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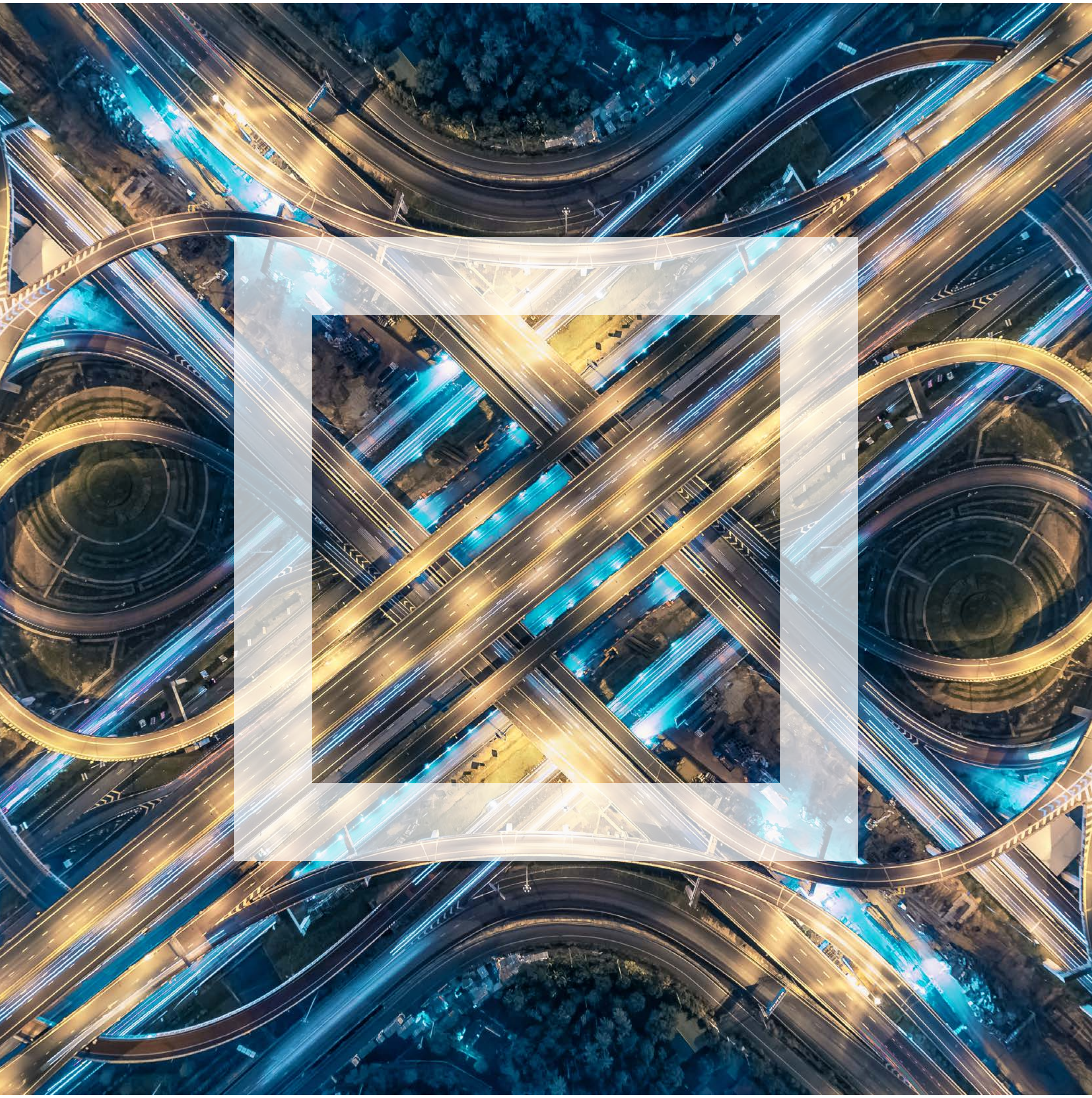

THE FUTURE OF FINANCIAL REPORTING 2023:
THE CURRENT DEBATE ON INTANGIBLE ASSETS. WHERE ARE WE HEADING?

A discussion paper based on the British Accounting and Finance Association (BAFA), Financial Accounting and Reporting Special Interest Group (FARSIG) Virtual Symposium, 13 January 2023.

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Silvia Gaia
Reader in Accounting
University of Essex

Simone Aresu
Associate Professor in Accounting
University of Cagliari

Penny Chaidali
Lecturer in Accounting
University of Cardiff

Omiros Georgiou
Associate Professor in Accounting
University of Birmingham

Michael John Jones
Emeritus Professor of Financial Reporting,
University of Bristol

Andrea Melis
Professor of Corporate Governance and Management Accounting
University of Cagliari

Luigi Rombi
Senior Lecturer in Accounting
University of Cagliari

For further information, please contact:

Sharon Machado, Head of Sustainable Business,
Policy and Insights, ACCA. Sharon.Machado@accaglobal.com

About Financial Accounting and Reporting Special Interest Group (FARSIG)

FARSIG is a group set up under the aegis of the British Accounting and Finance Association (BAFA). The main purpose of FARSIG is to further the objectives of BAFA and for that purpose to:

- encourage research and scholarship in financial accounting and reporting
- establish a network of researchers and teachers in financial accounting and reporting
- enhance the teaching of financial accounting and reporting
- provide support for PhD students in financial accounting and reporting
- develop closer links with the accountancy profession in order to inform policy
- publish a newsletter and organise targeted workshops
- develop and maintain relationships with BAFA and the professional accountancy institutes
- provide a forum for the exchange of ideas among accounting academics.

The symposium, which is one of an annual series that started in 2007, provides a forum for academic, practitioner and policy-orientated debate. Such forums are useful for expressing and developing rounded opinion on the current meta-issues facing financial reporting. Furthermore, they serve to illustrate the policy relevance and impact of current academic and practitioner thinking and outputs, in accordance with calls from the Economic and Social Research Council for relevant and rigorous research combining practitioner and academic perspectives.

The authors would like to express their thanks to the four main speakers, both for their presentations and for their subsequent time and comments during the development of this discussion report. The authors have tried to capture faithfully the flavour of the original presentations. Nonetheless, although the original speakers were shown the commentary on their presentations, any errors or omissions remain our own. Thanks are also due to the Association of Chartered Certified Accountants (ACCA) for hosting the symposium and for its support of the publication of this discussion report. Finally, could any readers who wish to learn more about FARSIG or to become FARSIG members please contact any one of the authors.

Silvia Gaia is the chairperson of the FARSIG Committee and a reader in accounting at the University of Essex. Simone Aresu is an associate professor in accounting at the University of Cagliari, Italy. Penny Chaidali is a lecturer in accounting at the University of Cardiff, UK. Omiros Georgiou is an associate professor in accounting at the University of Birmingham, UK. Mike Jones is an emeritus professor of financial reporting at the University of Bristol, UK. Andrea Melis is a professor of corporate governance and management accounting at the University of Cagliari, Italy and Luigi Rombi is a senior lecturer in accounting, also at the University of Cagliari, Italy.

