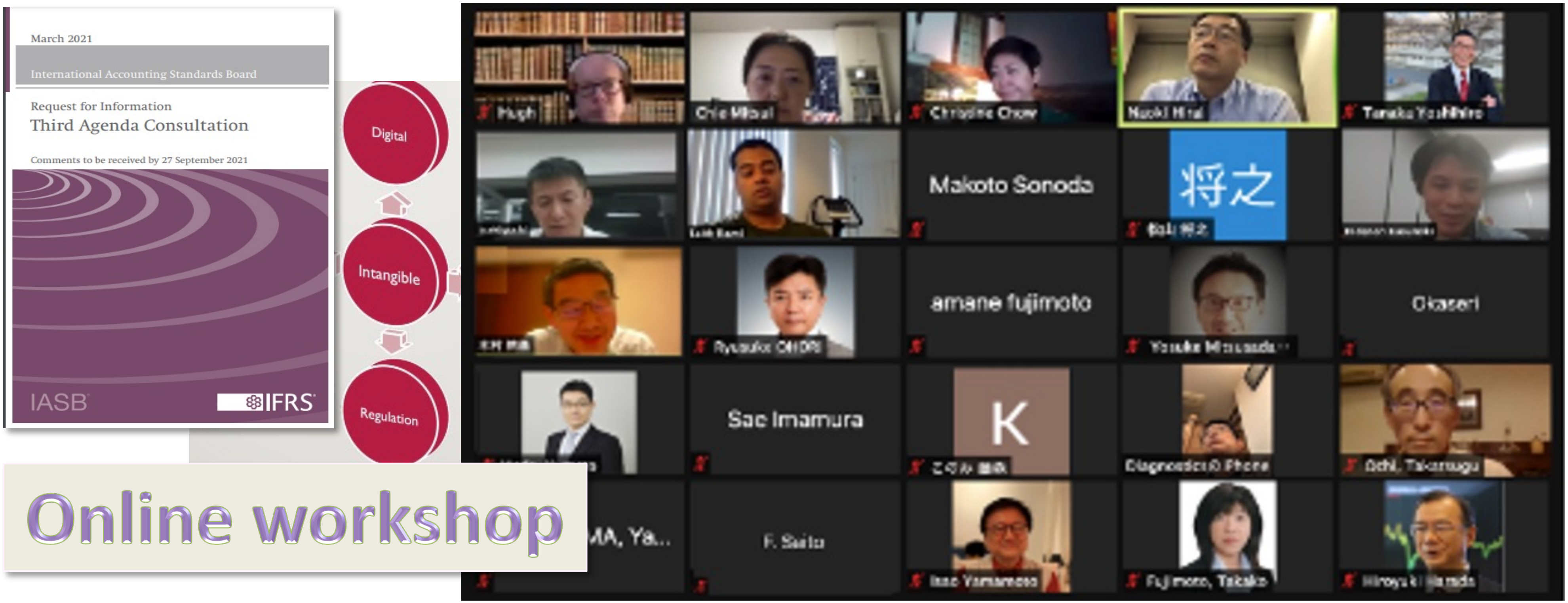
IASB Agenda Consultation 2021 !! / Intangible Assets

---- Why should we rely so much on non-financial information? ----



Online workshop

20th IFRS Digital Reporting Workshop

Date and time : 2nd July 2021, 18:30-20:30 JST

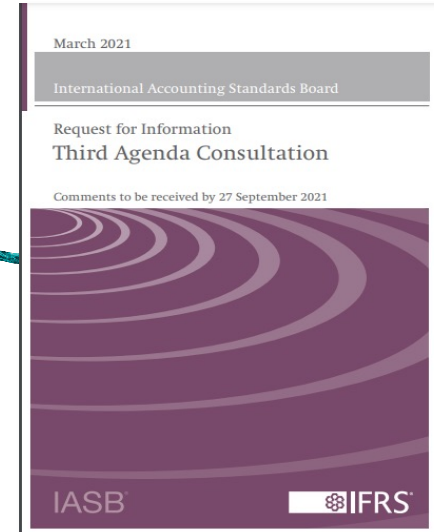
What kind of CG discussions outside Japan?

