, in this proposal it is considered, unlike~~ the FRC staff's proposal and the World Intellectual Capital/Assets initiative (WICI), in this proposal it is emphasised~~)~~ that there might be situations, as illustrated in Figure 4.1 above, where qualitative information provides relevant information on its own with respect to~~of~~ potential value creation. In cases where the quantitative information is very preliminary or imprecise, especially in the early stages~~stage~~ of new projects, the provision of qualitative information is useful for primary users of financial statements.

~~4.42~~5.42 The review of the IASB's Management Commentary Practice Statement (MCPS) is expected to place greater emphasis on information about intangible resources. The IASB clarified that the MCPS will remain principles-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 the primary users' understanding of the nature and importance of those resources and relationships (and their continued availability) to the future operation of the business. To support that principle, the MCPS is expected to provide high-level guidance for identifying the resources and relationships involved, 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.

Identified advantages and disadvantages of information relating to specific intangibles

~~4.43~~5.43 The table below includes some advantages and disadvantages of ~~direct~~ information relating to specific intangibles compared with ~~fair value~~ recognition (see Chapter 3), ~~/~~disclosure of fair value (as suggested in the KASB papers) and information on expenses affecting future~~for assessing how~~ performance (see Chapter 5).~~could be affected by changes in intangibles.~~ Some of the below listed advantages and disadvantages are ~~developed~~ further explained after the table.

Advantages of ~~direct~~ information relating to specific intangibles
• Provides~~It provides~~ more granular and detailed information than information on expenses affecting future ~~for assessing how~~ performance ~~could be affected by changes in intangibles~~ and compared to disclosing the fair value of intangibles / recognising intangibles.
• Provides information on how an entity is creating value by linking the identification of key intangibles with the entity's business model and providing information on these intangibles.
• The disclosures could also include information that would have a negative impact on the entity's earnings, that is 'negative intangibles' / 'intangible liabilities'. For example, if customers are dissatisfied with the entity.
• Generally less~~Less~~ subjective than disclosing the fair value of intangibles (~~either for recognition~~ or recognising and measuring intangibles at fair value).~~disclosure purposes).~~
• More useful for the~~to~~ assessment of stewardship than information on expenses affecting future~~for assessing how~~ performance (as the~~could be affected by changes in~~ intangibles are specified).~~.~~
• Generally, it could be assumed to be less costly to provide than the fair value of intangibles or recognising more intangibles on the statement of financial position. Depending on the information to be provided (including KPIs) information could be less costly to prepare than information on expenses affecting future performance.~~(either for recognition or disclosure purposes).~~
• Could lead to less concern from preparers than providing the fair value of intangible resources. Providing such forward-looking information could be in conflict with local regulations or even give rise to possible legal issues (for example,~~e.g.,~~ if the intangible is~~if~~ finally sold to a materially different price).

Disadvantages of ~~direct~~ information relating to specific intangibles
• In some cases, it is difficult to determine the particular intangible the disclosures relate to (intangibles are often interrelated).
• Identifying the key intangibles of an entity could be judgemental.
• Information could be commercially sensitive (affecting both the entity's competitive position and the risk of litigation).

- ~~Depending on the KPIs, information could be more costly to prepare than information for assessing how performance could be affected by changes in intangibles.~~

- It would not provide a solution to the issue that acquired intangible assets are accounted for differently than~~if they have been acquired versus if they have been~~ internally generated.

- IFRS performance measures will continue to be distorted as not all intangibles are recognised (see paragraph 3.5 above).

- Information on specific intangibles might not reflect the value the intangible is creating for the entity in combination with other assets. While this would also be the case if intangibles would be recognised, the recognition, to the extent that a reliable measurement could be provided, could mean that the value created by the combination of assets would appear from IFRS performance measures.

Subjectivity

~~4.44~~5.44 Some ~~argue that~~ users note that they are not as~~so much~~ interested in the management's valuation of individual assets as in receiving information to determine the entity's value based on~~they have~~ their own models~~to assess the value of an entity as a whole~~. They consider that the entity's own valuation of the intangibles implies a high element of subjectivity and might be biased~~there might be bias toward management's over-optimism in evaluating the intangibles~~.

~~4.45~~5.45 There is also a lack of measurement systems for most of the internally generated intangible assets, as well as value assessment methodologies to avoid overestimation or duplication in the valuation calculations. As noted in Chapter 3, it is not only measurement at fair value of recognised intangible assets that could be a problem, but also measurement at cost~~Internally generated intangibles recognised at fair value could result in abuse and make debt/equity ratios look better~~.

Identifying key intangibles

5.46 For many entities it should be possible to identify key intangibles based on the entity's business model. Similar entities in the same sector would identify similar key intangibles and investors would already be asking for information about these. There may however be entities that consider it more challenging to identify their key intangibles. For these entities, the identification may therefore be more judgemental. In order to operationalise the approach described in this chapter, it should accordingly also be considered whether guidance could be provided to help entities in identifying their key intangibles. Such guidance could refer to what is generally considered to be relevant in the communication with users of financial reporting in a given sector, what is monitored by the board of directors. Reference may also be made to the term 'key resources' in the IASB's project on the management commentary practice statement.

Granularity

~~4.46~~5.47 Sufficiently~~Sufficient~~ detailed and granular information related to the value of intangible assets enables primary users of financial statements to assess how intangibles contribute to the value of an entity~~intangibles~~ using their own models. For example, to know how a marketing plan has been designed and implemented, when it started~~did start~~, in which forms it was pursued, how many clients/households were involved, etc. could help users to estimate the value of a customer list or a brand.

~~4.47~~5.48 This provides more detailed information about an intangible than the valuation of the intangible itself, which is an ultimate outcome that users would not generally find very useful, due to the subjectivity involved. It also produces more in-depth information on intangibles than information for assessing how performance could be affected by changes in intangibles, which may provide valuable information on the income statement but serves to draw conclusions on the company as a whole rather than on individual intangible assets.

Stewardship

~~4.48~~5.49 The disclosure of~~disclose~~ meaningful KPIs on key intangibles allows users to have more tools at their disposal to assess the performance of the management. For this to be effective, KPIs must be clearly defined and consistent over time.

Definitions and identifiability

~~4.49~~5.50 Information relating to specific intangibles~~Direct information~~ requires specific intangibles to be identified and there is no common definition nor common understanding on the categories of internally generated intangible assets. As explained in Chapter 2, different terms are used for the same types of intangibles and some intangibles are overlapping (for example,~~e.g.,~~ reputation versus brand value), which can make it complex to provide ~~direct~~ information relating to specific~~on~~ intangibles. In addition, certain KPIs are not necessarily related to a single intangible as they might affect the value of more than one intangible.

