

Ref: Research Project; The Production and Consumption of Information on Intangibles: An Empirical Investigation of CFOs and Investors

Link to consultation: <https://www.surveymonkey.com/r/JY8VP67>

BETTER FINANCE Response

The Production and Consumption of Information on Intangibles: An Empirical Investigation of CFOs and Investors

10. In your opinion, is there any useful information on intangibles that is missing from today's financial reporting (reference to IAS 38)?

- ✓ **Yes**
- No

Please comment

The main issue is the complexity to measure and value intangible assets in the financial reporting of the company. However, intangibles could have an added value in terms of non-financial reporting in particular regarding the assessment of the sustainability of the company. Specific rules and recommendations on how to assess and measure intangibles are necessary in order to streamline the information disclosure of these companies' assets. This is particularly relevant with the rise of big tech company which rely mostly on intangible assets as brand value, consumer list, consumer satisfaction and loyalty, etc.

11. In your opinion, which is the most important information missing? (multiple choices are possible) [you do not have to reply to this question if you have answered "no" in the previous one (no. 10)]

- ✓ **Brand(s)**
- R&D
- Intellectual property and know-how
- Software and information systems
- Strategy and planning
- Business Model
- ✓ **Customer satisfaction and loyalty**
- ✓ **Customer list**
- ✓ **Corporate reputation and image**
- ✓ **Relationships with suppliers**
- Training
- Human Capital (competences, skills, seniority)
- ✓ **Organisational climate (employee satisfaction & engagement)**
- ✓ **Intangibles-related risks and opportunities**

Other

Please specify and/or comment

12. In your opinion, which of the following unaccounted/internally generated intangibles should be financially measured and included in the balance sheet as an asset and on which measurement basis?

Brand(s)	at Cost	at Fair Value	at Value in use
R&D	at Cost	at Fair Value	at Value in use
Intellectual property and know-how	at Cost	at Fair Value	at Value in use
Software and information systems	at Cost	at Fair Value	at Value in use
Corporate reputation and image	at Cost	at Fair Value	at Value in use
Training	at Cost	at Fair Value	at Value in use
Human Capital	at Cost	at Fair Value	at Value in use

Please specify "Other"

13. If for you it is relevant to be able to assess/predict future cash outflows (timing and amount, for decision making and cash budgeting/financial planning) related to the replacement of intangible assets that are recognised in financial statements and not automatically replaced, which of the following information would in your view be most useful for that purpose? (multiple answers are possible)

[A customer list is an example of an intangible asset that is generally considered to be replaced automatically through business' operations. On the other hand, a patent or a brand is generally not replaced automatically.]

- Information on the types of intangible assets (e.g., customer list, patents, brands) and related amounts included in the item 'Intangible Assets'
- Information on the amount of acquired intangible assets that are included in the item 'Intangible Assets'

- Information on the expected useful life of the categories of intangible assets
- Information on the management's assessment of the amount of non-automatically replaced intangible assets that are included in the balance sheet item 'Intangible Assets'
- Information on the management's assessment of the period over which the most significant recognised intangible assets (that are not non-automatically replaced) would contribute to the company's cash generation
- Information on the management's assessment of when the most significant (non-automatically replaced) intangible assets would have to be substituted to maintain the contribution to the company's cash generation that these assets currently provide
- Information on specific risks that are related to (non-automatically replaced) intangible assets

Other (please specify)

Question Title

14. Would you consider it important that information can be provided to help your assessments on whether significant intangible assets - recognised in financial statements - are replaced "automatically" or not, as a result of the company's operations?

- Yes
- No

Please specify and/or comment

In your opinion, where should information on unaccounted/internally generated intangibles be located/positioned in the corporate reporting system? (multiple choices are possible)

- Financial statements
- Supplementary Notes to Financial Statements
- Management Commentary/Strategic Report
- Intellectual Capital Report
- ✓ **Sustainability/Corporate Social Responsibility (CSR) Report**
- ✓ **Non-Financial Reporting Statement according to the EU Directive**
- Integrated Report

Please specify and/or comment.

Since it would be too complex to include additional intangible in the company's financial statements, it would be extremely helpful to provide guidance in the company's non-financial reporting on how to disclose relevant information about intangible assets.

16) In your opinion, in which form should information on unaccounted/internally generated intangibles be disclosed? (multiple choices are possible)

- Financial figures
- Narrative disclosure
- KPIs
- ✓ **A combination of the above.**

Please specify and/or comment.

