RESEARCH PROJECT SUPPORTED by the
UNIVERSITY OF FERRARA-EFFAS-ICAS-EFRAG

THE PRODUCTION AND CONSUMPTION OF INFORMATION ON INTANGIBLES: AN EMPIRICAL INVESTIGATION OF CFOs AND INVESTORS

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Objectives of the University of Ferrara research

1) Provide more **empirical insights** on the views of preparers on **intangibles-related information** (especially for unaccounted intangibles), and on **how this information is consumed/used** by investors and financial analysts

2) Contribute to the **currrent national and international policy debate** on intangibles

Research Methodology

Two phases:

1. Large & Complex International Survey (54 or 57 questions depending on the case study)

- self-administered through a dedicated website (314 respondents, of which 113
- three slightly different questionnaires (which included General and Specific questions) based on three dissimilar case studies (IFRS/IAS 38 only; Fair-valued intangibles; IFRS+KPIs and narratives on intangibles) →

2. Two online meetings with two focus groups "Users" and "Preparers" (16-17 people each)

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unique empirical database on the attitudes and preferences of users, preparers and others vis-à-vis the reporting on intangibles

Type of respondents

Users	%
Buy-side analysts	39.4
Asset Managers	29.6
Sell-side analysts	9.9

Preparers	%
Unlisted company	52.3
Listed company	32.3
Large company	43.1
SMEs	35.4

Others	%
Academics	27.4
Business Consultants	23.5
Auditors	14.5

Professional position	%
Users	20.7
Preparers	22.6
Others	56.7

Gender	%
Male	67.4
Female	31.1
n.a.	1.5

Country of work	%
EU	81.8
UK	5.6
Americas	3.0

Age	%
50-59 years	33.7
40-49 years	24.6
30-39 years	18.6

Educational background	%
Business Economics and Finance	58.0
Accounting	13.4

The total sample is composed of 314 respondents who have participated in the survey . Out of these, 113 people completed the whole survey.

General Questions: Findings

- **Intangibles** are generally perceived to be a fundamental component of corporate reporting that is currently lacking
- Relevant **categories of intangibles** are recognized as missing from today's financial reporting → preparers tend to privilege information on human capital and intangibles-related risks and opportunities, whilst users indicate that on IP and know-how
- **Positioning of information →** convergence of both preparers and users on, in the order, 'Supplementary notes to financial statements', 'Non-Financial reporting statement according to the Non-Financial Reporting Directive', 'Integrated Report', and, lastly, 'Management Commentary'
- **Current framework(s)/standard(s)** for the measurement and disclosure of this information → both users and preparers, indicate, in the order, the International <IR> Framework (2021), a revised version of IAS 38, and the EU NFRD/CSRD
- **Form of disclosure** → a convergence amongst users and preparers regarding a combination of narrative, KPIs and financial figures
- **Auditing of intangibles-related information** → necessary but need for a 'proper' auditing standard

Focus: Overlapping between ESG and intangibles

Overlapping between ESG and intangibles-related information → users tend to share the viewpoint that it exists, while preparers are a bit less convinced by that overlapping

Intangibles are also seen by some preparers and users as a sort of pre-condition for ESG → if a company manages intangibles-related aspects efficiently and effectively, this can positively impact the ESG performance of companies

"And what intangibles [do]… is, of course, improving the effects that we have on these ESG indicators on the climate and nature side. We're getting better processes, better technology improving and the way we do our business to reduce our footprint … the impact on the natural world around us." *(Preparer)*

Specific Questions: Findings
(related to the case studies proposed)

Principles of decision-making usefulness and stewardship

- Usefulness and stewardship associated with intangibles-related information → users appear to have more optimistic vision vis-à-vis preparers
- Perception of the usefulness and stewardship principles with reference to the treatment of intangibles in the three case studies:
  - Preparers privilege case study 1 (traditional IFRS financial statements)
  - Users prefer case study 3 (traditional IFRS financial statements + KPIs and narratives)

Specific Questions: Findings (cont'd)
(related to the case studies proposed)

Usefulness of Information on Detailed Categories of Intangibles

- Users are more interested than preparers in information on specific intangibles, with one exception → information on 'business model' which for preparers represents an efficient and effective way to communicate how they create cash flows and, generally, value.