We have been discussing disclosure related issues since 2014. mostly investors and related market participants in Japan and inviting foreign friends. Discussion themes are chosen by IFRS or Corporate Governance issues and responding public consultation of IASB or other organizations in sometimes. Since we responded EU consultation Fitness Check in 2018, recently also picking up the Sustainable / environment topics as agenda.

Various intangible assets, such as human assets, intellectual property, business models, etc., which are becoming more important factors for corporate value, are not shown on the BS and suddenly become apparent as corporate value at the time of acquisition. It makes the analysis difficult. Maybe we can say that non-financial disclosures have become important to make up for the confusing parts. IASB is now seeking comments on themes to be addressed over the next five years. Intangible assets is one of the candidates. Discussions on this theme have already been held in the EU and other countries for several years. We will invite people who have been involved in these discussions from UK and EU.

	Who join the discussion?
Attendees (Japan) *attendees have joined this workshop as private,	22 Investors, 5 Investor(Analysts) organization, 2 sell-side analyst, 1 pension & insurance & bank, 6 Information providers/Researchers, 6 Company side (include Independent non - executive director, support service), 8 Auditor, 5 Regulator & Accounting setter & stock exchange, 1 other
Attendees (outside Japan)	3 Investors & its organization, 1 Information providers/Researchers, 1 Auditor

What is Agenda Consultation of IASB



Every five years, the IASB asks its stakeholders for input on its five yearly work plan. This stakeholder feedback will help shape the board's priorities. Over the last decade, the board has issued standards on financial instruments, revenue recognition, leases and insurance. In addition the board has worked on projects aimed at improving communication in financial reporting.

The board is looking for feedback in three areas:
1. whether they have struck the right balance in terms of its various activities.
2. whether the criteria used to add a new financial reporting issue on to the plan represent the right criteria.
3. which financial reporting issues they would like to add to the agenda.

BALANCE OF THE BOARD'S ACTIVITIES
The board undertakes six main activities. The first is developing new IFRS standards and amendments to existing IFRS standards. Its second main activity is the maintenance and consistent application of IFRS standards. Third, the board maintains the IFRS for SMEs standard. Fourth is supporting digital financial reporting by maintaining the IFRS taxonomy. The fifth activity is supporting the understandability and accessibility of IFRS standards. And finally, sixth, is engaging with stakeholders.
The consultation document provides an overview of each of these activities and the priorities attached to each.

FINANCIAL REPORTING ISSUES
Seeking feedback on which financial reporting issues should be added to the work plan for the period 2022 to 2026.
The board has provided some examples of financial reporting issues which could potentially be added to the work agenda. Many stakeholders have already suggested that intangible assets, the topic of today's conversation, should be added to the agenda. In the consultation document, the board challenges whether stakeholders always mean the same thing when they refer to intangible assets as a project. In particular, should the project be concerned with the recognition and measurement of intangible assets or should it instead be focused on disclosures?

IASB Agenda Consultation / Intangible Assets

How to address INTANGIBLE ASSETS?   IASB current discussion/directions

Stakeholders have in the past noted that IAS 38 covers a variety of transactions and assets which were not envisaged when the standard was first developed.
-IAS 38 may not provide useful information about some new types of transactions and assets, for example intangible assets held for investment purposes such as cryptocurrencies or emission rights.
- The standard may be too restrictive about when internally generated intangible assets can be recognised and when subsequent measurement of intangible assets at fair value is permitted. As economies become more knowledge-based, resources such as big data are playing a bigger and bigger role in creating value. Stakeholders have said that these restrictions result in financial statements which may omit relevant information
- The difference in the treatment of internally generated intangible assets and intangible assets recognised as part of an acquisition makes comparisons between companies that grow organically and those that grow through acquisition more difficult. At the same time, some stakeholders have said that recognising more internally generated intangible assets would give rise to operational difficulties and uncertainties associated with measurement. They said the benefits of reporting that information may not justify the subjectivity involved and the costs incurred to provide such information.
- Disclosures about expenditure on intangible resources that are not recognised as assets may provide insufficient useful information.

