

Recognition and Disclosure of Intangibles under International Financial Reporting Standards

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INTANGIBLE ASSETS



Accounting for intangibles under IAS 38 and IFRS 3

‘an intangible asset shall be recognised if, and only if: (a) it is probable that the *expected future economic benefits* that are attributable to the asset will flow to the entity; and (b) *the cost of the asset* can be measured reliably. [IAS 38.21]

‘the acquirer recognises the *acquired identifiable intangible assets*, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense’ [IFRS 3.13]

‘*Internally generated* brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.’ [IAS 38.63]

‘An entity is *encouraged, but not required*, to disclose the following information: (a) a description of any fully amortised intangible asset that is still in use; and (b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria...’ [IAS 38.128]

Background

Stakeholders have raised the following issues about IAS 38 – accounting for intangibles:

1. The **discrepancy in recognition** between similar items depending on whether they are **acquired or internally generated** (EFRAG, 2021; 2023; UKEB, 2023)
 2. **Disclosure is limited** as IAS38 does not require, but only encourages, entities to provide a brief description of intangible assets that are not recognized (EFRAG, 2021; 2023)
- **WE CONSIDER DIFFERENCES IN RECOGNITION AND DISCLOSURE IN ACQUISITIVE AND NON-ACQUISITIVE FIRMS**

Purpose of the study

What are the variations in ‘**Recognition**’ and ‘**Disclosure**’ of intangibles in *Acquirers vs. non-acquirers*?

We hope the findings will inform IASB on:

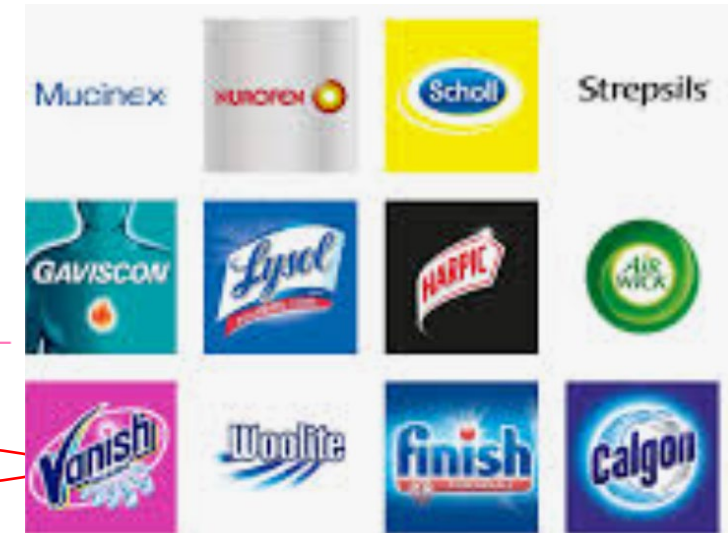
- Whether stakeholders (e.g., investors) have enough/useful information under the current standard
- To assess the *potential need* to amend IAS 38
- Especially given comprehensive review of IAS 38 by IASB

E.g. Acquisitive: Reckitt

Group Balance Sheet

As at 31 December 2023

	Note	2023 £m	2022 £m
ASSETS			
Non-current assets			
Goodwill and other intangible assets	9	18,588	20,203
Property, plant and equipment	10	2,399	2,473
Equity instruments	11	118	86
Deferred tax assets	12	287	244
Retirement benefit surplus	23	270	294
Other non-current receivables	14	172	157
Total non-current assets		21,834	23,457
Current assets			
Inventories	13	1,637	1,825
Trade and other receivables	14	2,062	2,082
Derivative financial instruments	15, 17	64	59
Current tax recoverable		80	155
Cash and cash equivalents	16	1,387	1,157
Assets held for sale	31	72	7
Total current assets		5,302	5,285
Total assets		27,136	28,742



9 Goodwill and Other Intangible Assets

	Brands £m	Goodwill £m	Software £m	Other £m	Total £m
Cost					
At 1 January 2022	13,448	10,212	547	266	24,473
Additions	-	-	77	4	81
Arising on business combinations	-	(2)	-	7	5
Disposals	(59)	(6)	(3)	-	(68)
Reclassifications	-	-	16	(16)	-
Exchange adjustments	1,136	832	16	17	2,001
At 31 December 2022	14,525	11,036	653	278	26,492
Additions	-	-	101	-	101
Arising on business combinations	-	17	-	39	56
Disposals	(1)	-	-	-	(1)
Reclassification from tangible fixed assets	-	-	4	-	4
Reclassifications to held for sale	(124)	-	-	-	(124)
Exchange adjustments	(583)	(660)	(5)	(4)	(1,252)
At 31 December 2023	13,817	10,393	753	313	25,276
Amortisation	20	-	79	8	107
Impairment	-	810	2	-	812
Disposals	(1)	-	-	-	(1)
Reclassifications to held for sale	(77)	-	-	-	(77)
Exchange adjustments	(10)	(422)	(4)	(6)	(442)
At 31 December 2023	311	5,815	412	150	6,688
Net book value					
At 31 December 2022	14,146	5,609	318	130	20,203
At 31 December 2023	13,506	4,578	341	163	18,588

