EFRAG
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27 October 2022

Dear EFRAG members,

Better Information on Intangibles (DP/2021/8)

The UK Endorsement Board (UKEB) welcomes the opportunity to provide input into the questions asked in EFRAG's Discussion Paper: *Better Information on Intangibles – Which is the best way to go?*

The UKEB is responsible for endorsement and adoption of IFRS Accounting Standards for use in the UK and therefore is the UK's National Standard Setter for IFRS Accounting Standards. The UKEB also leads the UK's engagement with the IFRS Foundation (Foundation) on the development of new standards, amendments and interpretations.

The UKEB has not yet developed its own recommendations on accounting for intangibles and therefore the answers provided below do not represent its views. Rather they are indicative of the views heard from stakeholders during interviews undertaken by the UKEB Secretariat as part of the UKEB's own qualitative research project on intangibles (see Table 1 for an overview of stakeholders who took part in the research) which commenced in Spring 2022. The UKEB will continue its research and plans to base its conclusions for current and future projects, including any endorsement and adoption assessment of new or amended International Accounting Standards, on the full extent of that work. These conclusions may therefore differ from the stakeholder views shared in this letter.

In early 2022, the UKEB began a proactive research project to contribute to the international debate on accounting for intangible items. The research focuses on how the accounting for, and reporting of, intangible items could be improved to provide investors with more useful general purpose financial statements to assist them to make better informed decisions. Aspects of that research complement EFRAG's research work in this area and we look forward to exploring other opportunities for collaboration in the future.

The initial phase of the UKEB's research is focused on understanding UK stakeholder views (particularly those of investors) on the accounting for, and reporting of, intangibles. The first project is a report drawing on qualitative research based on in-depth interviews with over 30 stakeholders from a range of backgrounds (see summary in table on following page), supported by a review of key literature. The research is explorative by design. It will provide a better understanding of UK stakeholders' perspectives as well as the economic outcomes arising from the existing accounting framework. A more detailed report presenting the views from these interviews is expected to be published early in 2023. It will also form the basis for later research by the UKEB with a view to developing a foundation for its recommendations to the IASB.

The UKEB will share its detailed findings and views once it has completed its research and published its report. In the meantime, the UKEB looks forward to future opportunities to collaborate with EFRAG on other research projects.

If you have any questions about this letter, please contact the project team at UKEndorsementBoard@endorsement-board.uk

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

If you have any questions about this response, please contact the project team at UKEndorsementBoard@endorsement-board.uk

Table 1: UKEB Interviewee overview

Stakeholder background	Number of interviewees end July 2022
User	13
Preparer	6
Auditor	2
Standard Setter	2
Academic	6
Other	4
	33

Appendix 1: Questions on Better Information on Intangibles (DP/2021/8)

Question 1 - Issues with the current information

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?

A1 From the interviews with UK stakeholders, we have heard concerns that are broadly consistent with the issues raised in chapter two of the EFRAG report.

Limited recognition

A2 Many stakeholders identified inconsistencies in recognition between IAS 38 *Intangible Assets* and the Conceptual Framework which has been updated a number of times since IAS 38 was first issued. Specifically, IAS 38 requires expenditure to meet a definition of "asset" and "control" that is no longer consistent with the revised Conceptual Framework. This means that the standard no longer reflects current thinking on what constitutes an asset and therefore does not adequately capture key intangibles that are relevant to some entities.

A3 IAS 38 requires many specific types of internally generated intangibles to be expensed. These include marketing expenditures, internally generated brands, training, customer lists and similar. Almost all stakeholders commented that this prohibition from capitalisation of expenditure that could otherwise be deemed as contributing to an intangible asset fails to capture useful information about many intangible items.

A4 For those items that do meet the definition of intangible asset, recognition of internally generated intangibles under IAS 38 is limited to the "development phase". It was suggested by some stakeholders interviewed that the criteria for entering the development phase could be considered somewhat arbitrary and open to significant interpretation leading to substantially different accounting outcomes for different entities, even in the same industry.

Limited consistency

A5 There are significant differences between the initial accounting for internally generated intangible assets (frequently expensed), acquired intangible assets (which use a cost basis) and intangible assets acquired through a business combination (which use a fair value basis).

A6 Stakeholders commented that this leads to significant differences in the accounting for otherwise comparable companies, dependent on whether they have grown organically or through acquisitions. This has led users to acquire their information from other sources in order to compare companies that grown externally and companies that grow organically, in order to be able to compute comparable KPIs and performance indicators.