Cost

~~4.50~~5.51 Providing ~~direct~~ information relating to specific intangibles as ~~that~~ suggested in this chapter could generally be assumed to be less costly than the costs of recognising additional intangibles. It would be less costly than recognition as entities would not have to account for additional intangibles (including performing impairment tests or estimating fair value).

~~4.51~~5.52 Whether providing information relating to specific intangibles ~~However, it~~ would ~~generally~~ be more or less costly than providing information on expenses affecting future ~~for assessing how~~ performance, would likely depend on the specific circumstances of each case. When providing information relating to specific ~~could be affected by changes in intangibles as to provide direct information on~~ intangibles, entities would have to identify the various key intangibles and prepare information for each of those. As discussed in Chapter~~chapter~~ 5, to provide information on expenses relating to future~~for assessing how~~ performance, an entity might on the other hand have to provide more detailed ~~could be affected by changes in intangibles entities would need to provide information on specific income statement costs that would help users to assess which costs relate to the current year and which costs relate to future periods. Generally, financial figures are available within the company's books and the hardest aspect would be to determine which~~ information on its costs than currently.~~is useful for users to make that distinction.~~

~~4.52~~5.53 Some entities already provide information related to key specific intangibles in internal reports prepared for managerial purposes, which means that the cost of disclosing this information would be limited for these entities.

~~Chapter 5:~~CHAPTER 6: INFORMATION ON EXPENSES AND RISK/OPPORTUNITY FACTORS THAT MAY AFFECT FUTURE ~~FOR ASSESSING HOW~~ PERFORMANCE ~~COULD BE AFFECTED BY CHANGES IN INTANGIBLES~~

Chapter 5~~This chapter~~ discusses an approach under which~~the proposal to disclose~~ information on intangibles is provided indirectly, by communicating on the non-capitalised costs and risk/opportunity factors that may affect future performance~~the generation or maintenance of the intangibles~~ of an entity. As a result, the information provided under this approach does not provide a measure~~The underlying assumption is that users are not particularly interested in measures~~ of 'the stock' of intangibles, but provides information to help users assess the future ~~as they indirectly value these themselves based on the~~ profitability/margins ~~of the statement of financial performance~~ and/or projected future cash flows~~. Relevant information is thus information to assess whether the current margins can be maintained, enhanced or will decrease in future periods.~~ resulting from changes in the contribution of intangibles. Relevant information is thus information to assess whether the current margins can be maintained, enhanced or will decrease in future periods. That is, information on factors that change (the contribution~~values~~ of) intangibles, rather than information on the value of intangibles. Changes in how~~the values of~~ intangibles affect performance can arise from the entity's investments and disinvestments in intangibles and from risk/opportunity~~other~~ factors. Chapter 5~~This chapter~~ accordingly considers~~consider~~ an approach under which an entity should provide information on:

- *Costs of a period that are not capitalised~~,~~ but could be considered to relate to benefits that will be recorded in future periods. This chapter discusses~~includes~~ both an approach under which~~proposals on how~~ an entity provides~~can provide~~ information to help users in their assessments of what costs relates to future periods and an approach under which an entity's management provides its assessment on which non-capitalised costs that relate to future earnings~~proposals on what information an entity can provide if the distinction of costs should be based on the management's assessments~~.*
- *Factors that could affect (the contribution of) both recognised and unrecognised intangibles. Under the approach discussed in this chapter, it is considered~~This chapter proposes~~ that sufficient information on risk/opportunity factors that could affect the contribution of intangibles to the financial performance of an entity ~~these factors~~ would generally be provided if entities disclose information on risk/opportunity factors that are material and specific to the entity.*

One of the advantages of the approach is that a fixed terminology to be used to distinguish between different intangibles is not necessary for providing information on the costs of a period that are not capitalised. However, a fixed terminology for types of costs may be needed. Also, as the approach is based on the combined effect on earnings at entity level, the approach caters for the fact that often intangibles do not create much value on a stand-alone basis but together with other intangibles and assets.

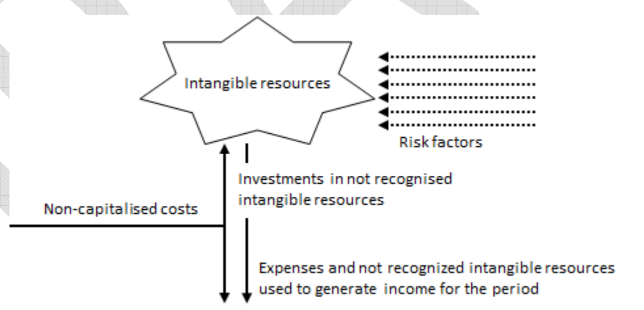
Some of the disadvantages of the approach of providing information on uncapitalised costs are that information on the effectiveness of the investments are not reflected (and IFRS performance figures will still be distorted) and the information will thus not be so useful for assessing management's stewardship. However, other aspects of the management's stewardship will be provided by disclosing how the entity is dealing with risks and opportunity factors.

Why consider information on costs and risk/opportunity factors that may affect future~~for assessing how~~ performance~~ could be affected by changes in intangibles~~?

~~5.1~~6.1 Academic research indicates that professional investors consider the statement of financial performance to be ~~more~~ relevant for their investment decisions and for~~than~~ the assessment~~statement~~ of stewardship[23]~~.financial position24.~~ It could thus be assumed~~argued~~ that ~~the most important information on intangibles is~~ information that would enable~~enables~~ financial statement users to further assess~~‘getting~~ the financial performance of a period~~right’~~ and~~ provide information~~ for predicting ~~the~~ future financial performance would be useful.

6.2 As it appeared from Chapter 3, there could be some issues with recognising all types of intangibles that could affect the performance of future periods. Accordingly, some of the non-capitalised costs of a period could relate to the income in future periods. These non-capitalised costs thus represent investments in (or maintenance of) unrecognised intangibles. This is illustrated in Figure 5.1 below. The figure also shows that (the financial contribution to the entity of) these unrecognised intangibles are affected by risk/opportunity factors. Finally, the figure shows that the entity’s performance of the current period is affected by the use of this pool of unrecognised intangibles. That is, future performance (including future margins) will be affected by how the pool of unrecognised intangibles can contribute to the financial performance (together with other assets of the entity) in the future. Accordingly, if the effect of an entity’s investment in the pool of unrecognised intangibles in a period would outweigh the decline the pool’s income generating capacity in the period, the entity may be able to generate more income / better margins in the future periods than in the current period (unless the intangibles are affected adversely by risk factors).