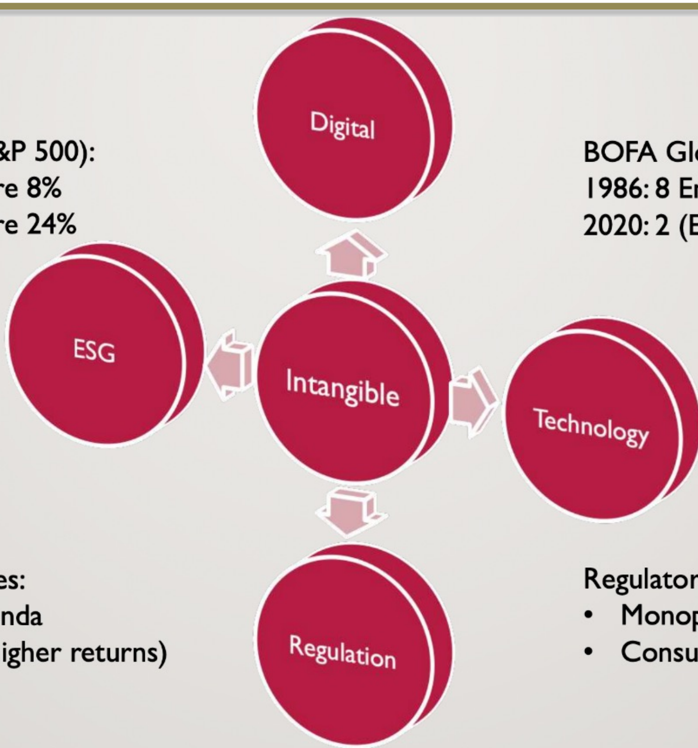
A possible solution to the difference in accounting between acquired and internally generated intangible assets could be to reconsider IFRS 3 (business combinations) . The board began exploring that solution. However, following feedback, the board decided not to develop these proposals.
As part of its project to revise IFRS practice statement 1 Management Commentary, the board is proposing that management commentary provide information about key resources, including intangibles not recognised as assets in the company's financial statements.

Now the board could consider
- Require improve disclosures about intangibles not recognised as assets. This is likely to be a medium-sized project;
- Require disclosures about the fair value of some intangible assets, especially those held for investment. This is also likely to be a medium-sized project; or
- Undertake a comprehensive review of the standard, including the definition of intangible assets. This is likely to be a large project.

Issue is INTERNALLY GENER ATED ASSETS

Internally generated assets is the real issue.

Yardeni Research (S&P 500):
2013: FAANGM share 8%
2021: FAANGM share 24%



BOFA Global Research (S&P 500):
1986: 8 Employees = $1mln Revenue
2020: 2 (Employees = $1mln Revenue

Regulatory Incentives:
- Sustainability agenda
- Investor belief (higher returns)

Regulatory Risks:
- Monopoly (fair competition)
- Consumer protection

Intangible assets are influenced by four things, Digital economy, Technology (not just technology companies, but wider technological infastructure), ESG and Regulation. The S & P 500 companies earned a million dollar revenue per eight employees in 1986, but two in 2020. It is internally generated assets that are at play in this situation. Technology companies are successful as they disrupt and become dominant. However, investors should consider that this success will draw regulatory actions in the future. For example, fair competition? or protection of consumers?