Limited disclosure

A7 While there are a substantial number of disclosure requirements for recognised intangible assets under IAS 38, there are virtually no requirements related to intangible expenses. Given that most internal expenditure on intangibles is currently required to be expensed, we heard numerous comments that the current requirements are inadequate.

Question 2— Which way to go?

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)?**

A8 Many of our stakeholders indicated a desire for enhancing the accounting for intangibles and suggested a number of approaches to improving the information on intangibles. A minority of stakeholders suggested or supported either getting rid of specific requirements for intangibles altogether, folding them in with other standards, such as property plant and equipment, or developing specific standards for specific intangibles.

A9 However, most stakeholders suggested incremental approaches consistent with those outlined in the EFRAG report.

A10 As will be discussed in more detail below, generally stakeholders wanted enhancements to the standard with regard to recognition and measurement. In addition, they wanted better disclosure, both about recognised intangibles and expenses that are related to intangible items. These views are consistent with the ones mentioned in Question 2 with reference to Chapters 3-5.

Question 3—Recognition

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 *Intangible Assets* should be amended to permit the recognition of certain internally generated intangible assets (in addition to development costs)? (Please explain your answer).

A11 According to the research, most stakeholders wanted any new standard for intangibles to recognise and capitalise a greater range of expenditures, potentially including research, training, and certain marketing expenditure in some circumstances

A12 Many stakeholders argued that the Conceptual Framework definition of an asset introduced in 2018 should form the basis for recognising intangible items (as opposed to the older definition reflected in IAS 38).

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 recognise 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 recognise some types of intangible assets that exists in IAS 38 should be removed? (Please explain your answer).**

A13 A number of stakeholders explicitly identified these prohibitions as problematic. Some noted that the prohibitions seemed to exclude items that otherwise could meet the Conceptual Framework definition of an asset. Also, it was suggested that these prohibitions represent a rule-based approach to accounting that is inconsistent with a desire for principle-based standards.

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)	**Recognise (as an asset) all defined intangibles; with no specified conditions or thresholds (see paragraphs 3.15 - 3.35 of this Discussion Paper);**

A14 Many stakeholders appeared to favour an approach that was based on recognition of intangible assets that met the revised Conceptual Framework definition of an asset.

	b)	**Threshold for recognition of an asset (see paragraphs 3.36 - 3.48 of this Discussion Paper);**

A15 Some stakeholders identified certain recognition thresholds beyond those in the Conceptual Framework (discussed below).

	c)	**Conditional recognition of an asset (see paragraphs 3.49 - 3.59 of this Discussion Paper);**

A16 No stakeholders interviewed advocated for a conditional recognition approach that could allow recapitalisation onto the balance sheet once certain conditions are met.

	d)	**No recognition (that is, expensing all internally generated intangibles) (see paragraphs 3.60 - 3.67 of this Discussion Paper); and**

A17 No stakeholders interviewed advocated for a total prohibition on recognising internally generated intangible assets.

	e)	**None of the above or other suggestions (please explain).**

A18 N/A

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);**

A19 A number of stakeholders identified probability of economic inflow greater than 50% as a possible threshold for conditional recognition.

b)	**Criteria based on the identifiability of the expenditure related to the intangibles;**

A20 A number of stakeholders raised concerns about the allocation of expenditure to specific intangibles given the perceived difficulty in separating out the resultant benefits from other assets used by the organisation.

(c)	**Criteria based on the technical or commercial feasibility of the intangibles considered at inception of the development;**

A21 No stakeholders specifically discussed these criteria.

(d)	**Criteria based on separability of the assets, that is, the existence of a legal right and/or the ability to sell, transfer, licence or pledge the asset;**

A22 A number of stakeholders identified legal or equivalent rights over benefits as a matter that should be considered as a possible threshold for conditional recognition.

(e)	**All or a combination of the above depending on the nature of the intangibles (please explain);**
(f)	**Other suggestions (please specify).**

A23 N/A

Question 4— Possible Measurement Bases

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 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 value model');

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

A24 Many stakeholders were generally comfortable with capitalisation of many types of costs associated with intangibles, particularly where there were clearly identifiable rights attached to the associated intangible item. They view this as an important step in addressing the issues of standard inconsistency and differences between organic and acquisitive growth.

A25 During discussions, most stakeholders agreed that accrual accounting, which would not only capitalise costs but would also require amortisation (dependent on the determination of a reasonable useful life) and impairment, would provide more relevant and reliable information.

