CaixaBank

Quality, trust and social commitment

European Financial Reporting Advisory Group

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Discussion Paper "Better Information on Intangibles- Which is the best way to go?

Dear EFRAG Members,

CaixaBank welcomes the opportunity to comment the Discussion Paper "Better Information on Intangibles- Which is the best way to go? Issued by EFRAG on August 2021.

We appreciate EFRAG´s research work and initiatives which aim to influence future standard-setting developments by the IASB, related to provide better information for intangibles, as they play a key role in the decision- making process of stakeholders.

In general terms, we agree with the issues described in this discussion paper, highlighting difficulties for users to compare entities that grow organically with those growing by means of acquisitions, or the impacts in the market value of a company by the insufficient information about intangibles in its primary financial statements. Therefore, the information required by current accounting standards needs to be extended to enhance comparability between entities, and to facilitate decisions by stakeholders, in such a way that users of the financial statements see their expectations fulfilled in terms of the information provided being sufficiently useful for their decision-making process. As described throughout this letter, intangibles play a crucial role in estimating the market value of an entity. There is no doubt of the impact of certain strategic intangibles on the success of an entity's business model. For these reasons, there are many regulatory movements around intangible assets, and lately especially with respect to sustainability information.

We believe that to meet these objectives, the approach that might be proposed should seek to continue providing complete, faithful, and auditable information, and at an affordable cost for preparers. We do not consider adequate to amend IAS 38 removing the general prohibition of recognition of internally generated intangibles, except for some very specific types of assets. As indicated in this paper, not all intangibles would meet the definition of assets, and besides, their measurement, either at cost or fair value, is complex, subjective, and uncertain. For these reasons recognizing all internally generated intangible assets is not the most appropriate approach. Instead, capitalization of certain costs if specified conditions are met and improving disclosures specially regarding to internally generated intangibles would be our preferrable approach.

In terms of recognition, the current sophistication of software projects due to the digitalization of companies and the new ways of agile working make it necessary to evaluate if IAS 38 should be amended to allow the recognition of research assets. As a reference, Spanish accounting framework permits the recognition of certain research costs (see further detail in question 3).
With respect to measurement our preferrable approach is to expense all research cost unless certain conditions are met, mainly being specific-project identifiable expenses, and the project being technically,

commercially, and economically successful and profitable. Our preferred approach for recognizing research costs would be cost model with subsequent amortization.

Finally, with respect to other information and disclosures over intangibles, either in the notes of the financial statements or the management report, we consider that it would be adequate to apply the following approach:

a. Disclosure intangibles that are key to an entity´s business model since this information allows users of financial reports to understand the intangibles in relation to the entity's value creation process and so to help them in making decisions
b. Disclosure intangibles that are controlled by an entity; for which ownership rights are relatively clear and for which markets exist (generally they can be bought and sold) or resulting of potential business combinations between group entities for which a fair value has been estimated.
c. Focus predominantly on qualitative information rather than quantitative information
d. Following a cost/benefits approach and considering sensitive commercial information

It is worth to mention that sustainability reporting requirements, that are being developed both inside and outside EU, may have increasing relevance in all discussions held about intangible asset recognition and disclosures. Connectivity between financial and sustainability information within the management report will be essential, and the effort in seeking the better information in the intangibles should be aligned with other work groups and regulatory proposals about sustainability reporting.

Yours faithfully,

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ANNEX

QUESTION 1 - ISSUES WITH THE CURRENT INFORMATION

Chapter 2 summarizes issues put forward with the current information on intangibles. Do you think the issues listed are relevant and valid? Are there additional issues with the current information on intangibles that are not listed? If so, what are these issues?

In general terms, we agree with the issues listed in this chapter, such as difficulty for users to compare entities that build up substantial intangibles internally, with those that purchase most of its intangible assets, or, impacts in the market value of a company by the insufficient information about intangibles in its primary financial statements.

However, we believe that it should be found an approach to solve these issues but considering the difficulties on the accounting treatment of the intangibles, for example, not all intangibles would meet the definition of an asset, or the measurement of these assets require a high degree of judgement.

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; information on future-oriented expenses and risk/opportunity factors) and, within each approach, different alternatives to provide better information on intangibles.

