IFRS Accounting

European Accounting Association – European Financial Reporting Advisory Group (EFRAG) – International Accounting Standards Board Research (IASB) Workshop

Current and future research on Intangible Assets

January 2024

The EAA-FRSC Intangibles Research Group

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- Alberto Quagli (University of Genoa)

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The group has been created at the beginning of 2022 on the occasion of the EAA-FRSC response to the EFRAG's Discussion paper on "Better Information on Intangibles"

EFRAG and IASB participants

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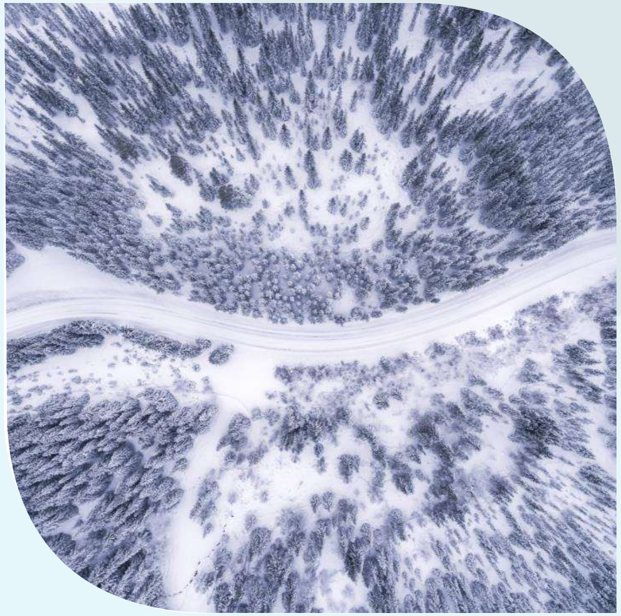
Better Information on Intangibles

Input received on selected topics

30 January 2024

Didrik Thrane-Nielsen – EFRAG Project Director

Rasmus Sommer – EFRAG Technical Staff



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OVERVIEW

This presentation will cover some of the suggestions made in EFRAG's Discussion Paper: *Better Information on Intangibles–Which is the best way to go?*; feedback received in response to the Discussion Paper; and EFRAG' tentative recommendations on:

- Scope & Definition
- Recognition
- Measurement
- Disclosures

Scope & Definition

Scope of the IASB's project

The IASB should not only consider intangible assets. EFRAG's Discussion Paper ('DP') and recommendations (based on feedback received) consider information on 'intangibles', not only intangible assets. Some of the proposed information may be better placed in the management commentary. Constituents replying to EFRAG's DP had many different views on where to place the information.

The scope of IAS 38 should be clarified (e.g., cryptocurrencies and prepayments versus intangible assets (e.g., in relation to broadcasting)).

EFRAG recommends to consider providing application guidance on, for example, recognition requirements and when capitalisation of costs should end for intangible assets that are being continuously developed.

EFRAG's DP only considered intangibles used in an entity's operation. However, in relation to its work on crypto assets and liabilities EFRAG recommended to update IAS 38 to include principles for measurement of crypto assets (at either cost or fair value) as well as principles for distinguishing the presentation of fair value in either profit or loss or OCI.

Scope & Definition

Definitions

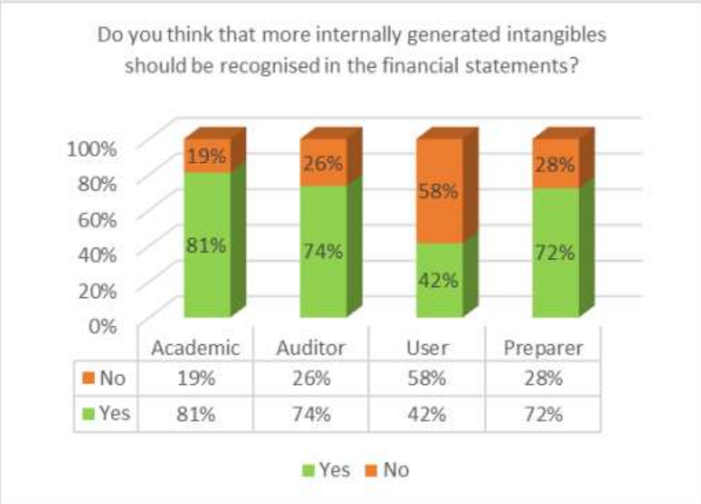
The revised IFRS Accounting Standard should be based on the revised Conceptual Framework (including the definition of an asset).

Majority of respondents considered that it would be useful to introduce a common terminology for intangibles.

Recognition

Only items meeting the CF definition of an asset and meeting certain recognition criteria should be recognised.

The recognition criteria of IAS 38 should be reviewed (but many different ideas were presented in the feedback to EFRAG's DP), including whether the rationales for prohibiting certain intangible assets being recognised still apply (majority of respondents thought the prohibitions should be removed, but EFRAG noted that there would be some challenges with doing so).



rated intangibles be recognised (result from outreach

Types of internally generated intangibles that could be recognised (as per feedback):

- Research and development

- IT/Software (IFRS IC agenda decision not useful)

Measurement

For intangibles used in an entity's operation: majority of respondents found generally cost to be the most useful measurement basis, and would, in EFRAG's view, also generally follow from the guidance in the Conceptual Framework.

Users are not interested in the fair value of single assets–they are trying to estimate the fair value or the entire entity.

Disclosure

Disclosures should be provided for intangibles that are key to an entity's business model (both recognised and unrecognised). The disclosure should provide information about the performance of the intangible (e.g. in the form of KPIs). Differing views on the criteria to be used when considering the location of the information: notes versus management report.

Disclosures should be provided to assess the amount of expenses recognised that (may) relate to future income. Differing views on whether this information should be provided by asking the management to provide its view; by requiring more disaggregated information on expenses; or a combination.

Information about risk and opportunities specific to an entity and related to intangibles should be provided (in the management commentary). Important to consider interaction with sustainability reporting.

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EFRAG
Financial reporting

Contents

- Third Agenda Consultation
- Objective of Research Workshop
- How does the IASB use academic research?
- Potential areas for the IASB to explore

Third Agenda Consultation – Feedback

- Old Standard
  - Cannot cope with 'new' intangibles
  - Cannot cope with 'agile' vs 'traditional linear' development
  - Cannot cope with new ways of using intangible resources (eg software as a service)
- Financial statements do not reflect increasing importance of intangibles in business models
  - Impeding access to finance
  - Recognition criteria too strict
  - Prohibitions in IAS 38 not providing users with information they need
  - Users mixed – some want more recognised; some want better disclosures about unrecognised intangible assets
- Difficulty of comparing entities that acquire vs those that internally generate
- Restrictive when can measure at fair value
- Challenging to measure cost or fair value of most internally generated intangible assets
- Valuation is user responsibility
- Lack of information about (unrecognised) intangible assets
  - Disaggregate SG&A expenses, highlighting growth-related expenses
  - Sources of business value – qualitative information
  - Quantitative information – eg kpis
  - Human capital (ie intangible items)
  - Interaction with ISSB and Management Commentary