The amount stated for brands represents the fair value of brands acquired since 1985 at the date of acquisition. Other includes product registration, distribution rights, capitalised product development costs and customer contracts.

Non-acquisitive: Deliveroo



Consolidated statement of financial position

As at 31 December 2023

(Registration number: 13227665)

	Note	2023 £m	2022 £m
Non-current assets			
Property, plant and equipment	14	39.0	49.3
Right of use assets	15	55.2	73.5
Intangible assets	16	67.8	72.9
Deferred tax assets	17	1.8	4.1
Investments in financial assets	18	2.9	2.9
Trade and other receivables	19	14.1	22.6
Total non-current assets		180.8	225.3
Current assets			
Inventory	20	14.8	19.4
Trade and other receivables	19	147.6	109.6
Other treasury deposits		75.7	50.5
Cash and cash equivalents	21	603.1	949.1
Total current assets		841.2	1,128.6
Total assets		1,022.0	1,353.9

16 Intangible assets

	Goodwill £m	Acquired software £m	Capitalised development expenditure £m	Total £m
Cost				
At 1 January 2022	4.9	9.8	104.6	119.3
Additions	—	—	50.3	50.3
Currency translation	—	0.2	(0.1)	0.1
At 31 December 2022	4.9	10.0	154.8	169.7
Additions	—	—	36.1	36.1
Disposals	—	(0.1)	—	(0.1)
Currency translation	—	(0.1)	—	(0.1)
At 31 December 2023	4.9	9.8	190.9	205.6
Accumulated amortisation				
At 1 January 2022	—	(4.7)	(61.8)	(66.5)
Amortisation charge for the year	—	(1.1)	(29.2)	(30.3)
At 31 December 2022	—	(5.8)	(91.0)	(96.8)
Amortisation charge for the year	—	(3.9)	(37.1)	(41.0)
Currency translation	—	(0.1)	0.1	—
At 31 December 2023	—	(9.8)	(128.0)	(137.8)
Net book value				
At 31 December 2023	4.9	—	62.9	67.8
At 31 December 2022	4.9	4.2	63.8	72.9

Goodwill was recognised on the acquisition of assets from Omakase Inc. It has been allocated to the cash-generating unit ('CGU') 'Roofoods Ltd'. The recoverable amount of the group of CGUs is determined from value-in-use calculations. The key assumptions in these calculations comprise discount rates, growth rates, pricing fluctuations and changes to direct costs. These assumptions are consistent with available external information sources. Discount rates are estimated rates that reflect current market assessments of the time value of money. The discount rate used was 14% (2022: 15%). A terminal growth rate of 2.5% (2022: 2.5%) was used to extrapolate cash flows beyond the forecast period.

For the purpose of the goodwill impairment review, management prepares cash flow forecasts for a period of five years. Thereafter a growth rate is applied that does not exceed the long-term average growth rate for the industry and geography. There is no reasonably possible change in any key assumptions that would cause the carrying amount to exceed the recoverable amount.

Literature review on recognition

- Value relevance of financial statements has *decreased over time* due to the increase in unrecognized intangible assets (e.g., Lev, 2018; Lev, 2019; Zambon et al., 2020)
- Acquired identifiable intangible assets that are recognized separately from goodwill are *value relevant* (Kallapur & Kwan, 2004; Sahut et al., 2011; Bauman & Shaw, 2018; King et al., 2023) and lead to *future cashflow improvements* (Deng & Lev, 2006)
- Capitalizing development costs is *informative* (Kimbrough, 2007; Oswald et al., 2017; Mazzi et al., 2022a), *value relevant* (Tsoligkas & Tsalavoutas, 2011) and can have *real effects* (Dinh et al., 2019; Oswald et al., 2022)
- Current recognition criteria for R&D can disincentivize firms from capitalizing R&D costs (Ma & Zhang, 2023). Hence, *capitalizing development costs is not pervasive* (Mazzi et al., 2019; Campbell et al., 2023)

RESEARCH QUESTION 1

- What is the difference in **recognition** of intangible assets in **acquisitive** compared to **non-acquisitive** firms?

