September 27, 2021

Technical Director
IASB
Columbus Building
7 Westferry Circus
Canary Wharf, London, E14 4HD

Re: RfI – Third Agenda Consultation

Dear Technical Director,

We are pleased to provide comments on IASB's *Request for Information – Third Agenda Consultation*.

Duff & Phelps, A Kroll Business, the leading independent global valuation advisory firm, helps clients make confident decisions in the areas of valuation, real estate, taxation and transfer pricing, disputes, M&A advisory and other corporate transactions. Duff & Phelps acquired Kroll in 2018 and is in the process of rebranding as Kroll by the end of 2021.

Kroll is the world's premier provider of services and digital products related to valuation, governance, risk, and transparency. We work with clients across diverse sectors in the areas of valuation, expert services, investigations, cyber security, corporate finance, restructuring, legal and business solutions, data analytics, and regulatory compliance. Kroll has nearly 5,000 professionals in 30 countries and territories around the world.

We have provided input on select topics from our perspective of independent third-party valuation specialists. We would be pleased to discuss our comments with the IASB staff. Please reach out to Greg Franceschi at greg.franceschi@duffandphelps.com, Marianna Todorova at marianna.todorova@duffandphelps.com, Carla Nunes at carla.nunes@duffandphelps.com, or Gary Roland at gary.roland@duffandphelps.com, with any questions.

Sincerely,

Duff & Phelps, A Kroll Business

Office of Professional Practice
Duff & Phelps, A Kroll Business

kroll.com | T +1 650 798 5570 | Duff & Phelps, A Kroll Business
1950 University Ave
Suite 400
East Palo Alto, CA 94303

Questions for respondents

Question 3

Paragraphs 24–28 provide an overview of financial reporting issues that could be added to the Board's work plan.

(a) What priority would you give each of the potential projects described in Appendix B—high, medium or low—considering the Board's capacity to add financial reporting issues to its work plan for 2022 to 2026 (see paragraphs 27–28)? If you have no opinion, please say so. Please provide information that explains your prioritisation and whether your prioritisation refers to all or only some aspects of the potential projects. The Board is particularly interested in explanations for potential projects that you rate a high or low priority.

Kroll comments: In response to **Question 3(a)**, we have provided input on certain potential projects described in Appendix B, from our perspective of independent third-party valuation specialists. Our comments are set forth below, by topic.

Cryptocurrencies and related transactions

Kroll comments: Clear guidance reflecting the economic characteristics of cryptocurrencies is needed, rather than having constituents try to apply the existing accounting framework. Additionally, we agree that it is counterintuitive to apply accounting models, such as IAS 38 *Intangible Assets* or IAS 2 *Inventories* where the resulting measurement may be something other than fair value. In short, applying a patchwork of standards to cryptocurrencies can lead to inconsistent outcomes that do not faithfully reflect economic reality.

The *rationale* for pursuing this project is that crypto assets are a large and fast-growing asset class. While currently, most companies do not have material amounts of digital assets, there are companies that invest in or provide support services to digital asset companies that can have very large holdings. For example:

- An entity that provides software support to getting a cryptocurrency platform up and running might hold over a billion worth of that currency if it becomes successful.
- Mining businesses hold large quantities of digital assets.
- Certain investment companies concentrate on digital assets.

- Going forward, one could likely expect to see large quantities of digital assets being held by investment banking firms that help them go public.
- Some companies are taking steps towards or are already allowing payment in select cryptocurrencies (for limited purposes).
- Other companies are taking steps to allow routine payment for goods or services by customers paying in select cryptocurrencies.

We believe that the greatest urgency in pursuing a project in the digital assets class relates to cryptocurrencies[1]. Key questions about existence, ownership, measurement, and the potential for market manipulation need to be addressed. Furthermore, as companies begin to accept cryptocurrencies as forms of payment, there needs to be a way to account for and distinguish such "assets" in the context of the reporting currency.

Cryptocurrency may also be the most problematic to value of all digital assets. Its value is not tied to any underlying cash flows but is based solely on supply and demand. It is basically worth what the next person is willing to pay for it. The relevant markets are largely unregulated, wildly volatile, and rife with fraudulent trades inflating value.