Foreword

Sharon Machado
Head of Sustainable Business, Policy and Insights, ACCA

> *The intangibles that are vital to generating value for an organisation may not be immediately visible to investors, lenders, employees or just about anyone using the organisation's annual report.*

ACCA was pleased to host FARSIG's 2023 symposium, the annual discussion about the future of corporate reporting. This year's symposium, with the title *The Future of Financial Reporting 2023: The Current Debate on Intangible Assets. Where are we Heading?*, has rightly focused on exploring whether the accounting and reporting of intangibles – specifically goodwill and research and development (R&D) – can be further improved.

In today's highly competitive and rapidly changing business environment, revenue-generating services and contents are based on intangibles such as knowledge, know-how, new or enhanced designs, systems and processes. As vital as these intangible resources have become, some of them are not recognised as assets on balance sheets. Thus, the intangibles that are vital to generating value for an organisation may not be immediately visible to investors, lenders, employees or just about anyone using the organisation's annual report.

Investors and other users of corporate reports have been vocal in demanding more transparency in the accounting and reporting of intangibles, including goodwill and R&D. In fact, most respondents to the Request for Information made by the International Accounting Standards Board (IASB) for its Third Agenda Consultation have commented on, and rated, a project on intangible assets as a high priority. The IASB has responded by adding intangible assets to its research project pipeline for 2022 to 2026 (IASB 2022).

Intangibles-related information does not only concern the reporting organisation and its investors, but also affects the ability of auditors and regulators to fulfil their duties. Therefore, the range of intangibles-related discussions in this year's symposium is timely and would provide plenty of food-for-thought. The topics include:

- accounting for goodwill and subsequent measurement models
- usefulness of goodwill-related information and how an organisation's goodwill accounting influences its reporting decisions
- an information gap in reporting of R&D that indicates potentially broad and yet fundamental problems in the accounting and reporting of R&D, and
- stakeholders' reactions to the information gap in the reporting of R&D and some practical recommendations for overcoming the problem.

Two resounding key messages are that intangibles-related information is relevant for users and there is room for improvement in the recognition and measurement of intangibles, as well as in the nature and extent of information to be provided.

No matter what the scope of the IASB's intangible assets project may be, those engaged with it will certainly need to work collaboratively with businesses, national and regional standard setters, and academia to gather live data, field-test solutions and maximise alignment of definitions and accounting requirements.

We hope that this discussion paper will motivate:

- reporting organisations to review the extent of intangibles-related information that is provided in annual reports, and consider enhancing the relevance, connectivity and conciseness of these pieces of information, so they are decision-useful
- the IASB, in rethinking the fundamentals of intangibles when reviewing IAS 38; the definition, accounting, and disclosure requirements in the standard need to be updated and enhanced to maintain the relevance of information produced for the contemporary economy
- academia, to conduct further research on the accounting and reporting of intangibles.

Lastly, I would like to extend ACCA's thanks to the FARSIG committee for organising the symposium, for providing this discussion paper, and for enabling the interaction between accountants in business and practice with academics.

1. Introduction

At the beginning of 2023, the world was still facing an extraordinarily unstable social, economic and political scenario. While the COVID-19 pandemic crisis appears to be at the end, its health and economic after-effects persist, together with countries' divergent economic recoveries, risk deepening divisions at a time when global collaboration is required to address emerging global challenges like the green transition (International Monetary Fund 2023; World Economic Forum, 2023).

The return to a 'new normal' after the pandemic crisis was disrupted by a return of 'older' social and political risks, including inflation, cost-of-living crises, trade wars, geopolitical confrontation, and the spectre of nuclear warfare. Existing geopolitical and geo-economic tensions have been given renewed momentum by the war in Ukraine, with nationally focused political agendas that not only involve Russia and Ukraine, but extend to other important countries, including China, the United States, the United Kingdom, and the European Union members. Geopolitical tensions are spilling over into the economic sphere as global competition between China and the United States is increasing (World Economic Forum 2023). More specifically, the outbreak of war in Ukraine, and the related energy crisis, are having severe impacts on the social, economic and political spheres. The escalating increase in energy prices is causing disruptions in supply chains and, consequently, in the production of goods and services, pushing up inflation to levels not seen in the last four decades. This is leading to a cost-of-living crisis and fuelling social unrest (International Monetary Fund 2022; World Economic Forum 2023). In most countries, amid the cost-of-living crisis, the priority remains achieving a sustained reduction in inflation toward target levels (International Monetary Fund 2022; 2023).

In those countries that can afford support from state aid, military expenditure and private investment, R&D into emerging technologies continue, yielding advancements in important technologies, such as quantum computing, artificial intelligence (AI), and biotechnology. In those countries that do not (or cannot) support R&D, inequality and divergence from wealthier nations will grow. Overall, technology seems to exacerbate inequalities, rather than reducing them, while cybersecurity risks remain a constant issue (World Economic Forum 2023).

Within this turbulent social, economic and political scenario, the 'cost of living crisis', with inflationary pressures disproportionately hitting those people who can least afford it, is ranked as the most severe global risk in the short term (World Economic Forum 2023).
The pandemic caused the biggest setback to global poverty-reduction efforts since the 1990s, and was made worse by the war in Ukraine (eg United Nations, 2022). A recent study by the World Bank (2022) has reported that we are unlikely to meet the UN Sustainable Development Goal of ending extreme poverty by 2030.

Despite the dramatic social, economic and political scenario, the World Economic Forum's risk report (2023), documents that environmental risks are expected to dominate over the next decade. Notably, climate action failures, natural disasters and extreme weather events are the top global risks over the next ten years, while biodiversity loss and ecosystem collapse are viewed as among the fastest accelerating global risks in the near future. Expected trade-offs between food security and nature conservation are likely to be faced. Restoring trust and fostering cooperation between (and within) countries will be fundamental and crucial to addressing these interconnected risks and preventing the countries of the world from drifting farther apart (International Monetary Fund 2023; World Economic Forum, 2023).

THE RETURN TO A 'NEW NORMAL' AFTER THE PANDEMIC CRISIS WAS DISRUPTED BY A RETURN OF 'OLDER' SOCIAL AND POLITICAL RISKS, INCLUDING INFLATION, COST-OF-LIVING CRISES, TRADE WARS, GEOPOLITICAL CONFRONTATION, AND THE SPECTRE OF NUCLEAR WARFARE.

The 2023 annual FARSIG symposium on the 'Future of Financial Reporting' was held, in cooperation with ACCA, on a virtual platform, on Friday 13 January 2023, against this background of social, economic and political instability and continuing developments and challenges for how companies account for and report their performance. These also occurred in areas that are mainstream in the accountancy profession and academia, such as accounting for goodwill and intangibles, and R&D reporting.

The title of the 2023 FARSIG 16th annual symposium was 'The Future of Financial Reporting 2023: The Current Debate on Intangible Assets. Where are we Heading?'. The annual symposium provided a forum for both academics and practitioners to hear and engage in a state-of-the-art debate with the following well-informed, high-profile speakers, listed here in alphabetical order.