Literature on disclosure

- Disclosure on intellectual capital is found to be both *informative* (Ousama et al., 2011) and *value relevant* (Vafaei et al., 2011)
- Voluntary disclosure of R&D expenses is *value relevant* beyond earnings, book value and capitalized R&D (Chen et al., 2017)
- Limited evidence that firms *supplement their lack of recognition* with more disclosure (Schiemann et al., 2015), especially outside the financial statements e.g., in sustainability reports (Castilla-Polo & Ruiz-Rodriguez, 2017)
- Other studies find that *disclosure is inadequate* (Gerpott et al., 2008; Tsalavoutas et al., 2014; Mazzi et al., 2022; Zambon et al., 2023). For example, Australian firms that were required to de-recognize internally generated intangible assets after the adoption of IAS 38 did not choose to provide alternative or substitute disclosure elsewhere in their annual report or financial statements (Ho et al. 2023)

RESEARCH QUESTION 2

- What is the difference in **disclosure** of intangible items in **acquisitive** compared to **non-acquisitive** firms?

Sample selection

- Our initial sample includes all firm-year observations in the United Kingdom during the period **2017-2022** from Refinitiv Eikon (Datastream)
- We remove firm-year observations belonging to the mining, oil and gas and financial services industries as well as those with missing data. Our final sample with financial data is **3,475 firm-year observations**
- For our analysis on disclosure, we require the firm to have publicly available annual reports. Cross referencing with the sample above, we arrive at a sample of **1,460 firm-year observations**

Overview of methodology

- We first examine *level of recognized intangible assets* in sample
- We determine *proxies of disclosure* of intangible items through a textual analysis of keywords
- Three proxies represent different types of disclosure
- We compare the recognition and disclosure of intangibles across acquisitive and non-acquisitive firms, controlling for different *characteristics of firms*

Methodology

1. Recognized intangible assets - INT_{REC}

- Data on net intangibles (and amortization) from Datastream
- Limited data on reported development costs, brand, patent, R&D and other type of intangibles

2. Disclosure of intangible items -

INT_{DiS_A} INT_{DiS_B} INT_{DiS_C} INT_{DiS_ALL}

- We create three disclosure proxies based on textual analysis of annual reports using a bag of words approach (using Python)
- The final disclosure proxy is a sum of the other three

Bag of words approach

- We identify words/terms related to intangible items from search of literature and professional documentation
- These are classified as:
 1. **Contractual intangible assets (INT_{DIS_A})** such as **brand, licence, patent, property right, quota, and trademark**
 2. **Non-contractual intangible assets (INT_{DIS_B})** such as **R&D, intellectual property, cloud computing, and trade secrets**
 3. **Broad intangible items (INT_{DIS_C})** such as **customer lists, ESG (environmental, social and governance), training, digital transformation, and member relationships**

Multivariate tests

To investigate differences across **acquisitive and non-acquisitive firms** while controlling for other firm characteristics

$$INT_{REC} = \alpha + \beta_1 ACQU + \beta_{2-n} Firm\ characteristics + \varepsilon \quad (1)$$

$$INT_{DIS} = \alpha + \beta_1 ACQU + \beta_{2-n} Firm\ characteristics + \varepsilon \quad (2)$$

$$INT_{DIS} = \alpha + \beta_1 ACQU + \beta_2 INT_{REC} + \beta_3 RDI + \beta_{3-n} Firm\ characteristics + \varepsilon \quad (3)$$

'*ACQU*' is an indicator variable that takes on a value of 1 if the firm reports during the year a non-zero value of goodwill, minority interest or an acquisition on CF statement; zero otherwise

Descriptive statistics of key variables

Variable	Acquisitive					Non-acquisitive					Diff. in mean	p-value	
	N	Mean	Med.	Min	Max	N	Mean	Med.	Min	Max			
INT_{REC}	1,223	0.323	0.299	0.000	0.943	237	0.088	0.014	0.000	0.827	0.235	0.000	***
INT_{DIS_A}	1,223	0.027	0.019	0.000	0.250	237	0.023	0.014	0.000	0.123	0.004	0.051	*
INT_{DIS_B}	1,223	0.020	0.008	0.000	0.146	237	0.034	0.024	0.000	0.153	-0.014	0.000	***
INT_{DIS_C}	1,223	0.016	0.012	0.000	0.101	237	0.009	0.007	0.000	0.056	0.007	0.000	***
INT_{DIS_ALL}	1,223	0.063	0.050	0.000	0.393	237	0.066	0.058	0.000	0.278	-0.003	0.404	
RDI	1,223	0.085	0.000	0.000	28.273	237	1.043	0.000	0.000	57.988	-0.958	0.000	***