Figure 5.1 Information on non-capitalised costs and risk/opportunity factors



6.3 By receiving information about non-capitalised costs and risk/opportunity factors, users of financial statements would thus have information that would be useful for predicting future performance compared to current performance.

[23] See, for example, the EFRAG/ICAS study Professional investors and the decision usefulness of financial reporting (2016), conducted by: Stefano Cascino, Mark Clatworthy, Beatriz García Osma, Joachim Gassen, Shahed Imam and Thomas Jeanjean.

~~[24] See the EFRAG/ICAS study Professional investors and the decision usefulness of financial reporting (2016), conducted by: Stefano Cascino, Mark Clatworthy, Beatriz García Osma, Joachim Gassen, Shahed Imam and Thomas Jeanjean.~~

~~5.2~~ For example, if users would receive information that an entity has reduced its marketing expenses related to a particular line of products (a decrease in non-capitalised costs related to the future), this could signal a lower revenue in the future as a result of a lower awareness of the entity's products. Similarly, if the public would be focused on what entities do to prevent money laundering (a risk factor),~~Arguably, an appropriate matching of income and expenses in the statement of financial performance and information, useful for predicting future financial performance, could be achieved by recognising intangibles in the statement of financial position and measure these in a manner that would result in a correct matching in the statement of financial performance (without elaborating in this paper on what that would mean). However, such an approach could have significant implications for the recognition and measurement of items in the statement of financial position, result in mismatching effects and it could be unjustifiable costly considering the benefits (including issues related to the faithful representation of the information) of the information and alternatives (see Chapter 3 above).~~

6.4 ~~An alternative to recognition could thus be to provide~~ information about what the entity is doing in this regard ~~that~~ could help users of financial statements forming expectations about the entity's future revenue (affected through changes in intangibles such as reputation and brand) as well as ~~to assess the 'correctly matched' performance of an entity. Such information for~~ assessing the management's stewardship.

~~5.3~~6.5 Information for assessing how current and future performance is affected by risk/opportunity factors and non-capitalised costs relating to future periods, ~~how performance~~ could be provided ~~affected by changes in intangibles could include information about the generation and maintenance (or changes) in intangibles~~ without specifying the particular intangible for~~to~~ which the financial contribution will be affected.~~change is relate and factors affecting intangibles. The information could be useful for users of financial reports when analysing the entity's financial performance and making predictions about future cash flows.~~ The information could thus be provided as either complementary or alternative information to the ~~direct~~ information on specific intangibles discussed in Chapter 4 or the recognition and measurement of intangibles discussed in Chapter 3.

Useful information on non-capitalised costs and risk/opportunity factors

~~What is information for assessing how performance could be affected by changes in intangibles?~~

~~5.4 This paper uses the term 'information for assessing how performance could be affected by changes in intangibles' and 'indirect information' interchangeably to describe information useful for predicting any future change in profitability caused by changes in the contributions of intangibles (in combination with other assets). That is, 'information for assessing how performance could be affected by changes in intangibles' or 'indirect information' is information on factors that change the entity's performance, rather than information on the value of specific intangibles. For example, although a company does not report its brand asset on its statement of financial position, earnings from the brand are reflected in its profitability. Thus, the firm is readily valued from its earning and information useful for estimating changes to the future earnings, rather than for estimating the value of the brand, could thus be sufficient.~~

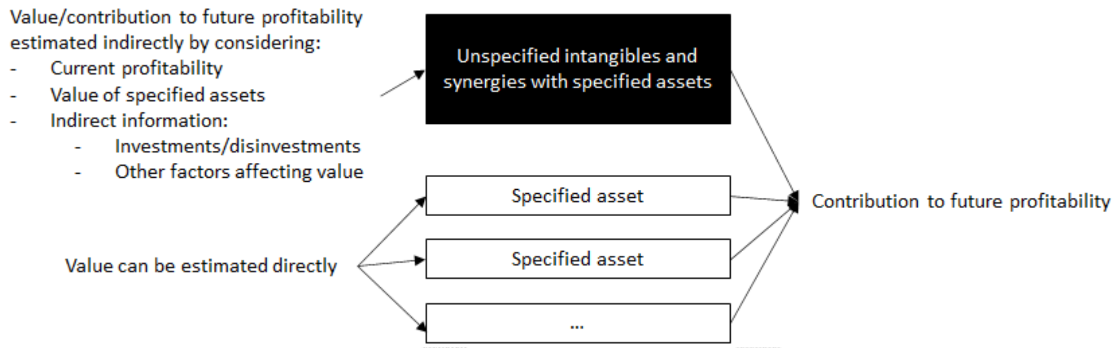
~~5.5 Changes in future profitability related to intangibles can arise from:~~

~~a) An entity's investment or disinvestment (including inadequate maintenance) in intangibles;~~

~~b) Other factors (affecting a single, several or all of the entity's intangibles).~~

~~5.6 This is illustrated in Figure 5.1 below.~~

~~Figure 5.1 Illustration of information for assessing how performance could be affected by changes in intangibles (i.e. indirect information)~~

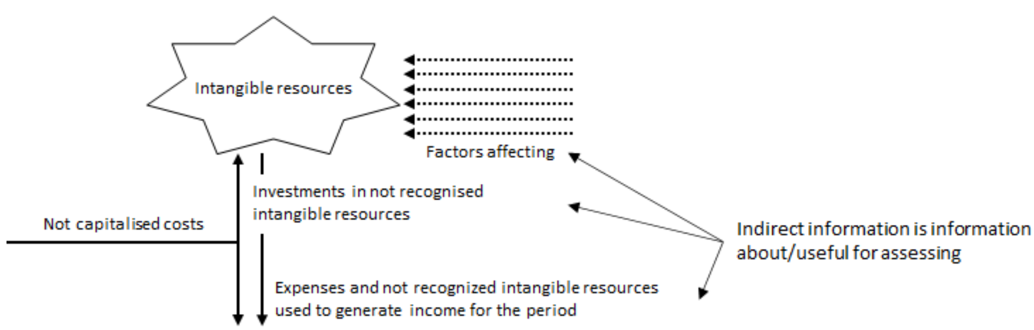


~~5.7 For example, if an entity reduces its marketing expenses related to a particular line of products, this may result in, among other things, a lower awareness of the entity's products (which could affect the value of an entity's brand and perhaps an entity's reputation) and hence lower revenue in the future. In this example, the change in the future profitability of an entity is accordingly related to the entity's 'investment' decision on intangibles ('investment' in scare quotes as the expenses used for the marketing would generally not be capitalised).~~

~~5.8 An example of other factors affecting the entity's future profitability could be a change in public focus on a particular issue. For example, if the public would be focused on what entities do to prevent money laundering, this could affect an entity's future revenue (through changes in intangibles such as reputation and brand) if the entity has either performed very well or very poorly on this area.~~