These internal intangible assets will be capitalised as goodwill or other intangible assets when acquisition would happen. But, would never show up on a BS, where group is pursuing organic growth. There are four options to solve it. First FV, however, there is a problem that FV will be very volatile. Next is a way to record the minimum cost in BS based on monetisation test. I think it is better for the governance perspective to capitalise it. Once on the balance sheet, the board will monitor it. The third is to list the costs that contribute to intangible assets in the PL as a separate line item. That information will be helpful to investors (even if the net income is the same). Fourth is a disclosure only solution. One of the big four representative said, "Goodwill should be amortised because it's difficult to audit." However, on ESG disclosures they favoured full auditing. It is a cognitive dissonance ...

SOLUTION – INTERNALLY GENERATED INTANGIBLE ASSETS

- FV (IFRS 3)
- Minimum Costs (monetisation test)
- P&L separate costs line
- Disclosure only

Why intangible asset is difficult?

Case;
2 restaurants apparently have different talent to earning money.

BS
Looks same

Restaurant A
Asset 100
Net sales 100

Restaurant B
Asset 100
Net sales 800

Stock Price 100

Stock Price 1000

Tasty seasonable meal?
Manage customer list and
Sending birthday cards?
Nice interior?

Then Acquisition happened…

Restaurant A is acquired 100

Suddenly asset size of B is 10 times than A.

Restaurant B is acquired 1000….Goodwill 900!

Another issue of intangible assets easily move to other holders.
So, if the source of super revenue was this "intangible assets", predicting the future cash flow might be very difficult.

Before acquisition, This value of 900 not appeared on the BS

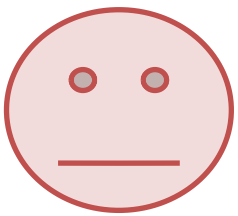
How company can explain this part?

Since the DCF method is used for corporate valuation generally, future cash flows are calculated based on expected income. It also often takes into account the market conditions of each business but it must be difficult to break down the source of revenue, from intangible assets.
For example,(this case above) if the source of revenue is human capital, such as a super chef, if he will be pulled out by another restaurant, it will have an impact on the profit forecast for the next year. If there is a chef education program instead, it may not affect cash flow in the future even if a couple of people are pulled out. However, generally, non-financial information like this (Chef / Education program) doesn't link to the financial statements directly, so must be difficult to understand well.

Market Cap VS Theoretical price calculated by DCF ?

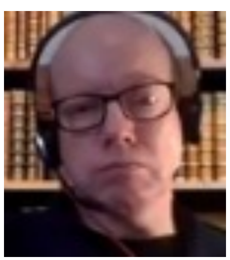
Regarding restrains cases, I sometimes examine a stock price as the actual corporate value, because there is an explicit gap between the actual stock price and book value per share in many cases.
Obviously that gap indicates the presence of other items, such as human capital, reputation of business, and so on., for instance, which are not contained in BS as certain items.
On today's agenda, in addition to the discussion of off-balance items of intangible asset, I would like to say, that we should think the stock price as a bench mark of actual corporate value, and how we can explain the price gap between the actual price and book value.

Investor in Japan



Investors want to consider non-financial information because in investment valuation, a discounted cash flow model (DCF) is often used to determine the expected value of a company. With the rise of sustainable investing that considers ESG factors, ESG premium and discounts are often applied during the valuation stage to reflect manager's judgement - what we call the 'ESG momentum' that demonstrates the 'direction of travel'. Good human capital management practices, suitable corporate structure and cost allocation structures embedded in the business model are 'intangible assets' that are becoming increasingly important. However, intangible assets involvement much judgement and interpretation, for example, investor would say "should the discount rate by adjusted more or less than 50 basis points?" ....What would they be to reflect social and human capital?