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 there is room for improvement regarding information on intangibles in financial reporting? If so:

a) Do you think the different approaches described 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.
b) If you do not think the different approaches described in the Discussion Paper could be combined in a manner that would meet (most of) the needs of users, which (if any) of the described approaches do you think could be worth investigating further with the objective of getting better information on intangibles:

- **Amending existing recognition and measurement requirements for intangibles (see Chapter 3);**
- **Providing disclosures on specific intangibles (see Chapter 4);**
- **Providing disclosures on future-oriented expenses and risk/opportunity factors that may affect future performance (see Chapter 5); or**
- **An approach other than those described in the Discussion Paper (please explain this approach)?**

We believe that current accounting standards need to be extended to provide better information on intangibles in financial reporting, so that users of the financial statements obtain useful and comparable information for their decision-making process. Intangibles play a crucial role in estimating the market value of an entity and there is no doubt about the impact of certain strategic intangibles on the success of an entity's business model. For these reasons, today there are many regulatory movements around intangibles, especially in relation to sustainability information.

We believe that to meet this objective, the approach that might be proposed should seek to continue providing complete, faithful, and auditable information, and at an affordable cost for preparers. As indicated in this paper, not all intangibles would meet the definition of assets, or their measurement, either at cost or fair value, might be complex, subjective, and uncertain. For these reasons we believe that amending IAS 38 to be able to recognize all internally generated intangible assets is not the most appropriate approach. However, we believe that it could be reviewed and amended so that capitalization of certain research costs is permitted, as well as for requiring additional disclosures on specific intangibles either in the notes of the financial statement or management report (Please see our thoughts in the following questions).

QUESTION 3 – RECOGNITION

Chapter 3 considers whether and how internally generated intangibles could be recognized 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 *Intangible Assets* should be amended to permit the recognition of certain internally generated intangible assets (in addition to development costs)? (Please explain your answer). If your answer to this question is 'yes', please also answer sub-questions 1 to 3 below.

1. **Paragraph 3.26 of this Discussion Paper explains that IAS 38 currently includes an explicit prohibition to recognize some types of internally generated intangible assets such as internally developed brands, mastheads, publishing titles, customer lists and similar items, staff training and marketing. Do you consider that the explicit prohibition to recognize some types of intangible assets that exists in IAS 38 should be removed? (Please explain your answer).**
2. **Paragraphs 3.10 to 3.71 of this Discussion Paper explore four possible approaches regarding the recognition of internally generated intangibles. Which of the following approaches would you support?**

   a) Recognize (as an asset) all defined intangibles; with no specified conditions or thresholds (see paragraphs 3.15 - 3.35 of this Discussion Paper);
   b) Threshold for recognition of an asset (see paragraphs 3.36 - 3.48 of this Discussion Paper);
   c) Conditional recognition of an asset (see paragraphs 3.49 - 3.59 of this Discussion Paper); if you prefer this approach, would you prefer an approach under which:
   (i) Costs are expensed in profit and loss until the condition is met.
   (ii) Costs are capitalized and fully impaired until the condition is met, at which point in time the impairment losses are reversed;
   (iii) Costs are expensed in other comprehensive income until the condition is met, at which point in time the expenses are 'recycled' and capitalized.
   d) No recognition (that is, expensing all internally generated intangibles) (see paragraphs 3.60 - 3.67 of this Discussion Paper); and
   e) None of the above or other suggestions (please explain).
   Please explain the reasons for your preferences.

3. **If you support 'Conditional recognition of an asset' or 'Threshold for recognition of an asset' in the previous sub-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, the 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 a legal right and/or the ability to sell, transfer, license or pledge the asset;
   (e) All or a combination of the above depending on the nature of the intangibles (please explain);
   (f) Other suggestions (please specify).

As indicated in the paragraph 3.1, intangibles are very diverse and different from each other, and must be classified in order to define an appropriate scope for each of them. We agree that the key criteria for classification are both control rights, and the difficulty of its measurement. Based on that, the three proposed categories for classification of intangible assets, A, B and C, are a proper starting point.

We believe that under IFRS, control is key to identify an asset and we don't consider adequate to amend IAS 38 removing the general prohibition of recognition of internally generated intangibles, except for some very specific types of assets classified in group A and B. Additionally, measurement of internally generated intangibles is also a critical factor to conclude which types of intangibles should be recognized in the balance sheet.