In the U.S., in December 2019, the AICPA issued a practice aid on the *Accounting for and Auditing of Digital Assets.*[2] The AICPA's guidance is very helpful, but to some extent leaves open questions with respect to measurement, and it is nonauthoritative guidance. As the AICPA guidance addresses certain fair value measurement issues under ASC 820, *Fair Value Measurement*, it could in theory apply to measuring fair value of crypto assets under IFRS 13 *Fair Value Measurement*, as the two fair value standards are converged. However, this is not the stated objective of the AICPA guidance, and both IASB and FASB standard setting is needed in this area.

Finally, given the significance and rapid growth of the digital assets class, IASB and FASB should collaborate in addressing recognition, classification, and measurement issues to ensure a consistent outcome.

We consider a project on cryptocurrencies to be of **high priority** for both boards.

---

[1] For international context, also see letter to FASB from U.S. Congress dated May 12, 2021: https://emmer.house.gov/_cache/files/4/5/4562d4a7-da45-47e1-b909-0ce278fb1ba7/D0DE45074191D0B18E1227324345F79E.congressional-letter-to-chair-jones.pdf

[2] The AICPA guide can be accessed here: https://www.aicpa.org/content/dam/aicpa/interestareas/informationtechnology/downloadabledocuments/accounting-for-and-auditing-of-digital-assets.pdf

Discount rates

Kroll comments: While conceptually, discount rates specified in various IFRS standards should be consistent with the required measurement bases, we do not believe that at this time, the benefits from a *Discount Rates* project would outweigh the associated costs.

A better alternative may be to make narrow-focused improvements either during the development and implementation of a new standard (e.g., IFRS 17 *Insurance Contracts*) or while making improvements to existing standards (e.g., discount rates used in *IAS 36 Impairment of Assets*, pursuant to the post-implementation review of IFRS 3 *Business Combinations*).

We believe that this project is of **low priority** for IASB to address.

Intangible assets

Kroll comments:

Scope of potential project on intangible assets

Consistent with our position in our response to FASB's recent *Agenda Consultation*, we believe that the IASB should take a holistic approach to the accounting for *acquired intangibles* (in business combinations and asset acquisitions) and *internally generated* intangibles. In any event, a harmonized approach in the accounting, to the best extent possible, **should not come at the expense of the intangible assets currently recognized and measured in acquisitions,** which would be an enormous step backwards from sharing value-relevant information with users.

In pursuing a project on intangible assets, the IASB should collaborate with the FASB, considering that this is an opportunity to fully evaluate the accounting and reporting for intangibles, rather than patch existing or outdated standards that may have come together piecemeal, and are thus not reflective of the nature of the current economy.

Intangible assets currently recognized in business combinations should not be limited

The existing guidance for the separate recognition and measurement of identifiable intangibles is appropriate and operational.[3,4] Subsuming (certain) intangibles in goodwill will eliminate significant useful information.

The purchase price allocation process, in conjunction with the accounting recognition and measurement requirements, explains what investments have been made as part of the transaction, considering the company's business model, value drivers, competitive dynamics and *by employing the principles of corporate finance*. The more intangibles are subsumed in goodwill, the more unexplained the substance of the transaction becomes, which rightfully sparks questions from auditors, regulators, and investors.

Perspective in recognizing intangible assets

It is critical to recognize that assessing the merits of an intangible asset solely through the lens of whether it can be *sold or separated from a business, or transacted outside of a business acquisition,* falls short of conveying the importance of the asset used in an ongoing operation. Such a narrow approach would fail to capture the economic value associated with many intangible assets.

A prime example of an asset that falls in this category are customer intangible assets, which are key assets in many industries. Especially in the case of defense contractors, cable and technology companies, customer contracts are a critical intangible asset and the fair value of the backlog of contracts in place (and expected renewals) provide a meaningful indication of contracts in hand as opposed to those that have yet to be won. Customers in place are less risky than the future yet-to-be won (new) customers. Retention metrics are key operating indicators in these industries, and the data underlying these metrics is very robust. Thus, existing customer contracts and contract renewal expectations provide relevant and decision-useful information about expected cash flows and their risk. In addition, the way companies interact with their customers

---

[3] Most respondents to the IASB's Discussion Paper, ***Business Combinations – Disclosures, Goodwill and Impairment*** agreed with the Board's preliminary view that it should not develop proposals to include in goodwill some separately identifiable intangible assets recognized in a business combination. In their view, the separate recognition of these intangible assets provides useful information, and they did not see a need for a change.