- **Seema Jamil-O'Neill**, the technical director of the UK Endorsement Board, 'Accounting for goodwill and intangibles in the 21st century'
- **Anne Jeny**, a professor at the IESEG School of Management (France), 'Goodwill accounting: Insights from empirical research'
- **Aaron Saw**, senior subject manager of ACCA in the area of corporate reporting, 'Reporting of R&D – the disclosure or information gap: Feedback from roundtables'
- **Ioannis Tsalavoutas**, a professor of accounting and the leading founder of the Adam Smith Observatory of Corporate Reporting Practices at the University of Glasgow (UK), 'Reporting of R&D – the disclosure or information gap'

These four experts were brought together to discuss existing issues, new developments, and their effect on the future of financial reporting. Specifically, they provided their original views on significant current issues in intangible assets' accounting and reporting, documenting the opportunities and challenges that corporate reporting is facing from the perspectives of standard setters, practitioners and, of course, academia.

As in earlier years, the symposium was held using a virtual platform to foster inclusivity of worldwide attendance and participation. The four presentations were followed by an informed and lively panel discussion, moderated by the FARSIG chair, where the speakers gave their expert perspectives on a series of questions raised by the national and international audience.

Issues raised by the symposium

Before introducing the issues raised in the presentations given during the annual symposium, the main themes presented and debated at the symposium are briefly summarised in Table 1.1, which also presents the key symposia themes since its first event in 2008. During this year's symposium, there was a critical examination of some of the key open questions on accounting for goodwill and intangibles, and research and development reporting.

Which factors affect R&D reporting? Are companies that do not report any R&D expense in their financial statements really 'R&D inactive'? How do preparers assess the materiality of R&D expenses? Which information, in addition to the amount, should be disclosed about research expenses to improve transparency, relevance and fitness for representation in corporate reporting? What are the costs and benefits that preparers face in reallocating R&D-related costs (eg staff salaries, rent, electricity, use of disposable materials) to R&D expenses? Is goodwill-related accounting information value-relevant? To what extent does goodwill impairment predict a company's future operating performance? How can the reliability and value-relevance of goodwill impairment testing be improved? Should amortisation of goodwill be reintroduced? Should a hybrid model for goodwill accounting be implemented?

Some of these questions are relatively new, while others are 'evergreen'. All are still critical as informed decision-making and proper stewardship of resources employed in a company's activities could be enhanced to the extent to which accounting is able to help, by using all its potential, in providing an answer to these critical questions. The expert speakers provided their informed views on these open and controversial issues, which continue to present key challenges to standard setters, practitioners and academics. The common themes that emerged during the presentations were discussed in more depth during the panel discussion.

Table 1.1. shows a summary of the key themes raised at the 'Future of Financial Reporting' symposia since their establishment in 2008. In 2023 the speakers' presentations revolve around the following central themes: accounting for goodwill, accounting for intangibles, and R&D reporting.

TABLE 1.1: Overview of key symposia themes, 2008–2023

2023	• Accounting for goodwill • Accounting for intangibles • R&D reporting	**2022**	• Materiality in sustainability reporting • Sustainability reporting in capital markets • Sustainability reporting for market players • Climate-related disclosures prototype • A roadmap to improve sustainability reporting
2021	• The Endorsement Board • Reliability of financial reporting in extraordinary times • Narratives in corporate annual reports • The standard setting for financial and non-financial information	**2020**	• Accounting regulation for non-financial information • Accounting for intangibles • Accountancy profession • Integrated Reporting
2019	• Conceptual framework • Narratives in corporate annual reports • Accounting in the public sector	**2018**	• The role of accounting in shaping capitalism • The role of Big Data and AI in corporate reporting and investment • Digital reporting • Conceptual Framework • Integrated Reporting
2017	• The evolution of corporate reporting • Corporate reporting vs financial reporting • Financial narratives • Accountancy profession • Future of Chinese and Western auditing	**2016**	• The use of information by capital providers • Conceptual Framework: measurement • Transparent corporate reporting • Integrated reporting and the capital markets • The perceived role of the accountant in the society
2015	• Accounting for goodwill • Corporate governance • Integrated reporting • Sustainability accounting • IASB and politicisation of standard setting	**2014**	• Conceptual Framework, measurement • EU Accounting Directive for SMEs • UK FRS: tax implications • The use of information by capital providers • Compliance with mandatory disclosure requirements
2013	• Conceptual Framework, recognition and measurement • Regulatory Framework, governance and 'balanced reporting' • IFRS [International Financial Reporting Standards] adoption and national accounting practices • Nature and complexity of crises	**2012**	• Asset and liability recognition • Measurement, fair value and confidence accounting • Regulatory Framework and complexity of financial statements • Fraud and accounting scandals
2011	• Complex financial instruments, asset and liability recognition and measurement • Regulatory environment, complexity of financial statements • IFRS adoption and political interface • Carbon accounting	**2010**	• The role and need for global accounting standards • Understandability and usefulness • Political concerns • Sustainability accounting
2009	• Regulatory change • The convergence of global standards through IFRS • Fair value • Corporate governance • Asset securitisation and the 'credit crunch'	**2008**	• Conceptual Framework • Income measurement • Fair value • Financial communication

Sources: Jones and Slack 2008; 2009; 2010; 2011; 2012; 2013; Jones et al. 2014; 2015; 2016; 2017; 2018; 2019, 2020, 2021; Gaia et al. 2022.

Below, we present some of the most important developments that have occurred in accounting and corporate reporting in relation to accounting for goodwill and intangibles and R&D reporting during the years 2022 and 2023.

The IASB's agenda for 2023 includes several 'maintenance' projects, including amendments to IFRS 10 and IFRS 16, in relation to sale and leaseback of an asset in a single-asset entity. In response to the feedback received on its third agenda consultation, the IASB has also decided to create a reserve list of two projects: operating segments and pollutant pricing mechanisms. The project on operating segments is expected to examine the causes of users' concerns about the granularity of segment information provided by companies and the feasibility of potential solutions that could be implemented. The project on pollutant pricing mechanisms would aim to examine the types of pollutant pricing mechanisms (eg emission trading schemes) and accounting by traders and scheme administrators.

The IASB's agenda also includes some research projects on important themes, such as the statement of cashflows and related matters, and amortised cost measurement.

In relation to the theme of the symposium, IASB's research pipeline includes a research project on intangible assets, which is expected to review IAS 38 comprehensively with the aim of reflecting more accurately the increasing importance of intangible assets in today's business models. This project is expected to include important tasks such as the analysis of enhanced disclosure requirements (including disclosures about unrecognised intangible assets), a review of the scope of the accounting standard to decide whether some recognised intangible assets (eg intangible assets held for investment purposes) should remain within the standard, and a review of the definition of an intangible asset, the recognition criteria, and the measurement requirements. This evolving scenario in accounting for goodwill, intangibles and R&D is influencing companies' preparers and users of corporate reports as well as the accountancy profession and all stakeholders (including academics).