Top keywords in 1,460 annual reports

Contractual Intangible Keywords (A)	N	Non-contractual Intangible Keywords (B)	N	Broad Intangible Keywords (C)	N
Brand(s)	6,774	R&D*	10,312	Customer Relationship(s)	3,083
Licence(s)/License(s)	6,109	Intellectual Property	1,732	Business Model (s)	2,955
Patent(s)	2,250	Internally Developed Intangible(s)	990	Training	1,557
Computer Software	2,230	Software Development	644	Environmental	1,490
Franchise(s)	2,060	Database(s)	325	Consultant(s)	696
Trade mark(s)/ Trademark(s)	1,859	Trade Secret(s)	155	Customer List(s)	671
Contractual Arrangement(s)	1,106	Cloud Computing	126	Customer Base	619

*This also includes the terms Research & Development, Deferred Development, Product Development and Development Cost(s).

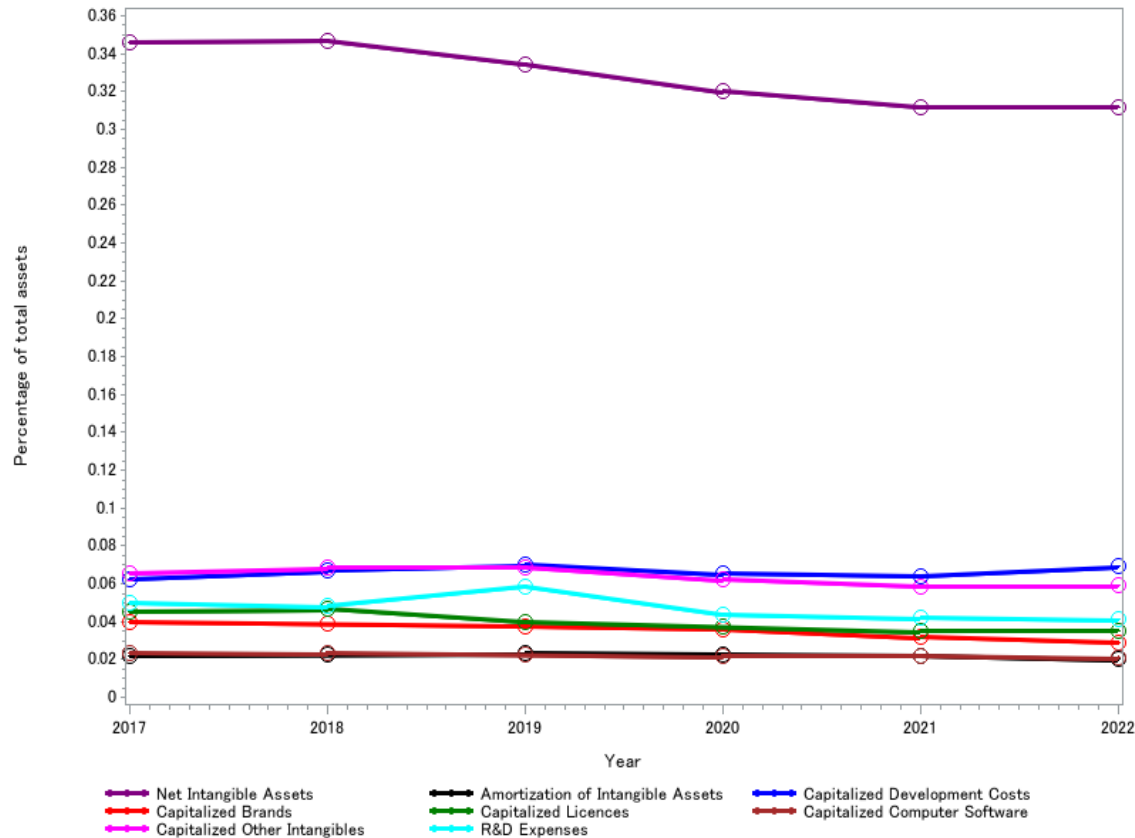
Findings – Univariate results – Recognition

- Level of recognized **net intangible assets** has slightly declined over the period 2017 – 2022 and remains small (about a third of total assets)
- **Acquirers** recognize more intangible assets than **non-acquirers**
- **Capitalized development costs** and **R&D expenses** higher in non-acquirers