On the one hand, we believe that internally generated intangibles as brands, mastheads, publishing titles, customer lists and similar items may have an active market; however under a fair value measurement basis, the measurement of these intangibles needs a high degree of judgment and is exposed to a significant amount of uncertainty and subjectivity. Accordingly, financial reporting may not be as faithful and comparable as it would be desirable. For this reason, we consider that they should not be recognized in the balance sheet. However, it would be interesting for users of financial reporting to have additional disclosures regarding these intangibles, for example, including information in the notes of the consolidated financial statements about intangibles generated in intercompany business combinations since these assets are not recognized in the consolidated balance sheet because they were eliminated in the consolidation process but may have been measured through a purchase plan allocation exercise (PPA) and recognized in the individual financial statements of the group company, under IFRS 3.

On the other hand, the current sophistication of software projects due to the digitalization of companies and the new ways of agile working require to evaluate if IAS 38 should be amended to allow the recognition of research assets, in the same terms that are allowed, for example, in the current Spanish accounting framework, that establishes the following:

"Research costs shall be recognized as an expense in the reporting period in which they are incurred. However, they may be capitalized as intangible assets if they meet the following conditions:
- The costs are individualized by project and clearly defined to enable them to be allocated over time.
- There is evidence of the project's technical success and economic and commercial feasibility.

Capitalized research costs shall be amortized over their useful life… Where there is reasonable doubt as to the technical success and economic and commercial feasibility of the project, any amounts capitalized shall be recognized directly in losses for the reporting period".

Our proposal is based on the approach "Conditional recognition of an asset (see paragraphs 3.49 - 3.59 of this Discussion Paper)" under which costs are expensed in profit and loss until specified conditions are met; and recognition criteria that we suggest is in line with the Spanish accounting framework detailed above:
- Criteria based on the identifiability of specific project- related expenditures.
- Criteria based on the technical success and economic-commercial profitability of the project.

We discard the other options of the conditional approach (3.49 b) and c)), because including 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 of the 'definition' of OCI, and in addition, it would generate volatility, and increase the costs of preparing financial statements.

QUESTION 4 - POSSIBLE MEASUREMENT BASES

Paragraphs 3.72 to 3.100 of this Discussion Paper consider possible measurement bases for internally generated intangibles without suggesting a preferred approach. If you think that IAS 38 should be amended to permit the recognition of certain internally generated intangible assets (in addition to development costs), which of the following suggested measurement approaches would you support:
a) Initial and subsequent measurement at amortized 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 value model');
d) Initial measurement at fair value (as deemed cost) and subsequent measurement at amortized cost with impairment ('IFRS 3 model')?

With respect to measurement approaches, as explained in Question 3, we would permit only recognition of research costs when certain conditions are met and maintain the general condition of expensing all research expenses. Our preferred approach for recognizing research costs would be cost model with subsequent amortization. Regarding option b), c) and d) that require fair value estimates we believe that the arguments against are more relevant, for example:

- imply more subjectivity and expose financial reporting to a higher degree of uncertainty.
- Volatility in either profit or equity
- Information might not as faithful as desirable due to the high level of uncertainty
- Costly method for preparers.

QUESTION 5 - INFORMATION RELATING TO SPECIFIC INTANGIBLES

Chapter 4 discusses an approach under which information on specific intangibles, that are key to an entity's business model, is provided to help users assess the contribution of the intangible to the value of the entity.

1 To the extent that information relating to specific intangibles should be provided, do you agree that the information should be limited to the intangibles that are key to an entity's business model? If not, why?
2 Preliminary feedback received from some users of financial reports indicates that an entity's fair value estimate of a specific intangible would generally not be particularly relevant information. Do you agree that disclosing the fair value of an intangible is less helpful for users than disclosure of quantitative and qualitative information that could assist them in forming their own views on the value for an entity of the specific intangible?
3 Do you agree with the advantages and disadvantages of information relating to specific intangibles as identified in Chapter 4 compared to recognition and measurement (see Chapter 3) and information on future-oriented expenses (see Chapter 5)? If not, which aspects do you disagree with and/or which additional advantages and disadvantages have you identified?

We consider that the new requirements about disclosures should be only about intangibles that are key to an entity´s business model since that allows users of financial reports to understand the intangibles in relation to the entity's value creation process and so to help them in their decision – making process. These would include both intangible assets that meet the definition of asset according international accounting framework, and others as intellectual capital, human resources, culture, reputation and others. Intangibles outside the entity's business model might not provide useful information to users.