Depending on the type of intangible. There are some intangibles that can be assessed against KPIs/metrics or science-based indicator (e.g., business model, etc.) other intangibles disclosure would better fit with a narrative approach (as for example, companies values and policies). Other examples could require a mix of the 3 approaches such as R&D (financial and KPIs). However, it is extremely important to create a standardized framework that will provide clarity on how to assess and disclose information on intangibles. Requirements on financial statements, KIPs and narrative need to be standardized in order to allow the highest degree of harmonisation in terms of information disclosed. In addition, recommendations should be provided regarding the manager's assessment of the useful life of intangible assets and the evolution during the financial year. In particular, we advise aligning these recommendations with the IFRS Practice statement Management Commentary.¹

17) If you believe there is a general need for more information on unaccounted/internally generated intangibles, do you think that this extra information would successfully overcome a cost-benefit analysis?

YES	NO	NOT NECESSARILY

Please comment.

If the extra information is provided in the non-financial reporting of the company then the extra information would successfully overcome a cost-benefits analysis. However, it is important to remind that the information disclosed should not enter into a contradiction with the financial statement. Clear recommendations should be provided in terms of measurement of the intangibles using specific criteria according to the nature of the intangible as narrative, disclosure, KPIs or costs/value-related information. Finally, particular attention should be given regarding the relevance of the information provided in order to avoid the overload of the information for the investors.

18) Should this extra information on intangibles be audited by a third party?

¹ <https://www.ifrs.org/issued-standards/management-commentary-practice-statement/>

YES	NO	NOT NECESSARILY
----------------	----	-----------------

Please comment.

In order to meet the criteria and the requirements on the information provided, we believe that sustainability information should be audited as for information related to intangibles.

19) In your opinion, to what extent is there an overlap between intangibles-related information and Environmental, Social and Governance (ESG) information?

- not at all (0) 50%
- ✓ **overlap (5)**
- complete overlap (10)

Please comment/provide examples

Intangibles are a key dimension for the assessment of the company's sustainability. As the measurement of intangibles in the financial reporting is highly debated due to difficulties to quantify the value of different intangibles in terms of costs and values. We consider that it is extremely relevant to include the assessment of intangible assets in the non-financial reporting thus providing information on the value creation of the company. Intangibles have stronger value if captured under the ESG considerations of the company.

Intangibles can be differentiated under quantifiable and non-quantifiable indicators. Those intangibles that can be considered relevant for the analysis of the company's sustainability refer to the system of interconnections between the company and its environment and eco-system which is beyond the quantifiable assets. For example: trust in the brand, relations with customers, employees' relations, stakeholders' relations, human capital, etc. This would determine the value development of the company.

20) In your opinion, which could be the most relevant current framework(s)/standard(s) for the

measurement and disclosure of information on intangibles? (please specify at least the 3 most relevant options)

- IAS 38 on Intangible Assets
- Revised IAS 38 with a less conservative approach to recognition of intangibles as assets
- Management Commentary Practice Statement (revised version)
- International Integrated Reporting Framework by the IIRC
- Intangibles Reporting Framework by World Intellectual Capital Initiative
- EU Accounting Directive
- ✓ **EU Non-Financial Reporting Directive**
- Other

Please specify and/or comment

Amending accounting standards for intangibles would result difficult due to controversy on how to effectively measure intangibles. In the US, research² shows the risks related to the deterioration of reporting quality due to the proliferation of intangibles accounted in the balance sheet of the companies. This in turn could affect the volatility of the company. Therefore, it is important to provide clear guidelines on how to assess intangible in the context of financial reporting.

21) In your opinion, should intangibles-related information that is currently outside financial statements be subject to standardisation and/or mandatory guidance?

- ✓ **Yes**
- No

Please comment

Clear guidelines are necessary to provide indicators for intangibles that are complementary to ESG characteristics, taking into account the associated risks, the visibility of the company and the double materiality. A common approach would help to provide a more exhaustive and comparable information for investors.

Section Three – Case Study

The sector and its main features

The company is medium-sized and operates in a global sector where brand strength, research, and product and process innovation are key. The customer management relationship, the reputation and image, the competences of the employees, the organisational procedures, as well

² <https://www.tandfonline.com/doi/pdf/10.1080/00014788.2018.1470138?needAccess=true>

as the effectiveness of information systems are further significant features of the firms competing in this international business environment.

