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Mr. Andrew Lennard
Financial Reporting Council
8th Floor, 125 London Wall
London EC2Y 5AS
United Kingdom

By email: intangibles@frc.org.uk

Dear Andrew

Discussion Paper – Business Reporting of Intangibles: Realistic proposals

CPA Australia represents the diverse interests of more than 164,000 members working in 150 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia commends the Financial Reporting Council for developing the Discussion Paper that contributes to the ongoing debate about the ability of current financial reporting and other frameworks to capture and present information on intangible assets and resources. Our comments in this submission relating to financial reporting are provided in the context of International Financial Reporting Standards (IFRS) developed and issued by the International Accounting Standards Board (IASB).

The Discussion Paper notes a few research studies that have called for reporting reform, pointing to a loss of relevance in financial reporting with the fundamental shift of global economies towards "knowledge based" industries in recent times and the resulting increase in intangibles which are not adequately reflected in financial statements. However, other research, also highlighted in the Discussion Paper, indicates that financial reporting has not lost relevance. CPA Australia has also contributed to this debate, funding research into "decision usefulness in financial reports", which finds that financial reporting remains relevant and useful in an Australian setting. Five papers encapsulating the findings of this research can be found at www.cpaaustralia.com.au/professional-resources/reporting/research.

An underlying assumption of the Discussion Paper appears to be that providing more information will enhance the usefulness of business reporting, but that may not necessarily be the case. Prior academic research[1] indicates that due to cognitive biases and information effects, including limited investor attention and information processing costs, investors do not perceive disclosures as useful as recognised amounts. As such, --adding to the weight of disclosures that currently exists may not enhance the usefulness of business reporting but, in fact, may make these less readable, particularly for less sophisticated users.

[1] Hirshleifer and Teoh 2003*, Limited attention, information disclosure, and financial reporting,*
Bratten et. al. 2013, *Evidence that Market Participants Assess Recognized and Disclosed Items Similarly when Reliability is Not an Issue*,
Yu 2013, *Does Recognition versus Disclosure Affect Value Relevance? Evidence from Pension Accounting,*

The Discussion Paper makes some important observations about the "boundaries" of IFRS based financial reporting founded on the IASB *Conceptual Framework.* We agree with the conclusions drawn in the Discussion Paper that it is appropriate to remain with the current recognition criteria for intangibles set out in IFRS, which are underpinned by the IASB *Conceptual Framework*.

Finally, it is important to point to the development of 'multi-capital' type reporting frameworks, most notably Integrated Reporting <IR>, which address as part of a business model-based 'stock and flow' of value creation and depletion, the interconnected character of various sources of dependency and impact. Aside from the significance amongst <IR>'s six capitals of *Intellectual capital* (defined as including a range of knowledge-based intangibles), is the endeavour to adopt a far more holistic (integrated) disclosure. Business reporting is in the process of transformation in which both understanding of boundaries and complementary information will be important to achieving effective development.

In the attachment to this letter, we have provided responses to specific questions raised in the Discussion Paper.

If you require further information on the views expressed in this submission, please contact Ram Subramanian, Policy Adviser – Reporting, on +61 3 9606 9755 or at ram.subramanian@cpaaustralia.com.au, or Dr. John Purcell, Policy Adviser – Environmental, Social & Governance on +61 3 9606 9826 or at john.purcell@cpaaustralia.com.au.

Your sincerely

Dr. Gary Pflugrath
Head of Policy and Advocacy

Attachment

Specific Questions/Comments

Question 1

Do you agree that it is important to improve the business reporting of intangibles?

As stated in our cover letter, research we recently funded supports the view that financial reporting remains relevant and useful. However, we acknowledge that the current IFRS based financial reporting framework has boundaries that dictate which intangibles can be recognised as assets within financial statements. These boundaries, built on the fundamental characteristics of relevance, reliability and faithfully representation, exclude from recognition those intangibles that are unable to meet these characteristics.

Given the growth in knowledge-based industries, and the inherent value represented by various intangible resources that may not be adequately reflected within financial statements, there is scope to explore how such information can be presented to stakeholders in a more fulsome manner. Although there may be boundaries set by IFRS around which intangibles can be recognised as assets, other reporting frameworks, notably Integrated Reporting and various narrative/analysis frameworks cater for the recognition and reporting of such information in a more holistic manner. There appears to be no discussion of such alternative frameworks within the Discussion Paper.

Question 2

Do you agree that an intangible should be recognised at cost under the two conditions set out above in (i)?

Question 3

Do you agree with the assumptions the paper makes regarding measurement uncertainty of intangibles?

Question 4

Do you agree that existing accounting standards should be revisited with the aim of improving the accounting for intangibles?