[4] For international context, note that overall, respondents to FASB's ITC **on *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*** opposed changing the current guidance for the recognition of identifiable intangible assets. This is also a relevant data point as the intangible assets recognition criteria in business combinations are aligned between IFRS and US GAAP.

and leverage customer information has changed dramatically in the modern information age. For example, the retail and consumer products industry has been utilizing customer contact information (email and text) to track customer behavior to predict and drive future customer revenue.

Recognizing intangible assets provides a perspective into assets that management has invested in. In many cases these investments are material. In the current knowledge-based economy, intangible assets provide insight into the value drivers of the company and manifest sources of competitive advantage. Subsuming such assets into goodwill (in a business combination) or expensing the cost of corresponding internally developed intangibles creates opaqueness.

Capitalizing investments in intangible assets[5]

Perhaps more broadly, and consistent with a holistic approach to evaluating the accounting for intangible assets, IASB should explore capitalizing investments in intangible assets. Current IFRS intangible asset capitalization guidance is limited. Presently, accounting requires the expensing of many types of costs (research, advertising, etc.) as they are incurred, when economically, there often is a benefit from such costs in future years. Such accounting distorts economic reality and skews the picture of invested capital and return on capital. Treating such costs as investments by capitalizing and amortizing them over a reasonable period would provide better insight into value creation and would be a step towards narrowing the gap between an entity's book value and its market valuation. This capitalization approach can be coupled with a fair value impairment model, requiring an impairment test when certain indicators are present. Reversal of impairment should, when certain criteria are met, also be explored; we think this should entail revisiting the current revaluation criteria in IAS 38 *Intangible Assets* and considering relaxing them.

Disclosures about intangible assets

A holistic approach to the accounting for intangible assets includes improving disclosures. However, disclosures are not an alternative for recognition and measurement (unless a fair value estimate is presented as part of the disclosures), rather, they are a useful supplement to measurement. Disclosures could have several drawbacks, including sharing potentially sensitive information, boilerplate language, and may be costly to provide.

---

[5] Also see ***Missing intangible assets distorts return on capital***, by Steve Cooper (former IASB board member) and Dennis Jullens (former member of advisory committees for IASB and EFRAG): https://www.footnotesanalyst.com/missing-intangible-assets-distorts-return-on-capital/

Interaction of ESG and Intangible Assets

ESG matters have been a focal point for a wide range of interested parties. We understand that a certain subset of ESG matters, such as climate-related risks, could be addressed by the current IFRS standards.[6] This is in part responsive to a set of issues that fall into the 'E' of ESG, with many more areas left to cover. We observe that moving forward, greater transparency about internally generated intangibles would be very responsive to the needs of interested parties, including investors and regulators, in the context of ESG.

In that vein, disaggregation of financial information and financial and non-financial KPIs can also be used as a means for communicating relevant information to address matters related to ESG and internally generated intangibles.

Project priority

We consider the accounting for intangible assets to be a **high priority** project.

Considering the importance of intangibles, ESG trends, and the time it takes to develop a large project into a final standard, the Board should start addressing the issues in an active project as soon as possible.

It is well acknowledged that the 21st century economy is overwhelmingly driven by information and intangibles, a trend that has been gaining foothold for decades and has accelerated in the aftermath of the financial crisis. More recently, the emergence of COVID-19 gave technology companies an even greater prominence, just as the shift to remote work in several industries has further pushed many companies towards a tangible "asset-light" model. For international perspective, in the U.S., it is estimated that the share of intangible assets as a percent of the S&P 500 market value was 32% in 1985, growing to 80% in 2005 and further rising to 90% in 2020.[7] Investor groups and government bodies have been calling for more information on intangibles.

This is not uniquely an IFRS issue; it is a global issue, which requires a common approach and a consistent outcome between IASB and FASB.

