Mr. Jean-Paul Gauzes
EFRAG Chairman
35 Square de Meeûs
1000 Brussels (fifth floor)
Belgium

Sophienstraße 44 DE – 60487
Frankfurt am Main, Germany
Direct number: +49 69 98959519
Fax number: +49 69 98957529
E-mail: office@effas.com
Internet: www.effas.com

Re: DP *Better Information on Intangibles*

Contact: Jeremy Harding

27th June 2022

Dear Jean-Paul,

The EFFAS Commission on Financial Reporting ("Commission", "We") would like to share with you its views on EFRAG's Discussion Paper ("DP") *Better information on intangibles*.

The Commission supports EFRAG's undertaking to address *Intangibles.* We agree that better information in the subject is needed. Entities' business operations have significantly changed over the past decades. Intangibles have become important elements as technology, brand names and market position are increasingly playing a relevant role in companies' operating activities. Hence, they are often key for analysts if they want to better understand how the entity tries to create value.

Also, we think, that in addition to the financial statements, other sources of information have become more relevant to assess the business risks and determine the value of an entity. A broader approach to corporate reporting is becoming more important to determine how a company creates value and how it will continue to do so.

EFFAS continues supporting EFRAG's comprehensive and high-quality documents. Also, we encourage EFRAG to continue addressing subjects of relevant interest for investors. Albeit the Commission would like to stress the need for clear and understandable documents avoiding density and repetition and published in a manner that facilitates a fluent reading.

Regarding the key points of the DP, we would like to comment as follows.

1.- Recognition and measurement requirements

We agree by and large with EFRAG's DP regarding the key points addressed on recognition and measurement, as noted in Chapter 3.

Regarding which types of intangibles should be considered for recognition, we think that internally generated intangibles as well as intangibles acquired that can generate future cash flows and create value for the entity should be recognized. Similarly, we agree that recognizing internally generated intangibles should be subject to meeting certain preconditions. Introducing however the recognition of other types of intangibles such as an item that the entity does not own, as the DP suggests, should be avoided. Introducing additional elements for recognition difficult to measure and to value might create more confusion in a subject already difficult to value.

Also, the Commission considers, that recognizing intangibles individually might not be a practical solution as entities do not separate intangibles from the goodwill acquired through an acquisition. Intangibles might be significantly different between companies and comparability will be very difficult between companies growing organically and growing through an acquisition and recognizing a goodwill.

For an intangible to be recognized it should be an element that provides information. For instance, an expenditure related to an internally generated intangible and considered a cost**.** The information should reflect the elements' capacity to generate future economic benefits. This also will be more consistent with the recognition of tangible assets.

Regarding EFRAG's four accounting approaches -as noted in points 3.10 and 3.11 - to recognize expenditures related to internally generated intangibles, we will support point (a) which considers the recognition as an asset of all intangibles meeting the definition with no specific conditions or thresholds. The recognition of an intangible, which is already difficult, should not become more complicated.

Also, we support the capitalization of certain costs related to an intangible asset if the intangible meets the definition of an asset. The capitalized costs should be able to generate economic benefits.

Entities customarily measure the overall goodwill of the CGU not only the acquired goodwill. The company should disclose and provide information on how it has internally generated the intangible and the expected cash flows. What drives its business model and the entity's value creation strategy should be depicted. As users, we do not consider the balance sheet the starting point for valuation. Free (operating) cash flows, EBITDA multiples and earnings are the basis for valuation.

Regarding what type of measurement is more appropriate for an intangible, we think that accounting an intangible at book value will reflect the actual amount of the invested capital while accounting at market value would incorporate an element of subjectivity.

We shared the view that measuring intangibles at historic cost would be more consistent with the way entities measured internally generated intangibles such as software while measuring at fair value can be confusing. Users want to know how much money has been invested in an intangible asset and the return on that investment which provides a measure on whether the company did the right thing.

2.- Information related to specific intangibles - disclosures

Although we agree with comments made in paragraph 4.8 related to the ...*financial stakeholders support to the idea of developing disclosures that foster a better understanding of intangibles,* these disclosures should be relevant and add value for the users. Information on a specific intangible should be useful and provide additional information on an entity's business model and its link to financial performance. Qualitative information can also be useful when providing information about an entity's business model and its value drivers.

Amount capitalized in a year related to internally generated intangibles should specify a cash flow estimate on yearly basis separated from a business combination.

As noted in paragraph. 4.19 of the ED, we agree that certain intangibles should provide specific information when this information is key for the business operation of that particular entity. **An overload of information must be avoided.**

3. Information on future-oriented expenses and risk/opportunities factors

Material information related to future-oriented expenses can be useful. In fact, we think that the recognition and amortization of all intangibles should be allowed only if the companies can provide a clear disclosure on the future performance of the intangible asset. The expected future performance of an intangible should be defined in terms of economic amounts and related quantitative drives (for example the number of new customers or number of savings in employees in FTE) connected to the expected future cash flows and the increase or decrease of revenues and costs connected to the investment. Each year the company that chooses to apply the accounting rule should create a disclosure to explain the change in expectations at a defined time on the investments and the effects in terms of change in risk/opportunities.

As we previously noted, entities providing granular information about recognized expenses and risk opportunity factors would facilitate users to better predict entities' capabilities to generate future cash flows. Future-oriented expenses try to guarantee value creation in the future. Information that facilitates users to better understand the management approach and an entity's strategy is very useful.

4.- Other matters

In reference to other points addressed in the DP such as information on risk and opportunities and others, we would like to refer to our previously expressed views. By and large, the Commission considers that information included in the financial report on factors affecting intangibles should be limited to key and relevant information that facilitates investors to gauge the capabilities of an entity to create value. Additionally, as mentioned in paragraph 6.5, we agree that introducing a more homogenous terminology on intangibles could be very beneficial.

Finally, we support that information provided by a company should be placed in the notes to the financial statements, if the information is related to an item connected to an asset or to an item recognized in the statement of financial performance. In other cases, the information should be placed in the management report.

If you would like to further discuss the views expressed in this letter, please contact us.

Javier de Frutos, Chairman
On behalf of EFFAS Commission on Financial Reporting

EFFAS was established in 1962 as an association for nationally based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 14-member organizations representing more than 16,000 investment professionals. The Commission on Financial Reporting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. CFR members are Javier de Frutos (Chairman, IEAF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Serge Pattyn (BVFA/ABAF, Belgium), Luca D'Onofrio (AIAF, Italy), Dr. Carsten Zielke (DVFA, Germany), and Andreas Schenone (SFAA, Switzerland).