The company is listed on a stock market with a value of EUR 195.8 million. The average multiplier of EBITDA for listed companies of that sector is 11 (P/E is equal to 27.5), whilst for the company examined it is equal to 9 (P/E is equal to 23.5).

Financial Statements for the fiscal year 2019 (in kEUR)

Summary Balance Sheet			Income Statement			
	2019	2018	2019	2019 %	2018	
Cash	3,200	2,600	Revenues	90,625	100%	86,746
Receivables	7,500	6,800	Cost of sales	(68,532)	-76%	(71,150)
Inventory	3,120	4,350	Other expenses	(343)	0%	(415)
Financial Investments	1,200	950	EBITDA	21,750	24%	15,181
Property, Plant and Equipment	35,230	33,100	Depreciation and amortisation	(7,828)	-9%	(7,780)
Intangible Assets	32,500	32,300	Impairment losses	(91)	0%	0
Total Assets	82,750	80,100	EBIT	13,831	15%	7,401
Trade payables	6,800	9,050	Interest expenses	(288)	0%	(248)
Pension liabilities	1,120	1,150	Taxes	(5,340)	-6%	(2,799)
Long term debt	5,340	6,400	Net income	8,203	9%	4,354
Shareholder Equity (including Net Income)	69,490	63,500				
Total Liabilities and Shareholder Equity	82,750	80,100				

Corporate/Non-financial report 2019

[Traditional financial statements + KPIs and narratives on human, organisational and relational capitals]

Accounting policies information 2019 (selection)

According to IAS 38, intangible assets are identifiable non-monetary assets without physical substance, controlled by the company and able to produce future economic benefits. All the intangibles reported have an operational nature, i.e., they are linked to, and employed in, the core business of the company.

Recognisable intangible assets are initially measured at cost or fair value. The company's intangible assets of the Statement of financial position (Summary Balance Sheet), which equals EUR 32,500,000 include:

- externally acquired brands of a carrying amount equal to EUR 20,250,000;
- externally acquired patents amounting to EUR 10,270,000;
- capitalised development expenditure (which have not yet led to patents) which amount to EUR 1.980 million (total annual amount of R&D expenditure is EUR 5 million; the expected time horizon of the impact of research output(s) is on average 5 years).

There is no goodwill.

All the above intangible assets are valued on amortised historical cost basis using the criteria set for tangible assets, and they are not revalued for financial reporting purposes.

Intangible assets with finite useful lives are amortised on a systematic basis over their useful life; the amount to be amortised and the recoverability of the carrying amount are determined in accordance with the IFRS criteria (IAS 38 and IAS 36).

Intangible assets with indefinite useful life (e.g., brands) are not amortised but tested for impairment at least once a year. Non-financial assets (tangible assets and intangible assets) are tested for impairment whenever events or changes in circumstances indicate that the carrying amounts for those assets may not be recoverable.

The financial statements for the fiscal year 2019 and 2018 are audited by a leading audit firm. In 2019 company report, the following non-financial information on intangibles is also provided on a voluntary basis:

Company purpose: It is to “help the world run better and improve people’s lives by empowering our customers and employees to create a better economy, society, and environment for the world.” Strategy and Planning: The company’s strategy can be illustrated using the following three key strategic pillars:

- High quality of delivered products and services to dynamically maintain the international competitive edge reached by the company;
- Strong innovation and research culture promoted through incentives and an agile development system open to collaborations with research centres, customers and territories;
- Flexible and clear organisational procedures achieved through IT systems and the empowerment of highly skilled and competent employees.

Business model: “The company’s business model is built to manage changing market demand and to capture new business opportunities through research and innovation. Customer focus and motivated employees are key to drive our business, create stakeholder value and to build a stronger company long term” (extract from company annual report).