For example, a recent investor survey concluded that well over 90% of respondents surveyed—which were approximately evenly split between North America, Europe, and

---

[6] IFRS Foundation educational material, ***Effects of climate-related matters on financial statements***, November 2020.
[7] Source: https://www.oceantomo.com/intangible-asset-market-value-study/

Asia—called for more transparent and specific disclosures for IP rights, and for their standardized accounting treatment across countries and regions[8].

In addition, consider the following from a recently proposed EU directive:[9]

- "The current legal framework does not ensure that the information needs of these users are met. This is because some companies from which users want sustainability information do not report such information, while many that do report sustainability information do not report all the information that is relevant for users. When information is reported, it is often neither sufficiently reliable, nor sufficiently comparable, between companies. The information is often difficult for users to find and is rarely available in a machine-readable digital format. **Information on intangibles, including internally generated intangibles, is under-reported, even though these intangibles represent the majority of private sector investment in advanced economies (e.g. human capital, brand, and intellectual property and intangibles related to research and development)."** *[emphasis added]*

- "Directive 2013/34/EU does not require the disclosure of information on intangibles other than intangible assets recognised in the balance sheet. It is widely recognised that information on intangible assets and other intangible factors, including internally-generated intangibles, is underreported, impeding the proper assessment of an undertaking's development, performance and position and monitoring of investments. To enable investors to better understand the increasing gap between the accounting book value of many undertakings and their market valuation, which is observed in many sectors of the economy, adequate reporting on intangibles should be required. **It is therefore necessary to require undertakings to disclose information on intangibles other than intangible assets recognised in the balance sheet, including intellectual capital, human capital, including skills development, and social and relationship capital, including reputation capital. Information on intangibles should also include information related to research and development.**"
[emphasis added]

---

[8] Source:https://www.columbiathreadneedle.co.uk/uploads/2020/11/e5a2c01886bf6bba00346269251ae587/grasping_the_intangible_nov_2019_emea.pdf

[9] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0189.

Negative interest rates

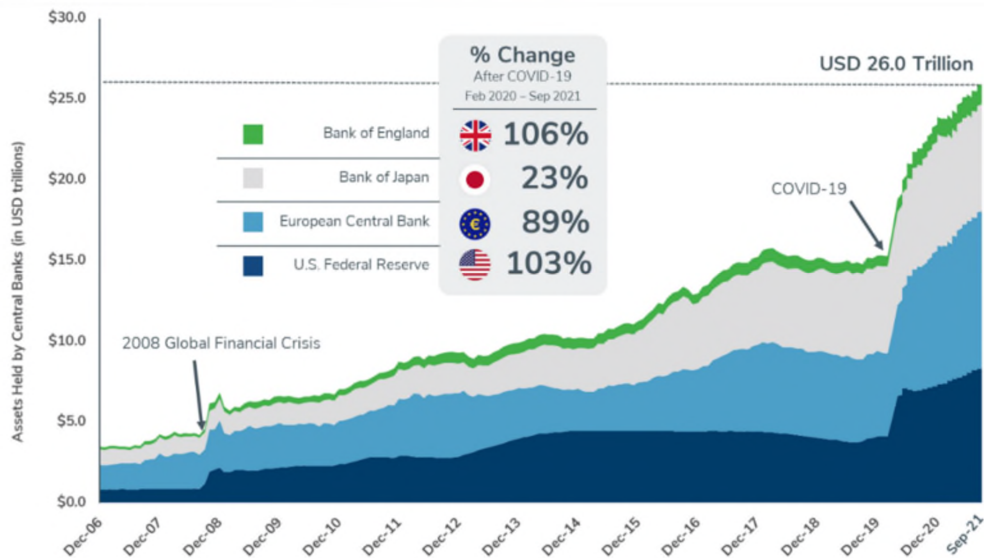
Kroll comments: Negative short-term and long-term interest rates may result in several challenges when measuring and reporting various assets and liabilities for financial reporting purposes. While some of these issues may impact financial institutions more significantly because of the nature of their assets and liabilities (e.g., measurement of financial instruments), all entities will be somehow impacted when operating in a negative interest rate environment.