Investor in London



Hugh

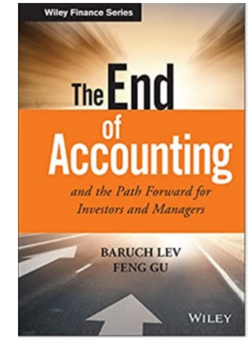
I agree with this comment. Every day, every second, the stock market is making a valuation. Somehow, it continues to value intangible assets and something that contribute to company value. Even if market volatility and expectations affect the stock prices. The question is whether accounting can contribute to this. Though accounting can provide information about the hidden value of a particular thing...I think it is an idea to think of this stock price as a benchmark for the actual book value. The insights that accountants can provide are that various items make various contributions. But, I think CEO or CFO should always prepare to be able to explain the gap between market cap and financial statements. Accountants might have a role to play for them... So I think it's worth starting to discuss "disclosure".

Should intangible asset be capitarised?

It wouldn't be very convenient for me to account for internally generated intangible assets in BS. We understand that determining the value of intangible assets at current time is part of a company's excess earning power for its peers. We forecast future cash flows. However, adding it to the balance sheet leaves room for arbitrary judgment. I prefer disclosure to recognition. I think Japanese companies should disclose more intangible assets. The other day I compared the market caps of GM and Uber. The two companies have similar size, but their configurations are different. GM has more officially recognised intellectual property, patents and trademarks than Uber. However, the market has determined that Uber's intangible assets are larger. Investors need information about them, probably because they are considering the business model and its sustainability.

Mr T
Investor in Japan

Investor in Switerland

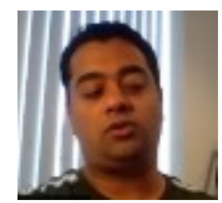


This is interesting approach. Except maybe that the theory underlying value investing style is that Price to Book should be 1, but price fluctuates around that That theory seems to be broken Contributing factors can be accounting artefacts, like goodwill amortisation, which has no relation to economic reality, but only to audit facilitation, which investors really don‘t care about one bit

Mt K
Investor in Japan

I don't think FV is very difficult for listed companies. I judge by the stock price. Listed companies provide sufficient information on acquired companies and can calculate the fair value to see if the stock price was overpriced. The problem is the size of the premium. But for unlisted companies, the information is limited and always very difficult to analyse.
Of course, the stock price is not always correct, but ...

Judgment is required if even the minimum cost is capitalised and placed on the balance sheet. However, once on the balance sheet, it needs to be accountable. If it is capitalised, you need to disclose various things. I think it will increase transparency by disclosing how much it is worth and how did management evaluate it so. In fact, even under the current rule, as Mr T says, there are places where judgments come in. And I also think it's correct to look at the market price.



KAZIM

Role of Disclosure

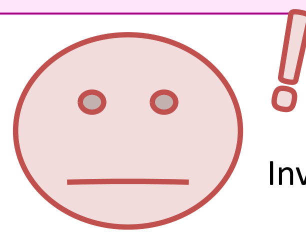
If Restaurant B has a great chef, so many customers choose Restaurant B, is this chef's skill an intangible asset? Or if Restaurant B has a chef education system and any chef can serve delicious food, is this business model an intangible asset?
Don't you think you wouldn't know if that wasn't disclosed?

Researcher

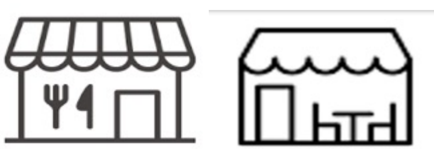
Investor
London

The judgmental part of an intangible asset is difficult, , but once capitalised, it is accountable, or when there is demonstrable economic benefits, such as with resale value, the assets can then be included in the balance sheet and audited. The size of economic benefits also plays a role. Despite increases in carbon prices in many markets over the years, the absolute amount is still small compared to overall company assets. In accounting, if an item is deemed immaterial, it may not need to be included; if it becomes material, and if it can be sold within a year, it can be included in inventory. We do not have a universal pricing mechanism for human capital but we do for some natural capital, such as carbon pricing or forest credit. This is an evolving area and more discussion is needed to find these agreed pricing mechanisms and metrics.
There are a lot of ESG ratings out there right now, and more will come with investors initiatives such as Influence map Company Scores also third party rating agencies, but you have to be very careful. The disclosure approach needs to become more robust, because sometimes it does not actually measure the attributes investors seek to evaluate. A single line of disclosure regarding the existence of a policy cannot give investors an additional perspective on the quality of implementation of the policy.
I firmly support disclosure, but we should not stop there. It is only the first steps.