It is critical to clarify definitions and concepts describing and explaining intangibles to guarantee the comparability between companies operating with similar business models. We think that providing both quantitative and qualitative information (such as description of the intangibles, useful life, internally generated or not, etc) rather than information on their fair value would be more useful to understand how they contribute to the profitability of the entity's business model and its value. Besides, as we stated before, the fair value measurements are usually complex, subjective, and uncertain.

Further, we agree with the advantages and disadvantages of information relating to specific intangible as identified in Chapter 4 compared to recognition and measurement, and with the examples of information relating to specific intangibles included in the table of the paragraph 4.19.

We would like to highlight the relevance that sustainability reporting requirements, that are being developed both inside and outside EU, may have in all discussions held about intangible asset recognition and disclosures. We believe, like EFRAG, that connectivity between financial and sustainability information within the management report will be essential and the effort in seeking the better information in the intangibles should be aligned with other work groups and regulatory proposals about sustainability reporting.

In Spain, in 2018, it was issued Law 11/2018, of December 28, which modifies the Commercial Code, the revised text of the Capital Companies Law approved by Royal Legislative Decree 1/2010, of July 2, and Law 22/2015, of July 20, on Account Auditing, on non-financial information and diversity. This law requires Spanish listed entities to include non-financial information in their management reports. This important milestone was the one that triggered Caixabank to start working hard about the best approach to provide useful, complete, comparable, and faithful non-financial information. We are actively working in some sustainability reporting EU task force performing advocacy activities as well as improving of our management report. If you are interested in knowing our approach, please visit our management report published in our website.

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QUESTION 6 - INFORMATION ON FUTURE-ORIENTED EXPENSES

Chapter 5 proposes various elements of information on expenses recognized in a period that could be considered to relate to benefits that will be recorded in future periods ('future-oriented expenses').

1 Do you consider that requiring such information could be useful? If so:
a) Should the information mainly complement information on specific intangibles (see Chapter 4) or should requirements on future-oriented expenses be introduced instead of requirements on information on specific intangibles?
b) Should the information mainly:
- **(i) Reflect the views of the entity's management by disclosing the recognized expenses the management considers relate to the benefits of future periods)? Or**
- **(ii) Help users perform their own assessments on the recognized expenses that relate to benefits of future periods, by providing further specifications and breakdown of the expenses of a period?**

2 Do you agree with the advantages and disadvantages of information on future-oriented expenses identified in Chapter 5? If not, which aspects do you disagree with and/or which additional advantages and disadvantages have you identified?

As we have explained before, our proposal approach would combine to amend the IAS 38 to recognize the research cost on the condition that certain criteria are met and provide quantitative and qualitative information about specific intangibles.

Disclosures about future-oriented expenses might be useful specially when recognition criteria of IAS 38 is not met. They could help users of financial information to understand both the entity's business model and its future profitability, and how they contribute to the entity value creation strategy. Although this approach may have disadvantages (sensitive information, difficulties to measure future revenues, etc), utility for users might exceed them.

QUESTION 7 - INFORMATION ON RISK/OPPORTUNITY FACTORS AFFECTING INTANGIBLES

Chapter 5 proposes that information included in the financial reports on factors affecting intangibles should be limited to disclosing risk/opportunity factors linked to the key intangibles (whether 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, 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/opportunity factors based on the probability of their occurrence and the expected magnitude of their impact.

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

Yes, we agree with this proposal of disclosing risks and opportunities linked to key intangibles only to the extent that they are probable or might have a material impact on the intangibles recognized.

QUESTION 8 - 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?

We agree with introducing a common terminology on intangibles with the aim of increasing comparability between entities, but finding a balance between the disclosure of useful information and the protection of commercial or sensitive information.

QUESTION 9 - 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 or to an item recognized in the statement of financial performance. 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? Should they be placed all in the same section or in different sections of the financial report and why?

Depending on the nature of the intangible we think that the new disclosures should be placed in:

- The notes of the financial statement if it is related to:
    - Intangible assets recognized in the balance sheet
    - Intangibles not recognized but that are controlled by an entity; for which ownership rights are relatively clear and for which markets exist (generally they can be bought and sold) or resulting of potential business combinations between group entities for which there is a reliable fair value

- The rest of intangibles, the information would be placed in the management report.