Many of these issues were, either directly or indirectly, discussed during the 2023 symposium by each of the four speakers, who offered a range of informed views. The issues specifically addressed during the 16th annual symposium are now presented, and then discussed in more depth, in the following sections.

2. Symposium papers

(in alphabetical order by speaker)

2.1 Accounting for goodwill and intangibles in the 21st century

Seema Jamil-O'Neill, UK Endorsement Board

2.2 Goodwill accounting: Insights from empirical research

Anne Jeny

2.3 Reporting of R&D – the disclosure or information gap: *Feedback from roundtables*

Aaron Saw

2.4 Reporting of R&D – the disclosure or information gap

Ioannis (Yannis) Tsalavoutas

2.1 Accounting for goodwill and intangibles in the 21st century

Seema Jamil-O'Neill, UK Endorsement Board

Seema Jamil-O'Neill is the technical director of the UK Endorsement Board (UKEB), where she was appointed in June 2020. Seema started her career as an auditor of listed and investment banking clients. She has worked as an accounting standard setter at the Financial Reporting Council (FRC) and its predecessor, the Accounting Standards Board (ASB), specialising in financial reporting standards for financial instruments and insurance contracts. More recently she worked at the Department for Business Energy and Industrial Strategy (BEIS) as the head of Accounting and Reporting Policy, leading the team responsible for maintaining the integrity of the UK accounting and reporting framework as the UK exited the EU. In that role, she also represented the UK at the European Commission's Accounting Regulation Committee as well as European Council working groups. She is a fellow of the Institute of Chartered Accountants in England and Wales.

Seema's speech at the symposium was about the work of the UK Endorsement Board on accounting for goodwill and intangibles. Seema began by explaining that the Endorsement Board was set up to influence the development of IFRSs and adopt them for use in the UK. She then provided a brief overview of the type of work the board does to set the context for the topic of her presentation. Seema described how the board is involved in numerous research activities, as it is keen that its recommendations to the IASB are evidence-based. It is engaged in proactive research projects aimed at influencing the long-term development of IFRSs. These projects tend to be as solutions-focused as possible. Findings from this research are used to influence the IASB by being cited in consultation responses to the IASB. They may also form some of the background information that the board develops when it formally adopts standards for use in the UK. Seema noted that a key part of the board's work is understanding UK stakeholders' views on any changes to accounting policies.

Post Implementation Review of IFRS 3 and the IASB's proposals

Seema proceeded to discuss how the UKEB recently dealt with the Post Implementation Review of IFRS 3 undertaken by the IASB. The IASB had identified a number of issues relating to poor disclosure about acquisitions, and in particular about goodwill. For goodwill impairment, problems were also identified relating to shielding and to excessive management optimism. There were calls for the reintroduction of goodwill amortisation but also for separation between intangibles and goodwill. The IASB's starting position on goodwill amortisation was that it was not minded to introduce amortising goodwill, even though stakeholders were split on this issue.

The IASB's objective was to explore how companies can, at a reasonable cost, provide investors with more useful information about their acquisitions. The IASB's proposals were about enhancing the disclosures about the acquisitions themselves, and potentially about their subsequent performance. On subsequent measurement, they were retaining the impairment-only model and considering ways of simplifying the impairment test. As regards presentation, there was some indication from the IASB that it could help with some of the concerns about goodwill by requiring companies to present the amount of total equity excluding goodwill in the statement of financial position. The IASB also proposed retaining existing recognition criteria for intangibles acquired on acquisition.

UKEB's research

Context

Seema proceeded to present the research project carried out by the UKEB on this topic. She explained that the motivation of the project was to try to provide quantitative evidence of the impact on the UK of the size of goodwill retained on company balance sheets. Initial research showed that goodwill is a significant balance for the majority of UK FTSE 350 companies: 228 companies in the FT350 were found to have reported goodwill balances in 2021. The total carrying amount of goodwill for those companies was £397bn, which was an increase of 78% from 2005 when IFRSs were implemented in the UK. Up to 2005 in the UK, the reporting requirements stipulated capitalisation of goodwill with a hybrid model, with amortisation over a period of time and impairment, as necessary. For FTSE 350 companies reporting goodwill in 2021, on average, it represented 18% of total assets or 63% of net assets. Seema noted that this is a big number which causes concern when considering whether goodwill is an asset. The other issue the UKEB can determine from its research is that a slowdown in the growth or significance of goodwill cannot be anticipated. Goodwill has not plateaued, mainly because mergers and acquisitions (M&A) activity had remained buoyant. M&A activity is still strong in sectors with a high price-to-equity ratio and in sectors that are expected to contribute significantly to the UK economy, especially in the coming decades, such as the technology, bio-technology and pharmaceuticals sectors. These sectors tend to be the ones that are at times more acquisitive, which means that we expect more goodwill to be generated. The average annual goodwill impairment charge over the period 2005–2021 was only about 2.85% of the average opening carrying amount of goodwill. This seems to indicate that not many impairments were being undertaken. Overall, the goodwill balances were increasing but few impairments were recorded.

Seema then explained that the IASB had asked the UKEB to perform more work in this area, aimed at understanding the detailed implications of the hybrid model. It involved both desk-based research and investor outreach. The main questions asked were whether transition to a hybrid model is feasible, what the impact of that will be on financial stability, how useful life would be determined, how amortisation could be introduced, and what the impact of that would be for goodwill. Under UK generally accepted accounting practices (GAAP), some private companies still amortise goodwill, and they determine its useful life.

The hybrid model for subsequent measurement of goodwill that was tested involved amortising goodwill on the basis of a remaining useful life estimated by management. This would require identifying significant goodwill components and then amortising on that basis. Impairment testing would be carried out only when there is an indication of impairment. This would be supported by some disclosures to increase management accountability for acquisitions.

SEEMA OUTLINED THE KEY AREAS OF RESEARCH FOCUS, WHICH WERE THE EFFECT ON FINANCIAL REPORTING OUTCOMES, THE FEASIBILITY OF AMORTISING GOODWILL UNDER A HYBRID MODEL, THE EFFECT ON FINANCIAL STABILITY, AND THE EFFECT ON AUDIT PROCESSES, SYSTEMS AND COSTS.

Research areas and methods

Seema outlined the key areas of research focus, which were the effect on financial reporting outcomes, the feasibility of amortising goodwill under a hybrid model, the effect on financial stability, and the effect on audit processes, systems and costs. Seema noted that, with the aim of being as robust as possible, more than one research method was applied for each one of these research areas. These methods included field testing and outreach to stakeholders.

Findings

Seema went on to describe the findings of the research project. Stakeholder views on the financial reporting outcomes anticipated from the introduction of a hybrid model were found to be mixed. Seema explained that although stakeholders included both preparers and investors, more outreach was done with preparers. The preparers, who viewed goodwill as a wasting asset, thought that a hybrid model will lead to a more faithful representation of the consumption of benefits. Their view was that goodwill is consumed and is thus eliminated over time. They also thought that a hybrid model would reduce the impact of shielding because, as goodwill is currently carried within large cash-generating units, and may be impaired, the testing does not lead to an impairment. Preparers also thought that the disclosures that the UKEB identified would generate relevant information for investors and that the hybrid model would improve comparability with entities that grow organically, as in both cases the cost of growth would be charged to profit. Investors, on the other hand, while acknowledging that the suggested disclosures would be useful, had mixed views on faithful representation. This is because some investors do not agree that goodwill is a wasting asset.