The downward pressure on interest rates is not likely to disappear any time soon, at least for developed economies. Aggressive monetary policies implemented as a response to the 2008 Global Financial Crisis and the ensuing Euro Sovereign Debt Crisis drove long-term interest rates in the U.S. and several advanced economies to historically low levels. These unconventional monetary policies included so-called quantitative easing ("QE") measures, which entailed the purchase of massive quantities of debt securities issued by governments in the United States, Japan, the Eurozone, and the United Kingdom, among others. The outbreak of COVID-19 has exacerbated the issue, with other countries, such as Australia and Canada, implementing QE polices for the first time in their history. To illustrate:

- The graph below shows the size of the balance sheets of major central banks around the globe, as result of their QE programs implemented since the 2008 Global Financial Crisis. The graph shows how total assets of the U.S. Federal Reserve Bank (the "Fed"), the Bank of Japan ("BOJ"), the European Central Bank ("ECB"), and the Bank of England have evolved from December 2006 until September 2021. Even though this is an imperfect measure of sovereign debt instruments held by these central banks (as balance sheets will include other types of assets), it is striking that the combined total assets amounted to approximately US$ 26.0 trillion in September 2021. This level is more than six times higher than the level registered in August 2008 of US$ 4.2 trillion, just before the onset of the 2008 Global Financial Crisis. While there were some attempts by central banks to taper the pace of asset purchases that had been implemented as response to the 2008 Global Financial Crisis and the subsequent Euro Sovereign Debt Crisis, the reality is that by the end of 2019, the size of the combined balance sheets had barely shrunk.

- After February 2020, there was a notable jump tied to the outbreak of the COVID-19 pandemic, with the combined balance sheets growing at an unprecedent pace, as central banks purchased massive amounts of securities to support country economies during the crisis. It is evident that unwinding these

large positions will take a long time, making downward pressures on interest rates a lasting phenomenon.[10]



In addition, unconventional monetary policies took on a whole new meaning when certain major central banks decided to implement a negative interest rate policy (dubbed "NIRP" in some of the financial press). The BOJ, the ECB, as well as the Danish, the Swedish and the Swiss central banks have all adopted this form of monetary policy at one point. The consequence of such policies is to also pressure interest rates further downwards. According to a recent analysis by the Financial Times, global negative-yielding debt stood at US$ 16 trillion in August 2021.[11]

The combination of all these policies has created significant challenges in the measurement of various assets and liabilities when estimating a risk-free rate—or any discount rate that relies on the risk-free rate as a building block to capture the time value of money. This is particularly acute when measuring fair value, where the use of negative interest rates causes distortions in value indications:

---

[10] For a further discussion of the issues, refer to Duff & Phelps, A Kroll Business, webinar titled "COVID-19 One Year Later – Impact on Cost of Capital and Related Valuation Issues", May 20, 2021. Available here: https://www.duffandphelps.com/insights/webcasts-and-videos/webcast-replay-covid-19-impact-on-cost-of-capital-related-valuation-issues.

[11] Stubbington, Tommy, "Bond rally pushes global stock of negative-yielding debt above $16tn", August 5, 2021, FT.com. Available here: https://www.ft.com/content/43280fe3-b6cd-44e1-bb75-25b0962b5ba1.

- Certain models cease to work and price instruments as intended (e.g., Black Scholes option pricing model)

- The present value of future cash flows required in many IFRS Standards (e.g., IAS 36 *Impairment of Assets*, IFRS 13 *Fair Value Measurement*, IFRS 16 *Leases*) results in a value indication that is higher than the sum of the undiscounted cash flows. This could be a reasonable outcome in economies suffering from deflation. However, this is not the case in most developed economies where negative interest rates are prevalent. Inflation is still positive, but the yields on government debt securities do not reflect inflation expectations by market participants. Central banks policies have distorted the relationship between economic fundamentals by artificially repressing interest rates.

- The use of negative interest rates, without further adjustments, when measuring the fair value of risky assets may lead to underpricing of risk for such assets, excessive risk taking by market participants, and potentially a system-wide disruption to financial markets, particularly during times of crises.

Guidance is needed to address (1) the pricing distortions being created by non-market participants intervening in global financial markets, and (2) the consequent impact on the measurement of assets and liabilities which uses, as one critical input, either risk-free rates or other discount rates that rely on risk-free rates as a building block.

We believe this project is of **high priority** for IASB to address.