~~5.9 Information about an entity's investment or disinvestment in unspecified intangibles is provided by the costs spent on these. In practice, it could be difficult to separate information on other factors that affect unspecified intangibles from factors that also affect specified intangibles. Such a separation is accordingly not proposed in this Discussion Paper. This is illustrated in Figure 5.2.~~

~~Figure 5.2 Information for assessing how performance could be affected by changes in intangibles (Indirect information)~~



~~5.10 When considering whether information on specific intangibles would be relevant, the importance of that intangible for the value creation of the entity needs to be considered. As the intangibles to which indirect information is related may not be identified, such an approach would not work for indirect information. Instead, it could be assumed that the information would affect the decision of a financial statement user if earnings/the future cash flows or changes in earnings/future cash flows at entity level could be significant as a result of the (dis)investment or the factor.~~

~~Information for assessing how performance could be affected by changes in intangibles that could be useful~~

~~5.11~~6.6 It follows from paragraph 1.1 and Figure 5.1~~2~~ that information for assessing how performance could be affected by non-capitalised costs and risk/opportunity factors can~~changes in intangibles~~ be categorised into:

a) Information on investments in unrecognised intangibles (versus ~~-~~costs used to generate income for the period (expenses of the period));

b) Information on the use of unrecognised intangibles;

c) Risk/opportunity factors~~Factors~~ affecting intangibles.

~~5.12~~6.7 These types of information are further explained and exemplified below. In the following paragraphs it is proposed that information on investments in unrecognised intangibles and information on the use of unrecognised intangibles is provided in the notes to the financial statements.

~~5.13~~6.8 This chapter~~Discussion Paper~~, however, does not include any suggestions on whether information on factors affecting intangibles should be included in the notes to the financial statements or in the management report~~commentary~~.

Information on investments in unrecognised intangibles

~~5.14~~6.9 As noted above, for~~For~~ users of financial statements to be able to make projections on future profitability and cash-flows, it would be useful to have information on whether the costs of the period have been incurred to generate income in the period or in future periods.

~~5.15~~6.10 There are two general manners in which this information can be provided. Either:

a) Entities can be asked to present separately, in the notes to the financial statements, expenses that according~~accordingly~~ to the management relate to the current (and past) period earnings and those incurred to generate earnings in future periods (alternatively this information can be provided on the face of the statement of the financial position, see Chapter 3); or

b) Entities can be asked to provide information that would help users of financial reports to make a distinction between costs related to the current period earnings and future periods respectively.

6.11 As an alternative to the two general manners, entities can be asked to provide information that would help users of financial reports to make the distinction, but at the same time disclose if there are significant and unusual expenses that relate to future periods.

6.12 The two approaches mentioned in paragraph 6.10 are further described and considered below. In addition, it is considered how information can be provided to help understand the entity's business model when, as mentioned in paragraph 6.5, the information provided is not linked to identified specific intangibles. Finally, it is noted that when using current margins and profitability to predict future earnings under the suggested approach, information on the amortisation costs of acquired intangibles could be useful.

Split made by the entity's management

~~5.16~~6.13 Asking the entity to split the expenses relating to the current (and past) and future periods has the potential to result in more accurate information due to the entity's access to detailed information, than if the entity would provide information to help users make their own distinction. Under such an approach, it would also be possible to require entities to provide additional information on the costs considered relating to the future. This could include information~~. However, users may be critical~~ about the management's estimates on when material non-capitalised costs relating to the future are expected to result in benefits (when it would be possible to make a reliable estimate, as it might be difficult for~~information received from an entity as the information would always involve~~ some types of costs, such as research costs).~~level of subjectivity. Users may accordingly want to make their own split.~~

~~5.17~~6.14 Should entities be required to do the split, guidance on which cost would relate to the future might need to be provided. This guidance could be based on what expenses would have been necessary in a no-growth scenario. ~~The information provided by entities could split the costs per function and per nature as illustrated in Figure 5.3 and list the margins if no investments in growth were made.~~

Split made by the user of the financial report

6.15 Although asking the entity to split the expenses could result in the most accurate information, users may be critical about such information received from an entity as the information would always involve some level of subjectivity. Users may accordingly want to make their own split.

Entities~~Figure 5.3 Current/future nature/function matrix~~

	Cost of sales		Distribution and marketing costs		Administrative expenses		Total	
	Current	Future	Current	Future	Current	Future	Current	Future
Changes in inventories of finished goods and work in progress								
Raw materials and consumables used								
Employee benefits expense								
Depreciation and amortisation expenses								
Other expenses								
...								
Total								

~~5.18 A presentation as that illustrated in Figure 5.3 may, however, not be the most suitable if many of the cells would be empty – for example because only some types of costs are related to a particular function. In that case lists could be more appropriate.~~

5.19 ~~For users of financial statements to receive information on when the costs related to the future would benefit the entity, it could be useful to inform about the management's estimates on when the material costs are expected to result in benefits. It could thus be required that entities provide information about this in the notes to the financial statements. An example of how such disclosures could be provided in the financial statements is provided in Figure 5.4.~~

~~**Figure 5.4 Example of disclosure on time range for benefits resulting from costs related to the future**~~

~~Of 'Other expenses' that are 'Distribution and marketing costs', CU 1 234 relate to advertisement campaigns of the financial year CU 765 are considered to relate to the income of the current period, while CU 469 are expected to benefit mainly the following two financial year (primarily the following financial year).~~

5.20 ~~If not providing the information directly, entities~~ could help users of financial reports makingstatements providing their own estimates of the cost of a period relating to the current period and those relating to future periods. This could be done by providing ~~For that purpose, a matrix that shows expenses by both function and nature could be useful to provide users of financial statements with information on types of expenses per function. The information could be provided in a manner similar to the matrix illustrated in Figure 4.2, however, without separate amounts for the costs related to the current period and to future periods. Again, if many of the cells would be empty, a list instead of a matrix could be a more appropriate manner of disclosing the information.~~

~~5.21~~6.16 ~~Although information on the types of non-capitalised costs that would be related to each function may help users making assumptions on the costs that relate to the current period and those relating to the future,~~ more granular information on the cost of a period~~will often be necessary for some types of costs~~. The entity could thus be required to provide information on specific costs (in addition to the current requirement in IAS 38 to disclose the aggregate amount of research and development expenditure recognised as an expense during the period), to the extent the costs would be material. The list of specific costs of the period could include, but not be limited to, for example:

a) Spending on patents;

b) Marketing costs (including information on spending on trademarks/brands);

c) Staff training costs (not included in research and development costs or sales and marketing costs).