FINDINGS ALSO DEMONSTRATED THAT THE TRANSITION TO A HYBRID MODEL IS FEASIBLE. THIS IS BECAUSE PREPARERS CAN DETERMINE USEFUL LIFE USING A RANGE OF FACTORS SUCH AS THE NATURE OF THE BUSINESS, THE PERIOD OVER WHICH THE SYNERGIES HAVE BEEN REALISED, AND THE REMAINING LIFE OF THE ASSEMBLED WORKFORCE.

Findings also demonstrated that the transition to a hybrid model is feasible. This is because preparers can determine useful life using a range of factors such as the nature of the business, the period over which the synergies have been realised, and the remaining life of the assembled workforce. Seema noted that this is consistent with UK GAAP. Some preparers suggested the use of default periods (ie a predetermined period for useful life), although this is considered problematic by the IASB. Preparers also demonstrated that they could address legacy goodwill (ie goodwill prior to the adoption of new guidance) as it is possible to analyse it by business combination. In this respect, a retrospective application of the hybrid model would be preferable in transition as it would provide a more faithful representation.

Seema noted that the research project did not identify any significant impacts on financial stability from a transition to a hybrid model. The project also did not identify any significant potential impact on audit, processes, systems or costs. Some preparers thought that audit processes for indicator-only impairment testing would be as extensive as they are for annual impairment testing, while others anticipated cost savings on audit fees if there were to be a transition to a hybrid model. Overall, the view was that as long as staff were educated about it, the hybrid model was feasible.

Seema proceeded to present a high-level overview of the stakeholder feedback on the benefits expected of a hybrid model. The majority of preparers, who participated in the field-testing, expected an improvement in financial reporting outcomes, while the views from investors were more mixed.

The IASB's final position

Seema explained that these research findings were presented to the IASB at its Accounting Standards Advisory Forum (ASAF) meeting in September 2022. The IASB has had subsequent discussions on this and, in November 2022, it decided against introducing amortisation as there was no compelling evidence that it would provide significant improvement to information for users. Also, it was unclear whether introducing amortisation would reduce costs for entities. The IASB decided to work on improving disclosure requirements and changes to the impairment test itself. Seema noted that she believes that it is likely that goodwill will be considered as part of the future work on intangibles as the concerns about it are a symptom of wider concerns with intangibles accounting.

The intangibles debate

Seema went on to discuss how there have been long-standing concerns about accounting for intangibles, which is now on the IASB's agenda. There is currently no timeline attached to the project itself, but it is expected to commence over the coming months.

The UKEB has started research in this area to build on its evidence-based approach. The board has begun its first piece of work on what will be a multi-phased approach to this. Initial work is aimed at understanding the landscape for intangible reporting in the UK. The board has been reviewing the academic literature in this area, trying to understand its relationship to the UK economy, and will then consider stakeholder views. This work will be summarised in a report expected to be published soon. The next phase will be a quantitative analysis of the reporting on intangibles by UK listed companies as well as an exploration of investor needs.

Seema then presented what the board has heard from stakeholders to date. The views from stakeholders are that accounting for intangibles is a significant issue for them, that it is currently very rules-based, that the approach for internally generated intangibles and acquired intangibles is very different, and the disclosures are not helpful and at odds with the reporting itself. Stakeholders would like enhanced disclosures so that they can demonstrate the impact of intangibles on business success and they would like disclosures to be more principles-based, as far as possible.

Seema finished her presentation by saying that the UKEB will continue its work in this area. It will be doing more quantitative work and carrying out an investor survey.

The board is also interested in maintaining its engagement with academics, as far as possible. The board has two members who are academics and a very active academic advisory group. The board intends to continue its engagement with BAFA and will alert academics to future calls for research. Finally, the board will continue to engage with the IASB on its intangibles project. Seema provided links to additional resources from the UKEB's website for anyone interested and thanked FARSIG for the opportunity provided to present at the symposium.

2.2 Goodwill accounting: Insights from empirical research

Anne Jeny, IESEG School of Management

Anne Jeny is a professor at the IESEG School of Management and an associate editor of Accounting in Europe. Her main area of expertise is intangible assets, in particular goodwill. Her research spans different areas of accounting and has been published in various journals, including *European Accounting Review*, *Journal of Accounting and Public Policy*, and *Accounting, Auditing & Accountability Journal*.

Anne started her presentation by outlining some knowledge from empirical accounting research on goodwill. Specifically, she emphasised that academics have contributed to the current debate by pointing out that a lot of empirical accounting research could be relevant for policymakers. Nonetheless, she also pointed out that not all academic research is equally reliable and only academics have the expertise to disentangle what is reliable and what is not. She clarified that the aim of her intervention was not to review all, or even most of, the literature on goodwill, as this has already been done (Amel-Zadeh et al. 2021). Similarly, she explained that although her opinions are grounded in years of studying intangible assets, she emphasised that the aim of her intervention was not to make any recommendations.

Anne then proceeded to argue that empirical goodwill literature has addressed two broad issues: i) the usefulness and information content of goodwill-related accounting numbers and ii) goodwill-related accounting and reporting decisions. The stream of research on the usefulness and information content of goodwill has mainly focused on understanding whether goodwill accounting standards contain useful information for users. By contrast, the stream of research on goodwill-related accounting and reporting decisions has focused on investigating whether goodwill accounting standards have led to reporting decisions that reflect fundamental firm performance rather than management's incentives.

Anne then proceeded to discuss what can be learnt from the first stream of empirical research, ie decision-usefulness studies. She emphasised that goodwill-related accounting numbers (ie goodwill balances and goodwill impairment losses) are generally value-relevant, meaning that these amounts correlate, in theoretically expected ways, with proxies for goodwill economic value, firm value and financial performance. Goodwill value relevance or, as Anne defined it, goodwill usefulness, is true before and after the introduction of the impairment-only approach brought in by IFRS 3 and SFAS 142. Anne also noted that we also know from these decision-usefulness studies that goodwill impairment announcements seem to have information content, meaning that when there is a goodwill impairment announcement, we can observe significant market reactions in event studies. Nonetheless, she also noted that markets often appear to anticipate large parts of the losses before goodwill impairment is announced. She also underlined that goodwill impairment predicts (negatively) future operating performance and, lastly, goodwill impairment decisions appear to reflect economic deterioration. This means that goodwill impairment decisions are associated with stock market returns and future accounting performance, with a negative coefficient association.