"We report according to the IIRC model, and we try to demonstrate in a business model, as a whole, how we create value through different capitals, and some are directly linked to this intangible [business model]. So, we tried to demonstrate that this creates value for the company but without having them in the balance sheet. I think it is not about monetization." (Preparer)

- The usefulness of information on intangibles is statistically correlated to the professional position (preparers vs. users) → only 'software and information systems' does not depend on the professional position, but the case study addressed

Discussion of results

- Intangibles-related information is <u>not perceived as equally useful by preparers and users</u>
- <u>Other factors</u> (age, educational background, etc.) <u>do not have an impact</u>, but in one case
- In general, <u>preparers appear to be more conservative than users</u> towards the release of this kind of information → perhaps this is amenable to the <u>SME and unlisted nature of the majority of organisations</u> to which preparers who participated in the survey belonged → for them more disclosure on intangibles translates essentially in <u>higher costs</u> difficult to bear
- Case Study 1 (IFRS only) perceived as the <u>most useful by preparers</u> for intangibles-related information over the other two. HOWEVER, the same case study is considered the one that provides <u>less information on intangibles</u>
- In terms of metrics, a general divergence of opinions emerges, with some exceptions → KPIs attracting the <u>joint interest of users and preparers</u> are on Brands, R&D, Software and Information Systems, Strategy and Planning, Business Model, Training, and Human Capital. All the metrics selected seem to be those highly related to costs and cash flow generation.

Recommendations and policy implications

- Intangibles represent a subject area that is particularly sensitive to:
  - **professional role played by individuals** → standards should possibly consider the diverging views and information needs of CFOs vs. investors.
  - **type of company** (SMEs and unlisted firms) → standardised intangibles-related disclosures may be mandatorily required only to large-sized and listed firms. SMEs encouraged towards a voluntary adoption with some focused incentives.
  - **reporting positioning** → tendency to see these disclosures 'close' to, and compatible with, supplementary information to financial statements or, anyway, located in only one document.
  - **categories of intangibles** → this information need may be satisfied through an evolution of accounting rules (e.g., R&D) and via ad hoc non-financial disclosures, especially where accounting rules cannot accommodate this information in financial statements because of the current conceptual frameworks and standards definitions.
- Evident need for guidance and incentives for companies/preparers, who may need more support than users

Recommendations and policy implications (cont'd)

- Many voices of dissatisfaction have been heard on:
  - the treatment of intangibles in IAS 38 and IFRS 3
  - lack of existence of an appropriate auditing standard focussing on the assurance of intangibles-related measures and disclosures

"*I go further actually saying that IFRS 3 is fundamentally broken. And the subsequent accounting actually makes markets less efficient. And the reason why I say that is that it has become an absolute standard that companies publish an adjusted EPS with all acquired intangibles added back*" (User)

- A proposal emerged for an accounting treatment of internally generated intangibles (with the characteristics of assets) alongside with that of financial instruments measured at fair value level 3 (IFRS 9)
- Intangibles appear to challenge the consolidated and widely accepted definitions regarding assets, liabilities and performance → "availability" to the entity ("WICI Intangibles Reporting Framework", 2016) vs. "control" on them (IASB Conceptual Framework) for recognising an accounting asset?

Recommendations and policy implications (cont'd)

- Clarify the <u>role of intangibles information vis-à-vis ESG information</u> → no general consensus, but the two sets of disclosures are recognised by many preparers and especially users as overlapping. This clarification is crucial because:
  - Intangibles are an important element of the emerging corporate reporting landscape (cf. the proposed European Commission's CSRD)
  - However, the "confusion" between intangibles and ESG may reduce and blur the recognition of the autonomous role and relevance of intangibles in company value creation processes
  - Need for more research and a better understanding of the respective roles and their synergic intertwining for value creation, i.e., the connectivity between intangibles and ESG
- Nobody seems to question the relevance of intangibles-related information → decisive role of the action of standard setters and policy makers → the direction of travel is settled, not yet the path

Thank you!

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