Third Agenda Consultation – Decision

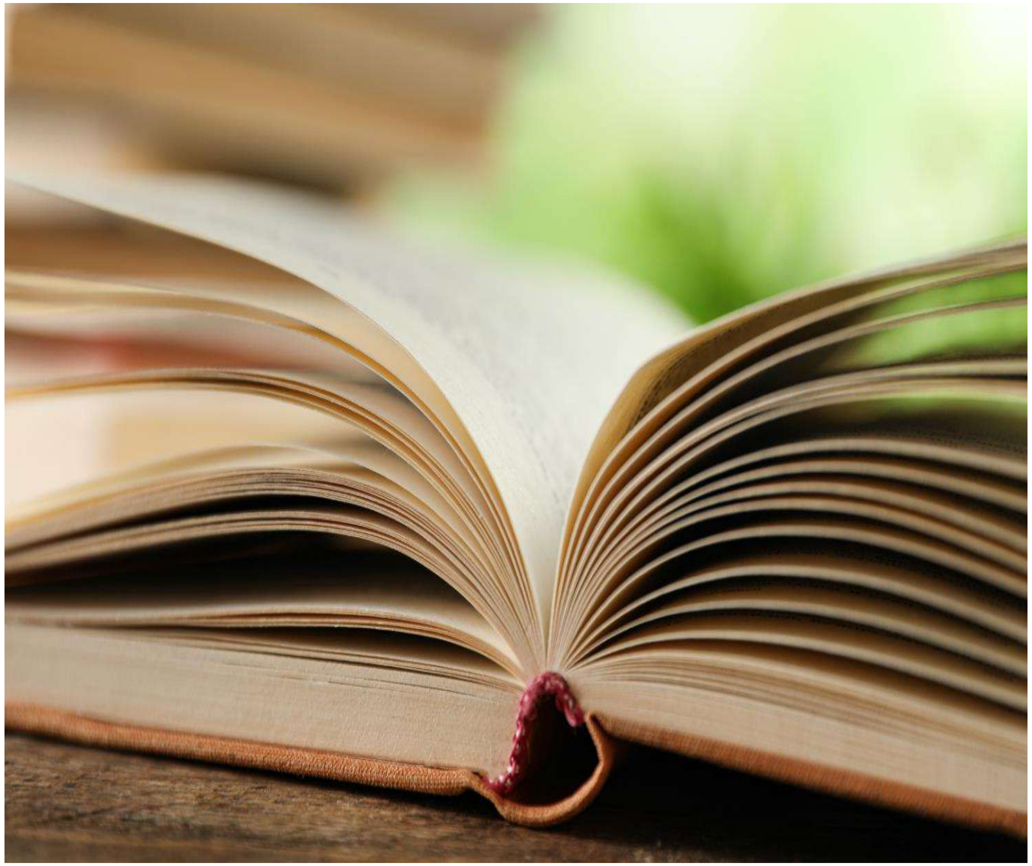
IASB research pipeline project: **Intangible Assets**:

This project will aim comprehensively to review the accounting requirements for intangible assets. Initial research will seek to identify the ***scope of the project*** *and* ***how best to stage work*** *on this topic to deliver timely improvements to IFRS Accounting Standards.*

Objective of Research Workshop

As preparation for when the IASB decides to start work on this pipeline project:

1. To highlight academic research that would provide evidence to help the IASB answer some of the potential questions that stakeholder feedback raises
2. To stimulate academic research in areas where there are gaps in the academic literature



How does the IASB use academic research?

The IASB:

- uses **evidence to support** its standard-setting decisions.
- seeks evidence at **all stages** in the development of an **IFRS Accounting Standard.**
- uses academic evidence in the following ways:
  - in **scoping** projects and **developing** standards, staff consider academic evidence and include it in IASB papers as appropriate.
  - **academic literature reviews** are included **in IASB papers** to add to evidence collected from other outreach.
  - the conclusions in post-implementation reviews are made after **considering evidence from academic literature reviews.**

Academic evidence is collected in several ways, for example through:

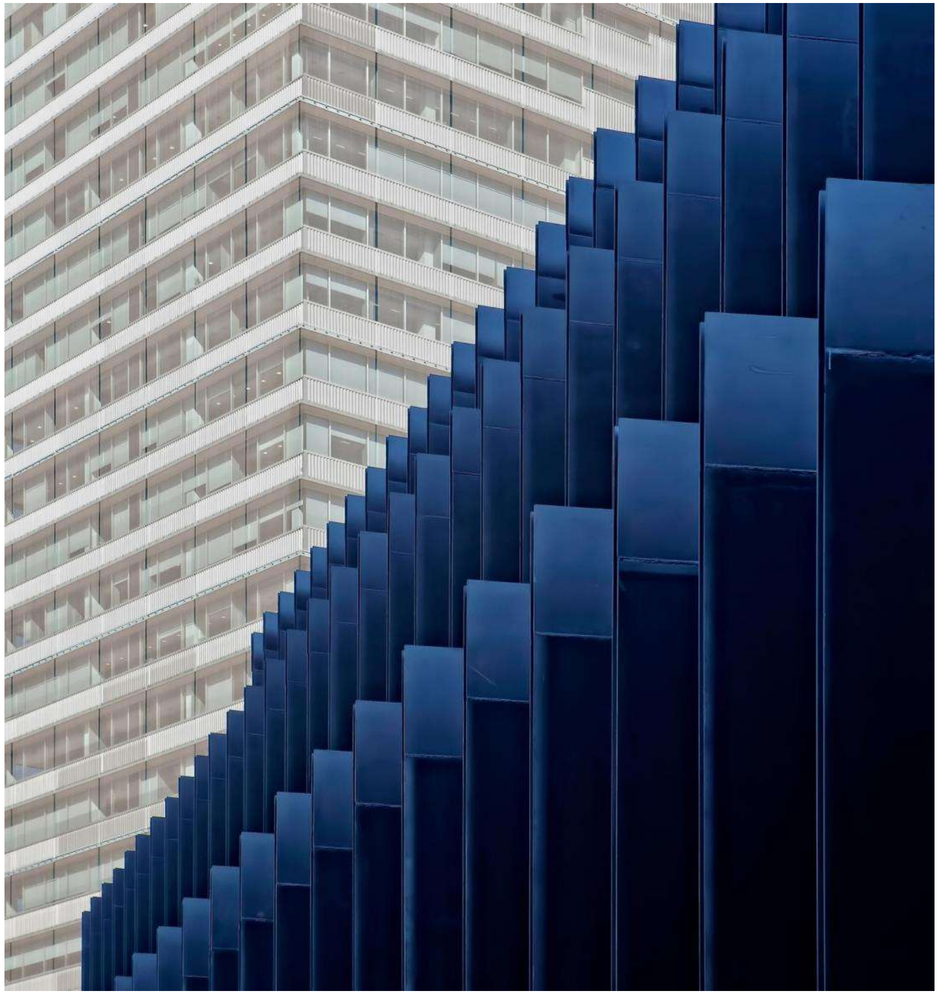
- IASB Research Forum
- Conference participation
- Online research workshops and seminars
- Journal special issues
- Research programmes (eg KPMG IAAER programme)

Potential areas for the IASB to explore (non-exhaustive)

- **Scope & Definition**
  - Financial statement items only or broader?
  - Are IAS 38 scope exemptions still appropriate?
  - Intangibles held for investing included (eg cryptocurrencies)?
  - What are the properties of intangible assets?
  - Update for revisions to *Conceptual Framework*?
  - Consistent labels/terminology required?
  - Specific practice issues (eg applying concept of control to software as a service)?
- **Recognition**
  - Are the recognition criteria appropriate?
  - Reconsider prohibitions in IAS 38?
  - Should there be a recognition difference between acquired and internally generated?
  - Reduce number of intangibles recognised in business combination?
- **Measurement**
  - Can cost be reliably identified (in all cases)?
  - Should the criteria for valuation (active market) be relaxed?
  - Can valuation be linked to a specific intangible?
- **Disclosure**
  - What information about unrecognised intangible assets do investors want?
  - Disaggregate expenses in Income Statement?
  - Provide information about risks and opportunities (drivers of value of business)?
  - Placement of information (financial statements vs MD&A)?