Anne then discussed the reporting-choice studies, which have been well-documented, on how goodwill accounting provides room for the opportunistic use of managerial discretion. Specifically, she highlighted that some decisions (eg purchase price allocation, initial goodwill measurement and goodwill impairment) are associated with proxies for firm- and managerial-level incentives. This is also true for disclosures on M&A transactions and goodwill impairment testing, which are two areas of importance to financial analysts and investors. She also noted that goodwill impairment decisions and the quality of disclosures are related to the intensity of monitoring, oversight and enforcement, as recently shown by Filip et al. (2020). Hence, problems in current goodwill accounting may, at least partly, be an 'application issue that would best be addressed by other means, rather than by changing the standard' as highlighted by Scott (2019).

She then proceeded to discuss the position of practitioners and regulators in accounting for goodwill. Specifically, Anne mentioned that since the IASB Discussion Paper DP/2020/1 Business Combinations – Disclosures, Goodwill and Impairment (IFRS 2020), four main topics should have been reviewed by regulators: improving disclosure about business combinations; improvements to the goodwill impairment test; using an indicator-only approach; and the reintroduction of amortisation of goodwill. Anne then discussed how empirical research could shed some light on these four questions, which are of interest to the regulators.

THE STREAM OF RESEARCH ON THE USEFULNESS AND INFORMATION CONTENT OF GOODWILL HAS MAINLY FOCUSED ON UNDERSTANDING WHETHER GOODWILL ACCOUNTING STANDARDS CONTAIN USEFUL INFORMATION FOR USERS. BY CONTRAST, THE STREAM OF RESEARCH ON GOODWILL-RELATED ACCOUNTING AND REPORTING DECISIONS HAS FOCUSED ON INVESTIGATING WHETHER GOODWILL ACCOUNTING STANDARDS HAVE LED TO REPORTING DECISIONS THAT REFLECT FUNDAMENTAL FIRM PERFORMANCE RATHER THAN MANAGEMENT'S INCENTIVES.

Improving disclosure about business combinations has been debated for a long time between, on the one hand, people who advocate additional disclosures and recognition and, on the other hand, defenders of the current, mainly voluntary, disclosure regime with limited recognition. She then discussed one of her studies (Jeny et al. 2019) where, with her co-authors, she looked at the purchase-price allocation context and investigated the effects of intangibles-related disclosure on the revisions of analysts' earnings forecasts. The results of the study show that disclosures are positively associated with the magnitude of analysts' forecast revisions, particularly for the so-called 'bad deals' (ie those deals that were negatively received by market participants when initially announced). She also noticed that, more importantly, the study shows that goodwill is associated with downward revisions of analysts' earnings forecasts and confirms that goodwill is interpreted by analysts as informative about overpayment. She believes that this evidence is indicative that disclosure of goodwill under IFRS 3 can be useful for financial analysts and market participants.

Anne then proceeded to address the second question, about the improvements to impairment testing. She outlined why goodwill impairment is considered to be one of the most complex accounting estimates and is subject to significant managerial discretion. She questioned whether there is an opportunistic use of this managerial discretion and noted that there is a growing body of evidence suggesting that firms do not always book goodwill impairments in a timely manner. There is a tendency to manipulate impairment tests to achieve some economic incentives that could be at the level of the firm or at the level of the management. She then noted that there are three potential consequences for practitioners, users of financial information and regulators: i) there may be a decrease in the degree of conditional conservatism of financial reporting; ii) such disclosure is unlikely to be informative, as it relies on inappropriate impairment inputs, as shown by Amiraslani et al. (2013); iii) investors, as well as financial analysts, may disregard the information provided by firms that manipulate impairment tests. She also emphasised that the issues related to improvements in impairment testing are not standards issues but application issues. Goodwill impairment decisions and the quality of disclosures are really related to the intensity of monitoring oversight and enforcement. As shown in the study of Andreicovici et al. (2020) auditors play a monitoring role. Flagging goodwill impairment as a key audit matter in the expanded audit report leads to improvements in the quantity and quality of the information about goodwill that managers disclose in the notes. This shows how auditors can have a positive impact on the implementation of a standard (especially for goodwill impairment testing).

> **THERE IS A TENDENCY TO MANIPULATE IMPAIRMENT TESTS TO ACHIEVE SOME ECONOMIC INCENTIVES THAT COULD BE AT THE LEVEL OF THE FIRM OR AT THE LEVEL OF THE MANAGEMENT.**

The third question that has been tackled by the IASB concerns the use of an indicator-only approach (ie removing the requirement to test for goodwill impairment when there are no indicators of possible impairment, such as the steady decline in the ratio of book value to market value, a comparison of that ratio with those of a peer group, the loss of market share of key products, and changes in key management personnel). Goodwill impairment is an important component of the financial reporting process (Ayres et al. 2019), and the information content of goodwill impairments is useful to financial statement users. Though this has not been proved, a lot of prior empirical research has shown that the market reacts negatively to the revelation of impairment losses (Bens et al. 2011, Knauer and Wöhrmann 2016). Firms experience lower analysts' forecast accuracy and higher dispersion of analysts' forecasts following an impairment loss announcement (Chen et al. 2015). Also, prospective information disclosed on goodwill impairment is negatively associated with the cost of equity (Paugam and Ramond 2015) and the level of disclosure transparency decreases the disagreement among analysts and between analysts and managers (Andreicovici et al. 2020). Anne then outlined the main takeaways from this indicator-only approach. Specifically, she noted that disclosure about goodwill impairment testing is a means of improving the disclosure of information on acquisitions. Moreover, she pointed out that the fact that the impairment test carried out annually has the advantage of informing users about the valuation trend of the goodwill, which makes it possible to see whether there is opportunistic use. Finally, IAS 36 has the virtue of linking the publication of financial information with the company's strategy.