We agree with the proposed recognition criteria that are similar to those articulated in IAS 38 *Intangible Assets.* Since IAS 38 sets out in detail, both the requirements and supporting material for recognition of intangibles as assets, we suggest IAS 38 should remain the primary reference point when seeking to recognise and present intangibles as assets within financial statements.

Yes, we agree with the assumptions the Discussion Paper makes regarding measurement uncertainty of intangibles.

There is scope for the IASB to explore how current IFRS, including IAS 38, could be improved to allow for the recognition of more intangible assets than is currently possible. The Discussion Paper notes that the IASB recently completed its revision of the *Conceptual* Framework and therefore it appears unlikely that a convincing case can be made to the IASB to revisit the *Conceptual* Framework in the near future. Whilst we acknowledge this, we believe that the Conceptual Framework should be seen as an evolving document that is updated as economic environments evolve and technological developments continue to disrupt the traditional ways of working. We believe that a market driven demand for the presentation of financial information on intangibles presents a compelling case for revisiting the *Conceptual Framework*. Accordingly, we suggest that the FRC recommends the IASB considers the topic of intangibles when it next revises its *Conceptual Framework.* Such consideration could include how elements of financial statements including assets could be further refined to accommodate the recognition of more intangibles, whilst retaining the fundamental characteristics of relevance, reliability and faithful representation.

Question 5

Do you agree with the above proposals relating to expenditure on intangibles?

We are concerned that the proposed additional disclosures could contribute further to disclosure overload that is often cited as a cause for complexity in financial statements, and a diminution of their relevance to users. Further, absent a practical set of requirements and/or guidance on how to make the distinction that is both consistent and comparable, a subjective distinction between "future-oriented" expenditure on intangibles and expenditure on intangibles that relates to the current period can prove challenging to both preparers and auditors of financial statements. The decision-usefulness and relevance of such information to investors and other stakeholders may also be adversely affected.

In our view, accommodating any additional disclosures through a formal development process within a globally recognised financial reporting framework such as IFRS could address the concerns we raise in the above paragraph. The IASB is undertaking a number of projects to streamline disclosures through its Better Communication in Financial Reporting initiative and the FRC may wish to make its recommendations to the IASB as part of one of the projects under this initiative.

Question 6

Do you agree with the proposals aimed at improving the quality of information on recognised and unrecognised intangibles in narrative reporting?

The Discussion Paper highlights some of the practical challenges associated with the narrative reporting of intangibles due to the unique nature of some of the intangibles that can be associated with individual entities and specific industries. Further, as highlighted in response to Question 5 above, distinguishing expenditure on intangibles between "future-oriented" expenditure and expenditure that relates to the current period can be subjective and challenging.

In our view, there is merit in considering the development of metrics proposed in paragraphs 4.9-4.20. The proposal to develop and establish industry-specific metrics on intangible expenditure within a given industry could enhance the usefulness of narrative reporting. As suggested, a standardised approach to calculating and presenting metrics could enhance comparability and consistency that remains relevant and useful to the market. If such metrics do not form part of a GAAP framework such as IFRS, they may still be useful as non-GAAP information. CPA Australia funded research highlighted in our cover letter found that non-GAAP performance metrics can be an effective way for entities to communicate industry-specific indicators of performance that GAAP cannot capture.

Question 7

What are your views about how the various participants involved in business reporting could or should contribute to the implementation of the proposals made in the paper?

In our view, accounting standard-setters play a significant role in developing standardised requirements or guidance that leads to consistent and comparable information on intangibles. Suitable criteria that can be reliably analysed and verified can also allow for the assurance of such information, providing much needed independent assurance of the information upon which the market can rely.

Question 8

Do you use additional information other than the financial statements when assessing and valuing intangibles? If so, can you please specify what additional information you use.

Whilst not an aspect of our own reporting, CPA Australia is aware of changes made in 2018 to the FRC's Guidance on the Strategic Report – Non-financial reporting. There, under Section 4 (The strategic report: purpose), the following additional words were included in paragraph 4.5:

> The strategic report should also include information relating to sources of value that have not been recognised in the financial statements and how these sources of value are managed, sustained and developed, for example a highly trained workforce, intellectual property or internally generated **intangible assets**, as these are relevant to an understanding of an entity's development, performance, position or impact of its activity. (our emphasis)

We see this as significant acknowledgement of both the business relevance of intangibles and the strong likelihood that users of corporate reports place a high level of significant on a combination of financial and non-financial/ narrative disclosure.

Question 9

Do you have any suggestions, other than those put forward in this paper, as to how improving the business reporting of intangibles might be achieved?

As a concluding general remark, given the initiatives of such groups as the International Integrated Reporting Council and the Corporate Reporting Dialogue towards more holistic reporting and the recognition of emerging methods of measurement, it way be worth maintaining a 'watching brief' on the activities of these organisation and any related work undertaken by the World Intellectual Capital Initiative and the Natural Capital Coalition.