Useful links

- Third Agenda Consultation Feedback Statement
- Intangible Assets pipeline project
- Call for papers for IASB Research Forum 2024
- Connections between financial statements and sustainability-related financial disclosures
- Management Commentary
- Integrated reporting
- IASB’s work plan
- IFRS - Resources for academics



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Aim, Scope and Limitations of the Present Overview

- Aim → the aim is to provide to the best of the Group's knowledge an overview of the literature – also with an interdisciplinary flavour – on certain topics of potential interest to the IASB vis-à-vis its upcoming project on intangible assets, including IAS 38

- Scope → the ambition is not to cover all the extant academic literature on intangible assets, but rather to focus on some key areas and papers that can be of interest to the IASB (see next slide on the detail contents of the Webinar). Goodwill will not be addressed as a topic per se

- By the same token, we do not have the ambition to cover – at least to the same extent – all the areas of potential interest to the IASB → also because of the paucity, if not lack, of research in regard to certain topics

- An important element to consider is that quite a significant part of the literature on this area deals with US data, which is not necessarily the only focus of the IASB, considered its global reach

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Potential areas for the IASB to explore (non-exhaustive)

- **Scope & Definition**
  - Financial statement items only or broader? ***(Stefano)***
  - Are IAS 38 scope exemptions still appropriate? *(no research)*
  - Intangibles held for investing included (eg cryptocurrencies)? ***(Clémence)***
  - What are the properties of intangible assets? ***(Jan)***
  - Update for revisions to *Conceptual Framework*? (no *research)*
  - Consistent labels/terminology required? ***(Clémence & Janice)***
  - Specific practice issues (e.g. applying concept of control to software as a service)? *(tbd)*
- **Recognition**
  - Are the recognition criteria appropriate? ***(Jan)***
  - Reconsider prohibitions in IAS 38? ***(Jan)***
  - Should there be a recognition difference between acquired and internally generated? ***(Christina)***
  - Reduce number of intangibles recognised in business combination? **(Christina)**
- **Measurement** ***(Jan)***
  - Can cost be reliably identified (in all cases)?
  - Should the criteria for valuation (active market) be relaxed?
  - Can valuation be linked to a specific intangible?
- **Disclosure**
  - What information about unrecognised intangible assets do investors want? ***(Laura)***
  - Disaggregate expenses in Income Statement? ***(Stefano)***
  - Provide information about risks and opportunities (drivers of value of business)? ***(Laura)***
  - Placement of information (financial statements vs MD&A)? ***(Laura)***
  - Interdisciplinary considerations on disclosure ***(Janice)***

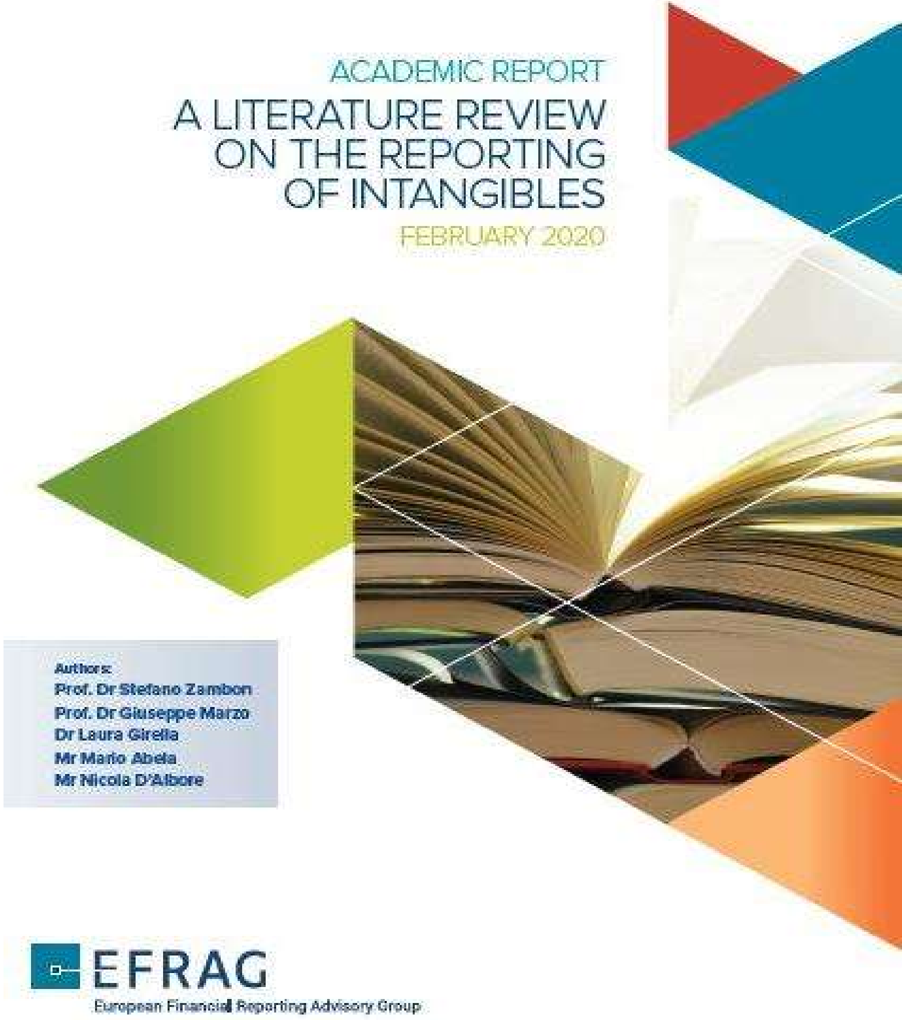
University of Ferrara

DEPARTMENT OF ECONOMICS AND MANAGEMENT

EFRAG's Commissioned «Literature Review on the Reporting of Intangibles» (February 2020)

Prof. Stefano Zambon (PhD, LSE)
Chair, EAA-FRSC Intangibles Research Group

The EFRAG's ACADEMIC LITERATURE REVIEW OF THE REPORTING ON INTANGIBLES



https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FA%2520literature%2520review%2520on%2520the%2520reporting%2520of%2520intangibles.pdf

EFRAG's Academic Literature Review (2020)

- Review primarily aimed to match the **knowledge interests and information needs of EFRAG** and, more in general, those of a non-academic audience.
- Focus of this review → **unaccounted internally generated intangibles** that are not purchased separately or in business combinations, including **not separable intangibles** (e.g. reputation, business model, and human capital)
- Period under consideration: quantitative – but also relevant qualitative – papers published from **2007 to 2019** (with a few exceptions).

- The five key areas investigated:

- A) Intangibles in a macro-perspective

- B) <u>Unaccounted intangibles and their impact</u> on the relevance of financial reporting

- C) Information on <u>specific unaccounted intangibles and its impact</u> on company performance, market value, and users

- D) Information on intellectual capital and its effects on company performance, market value, & users

- E) Frameworks and models for measuring and reporting on intangibles and their consequences on company performance, market value, and users

Main Findings

Unaccounted intangibles and their impact on the relevance of financial reporting

- The majority of 17 studies examined have found a significant positive association (not causation) between intangibles disclosure and company financial performance or market value.
- No authors claim that book value should correspond to market value. However, Prof. Lev claims to make balance sheet values more relevant as well as to apply the matching principle to the Profit & Loss account
- It is not clear to various authors what is the rationale of treating internally generated intangibles differently from externally acquired intangibles

<u>Inclusion of internally generated intangibles in financial statements</u>

- Different theoretical positions can be noticed
- According to some scholars, financial statements have lost their relevance, due also to the unaccounted intangibles, and thus they call for modifications in the accounting standards with the aim to make the gap between book and the market value of the firm less wide (Lev and Gu, 2016)
- Others maintain that the value of intangibles that are unaccounted does impact on and can be detected in the income statement → no compelling argument for modifying accounting standards on intangibles (Penman, 2009; Skinner, 2008)

Main Findings (cont'd)

<u>Information on specific unaccounted intangibles & its impact on company performance/market value/users</u>

- In general terms, **specific unaccounted intangibles have a positive effect on financial performance and market value of companies**. For example, greater expenditure on intangibles corresponds to an increase in the value of the company (Ehie and Olibe, 2010)
- However, the effect of specific intangibles on financial performance or market value is **positive, but not linear**. Moderation effect of other factors such as strategy and competitive intensity (e.g., Sánchez & Sotorrío, 2007)
- As to the **disclosure about specific intangibles →** <u>negatively associated with earnings</u> (Merkley, 2014 for R&D), but also a <u>positive effect on the share price</u> (Chen et al., 2017 for R&D). This positive effect more about the quantity of forward-looking information (Bayer et al., 2017 for customer satisfaction/awareness)

We did **not** find in the studies reviewed too much evidence on **how information about a specific intangible is used by investors and information users**. Only exceptions:

- Amir et al. (2003) → financial analysts compensate for the intangibles-related information deficiencies of financial reports but definitely <u>not</u> for all the deficiencies

- Barth et al. (2001) → "analysts expend greater effort to follow firms with more intangible assets, and intangible assets, most of which are not recognized in firms' financial statements, are associated with greater incentives for analysts to cover such firms, and greater costs of coverage»

- Hsu and Chang (2011) → voluntary disclosure of IC and information risk is negatively associated with analysts' earnings forecast errors and dispersions in the high-tech industries