Intangibles-related KPIs per category of intangible capital (drawn largely from the Generic KPIs suggested by WICI – www.wici-global.com/kpis/):

Human capital:

- No. of employees at the year-end: 419 (390 in 2018)
- Average no. of employee training hours: 2,264 (5,544 in 2018) [1]
- Competences turnover: 70.21% (85.31% in 2018) [2]
- Degree of employee satisfaction: 6/10 (7/10 in 2018) [3]

Organisational capital:

- Internal organisational climate survey: 57% of employees are positively satisfied (69% in 2018) [4]
- Costs for the innovation/maintenance of IT systems per year: EUR 94,126 (EUR108,176 in 2018)
- No. of organisational development project proposals from employees: 30 (45 in 2018)
- No. of organisational development project proposals from employees implemented: 25% (35% in 2018)
- Employee Retention rate: 80% (87% in 2018)
- New product ratio: 18% (24% in 2018) [5]
- Value added per employee: EUR 107,398 (113,065 in 2018)

Relationship capital:

- No. of active partnerships and joint ventures: 10 (15 in 2018)
- Average no. of suppliers per product/service line: 9 (10 in 2018)
- Customer satisfaction per product/service line: 6/10 (6.95/10 in 2018)
- Reputation level resulting from independent external survey: 4.9/10 (5.8/10 in 2018)
- Total no. of clients: 23 (31 in 2018)
- Percentage of revenues from top 5 customers: 52% (44% in 2018)

Risks and opportunities:

The organisational risk appetite is aligned with the changes that occur in the external environment and communicated and managed throughout the organisation via the risk management system. In particular, the analysis of risks and opportunities is carried out by the management in such a way that, on the one hand, mitigation measures to prevent or reduce collateral effects are identified and, on the other, incentive actions to achieve the improvements are set up.

The key risks categories are: legal and compliance, human rights, employee development, product quality, innovation and research activity, customer relationships and loyalty, reputation, and Green House Gas (GHG) emissions and reductions.

The Key Risk Indicators – KRIs provided in the report (and drawn from the Generic KPIs suggested by WICI – www.wici-global.com/kpis/) are the following:

Notes:

- [1] Amount of training hours on the number of employees (total and for HQ employees and sales' people)
- [2] Calculated as the percentage of productive personnel capable of covering at least three tasks
- [3] Employee satisfaction survey's results
- [4] Organisational climate survey's results
- [5] Calculated as sales of products or services within 3 years from the beginning of their selling / total sales

- 1) Compensation claims in pending lawsuits.
- 2) Diversification of risks (No. of main factories of suppliers of core products, or Herfindahl- Hirschman Index, showing the degree of decentralisation of the share of major products in relation to total sales).
- 3) Sale revenue concentration on main product/service lines.
- 4) Sale revenue concentration on top 5 customers.
- 5) Number of suppliers per product/service line.
- 6) Level of reputational risk.

Stakeholder Engagement:

The stakeholder engagement is mainly performed through employee surveys, customer satisfaction assessment, ongoing conversations with regulators and non-governmental organisations. The surveys are run by an external consultancy company. The Board is regularly updated on the key insights deriving from the stakeholder engagement exercises.

Section Four – Specific questions on intangibles reporting related to the case study. In this section, you will find specific questions that consider the annual report presented.

22) Overall, how would you assess the level of information on intangibles available in the above annual report? (where 0= insufficient, 5=neutral and 10= excellent)

0	5	10
insufficient	neutral	excellent

23) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on company brand(s) in the annual report presented?

(where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

24) In particular, to what extent would the following information on brand(s) be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Brand Strength Rating: **10**
- Brand Image/Reputation Rating :**10**
- Brand contribution to EBITDA Rating :**10**
- Brand valuation/value Rating: **10**
- Marketing expenses per brand Rating: **5**
- Other. Please specify

25) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on Research and Development (R&D) activities in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

26) In particular, to what extent would the following information on R&D be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Detailed amounts of R&D expenditure : **10**
- R&D expenses per segment of business: **10**
- Revenues from products generated by internal R&D: **10**
- No. of R&D projects nearing implementation: **10**
- % of sales from the last 5 years' internal research: **5**
- Average time to market of research output(s): **5**
- Expected time horizon during which each research outcome can affect profitability: **10**
- Other. Please specify.

27) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on intellectual property and know-how in the annual report presented? (where 0=not at all useful, 5= average and 10=very useful)

0	5	10
insufficient	neutral	excellent

28) In particular, to what extent would the following information on intellectual property and know-how be useful? (where 0=not at all useful, 5=average and 10=very useful)

- No. of active patents : **10**
- No. of innovative procedures not patented : **5**
- Revenues from the last 5 years' patents: **10**
- Other. Please specify

29) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on software and information systems in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

30) In particular, to what extent would the following information on software and information systems be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Degree of IT systems integration/substitutability: **5**
- Maintenance costs: **5**
- Compliance with cybersecurity standards/certifications: **10**
- Data storage choices: **10**
- Other. Please specify

31) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on strategy and planning in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

32) In particular, to what extent would the following information on strategy and planning be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Description of strategic pillars: **10**
- Mission and vision: **10**
- Market share: **10**
- Presence and main points of strategy/industrial plan: **10**
- Other. Please specify

33) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on business model in the annual report presented? (Business model is defined as “An organization’s system of transforming inputs through its business activities into outputs and outcomes that aims to fulfil the organization’s strategic purposes and create value over the short, medium and long term”.) (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

34) In particular, to what extent would the following information on business model be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Description of business activities/lines: **10**
- Illustration of value proposition: **10**
- Description of input/output/outcome: **10**
- Other. Please specify

35) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on customer satisfaction and loyalty in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

36) In particular, to what extent would the following information on customer satisfaction and loyalty be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Customer attrition rate: **10**
- Average customer retention period: **10**
- Revenues from new customers: **10**
- Repurchase rate (%) by customers: **10**
- Other. Please specify

37) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on customer list in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

38) In particular, to what extent would the following information on customer list be useful?(where 0=not at all useful, 5=average and 10=very useful)

- Customer list size: **10**
- Use of customer data: **10**
- Management storage of customer data: **10**
- Purchase/Sale of customer data : **10**
- Other. Please specify

39) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on corporate reputation and image in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

40) In particular, to what extent would the following information on corporate reputation and image be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Drivers of corporate reputation and image: **10**
- Types of reputation surveys conducted: **10**

- Reputation level by customer groups/business lines: **10**
- Other. Please specify

41) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on relationships with suppliers in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

42) In particular, to what extent would the following information on relationships with suppliers be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Data share among supply chain participants : **10**
- Degree of value chain integration Rating : **10**
- Types of suppliers' product quality certifications : **10**
- Types of suppliers' environmental certifications 10
- Other. Please specify

43) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on training in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

44) In particular, to what extent would the following information on training be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Level of employee participation in training courses: **5**
- Training costs on annual revenues : **5**
- No. of training courses completed by employees : **0**
- Post course salary increases: **5**
- Other. Please specify

45) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on human capital (employee competences, skills, experience) in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

46) In particular, to what extent would the following information on human capital (employee competences, skills, experience) be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Employee turnover per function and geography : **10**
- Employee satisfaction and engagement : **10**
- Employee competence level Rating : **10**
- Other. Please specify

47) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on organisational culture/climate (e.g., 'entities' DNA', employee satisfaction and engagement) in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

48) In particular, to what extent would the following information on organisational culture/climate would be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Gender equality : **10**
- Salary and promotion packages : **10**
- Employee turnover/absences : **10**
- Efficiency of production/commercial procedures : **5**
- Other. Please specify

49) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on intangibles-related risks and opportunities in the annual report presented? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

50) In particular, to what extent would the following information on intangibles-related risks and opportunities be useful? (where 0=not at all useful, 5=average and 10=very useful)

- Customer relationships and loyalty: **10**
- Employee development : **10**
- Product quality : **10**
- Other. Please specify

51) In your opinion, to what extent would it be useful for your decision making and assessments to have more information available on company's stakeholder engagement? (where 0=not at all useful, 5=average and 10=very useful)

0	5	10
insufficient	neutral	excellent

52) In particular, to what extent would the following information on company's stakeholder engagement be useful? (where 0=not at all useful, 5=average and 10=very useful)

- No. of company committees with citizens/customers: **5**
- No. of recipients of company's newsletter : **0**
- No. of website visitors : **5**
- No. of public events organised by the company : **0**
- Other. Please specify

53) In your opinion, in the annual report presented would you consider the level of corporate reputation in 2019 (4.9/10) as an intangible liability or a decrease in the value of this resource?

- YES
- NO

Please comment _____

54) In your opinion, to what extent would the above presented annual report be useful for financial decision-making by financial capital providers?

0	5	10
insufficient	neutral	excellent

55) In your opinion, to what extent would the above presented annual report be useful to evaluate the stewardship of resources by company management?

0	5	10
insufficient	neutral	excellent

56) In your opinion, in the annual report presented would the availability of more information on intangibles change the company's market value (as identified earlier in the sector profile)?

- No
- Yes

57) If more information on intangibles were to be provided, which direction would this affect the company's value in your opinion?

- Downwards
- Neutral/No effect
- Upwards