5.22 ~~Figure 5.5 below shows a presentation of the distribution of research and development costs of a company.~~

~~**Figure 5.5 Illustration on the distribution of research and development cost in a current financial report**~~

Research and Development Costs

€ million	2020	2019	Change € million	Change %
Healthcare	1,640	1,666	-26	-1.5%
Life Science	313	276	37	13.3%
Performance Materials	274	267	6	2.4%
Corporate and Other	62	59	3	4.3%
Total	**2,288**	**2,268**	**20**	**0.9%**

The ratio of research expenditure to Group sales was 13.0% (2019: 14.0%). The decline is due to the positive sales development.

~~From 2020 financial report of Merck Group.~~

6.17 Often, at least a part of those listed costs could affect future earnings. Users could thus assess whether the costs of the year could affect future earnings positively or negatively (for example, if the costs are lower than in previous years).

6.18 To assess how the costs related to future periods affect current margins, it would be necessary to link the specified costs with the line items in which they are included in the statement of financial performance. This could, for example, be done in a matrix as illustrated in Figure 5.2.

Figure 5.2 Nature/function matrix

	Cost of sales	Distribution and marketing costs	Administrative expenses	Total
Spending on patents				
Marketing costs				
Staff training costs				
Research costs				
...				
Total				

6.19 If many of the cells would be empty, a list instead of a matrix could be a more appropriate manner of disclosing the information.

Information to understand the entity's business model

~~5.23~~6.20 Users seem to consider line items in the financial statements to be most useful when they provide~~it provides~~ information about the underlying business model and when they help forecast firm activities or evaluate managerial performance[25]. It may be reasonable to expect that the same would apply to financial information in the notes of the financial statements. It will follow below that information for assessing how performance could be affected by changes in intangibles may not be as useful as information on specific intangibles to understand the entity's business model and strategy. This is because information for assessing how performance could be affected by changes in intangibles does not directly identify the intangibles that are important for an entity. However, information on which areas an entity is using/spending its resources/costs could provide some information on its business model.

~~5.24~~6.21 For this purpose, it could be considered to require information such as:

a) Granular cost information (see paragraph 0 above);

~~a)~~b) Number of employees and employee costs per function, per segment and region (if segments are not based on regions);

~~b)~~c) Marketing costs per market and brand (see also paragraph 6.16b).

6.22 Figure 5.3 below shows a presentation of the distribution of research and development costs of a company.

Figure 5.3 Illustration on the distribution of research and development cost in a current financial report

Research and Development Costs

			Change	
€ million	2020	2019	€ million	%
Healthcare	1,640	1,666	-26	-1.5%
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Total	**2,288**	**2,268**	**20**	**0.9%**

The ratio of research expenditure to Group sales was 13.0% (2019: 14.0%). The decline is due to the positive sales development.

From 2020 financial report of Merck Group.

[25] Cascino, S. et al. 2021. The Usefulness of Financial Accounting Information: Evidence from the Field. The Accounting Review (forthcoming).

Amortisation costs related to acquired intangibles

6.23 Finally, amortisation expenses related to acquired intangible assets recognised on the statement on financial position should be disclosed separately in the notes to the financial statements. When an intangible asset has been acquired and is replaced automatically by internally generated assets (that is, non-capitalised costs), the statement of financial performance is 'hit twice' until the acquired asset is fully amortised. Until the asset is fully amortised, both the amortisation expenses and the non-capitalised cost used to replace the asset would affect the statement of financial performance. Users may therefore want to be able to exclude the amortisation costs related to acquired intangible assets when calculating margins to be used for the projection of future profitability.

Information on the use of unrecognised intangibles

~~5.25~~6.24 For users of financial statements to project future cash flows, it is useful to know what happens when an intangible is used to generate income. Unlike (most) tangible resources, some intangibles may become more valuable and are hence able to generate more income in the future the more they are used. This could, for example, apply to some IT platforms that would increase in value the more content users put on them by users. On the other hand, similar to (most) tangible assets, some intangibles would need to be 'replaced' after some time which could involve significant costs (for example, intangibles resulting from a marketing campaign). Finally, while needing 'replacement' some intangibles are maintained 'automatically' through the operation of the business. This would, for example, normally be the case for a customer list.

~~5.26~~6.25 In Chapter 4, the information on specific intangibles proposed on whether an intangible is automatically replaced (or whether the intangible is related to products or customers) could be useful for distinguishing between intangibles that need replacement and intangible resources that do not, for example because they are automatically replaced. For intangibles that would require costly replacements, it could be useful for users of financial statements to receive information on the replacement period and cost of replacement for predicting future cash flows.

~~5.27~~6.26 A possible useful information would be the disclosure of information on unrecognised intangibles used to generate income for the period. ~~-~~However, unless preparers of financial information would be required to provide information on (or at least keep track of) the cumulative amount of costs that relate to the future and are not capitalised, it would not be possible to provide exact information on unrecognised intangibles used to generate income for the period.

~~5.28~~6.27 To some extent, however, users might be able to work around that for the prediction of future cash flows if they, based on the information on what cost of a year relates to 'investments' would be able to assess steady-state margins and would then be able to predict how the future would deviate from a steady-state. This prediction could be based on whether 'investments' increase or decrease.

Risk/opportunity factors~~Factors~~ affecting intangibles

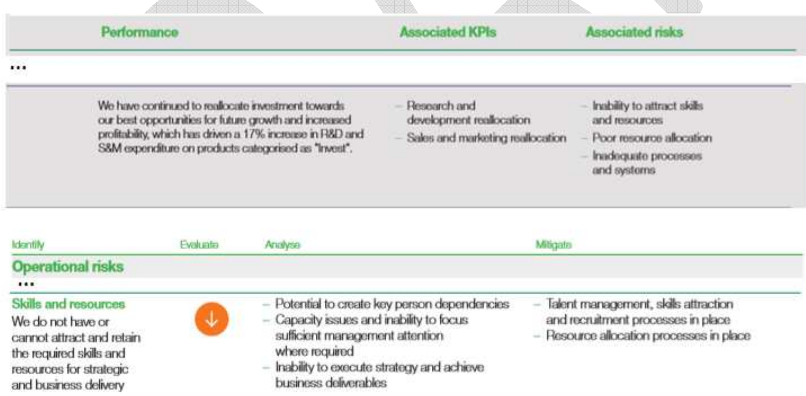
~~5.29~~6.28 A list of factors that could affect an entity's intangibles could be very long. Although this Discussion Paper only focuses on information that is useful for the primary users of financial reports, issues that might currently only be considered useful for other groups of financial statement users than the primary users,~~assessing the entity's policies in an area~~ could end up having a significant impact on for example,~~e.g.,~~ the entity's brands. The same could be the case for information about sustainability and climate. Accordingly, the information could also become useful for the primary users of the financial statements. An example was provided in paragraph 1.1 above.