Key takeaways

- Different intangible assets as well as divergent opinions and empirical results

- «Intangibles» emerges as a problematic area

- Ideally, evidence should come from various national and regional jurisdictions, which is not always the case

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Potential areas for the IASB to explore (non-exhaustive)

- **Scope & Definition**
  - Financial statement items only or broader? ***(Stefano)***
  - Are IAS 38 scope exemptions still appropriate? *(no research)*
  - Intangibles held for investing included (eg cryptocurrencies)? ***(Clémence)***
  - What are the properties of intangible assets? ***(Jan)***
  - Update for revisions to *Conceptual Framework*? (no *research)*
  - Consistent labels/terminology required? ***(Clémence & Janice)***
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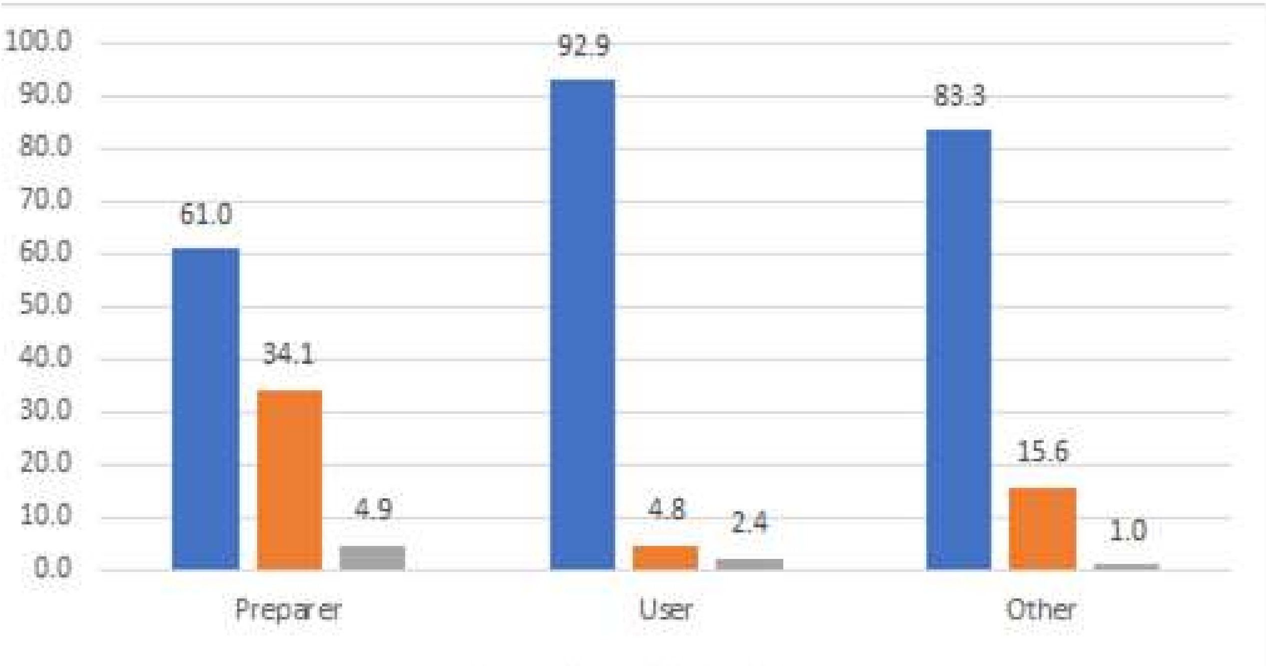
  - Provide information about risks and opportunities (drivers of value of business)? ***(Laura)***
  - Placement of information (financial statements vs MD&A)? ***(Laura)***
  - Interdisciplinary considerations on disclosure ***(Janice)***

Financial statement items only or broader?

- Survey carried out in 2021 → intangibles are generally perceived to be a fundamental component of corporate reporting that is currently lacking in financial statements and IAS 38 (92.9% for users, and 61% for preparers) (Zambon et al., ICAS-EFRAG-EFFAS Research Report, 2023)



EAA-FRSC Intangibles Research Group

Financial statement items only or broader? (cont'd)

- Paradox → according to users and preparers the IFRS report is the one that provides the least information on intangibles. However, at the same time, IFRS-based financial statements that include information on intangibles are generally considered as the most useful report if compared to other forms of reporting that include information on intangibles, such as the Integrated Report (Zambon et al., ICAS-EFRAG-EFFAS Research Report, 2023)

- No real answer on "financial statement items only or broader", but many advocate for a mix of 'forms' as long as this information is all included in one place (Zambon et al., ICAS-EFRAG-EFFAS Research Report, 2023). See later "Placement on Information"

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Intangible Assets

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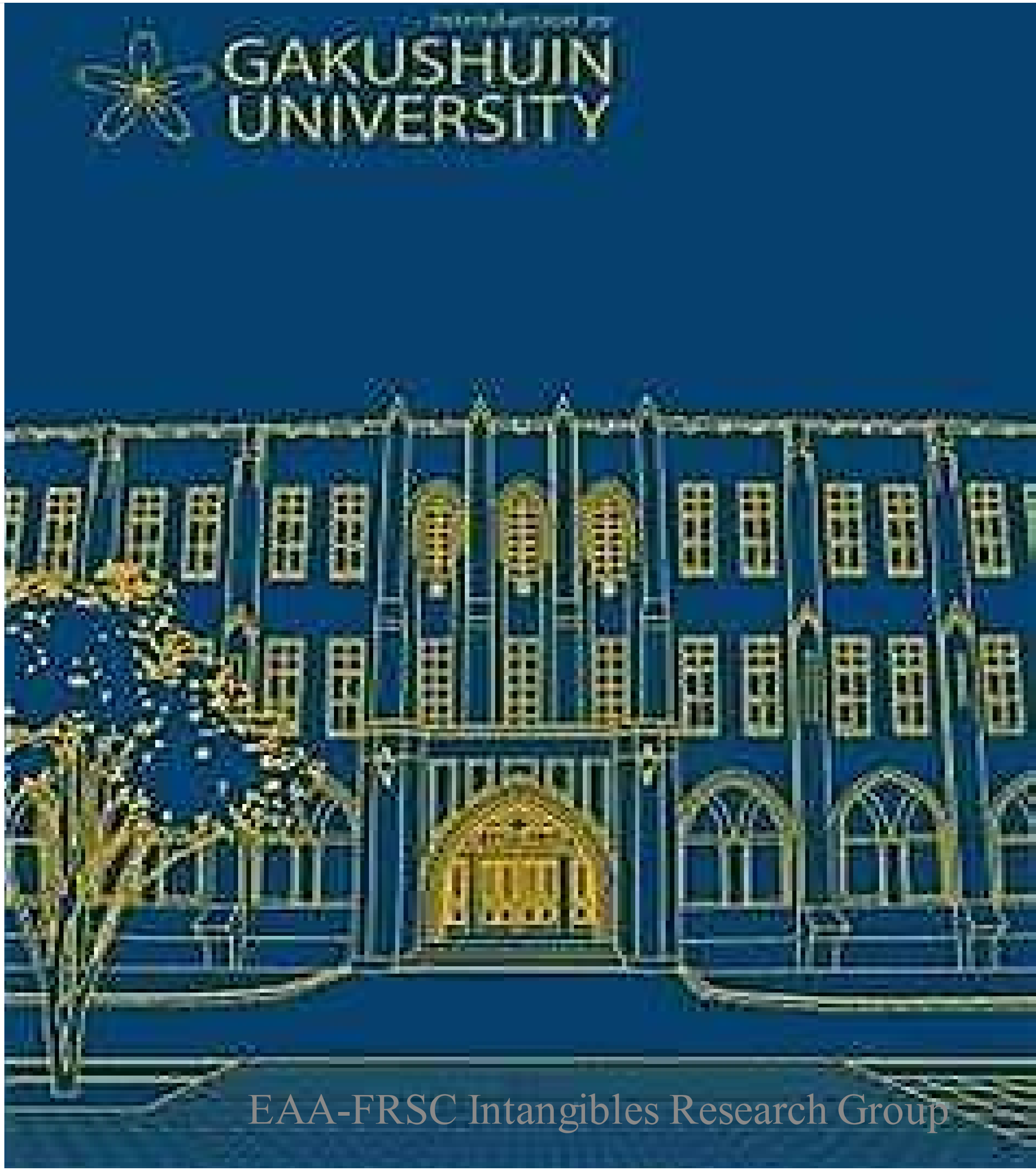