A26 A number of stakeholders who identified as users of financial statements were wary of over-capitalisation of internally generated intangible assets, particularly where there were no clear legal rights that provided certainty over the existence of an asset.

A27 Feedback on use of fair value for measurement purposes was more mixed. Some stakeholders thought there should be more fair value measurement of intangibles. However, there was a general acknowledgement that this would increase variability in the financial statements, as valuations of intangibles are likely to become more volatile.

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?

A28 While stakeholders did mention the importance of enhancing disclosure about intangibles that are central to an entity's business model, there was no suggestion from stakeholders that disclosure should be limited to only these assets.

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?**

A29 Users of financial statements were concerned that fair value would make it more difficult to understand the financial statements, particularly where markets were less active or non-existent. Preparers were concerned that users of financial statements would over-react to the variability that a fair value model would introduce.

A30 However, there was an awareness that fair value can be useful when it can be measured based on appropriate information. This could be a case-by-case assessment and take account of the enhancement in information, markets and techniques over time.

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?**

A31 N/A

Question 6— Information on future-oriented expenses

Chapter 5 proposes various elements of information on expenses recognised 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 recognised expenses the management considers relate to the benefits of future periods)? Or**

	(ii) Help users perform their own assessments on the recognised expenses that relate to benefits of future periods, by providing further specifications and breakdown of the expenses of a period?

A32 A majority of stakeholders observed that disclosure requirements related to intangible expenditures that are not capitalised must be enhanced. They want more granular information about the nature of expenditure, including but not limited to specific information on marketing, information technologies, training, and research.

A33 Stakeholders want to understand the relationship between such expenditure and the organisation's business model. Further, they request information on whether the entity is expecting relevant expenditures to maintain or enhance future cash flows.

A34 For many investors (as opposed to stakeholders more generally) improved disclosures was their primary recommendation with regard to accounting for intangibles. However, when the possible alternative approaches were discussed, there was often agreement that more could be done to improve the accounting in terms of recognition, measurement and disclosure for intangible items. Only a few thought that enhancing disclosure alone was sufficient.

A35 The following quotes from stakeholders interviewed summarise the main views that emerged on disclosures:

- Better disclosures are needed for both capitalised and unrecognised intangibles (Academic)
- Although there are substantial disclosure requirements for recognised intangible assets under IAS 38, these are often confusing. (Auditor)
- There is an issue with no requirements to disaggregate and provide granular information about intangible expenses [under IAS 38] (Investor)
- Reasons for expensing items and why were these not capitalised is lacking from the annual report (Academic)

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?**

A36 While the specific items identified were not explicitly discussed with stakeholders, the advantages and disadvantages identified would appear to be consistent with comments heard from stakeholders.

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 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, 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?

A37 Many stakeholders talked about the need for enhanced disclosure on risks associated with capitalised intangibles to compensate for the greater uncertainty about their value.

A38 They also believed there could be more information linking intangibles to related Key Performance Indicators (KPIs). This would help address concerns about over-capitalisation. For example, management could link useful life and impairment directly to the drivers of value that intangibles are expected to provide. As one user noted:

> "Key drivers of value for intangibles would be useful to disclose. For example, employee churn by division, or customer satisfaction (net promoter score)."

A39 A number of stakeholders thought that information on these key drivers would be central to future ESG reporting, and that these relationships would be important to highlight and would provide particularly useful information.

A40 The issue of materiality was raised in many interviews. Most stakeholders interviewed wanted increased granularity of disclosure. It was observed that intangibles are important drivers of value, but carry increased risk and uncertainty, and so greater disclosure and finer detail would be required to help users of financial statements assess their impact.

A41 Stakeholders were asked how this could be balanced with concerns about information overload. Most felt that for intangibles when assessing materiality qualitative factors are more important than quantitative ones. These qualitative factors are likely to be derived from the relationship between the intangible item and its importance to the business model.

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?

A42 A small minority of stakeholders mentioned broad categories of intangibles. However, this particular aspect was neither explicitly explored nor has it emerged as a theme from the interviews we conducted.

2 Do you agree that preparers of financial statements should not be required to disclose information on intangibles that would be (very) commercially sensitive?

A43 Some stakeholders expressed concerns about commercial sensitivity, but again stakeholders identified materiality as the overriding factor.

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?

A44 N/A

Question 8— 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 recognised 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?

A45 Stakeholders commented that having the information in the financial statements (including the notes) as opposed to in management commentary gives the information greater prominence, and because it will then have to be audited it will give users greater confidence in the information reported.