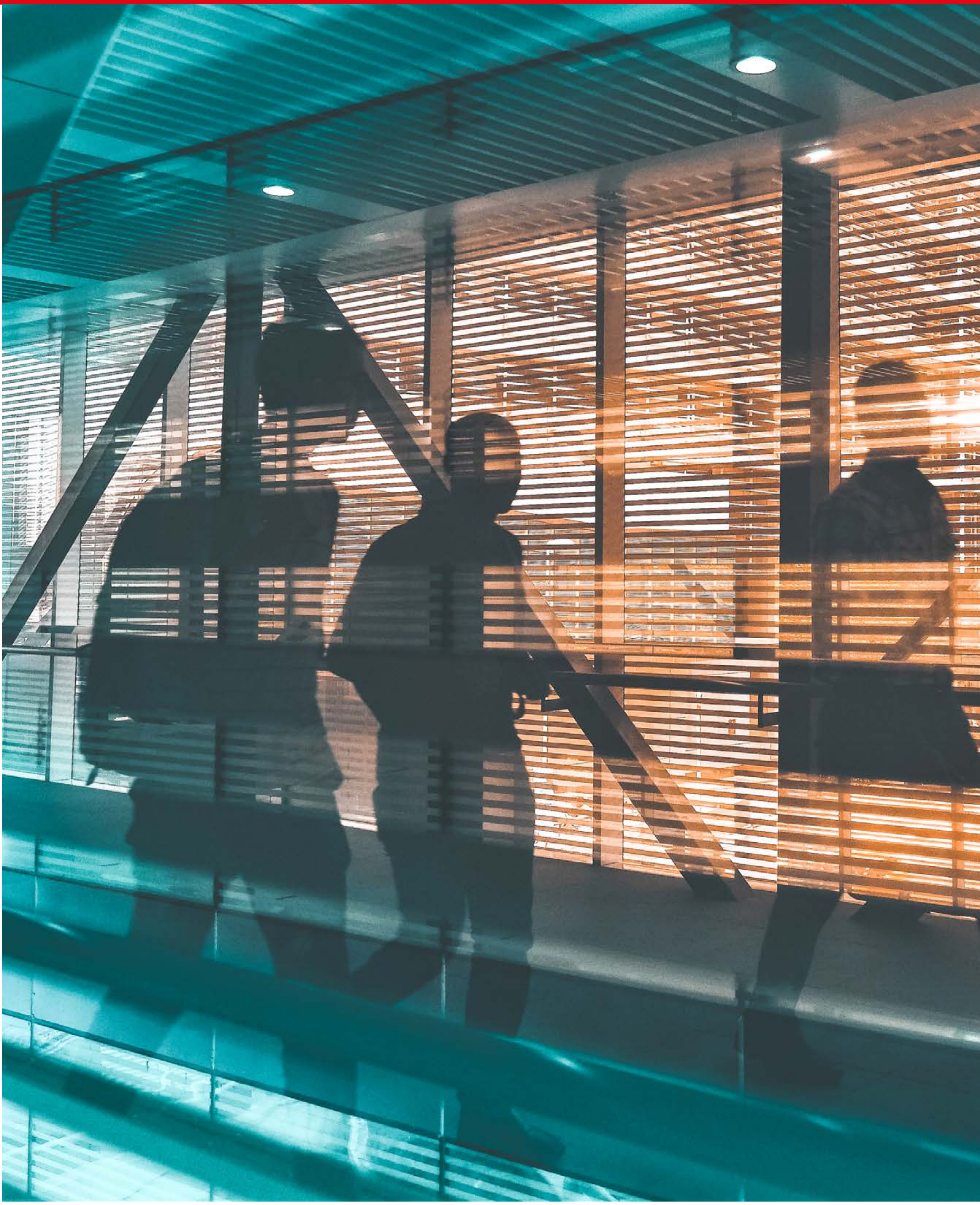
Anne finally tackled a persistent question related to the reintroduction of the amortisation of goodwill. This question is linked with a broader question of whether goodwill, as an asset, has a definite or indefinite useful life. She pointed out that some papers have provided evidence that goodwill is priced as an asset, and it is shown to have a positive association with equity market values. Even so, it is also associated with a lower valuation multiple than are other assets (Choi et al. 2000) and markets distinguish, to some degree, between valuable and worthless goodwill portions (Henning et al. 2000). She also noted that the value relevance of goodwill has increased since the adoption of IFRS and the implementation of the goodwill impairment test (Aharony et al. 2010). There is also evidence that goodwill amortisation understates the decline in goodwill value as perceived by stock markets.

Anne concluded by highlighting the risks of reintroducing an amortisation of goodwill for companies, users, financial information and regulators. First, she believes that it is unclear what the economic meaning of goodwill amortisation would be, and whether this would lead to impairment of goodwill disappearing if it is already amortised. Second, the time over which goodwill should be amortised is an open question. In her opinion, this will lead to new areas of debate and judgement and if we open the floor to judgement, we open the floor to another way of earnings management, and management discretion. Finally, she argues that there is also the risk of losing a lot of useful information about the underlying business of companies, since IAS 36 requires a high level of mandatory disclosure and going back to amortisation will present the risk of losing this information.

ANNE CONCLUDED BY HIGHLIGHTING THE RISKS OF REINTRODUCING AN AMORTISATION OF GOODWILL FOR COMPANIES, USERS, FINANCIAL INFORMATION AND REGULATORS. FIRST, SHE BELIEVES THAT IT IS UNCLEAR WHAT THE ECONOMIC MEANING OF GOODWILL AMORTISATION WOULD BE, AND WHETHER THIS WOULD LEAD TO IMPAIRMENT OF GOODWILL DISAPPEARING IF IT IS ALREADY AMORTISED. SECOND, THE TIME OVER WHICH GOODWILL SHOULD BE AMORTISED IS AN OPEN QUESTION.

2.3 Reporting of R&D – the disclosure or information gap: *Feedback from roundtables*

Aaron Saw, ACCA



Aaron Saw is a senior subject manager in the area of corporate reporting in ACCA. Aaron's areas of interest include both financial and sustainability reporting, business resilience, digital technology, improvement of audit quality and development of small and medium practices (SMPs).

Aaron's presentation focused on the feedback received from the participants of three roundtables organised by ACCA in November 2022 to discuss the main findings of research into R&D reporting. These findings were also presented by Dr Yannis Tsalavoutas during the symposium. The first roundtable comprised 10 participants from the business group, including auditors, preparers and users of financial statements. The second roundtable targeted policymakers and standard setters (10 participants). The third roundtable comprised people with backgrounds from business groups, policymakers and academia in the ACCA Global Forum for Corporate Reporting (17 participants). In these roundtables, ACCA had representatives from Asia, Africa, Europe, and Oceania, who gave their views and reflections on the main findings.

General reactions from participants on the main findings of R&D reporting research

Aaron discussed the general feedback received from the roundtable participants on the main findings of the R&D reporting research. First, participants did not expect a high proportion of R&D-inactive companies in industries such as financial services. For instance, one participant commented that there were many research activities concerned with fintech in the financial services industry so the high proportion (more than 70%) of apparently R&D-inactive companies in that industry was unexpected. If R&D is recognised as an expense rather than capitalised as an asset, the expense should still be reported separately. Notwithstanding that the technology industry has a lower proportion of R&D-inactive companies than other industries, another participant commented that technology is quickly shaping the business landscape and one would expect to see more disclosure on R&D in the technology sector as it is the key driver of technological advancements. Secondly, participants wondered whether R&D is happening in small and start-up companies. When small companies manage to prove the worth of their research, they are likely to be acquired by a larger company. In practice, the acquirer may not disclose the prior R&D costs of their acquired small companies and that could be the reason why R&D costs do not appear in the balance sheet of large (and listed) companies.

THE NATURE OF R&D IS DEPENDENT ON THE SECTOR CONCERNED, AND ACTIVITIES INVOLVING RELATIONSHIPS, HUMAN RESOURCES AND BUSINESS PROCESSES MAY NOT BE DEFINED AS R&D IN THE CONVENTIONAL SENSE. IF A COMPANY DOES NOT REGARD ITS ACTIVITY AS R&D, THE ASSOCIATED EXPENDITURE WOULD NOT BE REPORTED AS SUCH.

Thirdly, low R&D disclosure could be considered either as a compliance issue or as a reporting issue. The latter will require improvements to the quality of disclosure.