Should intangibles held for investing be included in the scope of IAS 38? (e.g. cryptocurrencies)

⇒ *Cryptoassets are a heterogenous group*

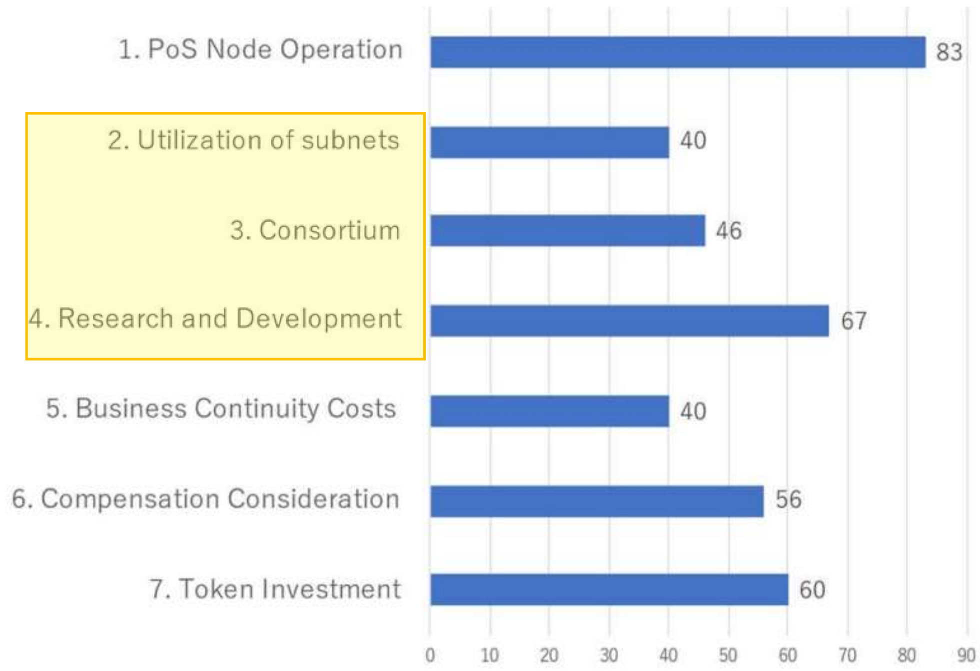
- Academic literature on blockchain and cryptocurrencies is abundant.

(Dai and Vasarhelyi, 2017; Toyokura, 2022; Jackson and Luu, 2023; Parrondo, 2023; Hubbard, 2023; Ikeda, 2023)

- **Most studies associate cryptoassets with fintech** and focus on payment and investment functions.

(Weber and Baisch, 2023; Parrondo, 2023; Nosaka et al., 2022).

- Studies about utility tokens, incl. nonfungible tokens (NFT), are scarce (Crano, 2023; Jayasuriya and Sims, 2023).
- Some companies use tokens for nonfinancial purposes, like developing their own blockchain (Luo and Yu, 2022).
- Some tokens change radically in content. For ex, Polkadot token, security ⇒ software in 2022.



*A survey by the Japan Blockchain Association (JBA, 2023) shows that **cryptocurrencies serve business purposes other than investment** in the web3 industry.*

Should intangibles held for investing be included in the scope of IAS 38? (e.g. cryptocurrencies)

⇒ *More issues in academic literature…*

➢ **Are cryptocurrencies nonmonetary?**

- The current consensus is yes (Sterley, 2019).
- But: Some jurisdictions have already admitted cryptocurrencies as a legal means of payment (El Salvador, Japan for limited amounts). One step further was stablecoins; most recently "Central Bank Digital Currencies" (CBDC) are the digital equivalent of cash ⇒ **CBDCs do not meet IAS 38 definition**
- More broadly, there is a gap between fintech-oriented literature and accounting regulation due to the narrow definition of cash in the latter

➢ **If cryptocurrencies remain in the scope of IAS 38, should they be measured at fair value?**

- This solution is generally supported in academic literature (Hubbard, 2023)
- But: Cryptocurrencies held for nonfinancial purposes, like R&D or developing corporate blockchain, are not addressed. The debate about market valuation for in-use intangibles in Appleton et al.(2023) is equally relevant for tokens
- There are multiple situations in which fair value is not relevant nor applicable, like prepayments or nontransferable tokens (JBA, 2023)

UNIVERSITY OF GOTHENBURG
SCHOOL OF BUSINESS, ECONOMICS AND LAW

Jan Marton

Properties of Intangible Assets

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What are the properties of intangible assets?

- Scalability gives high potential payoff, while residual value of unsuccesful assets is likely low or zero → economic volatility in the relation between investment and payoff is higher than for tangible assets (Crouzet *et al.*, 2022; Stulz, 2020)
- Can be copied → proprietary costs of early disclosure is high, especially for innovative intangible assets (Simpson & Tamayo, 2020; Stulz, 2020; Ho *et al.*, 2023)
- Note the substantial differences that exist between different types of assets (Zambon *et al.*, 2020, Chapter 6).

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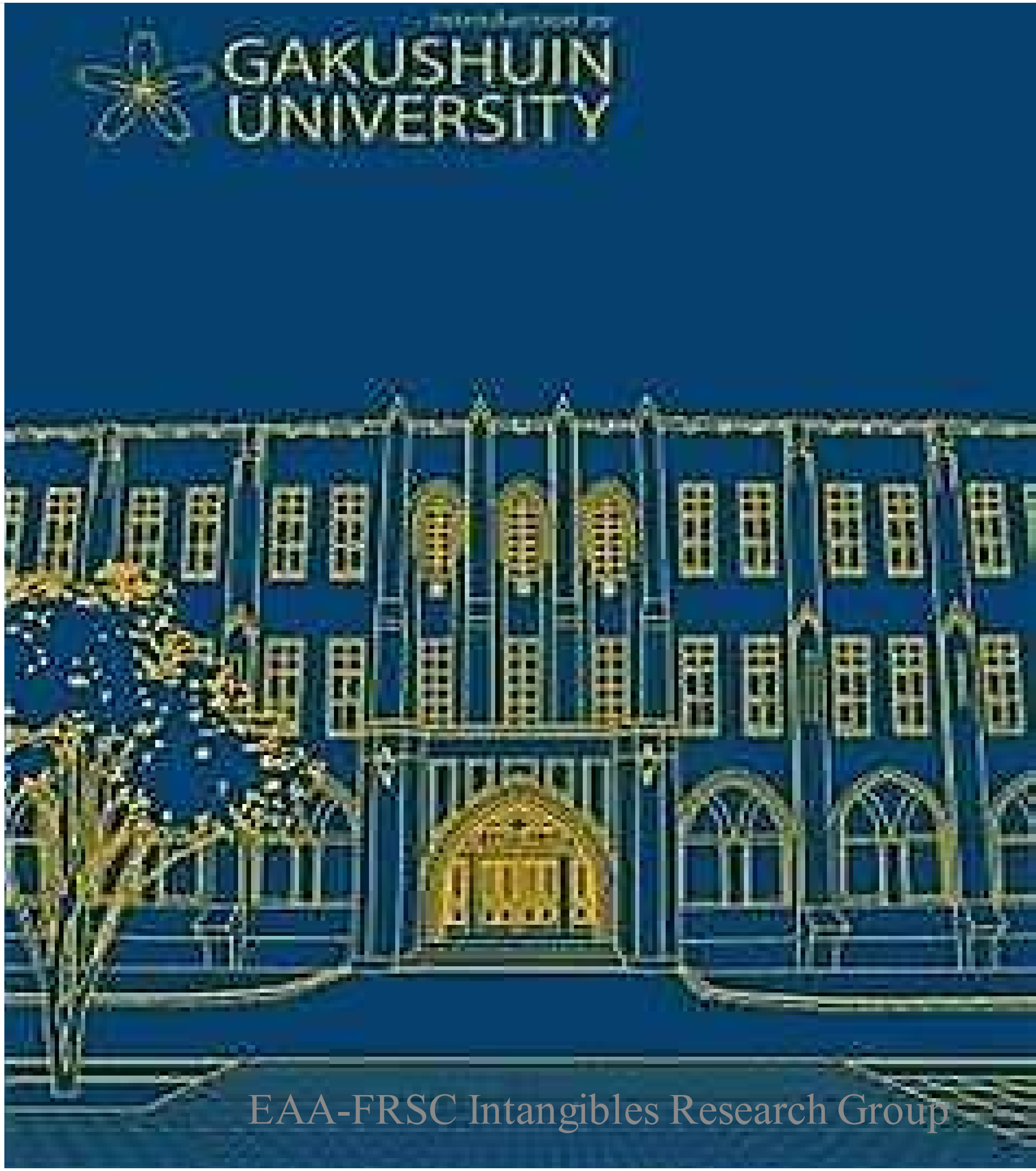