I can analyse it myself if the disclosure is sufficient. I don't believe in the current market price, but it's important to be able to analyse it myself.



Investor in Japan

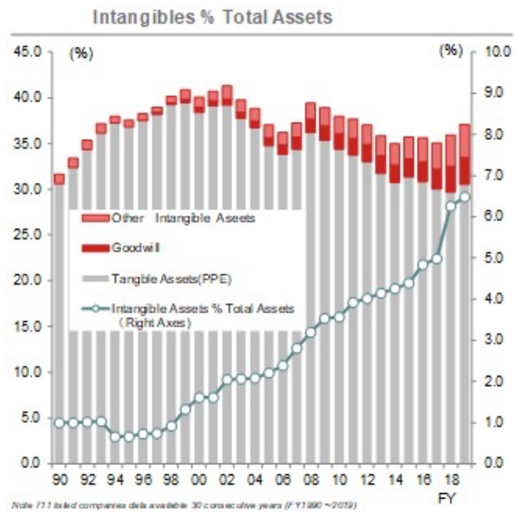


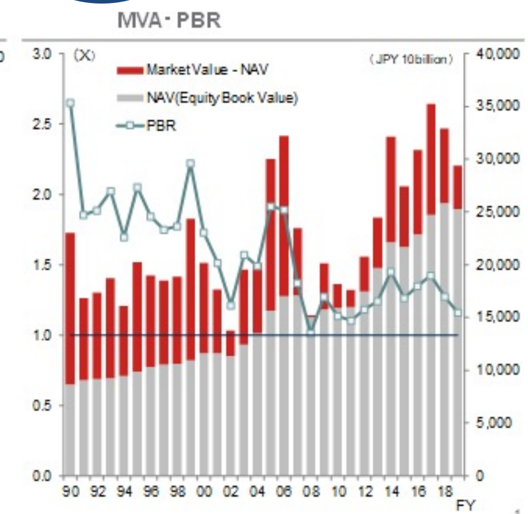
Perhaps we need a price. The price reflects how the market is valuing. You also see how the market priced natural capital parts, you can know how the market expects it. I think social capital is more difficult. However, if you look at what the market is looking at, you can see the potential in natural capital credits ...

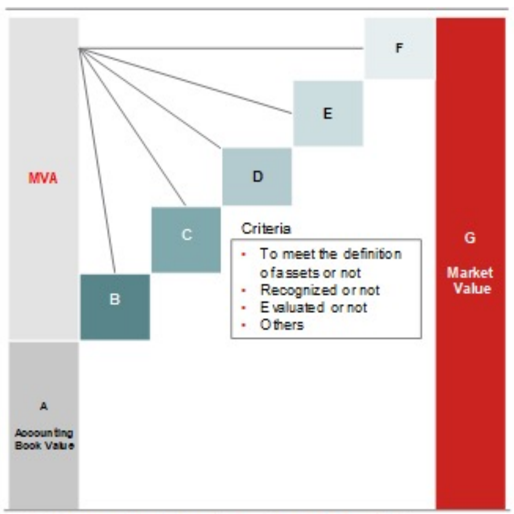
Discussions about intangible assets in the past