~~5.30~~6.29 Requiring entities to provide long lists of possible factors that could affect its intangibles might not be realistic or cost/benefit effective. Similarly, requiring all types of, for example, sustainability~~ESG~~ information in financial reports could make the financial reports less accessible for their primary users.

~~5.31~~6.30 This chapter~~Discussion Paper~~ accordingly presents an approach under which~~proposes~~ a requirement to disclose risk/opportunity factors would be limited to information that is~~are~~ material and specific to the entity – that is,~~i.e.,~~ 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,~~e.g.,~~ KPI's used to measure it) and how the risk/opportunity is managed and mitigated or taken advantage of.~~.~~ The factors should be limited to those that are material for the primary users of financial statements. The information~~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 ~~negative~~ impact. Each of the risk/opportunity factor should be described, explaining how it affects the entity. This approach would also require the entity to describe its business model (see Chapter 4).

~~5.32~~6.31 In some jurisdictions, entities are already required (either in the financial statements or in for example,~~e.g.,~~ listing documents) to disclose similar information for risks in general or for specific types of risks (for example,~~e.g.,~~ related to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters). Figure 4.4 provides an example of how such information is currently provided.

Figure 4.4 Illustration on how information on risks related to intangibles is currently provided



Extracts from the Sage 2014 annual report.

~~5.33~~6.32 Users may also consider general market information (for example,~~e.g.,~~ market growth and price development) to be useful. For example, if the market is growing this could increase the value of an entity's brand. However, as general market information could be retrieved by users from other sources, the approach presented in this chapter~~Discussion Paper~~ does not ~~propose to~~ introduce requirements for companies to disclose such information.

Initiatives considering information on expenses and risk/opportunity factors that may affect future~~for assessing how~~ performance ~~could be affected by changes in intangibles~~

~~5.34~~6.33 The idea that some costs~~cost~~ of a period are~~is~~ an investment in~~for~~ future periods (which could be both successful and unsuccessful) and that information about this could be useful, is not new. In its 2001 proposal for a new agenda project 'Disclosure of Information about Intangible Assets not Recognised in Financial Statements', the FASB, for example, noted that information to be provided on intangible assets (not recognised) could involve 'expenditures to develop and maintain them'.

~~5.35~~6.34 Academic research has, similarly, examined, for example, whether investments in intangibles, that are included in operating expenses should be measured and separated from operating expenses[26].

~~5.36~~6.35 In 2019, the staff of the UK Financial Reporting Council ('the FRC'), in the discussion paper *Business Reporting of Intangibles: Realistic proposals* (see paragraph 5.38 above) proposed specific disclosure requirements of the amount and nature of investments in unrecognised intangibles that are treated as an expense in the period, particularly those that are incurred with a view to generating benefit in subsequent accounting periods ('future-oriented intangibles'). These should be clearly differentiated from expenses that unambiguously relate to the period. However, the proposal went further than the approach presented~~what is suggested~~ in this chapter, as it also suggested that the cumulative amount of future-oriented expenditure that is expected to benefit future periods, and movements in it, should be disclosed.

~~5.37~~6.36 The proposals of the FRC staff were based on the approach that the entity should present directly~~determine by itself~~ which costs it considers relate to future periods.

~~5.38~~6.37 The views of respondents commenting on the proposals were divided. The main concern of those who did not support the proposals was the inherently subjective nature of the allocation of costs between current period expenses and expenditure on future-oriented intangibles. Many respondents believed that this could not be done in a consistent and non-arbitrary manner. There were also concerns that it would be open to manipulation by management, with a view to presenting a more favourable view of current period earnings.

~~5.39~~6.38 As noted above this chapter presents an alternative to having the management splitting costs between current period expenses and costs related to 'investments'.

~~5.40~~6.39 As mentioned in paragraph 6.31 information about certain risks is~~are~~ already required in many jurisdictions. Examples of EU legislation include: Regulation (EU) 2017/1129 (on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market) and the related Delegated Regulation (EU) 2019/980. These requirements may, however, not be interpreted as also requiring disclosures of positive outcomes of risks (that is, what is termed opportunities in the description above).

[26] See, for example: Kanodia, C, Sapra, H., Venugopalan, R. (2004). Should intangibles be measured: what are the economic tradeoffs? Journal of Accounting Research. 42: 89–120 and Enache, Luminita; Srivastava, Anup. (2018) Should Intangible Investments Be Reported Separately or Commingled with Operating Expenses? New Evidence. Management Science. 64 Issue 7, 3446-3468.

Identified advantages and disadvantages of information on expenses and risk/opportunity factors that may affect future~~for assessing how~~ performance ~~could be affected by changes in intangibles~~

~~5.41~~6.40 The table below includes some advantages and disadvantages of information on expenses and risk/opportunity factors~~for assessing how performance could be affected by changes in intangibles~~ compared with information on specific intangibles and recognition/measurement of intangibles. The advantages and disadvantages are considered further after the table.

Advantages of information on expenses and risk/opportunity factors that may affect future~~for assessing how~~ performance ~~could be affected by changes in intangibles~~

- A fixed terminology to be used to distinguish between different intangibles is not necessary for providing information for assessing how performance could be affected by changes in intangibles.
- As the approach is based on the combined effect on earnings at entity level, it can take into account that intangibles often do not create much value on a stand-alone basis but together with other intangibles or other assets. It is thus not a problem when providing the information that intangibles are interrelated.
- Does not require specific intangibles to be identified and measured. Issues with measurement of intangibles would be avoided.
- Depending on the information to be provided information could be less costly to prepare than information on specific intangibles.
- Generally, it could be assumed to be less costly to provide than recognising intangibles or providing information on specific intangibles.

Disadvantages of information on expenses and risk/opportunity factors that may affect future~~for assessing how~~ performance ~~could be affected by changes in intangibles~~

- Users would not receive information on specific key intangibles for the entity's business model.
- Effectiveness of investments in intangibles is not taken into account.
- Difficult to 'match' revenue with costs of previous investments.
- Less useful for assessment of stewardship.
- Not useful for assessing returns of an entity as the value of intangibles would not appear.
- Less granular information on intangibles compared with ~~direct~~ information relating to specific intangibles and recognition.
- The information could be commercially sensitive.

- Information on expenses that may affect future performance would not provide information on 'negative intangibles' / 'intangible liabilities'. Information on risks and opportunities could, however, capture some of this information.

- Would require guidance on what different types of costs should include.