Are Consistent labels/terminology required?
⇒ Lack of homogeneity

- Literature on the topic is scarce (no empirical study).
- In the pre-IFRS period, accounting standards regarding intangibles were diverse (Stolowy & Jeny-Cazavan, 2001). Comparative research has highlighted opposite traditions in the treatment of intangibles in Western countries (Richard, 1996; Thibierge, 1997; Bessieux-Ollier, 2003).
- Nonfinancial reporting models were developed to classify and report intangibles (Zambon et al., 2019), some including KPIs like the WICI Intangibles Reporting Framework (WICI, 2016).
- For corporate digital reporting, **XBRL includes a taxonomy of intangibles**. The list differs depending on the accounting standards used and the jurisdiction (Garcia *et al.*, 2023).
- Despite the adoption of IFRS, labeling of intangibles remains diverse (Tsalavoutas *et al.*, 2014), particularly within the EU (Garcia, 2022; Garcia *et al.*, 2023).

⇒ Academic literature highlights the **lack of homogeneity** of reporting policies.

Are Consistent labels/terminology required?
⇒Yes…to improve comparability and machine-readability

Pros

- Improve consistency/comparability (Garcia et al., 2023).
- Improve XBRL taxonomy (Garcia et al., 2023);

⇒ increased saliency of information (Arnold et al., 2012).

⇒ better tagging of descriptive information in other parts of reports.

- Consistent terminology improves the explainability of AI models (Zuroff & Chapados, 2023).

Cons

- IFRS are principles-based, which may conflict with a restrictive taxonomy (Beerbaum et al, 2021).
- Many types of intangibles, and the number increases (Garcia, 2022).
- Intangibles are industry-specific (Chalmers & Godfrey, 2006).
- Intangibles are often entity-specific (Appleton et al., 2023).

XBRL taxonomy for IFRS

Preferred Label	Reference
Intangible assets and goodwill	
Intangible assets other than goodwill	
Brand names	IAS 38.119 a $_{\text{Example}}$
Intangible exploration and evaluation assets	IAS 38.119 $_{\text{Common practice}}$, IFRS 6.25 $_{\text{Disclosure}}$
Mastheads and publishing titles	IAS 38.119 b $_{\text{Example}}$
Computer software	IAS 38.119 c $_{\text{Example}}$
Licences and franchises	IAS 38.119 d $_{\text{Example}}$
Copyrights, patents and other industrial property rights, service and operating rights	IAS 38.119 e $_{\text{Example}}$
Recipes, formulae, models, designs and prototypes	IAS 38.119 f $_{\text{Example}}$
Intangible assets under development	IAS 38.119 g $_{\text{Example}}$
Other intangible assets	IAS 38.119 $_{\text{Common practice}}$
Total intangible assets other than goodwill	IAS 1.54 c $_{\text{Disclosure}}$, IAS 38.118 e $_{\text{Disclosure}}$
Goodwill	IAS 1.54 c $_{\text{Disclosure}}$, IAS 36.134 a $_{\text{Disclosure}}$, IAS 36.135 a $_{\text{Disclosure}}$, IFRS 3.B67 d $_{\text{Disclosure}}$

Source: www.ifrs.org/issued-standards/ifrs-taxonomy/ifrs-accounting-taxonomy-2022/

Specific issues regarding the taxonomy of intangible assets

- General issues with the current taxonomy:
  1) Lack of definitions;
  2) Overlaps and redundancy of some items;
  3) Intangibles recognized based on the **separability criterion** are scarce (ex: customer lists);
  4) Digital assets are absent from the list.
- XBRL taxonomy can be extended using **anchored tags** at the discretion of preparers. ⇒ These tags are not standardized.
- Practical issues about labels (Garcia et al., 2023):
  - The distinction between **acquired and in-house R&D is unclear in the labels**. In the sample surveyed, 99% of capitalized R&D costs were acquired from M&As.
  - Large intangible-intensive companies use **classification by functions,** which differs from XBRL.
  - **Several levels of granularity** appear necessary to accommodate the needs and resources of preparers.

Nottingham Trent University

Are consistent labels/terminology required? Underlying legal aspects

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Are Consistent labels/terminology required?
⇒ Underlying legal aspects

- **Wide scope of intangibles, lack of interdisciplinary understanding, no consensus, minimal literature**

- Difference between intellectual property and intellectual capital

(Nenad Gajic, 'Intellectual property and intellectual capital: defining a relationship' (June 2017) Vol 7, Issue 2 Queen Mary Intellectual Property Law Journal pp. 242-255

- Terminology in the underlying legal frameworks would be expected to converge because of the international trade agreements on intellectual property. In fact, diversity in legal definitions and terminology remains (Verlinden & Baker, 2018)

Potential areas for the IASB to explore (non-exhaustive)

- **Scope & Definition**
  - Financial statement items only or broader? ***(Stefano)***
  - Are IAS 38 scope exemptions still appropriate? *(no research)*
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  - Update for revisions to *Conceptual Framework*? (no *research)*
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Recognition criteria and prohibitions in IAS 38

EQUIS ACCREDITED AACSB ACCREDITED AMBA ACCREDITED

Recognition criteria and prohibitions in IAS 38 – Accruals

- Recognition of investment represents a transactional accrual (Lewellyn & Resutek, 2016), while subsequent amortization and impairment are non-transactional (Lewellyn & Resutek, 2016; Dechow et al., 2022). The former are more useful than the latter.
- Depreciation, amortization and impairment are not useful to predict future cash flows (Ball & Nikolaev, 2022).
- A portion of SG&A is seen by market as investments in intangibles (Banker et al., 2019). Predictability of earnings and stock returns increases when intangible investments are separated (Enache & Srivastava, 2018).
- Negative association of cash flows and accruals has gone down over time (Bushman et al., 2016). When adjustment is carried out for unrecognized intangible assets, the decline disappears (Green et al., 2022).

Recognition criteria and prohibitions in IAS 38 – Usefulness

- Non-recognition leads to a decline in earnings usefulness (Dugar & Pozharny, 2021(IFRS, US GAAP); Lev & Zarowin, 1999(U)). Firms with accounting-related losses subsequently perform better than firms with economic losses (Gu et al., 2023(US GAAP))
- Non-recognition makes financial statements more useful by providing information about risk (Penman & Zhang, 2020; Oh & Penman, 2023(US GAAP))
- Recognized R&D introduces uncertainty in financial statements (Dinh et al., 2020(IFRS); cf. Dargenidou, et al., 2021(IFRS)), and negatively affects financial analysts (Dinh et al., 2015(IFRS)). Note that these results depend on level of uncertainty and other environmental factors.
- Investors favor R&D recognition, but consider current IAS 38 criteria too vague (Mazzi et al., 2022(IFRS))

Recognition criteria and prohibitions in IAS 38 – Firm effects

- There are managerial incentives to recognize in some situations (Russel, 2017(IFRS))
- Recognition is associated with higher investment in intangibles (Oswald et al., 2022(IFRS))
- Increased investment leads to higher efficiency (Battacharaya, 2021(IFRS); Dinh et al., 2019(US GAAP)).

Christina Dargenidou

Recognition: Acquired and Internally generated intangibles

Reduce number of intangibles recognised in business combination?

Should there be a recognition difference between acquired and internally generated intangible assets?