Recognition in acquirers and non-acquirers

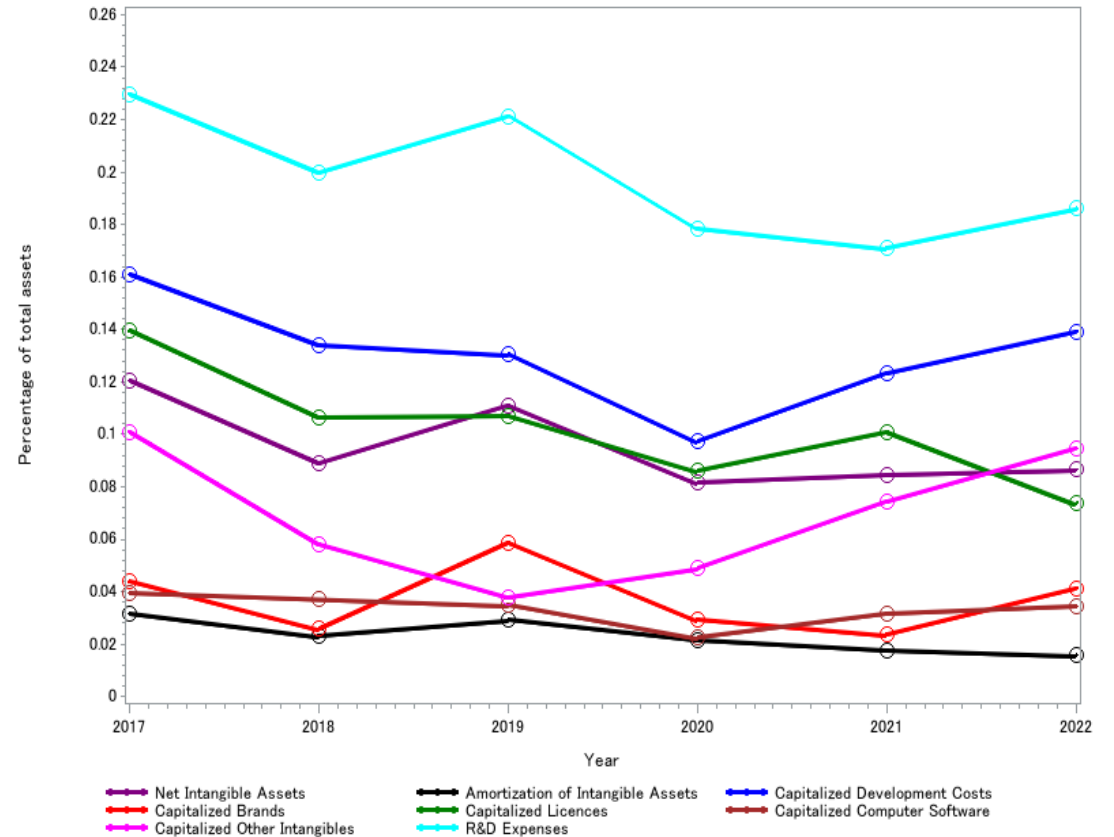
ACQUISITIVE FIRMS

- Net intangible assets slightly decreasing over time and represents around 32% of total assets in year 2022
- R&D expenses stable across the years at around 4% of total assets



NON-ACQUISITIVE FIRMS

- Net intangible assets slightly decreasing over time and represents around 9% of total assets in year 2022
- R&D expenses around 18% of total assets in 2021