- To the extent the entity is splitting costs related to the current period and to future periods (see paragraph 6.10), the information will be quite subjective. If, instead, information is provided to help users perform their own split, the information will be less subjective.

- It would not provide a solution to the issue that acquired intangible assets are accounted for differently if they have been acquired versus if they have been internally generated.

- Depending on the information to be provided information could be more costly to prepare than information on specific intangibles.

- IFRS performance measures will be distorted as not all intangibles are recognised (see paragraph 3.5 above).

Identifying intangibles

~~5.42~~6.41 Information for assessing how performance could be affected by changes in intangibles does not require specific intangibles to be identified. As explained in Chapter 2, different terms are used for the same types of intangibles and some intangibles are overlapping (for example,~~e.g.,~~ reputation versus brand value), which can make it complex to provide information on specific intangibles.

~~5.43~~6.42 On the other hand, information for assessing how performance could be affected by changes in intangibles would require more guidance on how to classify different types of costs in order for the information to be comparable and reduce the possibility of the different cost categories to be used opportunistically by management (for example, guidance should be provided on what should be included in research costs, in marketing costs, in costs on patents and in staff training costs).

~~5.44~~6.43 Also, when intangibles are not identified, it may be more difficult for users of financial statements to understand the specific intangibles that are vital for the entity and the entity's business model.

~~5.45~~6.44 Only providing information on (or to help the users assess) costs related to future periods (that is,~~i.e.~~ 'investments'), does not inform on how well these investments perform. In some cases, it may be possible for users to assess the effectiveness of the costs spent by calculating (to the extent information is available) and comparing, for example, the costs an entity spends on establishing a new customer relationship. However, this may often not be possible. For example, an entity can spend a lot of money on training staff in a new computer system which is then scrapped before it is taken into use, this failed investment will not appear directly from the financial statements (for example,~~e.g.,~~ in the form of an impairment loss). Similarly, it can be that an entity is decreasing its marketing expenses, but if the money is just spent more wisely, this decrease may not mean that the intangibles related to customer's perception and knowledge of a product/entity would decrease. Qualitative information related to the cost, for example, explanations of changes compared with last year may help users understand the management's intentions and expectations related to the changes. However, it may not be possible subsequently to check whether the management's expectations were realised. Information for assessing how performance could be affected by changes in intangibles may accordingly not be as good as information on specific intangibles for assessing the management's stewardship.

Measurement of intangibles

~~5.46~~6.45 As information for assessing how performance could be affected by changes in intangibles does not include measurement of intangibles at either cost or fair value, the issues related to the uncertainty of such measurement could be avoided.

Use of investments

~~5.47~~6.46 As previously noted, and unlike other proposals[27], this chapter does not propose that preparers would be required to register and keep track of the cumulative amount of not capitalised costs that relate to 'investments'. The input on which this discussion paper is built, did not identify as a user need information on the cumulative amounts of not capitalised costs related to future earnings. This also means that users of financial statements will not be able to receive information on when the 'investments' are used and hence determine the 'correct' margins by matching the income of a period with the related expenses. It also means that the calculated returns will not be comparable between entities that have acquired intangibles and entities that have developed intangibles internally (under circumstances where the costs could not be capitalised).

~~5.48~~6.47 To the extent that the management provides an assessment of the costs that relate to future periods, the suggested disclosures on when the costs are expected to result in benefits could be used to estimate this. However, this would require users to keep records of the 'investments' of previous periods and when the benefits of these were expected to incur. This may be less of an issue as financial information is digitalised. Users would, nevertheless, not receive information in advance if the 'investment' is no longer expected to result in benefits or if the time period for the benefits has changed.

[27] For example, the proposal of the FRC staff mentioned in paragraph 6.35.

Costs of preparing the information

~~5.49~~6.48 Providing information for assessing how performance could be affected by changes in intangibles as that suggested in this chapter could generally be assumed to be less costly than the costs of recognising additional intangibles.~~ or providing information on specific intangibles.~~ It would be less costly than recognition as entities would not have to account for additional intangibles (including performing impairment tests or estimating fair value). It may~~would~~ be less costly than information on specific intangibles, as entities would not have to identify the various intangibles and prepare information for each of those. However, in order to provide information on expenses relating to future performance, the entity may have to register costs more granularly than currently. This would increase the costs for preparers~~Information for assessing how performance could be affected by changes in intangibles, as considered in this Discussion Paper, would imply that additional information is provided about the changes of intangibles in a period. This means that, for example, that additional information would not have to be stored from one accounting period to another~~.

~~5.50~~6.49 To the extent that information on expenses related to future~~for assessing how~~ performance ~~could be affected by changes in intangibles~~ is used to supplement information on specific intangibles, any~~the~~ cost-saving benefits ~~of information for assessing how performance could be affected by changes in intangibles~~ would~~, however,~~ diminish or disappear completely.

~~Chapter 6:~~CHAPTER 7: WAY FORWARD, ~~AND~~ CHALLENGES AND ISSUES FOR POSSIBLE SOLUTIONS

When considering how to provide better information on intangibles, consideration~~it~~ should also be given to~~considered~~:

- *whether~~Whether~~ it would be beneficial to establish a common terminology on intangibles;*
- *how~~How~~ to provide useful information but at the same time not require entities to disclose information that is ~~very~~ commercially sensitive;*
- *where~~Where~~ the information should be provided – in the financial statements (including the notes), in the management report~~commentary~~, or somewhere else;~~);~~*
- *whether~~Whether~~ it would be~~is~~ possible to audit the information and at a cost that would not outweigh the benefits of having the information audited;*
- *whether~~Whether~~ the approach to providing information on intangibles could affect an entity's access to finance;*
- *whether~~Whether~~ some of the current requirements can be removed.*

Which way forward?

~~6.1~~7.1 This Discussion Paper identifies ~~has identified~~ different approaches for better information on intangibles. It considers~~It could thus be considered~~ that better information on intangibles could be achieved by:

a) Approach 1: Amending recognition and measurement requirements for intangibles (Chapter 3 provides~~provided~~ different ways~~manners~~ in which this could be done);

b) Approach 2: Providing information on specific intangibles (Chapter 4 provides~~provided~~ examples of information on specific intangibles that could be useful);

c) Approach 3: Providing information on expenses and risk/opportunity factors that may affect future~~for assessing how~~ performance ~~could be affected by changes in intangibles~~ (Chapter 5 discusses~~discussed~~ different approaches in~~for~~ this respect and provides~~provided~~ examples of information that could be useful).

~~6.2~~7.2 For each of the identified ~~these~~ approaches, information on risk/opportunity factors affecting intangibles would be useful.