- Consensus evidence on the (value) relevance of **acquired** intangibles

(IFRS) Europe: Oliveira, Rodrigues and Craig(2010) Sahut, Boulerne and Teulon (2011), Cordazzo and Rossi (2020); Australia: Chalmers, Clinch and Godfrey (2008); Africa: Tunyi, Ehalaiye, Gyapong and Ntim (2020).
(US GAAP) Bauman and Shaw, 2018; Landsman, Liss and Sievers, 2021; King, Linsmeier and Wangerin, 2023).

- Are **acquired** intangibles different from internally generated intangible assets?

(US GAAP) Kimbrough and Brown (2011): compare capitalised R&D estimates, goodwill and identifiable intangibles in terms of earnings properties: **underlying contractual and legal rights**.

Should there be a recognition difference between <u>acquired</u> and internally generated intangible assets?

Evidence from Purchase Price Allocation data (M&A):
fair value estimates of intangible assets

(US GAAP): Beneish, Harvey, Cheng and Vorst (2022) find that unpatented (and unrecognised) innovation has an important role determining merger value creation. Kimbrough (2007) shows that the market values, at least partially, reflect the target's unrecognised R&D capital – **analysts' private information search** appears to fill this gap.

- Whilst the (limited) evidence above points to the potential of **disclosure** and the presence of **contractual/legal rights** for streamlining the recognition difference between acquired and internally generated intangibles,
- We don't know much about differences in terms of future benefits **uncertainty (and uncertainty resolution)** between these two categories of intangible assets.

Reduce number of intangibles recognised in business combination?

➢ *Identifiable intangibles are an important source of information*

(US GAAP) King, Linsmeier and Wangerin (2023): strategically important and wasting intangibles **provide information different from that provided by goodwill**.

(US GAAP) McInnis and Monsen (2023):disaggregation of intangible assets into identifiable intangibles and goodwill, **provides predictive ability for future operating income and cash flows**.

(Experimental) Leitter, Koonce and White (2023) : providing investors with either a strategic disclosure or separate identification of intangibles can **help investors better understand and foresee the benefits of business acquisitions.**

(IFRS, Germany): Buxbaum, Schabert, Schultze, Wilhelm and Wyatt (2023): the proportion of the purchase price allocated to fair valued net identifiable assets including the previously unrecognized identifiable intangible assets, separated from goodwill – **is significantly associated with measures proxying decision usefulness**

Reduce number of intangibles recognised in business combination? (cont'd)

Evidence is less explicit/scarce outside the US. Lack of straightforward comparisons in terms of relevance or predictive ability between goodwill and identifiable intangible assets although empirical tests present related empirical evidence – possibly, with varying conclusions. Why?

- Managerial incentives and institutional environment influence in the determination of the Purchase Price Allocation and fair values of identifiable intangibles.

(US GAAP) Shalev, Zhang and Zhang (2013)- executive compensation; Lynch, Romney, Stomberg and Wangerin (2019)- tax incentives; Zhang and Zhang (2016) –firm/CEO characteristics; Ashby, Chyz, Myers and Whipple (2024) - Non-GAAP reporting.

(IFRS) Frii and Hamberg- ownership structure (2021)/Sweden; Tunyi, Ehalaiye, Gyapong and Ntim (2020)/Africa.

IFRS Accounting

Potential areas for the IASB to explore (non-exhaustive)

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Measurement

Measurement – Economic characteristics

- Theory of investment can be adapted to intangible assets (Peters & Taylor, 2017)

- Recent theoretical dynamic option models link accounting to valuation (Breuer & Windisch, 2019; Hemmer & Labro, 2019; Hiemann, 2020). Hiemann (2020) views loss-making firms as real options, and it predicts that higher economic volatility leads to higher value for such firms.

Measurement – Relevance of assets

- There is interaction between income statement and balance sheet (Barker et al., 2022) and information about assets is useful, in addition to the income statement (Chen et al., 2022(US GAAP))
- Specific intangible assets in balance sheet increase usefulness of financial analysts’ recommendations (Segara et al., 2023(US GAAP))
- A firms’ historical performance is informative about its ability to innovate (Cohen et al., 2013(US GAAP))

Measurement – Method

- Recognition of investment at cost is a transactional accrual, while remeasurement at current value is a non-transactional accrual (cf. Lewellyn & Resutek, 2016)
- Insufficient knowledge about measuring non-financial assets at fair value (Sellhorn & Stier, 2019)
- Overview of measurement methods of intangibles for internal use (Van Criekingen et al., 2022)

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Disclosures on (unrecognised) intangible assets

Associate Professor Laura Girella (PhD)
University of Modena and Reggio Emilia

Information about unrecognised intangible assets that investors want

Some authors find that information on **human capital** is perceived as the most useful for preparers (Mavrinac and Siesfield, 1997; Bornemann et al., 1999, Miller et al., 1999; Gan, 2001; April et al., 2003). Others that **relational capital** is perceived as the most useful by preparers, users (Flöstrand, 2006) or both (Ousama et al., 2001)

Zambon et al., ICAS-EFRAG-EFFAS Research Report (2023) → Users indicate IP and know-how (55%), and intangibles-related risks & opportunities (48%) are the most relevant categories of intangibles are recognized as missing from today's financial reporting. More specifically, users tend to require more specific information on unrecognized intangibles than preparers

- **Brands** (P: 5.5; U: 7.1)
- **R&D** (P: 7.2; U: 7.9)
- **IP & Know How** (P: 6.2; U: 7.8)
- **Software and information systems** (P: 6.9; U: 7.3)
- **Strategy & planning** (P: 6.9; U: 7.3)
- **Business model** (P: 7.2; U: 7.8)
- **Customer satisfaction and loyalty** (P: 6.0; U: 7.8)
- **Customer list** (P: 4.0; U: 6.3)
- **Corporate reputation & image** (P: 5.6; U: 6.4)
- **Relationships with suppliers** (P: 5.7; U: 7.3)
- **Training** (P: 5.2; U: 6.9)
- **Human capital (skills)**(P: 6.6; U: 7.8)
- **Organisational culture/climate** (P: 6.5; U: 7.1)
- **Intangibles-related risks and opportunities** (P: 6.5; U: 7.7)
- **Stakeholder engagement** (only for case study 3) (P: 6.5; U: 5.9)

NB: scores are out of 10

Disaggregate Expenses in Income Statement and Future-Oriented Expensed (FOEX)

Prof. Stefano Zambon (PhD, LSE)
Chair, EAA-FRSC Intangibles Research Group

Disaggregation of expenses and its Usefulness: Evidence

In general, few evidence and some mixed results on this topic:

- Berger et al. (2023) → motivated by the FASB's project on the disaggregation of income statement expenses (FASB, 2021/2022), a study on a Korean rule change that allowed firms to withhold a previously mandated disaggregation of cost of sales (CoS). They find that after withholding, firms' profitability increases by 1.6 percentage points → withholding affects profitability by reducing the transfer of competitive information to peer firms → firms withhold disaggregated CoS to protect cost innovations from rivals
- Holzman et al. (2021) → greater earnings disaggregation in financial statements leads to favorable market outcomes → disaggregation separates earnings components with heterogeneous characteristics → evidence is consistent with homogeneous earnings disaggregation to help investors' ability to impound earnings information into price efficiently
- Chen et al. (2015) → they construct a new measure of disclosure quality— disaggregation quality (DQ)— and offer validation tests. They find that DQ is negatively (positively) associated with analyst forecast dispersion (accuracy) and negatively associated with bid-ask spreads and cost of equity
- E. Hirst et al. (2007) → They develop and test a model that explains how disaggregation positively impacts three factors that, in turn, influence forecast credibility: perceived precision of management's beliefs, perceived clarity of the forecast, and perceived financial reporting quality.