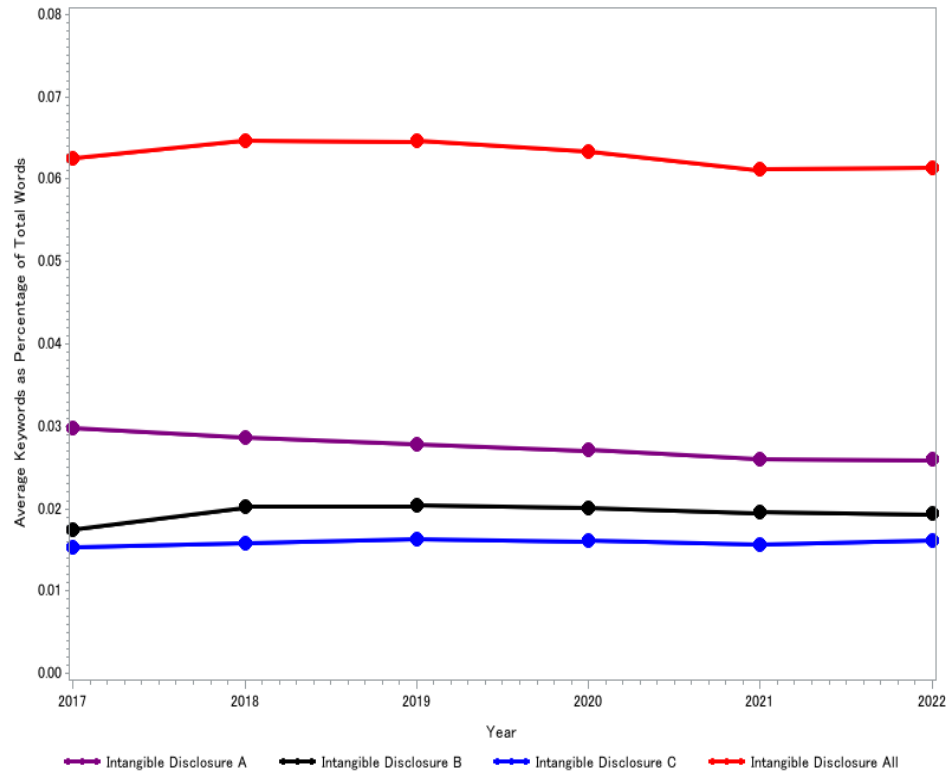
Findings – Univariate results – Disclosure

- **Level of Disclosure** has **not changed much over time** for acquirers for most intangible-specific items
- **Non-acquirers** disclose more non-contractual intangible items (Category B) than **acquirers**

Analysis of disclosure

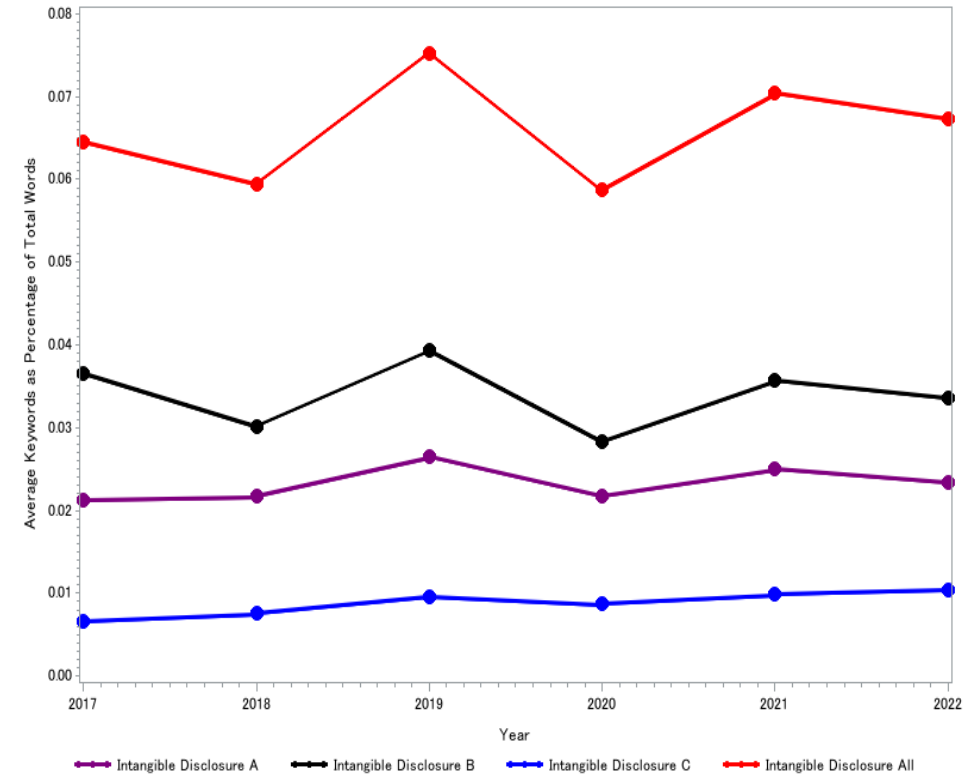
ACQUISITIVE FIRMS

- Disclosure stable over time
- Disclosure of contractual intangible items (Category A) remains the highest throughout the sample period