~~6.3~~7.3 Some of the approaches could be combined or different approaches could be used for different types of intangibles (for example,~~e.g.,~~ one approach could be used for intangibles that meet the definition of an asset and another approach could be used for intangibles that would not meet the definition of an asset). Approaches 1 and 2~~The approaches~~ mentioned in ~~a) and b) in~~ paragraph 7.1 could thus be combined. Approach 3~~c)~~ could in principle also be combined with Approach 2,~~b),~~ however, many of the (cost) advantages of providing information for on expenses that may affect future~~assessing how~~ performance ~~could be affected by changes in intangibles~~ would then disappear.

Some additional factors to consider

7.4 When considering possible solutions for better information on intangibles, there are some other factors to consider. The previous chapters have already mentioned some of the following factors.

Terminology

~~6.4~~7.5 There is no fixed terminology when it comes to describing intangibles. Different words can accordingly be used for the same intangible, and the boundaries of what is included in a particular term can differ. The introduction of a common terminology could therefore be considered as something that could be useful for the reporting of intangibles. If information on intangibles would be based on information on expenses that may affect future~~for assessing how~~ performance~~ could be affected by changes in intangibles~~ (see Chapter 5), a common terminology on intangibles might be less necessary than if information on specific intangibles would be provided or if more intangibles would be recognised in the financial statements. However, in that case, it may be beneficial to provide more guidance on how to classify different types of costs.

~~6.5~~7.6 The introduction of a common terminology might also clarify how different intangibles may be overlapping.

Sensitivity~~Sensitiveness~~ of the information provided

~~6.6~~7.7 Another factor that was mentioned in previous chapters, is~~above, although only shortly, was~~ that some of the information proposed could result in entities having to disclose information they consider commercially sensitive. It~~Although the threshold should be high, it~~ would therefore be necessary to allow entities not to present certain information if it would be highly commercially sensitive. When this would be the case, it should be considered whether alternative information could be presented (a type of ‘comply or disclose alternative information’ approach).

Placement of information

~~6.7~~7.8 This Discussion Paper~~discussion paper~~ only considers information that could be presented in the financial reports (the financial statements, including the notes~~, to the financial statements~~ and the management report).~~commentary.~~ The discussions in Chapter 4 and Chapter 5 about information on specific intangibles and information on expenses and risk/opportunity factors related to the future, ~~for assessing how performance could be affected by changes in intangibles in Chapter 4 and Chapter 5~~ do not generally~~ not~~ consider what information would be best placed in the notes to the financial statements and what information would be better placed in the management report~~commentary~~. Similarly, the Discussion Paper~~discussion paper~~ does not consider whether some of the proposed information might be better provided outside of the financial reports. Currently some preparers communicate additional information on intangibles that is useful for the primary users of financial statements outside financial reports. This, for example, happens when it would be very costly or ~~/~~not possible to have the same type of internal scrutiny and control of the information as is applied for the information provided in the financial reports. ~~Besides discussing what information to be provided, it could be relevant also to discuss where the information should be provided.~~

Besides discussing what information to ~~Auditability and audit costs~~

7.9 ~~The previous chapters considered the issues that could~~ be provided, it would also be relevant to discuss where~~related to prepare the information and the costs of preparing~~ the information~~. In addition to this, it~~ should be provided.

7.10 Whether~~considered whether it would be possible to audit~~ the information considered in Chapters 4 and 5~~(including how subjective the information will be) and whether the benefits of having the information audited~~ would be best provided in the notes to the financial statements or in the management report could depend on the type of the information and which role is assigned to the notes to~~outweigh~~ the ~~costs of having it audited. Users of financial statements might, for example, find it useful that the~~ financial statements under the IFRS framework.

7.11 As suggested in the IASB's Exposure Draft *General Presentation and Disclosures*, the role of the notes could be to:

a) provide further information necessary for users of financial statements to understand the items included in the primary financial statements; and

b) supplement the primary financial statements with other ~~include some~~ information that is necessary to meet the objective of financial statements.

~~6.8~~7.12 A possible interpretation~~would free them from finding the information in other sources, but may not attach a high value to the fact that some pieces~~ of this suggested guidance could be that information related to specific intangibles (the approach considered in Chapter 4) should generally be placed in the notes to the financial statements to the extent the specific intangible, to which the information is related, would meet the definition of an asset[28]. Information related to intangibles that would not meet the definition of an asset should, on the other hand, be disclosed in the management report. For the approach suggested in Chapter 5 it would mean that additional information about the costs of the period, including any assessment of the management on whether they relate to the income of future periods or to the current (or past) period(s) would be included in the notes to the financial statements. The disclosures about the specific risk/opportunity factors affecting intangibles, would, on the other hand, be included in the management report to the extent they are not directly related to items that would meet the definition of an asset.~~audited.~~

7.13 An argument against the approach outlined in paragraph 7.12 above could, however, be that it would result in users of financial statements having to consult two different sources (or parts of the financial report) to find the relevant information on intangibles. In addition, there would currently be practical issues with requiring information to be presented in the management report, as the IFRS guidance on this issue is not binding and the content of the management report and whether or not entities should prepare a management report depend on local requirements. This might impact international comparability.

[28] This is because the objective of financial statements, as stated in the Conceptual Framework, is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources. The described approach also seems to be reflected in paragraph 128 of IAS 38, which encourages entities to disclose intangible assets controlled by the entity that do not meet the recognition criteria.

Potential effects on the ability to receive finance

~~6.9~~7.14 The~~To the~~ extent to which presenting information in a particular way~~that it~~ could impact an entity's ability to receive finance ~~that information is presented in a particular manner, this~~ should be taken into account. For example, when considering what assets should be recognised in the statement of financial position (including which assets should be recognised separately from goodwill), consideration~~it~~ should be given to whether~~taken into account if~~ recognising these assets could affect an entity's ability to receive finance. This is due to the fact that ~~(as~~ assets such as research and development in pipeline,~~;~~ brand reputation and customer loyalty might be accepted as collateral, ~~(~~whereas goodwill would not~~)~~[29].

Removal of some of the current requirements

~~6.10~~7.15 The previous chapters have mainly considered how additional information can be provided on intangibles. However, when addressing how to provide better information on intangibles (because 'better'~~better~~ is not the same as 'more'), it would also be appropriate to assess whether some of the current requirements, for example those related to how to account for intangibles acquired in a business combination, which can be costly for preparers to comply with, could be removed/amended without reducing the usefulness of the information provided to users.

[29] See, for example, Anna Thum-Thysen, Peter Voigt Unlocking Investment in Intangible Assets (2017).

APPENDIX 1: BIBLIOGRAPHY

TO BE INCLUDED

APPENDIX 2: ACKNOWLEDGMENTS

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