Disaggregation of expenses – The Case of Future-Oriented Expenses (FOEX)

- FOEX are sources of intangible assets. Useful for disclosing the reasons of the creation of internally generated intangible assets if recognised, and as unique information in the notes if they are not (A. Quagli *et al.*, EAA-FRSC Comment Letter on EFRAG DP, 2022).
- But some questions arise on this disclosure (A. Quagli *et al.*, EAA-FRSC Comment Letter on EFRAG DP, 2022):
  - What kind of firms? Some industries are more interested than others
  - What are the conditions to make FOEX disaggregation useful? Three problems can be detected:
    - Classification problem
    - Separation problem from other expenses
    - Usefulness problem → link with results may be uncertain: management view helps but…?
      → time dimension of disaggregation/disclosures → creation of intangibles needs time

	2021			2020			2019		
	CURRENT EX	FOEX	TOTAL	CURRENT EX	FOEX	TOTAL	CURRENT EX	FOEX	TOTAL
Intangible expenditures and financial items included									
R&D product/process									
financial items									
……..									
commercial - customer									
financial items									
……..									
human resource									
financial items									
……..									
social/institutional									
financial items									
……..									
REVENUES									
MARGINS									

FOEX: Qualitative characteristics and a synthesis

- How? A certain level of granularity needed to allow users running their predicting models
- When? Long-term disaggregation/disclosure appears to be necessary
- Where? Notes to the FS are audited and perceived as more relevant than Management Commentary in many studies. But:
  - FOEX are not necessarily linked to specific assets
  - Need to link FOEX to business models and business strategy (which are generally included in the Management Commentary)
- Who? At which level? Group, entity, and/or segment? (A. Quagli *et al.*, EAA-FRSC Comment Letter on EFRAG DP, 2022)

In summary:

- FOEX disaggregation: less expensive than recognizing assets (no valuations), but it requires judgments and administrative efforts
- Balance between proprietary/administrative costs and users' benefits
- Some guidance needed but flexibility in detailed classification should be allowed
- Caveat: risk of reducing FOEX to a further reporting duty. Without adequate content and format, disaggregation/disclosure of FOEX has no value (A. Quagli *et al.*, EAA-FRSC Comment Letter on EFRAG DP, 2022)

Information about risks and opportunities

Placement of information

Associate Professor Laura Girella (PhD)
University of Modena and Reggio Emilia

Information about risks and opportunities

- The study of risks related to knowledge or intangible assets remains a young field (Zieba et al., 2022)
- Perrott (2007) defined knowledge risk as the likelihood of losses resulting from the identification, storage or protection of knowledge that can reduce the operational or strategic benefits of an organization. Using the term risks related to intangibles, Durst (2013) argue that these risks can be both financial and non-financial risks. The termination of an employee is given as an example.
- More recently, Durst and Zieba (2017) proposed a division of risks related to knowledge into internal and external ones in order to highlight the risk's main occurrence. In a later work, the same authors proposed a knowledge risks map that groups knowledge risks into three categories namely human knowledge risks, operational knowledge risks, and technological knowledge risks (Durst and Zieba, 2019; Durst, 2024, forthcoming in Zambon and Girella, *Handbook on Intangibles*)

Placement of information

- Shared awareness that traditional financial statements might not be able to fully accommodate the disclosure of intangibles-related information. However, scant research of comparative placement of this type of information (e.g., IR vs MC, IR vs Annual Report)
- New models have been proposed (Lev and Gu, 2016) and since the inception of integrated reporting which clearly mentions intangibles' components as part of its multi-capital approach, some authors have started analysing whether this could be a viable and useful vehicle (Abhayawansa et al., 2019; Beretta et al., 2019; Camodeca et al., 2019; Terblanche and De Villiers, 2019)
- The Integrated Reporting Framework can be considered as new ways to frame and disclose this type of information, no more on a stand-alone basis but on a systemic manner (Corbella et al., 2018; Chiucchi and Giuliani, 2022; Salvi et al., 2020; Stacchezzini et al., 2019)
- Others suggest that the disclosure of this information in an IR can be used by managers opportunistically to advance their image (Melloni et al., 2015)
- Zambon et al., ICAS-EFRAG-EFFAS research report (2023) → convergence of both preparers and users on, in the order, 'Supplementary notes to financial statements' (45-55%), 'Non-financial reporting statement according to the 2014 Non-Financial Reporting Directive' (35-40%), 'Integrated Reporting' (33-40%), and, lastly, 'Management Commentary' (26% for both)

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Interdisciplinary Considerations on Disclosure

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Disclosure: Fair and Faithful Presentation (FFP)

IFRS Conceptual Framework 2018, Sections 2.4 -2.7

Fundamental qualitative characteristics are **relevance** and **faithful representation**.

Relevance = Relevant financial information is capable of making a difference in the decisions made by users.

EARLIER RESEARCH:

- MF Rickling *et al* ‘Using Mergers and Acquisitions and Socratic Pedagogy to Facilitate Critical Thinking on Relevance versus Faithful Representation in Financial Reporting (2015) *Journal of the Academy of Business Education* Vol. 16, p. 110
- D. Alexander, E. Eberhartinger ‘The True and Fair View in the European Union’ (2009) 18(3) *European Accounting Review* pp. 571-594, https://doi.org/10.1080/09638180902784405

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Disclosure: FFP & True and Fair View

CURRENT RESEARCH: The International Dimension

Meaning of 'Faithful' versus 'True'?

FFP/TFV are important in financial accounting, but a full harmonisation has never been achieved.

- L. Parte *et al.*, 'True and fair view/fair presentation as a nexus between conventional accounting, sustainability accounting and Islamic accounting: unifying three frameworks?' (2022) Vol. 36, issue 2 Economic Research-Ekonomska Istrazivanja;
- D. Alexander, E. Jermakowicz, 'A true and fair view of the principles/rules debate' (2006) *Abacus* Vol.42(2), pp. 132–164;
- S. Aisbitt, C. Nobes, 'The true and fair view requirement in recent national implementations' (2001) 31(2) *Accounting and Business Research*, pp. 83-90;
- N. Kirk, Perceptions of the true and fair view concept: an empirical investigation (June 2006) *Abacus* Volume 42, Issue 2, pp. 205-235.

FUTURE RESEARCH: How should 'accounting for intangibles' develop to accommodate harmonization of core disclosure principles across multiple jurisdictions?

Disclosure: Corporate Governance & Materiality

MATERIALITY:

A few fundamental problems in terms of corporate reporting and disclosure
First, material intangibles information must be selected and edited.
Second, irrelevant information must be eliminated.
Third, the complexity of intangibles information needs to be reduced.

CURRENT RESESARCH:

There will not be a ‘one size fits all’ corporate reporting solution as intangibles vary so widely and are used differently in diverse business sectors. Sectoral guidance will be needed.

S.A. Churchill *et al.*, ‘Does Intellectual Property Protection deliver Economic Benefits? A Multi-outcome meta-regression analysis of the evidence’ (2021) Vol 36 *Journal of Economic Surveys*, pp. 1477-1509

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Disclosure: Placement and Communication

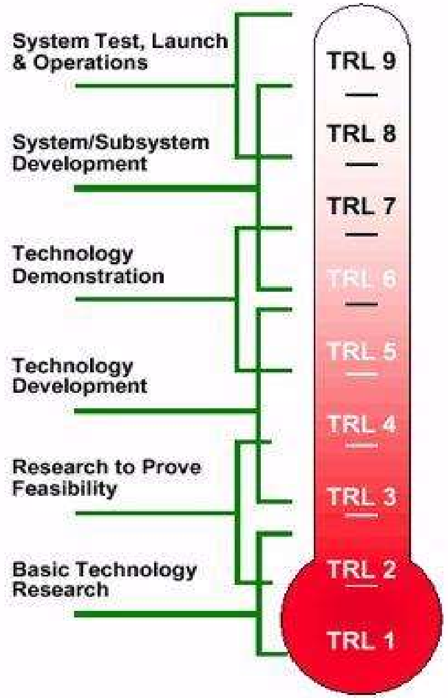
NEW FUNDAMENTAL TRANSDISCIPLINARY RESEARCH:

IFRS: ‘Additional disclosures where these are necessary to enable users to understand the financial position and performance of the entity, even where additional disclosure is not required by the accounting standards.’

Technology Non-Financial Information to contextualize figures

Technology Readiness Levels (TRLs)

J. Denoncourt, Part III, Shaping Intellectual Property Financing for Sustainable Innovation, Chapter 15 ‘Seeking and hiding: Corporate disclosure norms, non-financial technology information and the Technology Readiness Level (TRL) System’ (2023)



Placement in Notes to the Accounts, XBRL Tagging

Triangulate via Qualitative Narrative Reports containing Non-Financial Information

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