NON-ACQUISITIVE FIRMS

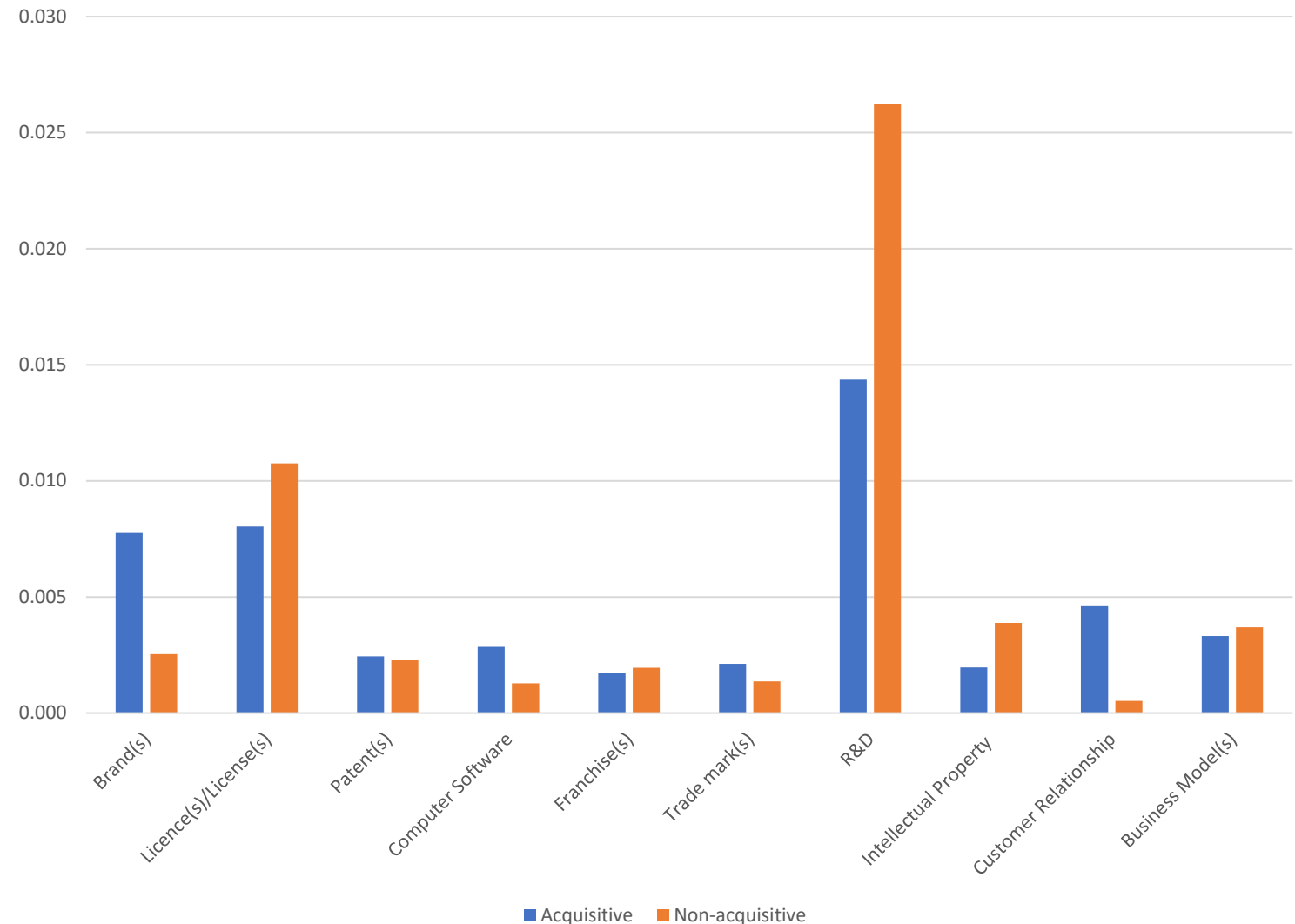
- Some variability in disclosure with some evidence of increase in total and broad intangible items (Category C)
- Non-contractual intangible items disclosed more than contractual in all years



Disclosure in acquirers vs. non-acquirers

- Acquisitive firms disclose more on 'Brands'
- Non-acquisitive firms disclose more on 'Licenses' and 'R&D'

Top Keywords Across Acquisitiveness



Findings – Multivariate results

- There is no difference between acquirers and non-acquirers in disclosure of contractual intangible keywords (Category A)
- There is evidence of **higher disclosure in non-acquisitive firms** for non-contractual intangibles (Category B), which includes internally generated intangibles, implying they may **supplement non-recognition** with higher disclosure of intangible information
- Acquisitive firms disclose more broad intangible keywords (Category C)
- After controlling for recognized intangible assets and R&D intensity, **acquirers appear to disclose less** than non-acquirers overall
- Firms in more **concentrated industries** disclose less regarding non-contractual intangibles, implying reluctance to provide proprietary information