"The end of accounting" says that profits, net assets and several other financial indicators are no longer relevant to market capitalization. Financial statements provide risk information and discount rates, and there is still some debate that they are important. It is often said that the market-book gap is an intangible asset (IA) from ESG and non-financial information. Therefore, it has become necessary to carefully consider the role of financial statements, the definition of intangible assets, and the source of value. The figure on the right shows the Intangibles vs PBR and MVA of Japanese companies. It points out that the importance of IA is increasing and that it is the opposite of the decrease in PBR / MVA. Even if the ratio of IA to total assets rises, it is only 7%, and PBR is on a downward trend in the long term. Has IA really increased in the last decade? I'm skeptical of the argument that intangibles are simply not in the B / S, or that there is a gap because there is no disclosure. “MVA = intangible value” can be misleading. IA is used in a broad sense. We tend to mix the issues such as, tangible / intangible with GAAP / non-GAAP, on-balance / off-balance, financial / non-financial (ESG), quantitative / qualitative, and book / fair value. On the other hand, the discussion of IA in accounting standards is strict. I find it surprising that the issue of internally generated intangibles will be included in the next agenda consultation. I would like both tangible and intangible assets to be recorded in BS on a BOOK value or investment capital basis as value drivers. The user will then reflect the discount rate and sustainable growth rate on it.

Investment banker & Accounting expert







One way is to regard the difference between MV and BV as IA. It would be desirable to quantify the factors behind the difference and to audit the validity of those factors, which, however, difficult as the level of PBR is an indicator of good or bad management. If the simplified KPIs or the like are set, some sort of mismanagement may be triggered. There are also issues of mispricing, liquidity and minority shareholder discounts in assessing the level of PBR. The factors that influence the level of PBR are diverse and largely depend on the perception of market participants and the composition of investors and shareholders as to the company and its context. Acknowledging such issues, but one approach may be letting the management assess and explain the level of PBR which may be derived over at least a couples years.

There was a special report published by the FASB in 2001. As a breakdown of MVA, it proposed to disclose it together with the reconciliation table. Breakdown criteria include whether it fits the definition of an asset. I don't want intangible assets to be put on BS by FV or MV for the purpose of setting PBR to 1. As a value driver, we support labelling and increasing disclosure of IA. I don’t think it is a matter of carrying the fair value of IA on BS because Valuation is the responsibility of the investors and analysts. However, it is interesting to see the disclosure about how managements estimate their value. In addition, it might be good if companies make two BS, book and market based.

Former Investment banker

Why intangible assets are considered difficult from the auditor's point of view

Financial information is a key input for estimating a company's future cash inflows and assessing a company's value. So unrecognised intangibles are becoming more and more problematic. There are opnions that intangible assets(IA) should be reflected in the financial statements(FS) in the primary financial statements, in the footnotes to the FS, or as part of non-financial information. For example, the requirements for non-financial climate change disclosure are now being expanded and discussions are underway on the ISSB to be established at the IFRS Foundation. With this in mind, we need to consider whether financial statements or non-financial information are appropriate if IA is disclosed in corporate reports.

To that question, I think it should be disclosed as non-financial information. This is because FS notes are usually provided to explain what is presented as an asset or liability. On top of that, recognising IA by FV and putting them in FS is a very challenging point in the next two points.

1. When will IA be recognised in the FS for the Achieving fair presentation? According to IAS 38, assets are generally recognised when future economic benefit (cash flows) are expected or costs become reliable. From the auditor's point of view, this threshold is very challenging for IA. The value of IA fluctuates depending on the environment, and it is very difficult to assess the probability that economic benefits will flow into a company.

2. Regarding the implementation of audit procedures, we first perform a risk assessment in the audit of IA valuation. Degrees of assessment of risks could be categorized as Risks of misstatement, Risks of material misstatement, Significant risks. Due to the nature of IA, there is a lot of room for judgment, so IA often fall under the category of significant risks, and the following three areas must be verified. Are the methods correct?, the assumptions correct?, and the data relevant and reliable? Regarding whether the judgment is appropriate, depending on situations, it may be necessary to evaluate whether the overlay is appropriate. In assessing the appropriateness of key assumptions, we evaluate whether management has the intent and ability to implement a particular course of action. Then we check if the data is purposeful and reliable, and if management has any bias.

For these we need to create extensive documentation and may ask involvement of experts. Also, if this is significant risks, the audit will have to perform much more extensive procedures as these are areas to verify these audit processes, as these areas subject to greater scrutiny by audit regulators.