Multivariate results

Dependent Variable	INT_{REC}		INT_{DIS_A}		INT_{DIS_B}		INT_{DIS_C}		INT_{DIS_ALL}	
	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value
Intercept	-0.176	0.000***	0.004	0.591	0.052	0.000***	0.002	0.509	0.058	0.000***
<i>ACQU</i>	0.188	0.000***	0.003	0.193	-0.009	0.000***	0.006	0.000***	0.000	0.932
<i>AGE</i>	-0.001	0.003***	0.000	0.030**	0.000	0.000***	0.000	0.357	0.000	0.002***
<i>MVE</i>	0.014	0.000***	0.001	0.101	-0.002	0.000***	0.000	0.278	-0.001	0.172
<i>LEV</i>	0.253	0.000***	0.010	0.037**	-0.021	0.000***	0.004	0.091*	-0.007	0.369
<i>HHI</i>	0.047	0.111	0.007	0.139	-0.020	0.000***	-0.006	0.011**	-0.018	0.014**
<i>MTB</i>	-0.001	0.000***	0.000	0.249	0.000	0.736	0.000	0.360	0.000	0.410
<i>PPE_net</i>	-0.516	0.000***	-0.032	0.000***	-0.022	0.000***	-0.006	0.006***	-0.061	0.000***
<i>CAPEX_CF</i>	-0.161	0.193	0.016	0.405	0.014	0.400	-0.018	0.044**	0.012	0.699
<i>AUFEEES</i>	-2.562	0.006***	-0.230	0.124	-0.029	0.817	-0.064	0.352	-0.323	0.169
<i>BIG4</i>	-0.010	0.413	-0.001	0.650	0.001	0.493	-0.001	0.101	-0.001	0.685
<i>AUOPIN</i>	-0.063	0.047**	0.001	0.869	0.004	0.345	-0.002	0.327	0.003	0.750
<i>EBEX</i>	-0.025	0.144	-0.004	0.132	-0.011	0.000***	0.000	0.896	-0.015	0.000***
<i>COVID</i>	-0.020	0.033 **	-0.002	0.321	0.000	0.884	-0.001	0.391	-0.002	0.337

Model 3

Dependent Variable	INT_{DIS_A}		INT_{DIS_B}		INT_{DIS_C}		INT_{DIS_ALL}	
	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value
<i>Intercept</i>	0.006	0.350	0.054	0.000***	0.005	0.125	0.065	0.000***
<i>ACQU</i>	0.000	0.977	-0.010	0.000***	0.003	0.008***	-0.007	0.040**
<i>INT_{REC}</i>	0.016	0.000***	0.010	0.006***	0.015	0.000***	0.041	0.000***
<i>RDI</i>	0.000	0.335	0.001	0.003***	0.000	0.117	0.001	0.075*
<i>AGE</i>	0.000	0.061*	0.000	0.000***	0.000	0.119	0.000	0.007***
<i>MVE</i>	0.001	0.257	-0.002	0.000***	0.000	0.868	-0.002	0.027**
<i>LEV</i>	0.006	0.194	-0.023	0.000***	0.000	0.902	-0.016	0.034**
<i>HHI</i>	0.006	0.184	-0.020	0.000**	-0.006	0.003***	-0.020	0.006***
<i>MTB</i>	0.000	0.411	0.000	0.611	0.000	0.922	0.000	0.776
<i>PPE_{net}</i>	-0.024	0.000***	-0.017	0.000***	0.002	0.425	-0.040	0.000***
<i>CAPEX_{CF}</i>	0.020	0.318	0.017	0.295	-0.016	0.066*	0.021	0.503
<i>AUFEEES</i>	-0.195	0.193	-0.016	0.895	-0.021	0.752	-0.233	0.318
<i>BIG4</i>	-0.001	0.703	0.001	0.467	-0.001	0.136	-0.001	0.773
<i>AUOPIN</i>	0.002	0.699	0.005	0.240	-0.001	0.534	0.005	0.486
<i>EBEX</i>	-0.003	0.235	-0.010	0.000***	0.000	0.860	-0.013	0.003***
<i>COVID</i>	-0.001	0.446	0.000	0.938	0.000	0.647	-0.001	0.561

Conclusion

- Acquirers recognise more intangible assets than non-acquirers
- Some evidence that non-acquirers supplement non-recognition with disclosure but only for certain intangibles

Thank you!