I found it very difficult. But are all these processes different from when an auditor sees Goodwill?
If they are the same, then this process has already taken place, right?

Researcher

Yes, they are. However, the difference is how to recognise internally generated IA. If it is Goodwill, it will be calculated from the price at the time of acquisition. On the other hand, when recognising internally generated IA, one must determine whether valuations are appropriate, not prices.

Auditor

Instead of our conclusion…

- Today we had a discussion about what financial statements should ideally be. The information investors need is the amount and contents of intangible assets, for example. Then how much did the company paid (if it was acquired) and what about its book value?

- There are times when a company does not want to disclose this information. Maybe when they don't want to be blamed for why they bought it at such a price. But I think they should explain, that is accountability. Investors need the information to calculate the FV ourselves. If on the financial statements, there is an intangible asset of 1 billion yen in their valuation, that alone is meaningless. Why they evaluate it so, the number that they concluded by calculation, they are important. It explains why it's the FV.

- I thought the internally generated goodwill (intangible asset) is difficult. Inconsistency with external goodwill is also an issue. The accounting side is makings efforts. Someone said that the market can find the value of a company, but if I agree with that, what is the accounting mission ... So accounting should make effort to close that gap. Maybe we have to consider about issues separately according to its nature. One is Goodwill, which is very difficult to calculate. On the other hand, you can calculate intellectual property and pharmaceutical patents. Though I think both are processes, not conclusions.

Today's topic is intangible assets, but in the case of restaurants, tangible assets have also the same issue. It happens because we use historical costs to recognize assets. So this is the question of what accounting should be. We have been considering historical costs to be meaningful. Because this is a record of facts. Based on this fact, accounting has sought to provide valuable information.
But if it includes expectation and valuation ad hoc, it will contamin accounting. Some people prefer pure historical costs to such mixed metrics. The current financial statements are mixed. That is why there is a limitation. However, the purpose of financial statements is not to indicate corporate value. It is about providing useful information to investors and analysts. From this point of view, what is the best way to handle intangible assets? One is further disclosure, the other is recognition of some intangible assets.. but why don't we start with disclosure as like Hugh's presentation? If we start with disclosure, we may agree that some parts are recognisable. These efforts are interesting. After this agenda consultation, we can start with good disclosure. BTW, this discussion is excellent and that is our intangible asset.

Discussion is to be continued….

Former IASB
Board member

Comments after workshops

Suppose it comes to the “disclosure vs. recognition” question, I prefer disclosure. Recognition has the problem of arbitrariness in the valuation and measurement process. This was pointed out by some attendees during the workshop.

- If we were to make an exceptional use of recognition, I think we should have two conditions: (1) it should be limited to certain intangible assets that are relatively easy to value and measure, and (2) the process of valuation and measurement should be clearly disclosed so that users can easily perform “recalculation.” Regarding the point (1), As one of attendees said (about natural capital, etc.) would be worth consideration, I guess.

While listening to the discussion, I thought that intangible assets are essentially human-generated value, and in a sense, it can be said to be a capitalisation of labour costs....

Although intangible assets are ideally capitalised, I felt once again that discussions don't proceed because it is difficult to give objectivity and guarantees to them. (For example, even if the patent is the same, the evaluation differs greatly between companies that have the technology to be able to utilize it and those that do not.) If the amount of investment and expense in intangible assets is disclosed in detail together with narrative information (text information), it becomes reasonable to entrust the valuation of intangible assets to investors (→ reflect on the stock price) within the framework of not capitalising intangible assets.

I felt the depth of the discussion on intangible assets. It was nice to be able to get an overview of what was at stake. I would like to pay attention to the part being discussed in the context of sustainable finance and how it will be coordinated.

It was great to patriciate this workshop on such an important and interesting topic with regards to intangible assets . It was very helpful to hear various experts’ insights from different perspectives.