Aaron then moved on to summarising the roundtable discussions on the main findings, which, among others, revealed more R&D disclosures in the Narratives section in annual reports than in the Financial Statements section; and a sizeable number of companies using a high volume of R&D-related terms in both the Narratives and Financial Statements sections, despite not disclosing any R&D costs separately. One key issue relates to the lack of clarity in the definition of R&D in IAS 38. The nature of R&D is dependent on the sector concerned, and activities involving relationships, human resources and business processes may not be defined as R&D in the conventional sense. If a company does not regard its activity as R&D, the associated expenditure would not be reported as such. For instance, as mentioned by a roundtable participant, development of software that might help to acquire customers at a lower cost may not be treated as 'research' in the sense of the pursuit of new scientific or technical knowledge.

Another issue is the fact that the kind of information that should be disclosed for research expenses is not made explicit in the standard. IAS 38 requires disclosure of the relevant amount of cost, if material, and disclosure of whether it is expensed or capitalised. This requirement only relates to the amount, however, thus leaving it to the discretion of preparers to include information about the R&D activity they deem to be relevant and of interest to users. Perhaps, according to roundtable participants, some companies might be thinking of materiality only in terms of the quantitative threshold, with the amount spent considered to be not material in a numerical sense. But it would be important to consider the qualitative aspects of materiality and the nature (rather than the amount only) of R&D that could influence economic decisions. Participants observed that materiality assessment is an internal, undisclosed, decision.

The last issue discussed by Aaron relates to the lack of incentives for reallocating costs to R&D for separate disclosure. For example, a company might have done R&D but did not report it separately in the financial statements. Participants, in both the business group and policymakers, offered their views that R&D costs could be similar to operating expenditures (eg staff salaries, rent, electricity, raw materials, use of disposable materials), and reported according to the nature of these expenses without reallocating a portion to R&D. A clearer definition of R&D would also help in this reallocation process. Roundtable participants said that reallocating certain expenses and reporting them separately as R&D would require creating new processes or internal controls. The efforts and costs may seem high compared with the incentives, if the latter are not explicit. These incentives include the value of R&D in an enterprise valuation. Although information about R&D may influence enterprise valuation, a participant said it is not the only factor and many other intangibles could also influence the enterprise valuation. In short, if the incentives are not clear, then companies are unlikely to spend incremental resources in reporting R&D expenditure separately.

Five important factors that affect R&D reporting

After unpacking the problems in R&D reporting, Aaron explained five factors that could lead to the problems (and solutions) faced in R&D reporting. These factors were summarised from participants' reflections on the main research findings. The first driver is related to culture, which affects disclosure. If a company is operating in an environment of secrecy, or if a company has concerns about industrial espionage, then it is going to disclose as little as possible to avoid letting competitors learn about its business. At the other extreme, companies that embrace transparency (perhaps influenced by their funding requirements) may be pushed to disclose extra information than they would otherwise like, so that investors or lenders know where their R&D expenditure is going. Then again, those companies that are compliance-centric are likely to disclose only to the extent of what is legally required.

> **IN PRACTICE, INCENTIVES ALONE MAY NOT BE ENOUGH AND REGULATORY REQUIREMENTS AND ENFORCEMENT ARE ALSO IMPORTANT IN PUSHING COMPANIES TO CLASSIFY THEIR EXPENDITURE APPROPRIATELY AS R&D BUT ALSO NOT TO EXAGGERATE R&D.**

The second factor is related to incentives, regulatory requirements and enforcement. If there are incentives, such as tax incentives or grants from governments to support R&D, then companies are motivated to disclose their R&D activities or what they are spending on R&D. In practice, incentives alone may not be enough and regulatory requirements and enforcement are also important in pushing companies to classify their expenditure appropriately as R&D but also not to exaggerate R&D. A roundtable participant suggested that companies may disclose a R&D amount separately, and more information on R&D, if regulators require a certain amount or percentage of R&D spending to qualify for a specific licence/access/eligibility.

A third factor relates to funding requirements, as companies looking for funding are likely to disclose more information, pushed, for instance, by prospective investors that appreciate knowing what R&D the company is spending the money on, regardless of whether the amount is capitalised or expensed. On the other hand, if the company is not looking for funding, then its managers may not be as motivated to disclose more. Where companies are required or asked to disclose more information, this typically appears in the front half of the annual report, and this is consistent with findings presented by Ioannis Tsalavoutas later in this symposium. Another roundtable participant commented that disclosures about R&D should be made useful for investors by clarifying the quantitative impact that the R&D has on revenues and earnings, and which part of the company will be affected.

The fourth element is related to governance and the board's responsibility for R&D disclosure. The board's knowledge of R&D reporting could influence disclosure. On the other hand, if boards disagree with the executive management choices on R&D disclosure, certain aspects will not be disclosed.

The fifth and last element relates to companies' interest in responding to the government's plan or ambition. For instance, the government may have announced plans or ambitions to develop certain kinds of technology, and companies that are directly or indirectly affected by this announcement or this ambition may say something about their R&D in the narratives.

Aaron argued that better R&D reporting goes beyond the company-level disclosure and has a direct effect on better information at the national level. National agencies rely on databases constructed using the information companies give in their annual reports, and these databases may offer misleading pictures on the level of R&D if companies doing R&D do not report the amounts separately.

What should be done?

ACCA posed some questions to roundtable participants on what should be done to overcome the problems faced in R&D reporting. For instance, we asked a question about what information would be required to improve transparency, relevance and faithful representation in corporate reporting. Participants suggested the time has come to rethink and redefine the concepts of R&D. This exercise should not stop at R&D and should extend to covering all intangibles. Updated definitions would support companies in deciding whether they are doing R&D, and whether the associated expenditure should be classified as, or reallocated to, R&D.

Another suggestion relates to the disclosure of information about R&D that is left to the discretion of preparers. Standards should require baseline information so that users can appreciate what R&D is happening in the group/entity and should recognise that a proportion of the company's value may come from intangibles. Roundtable participants believe this information should include more insights into the nature of the R&D, and segment reporting to show in which part of the group/entity R&D is being conducted and the segment for which that R&D is intended. At the same time, it would be important to link R&D reporting with financial performance. Distinguishing the research phase from the development phase using the current guidelines in IAS 38 can be challenging, as R&D is usually an iterative process and is developed bit by bit. Thus, participants suggested disclosing information about those R&D expenses that are related to the future even though they could not yet meet the capitalisation conditions.

PARTICIPANTS SUGGESTED DISCLOSING INFORMATION ABOUT THOSE R&D EXPENSES THAT ARE RELATED TO THE FUTURE EVEN THOUGH THEY COULD NOT YET MEET THE CAPITALISATION CONDITIONS.

As many companies have changed their business models in response to the COVID-19 pandemic, or are pivoting to or exploring a different business model, participants emphasised the importance of linking R&D reporting to the business models and strategies of the company.

Looking ahead, Aaron mentioned that companies will probably invest more in R&D (a type of intangible). Potentially, even businesses that are not conventionally spending on R&D may invest in R&D to address sustainability matters, such as emissions reduction, in their business models.

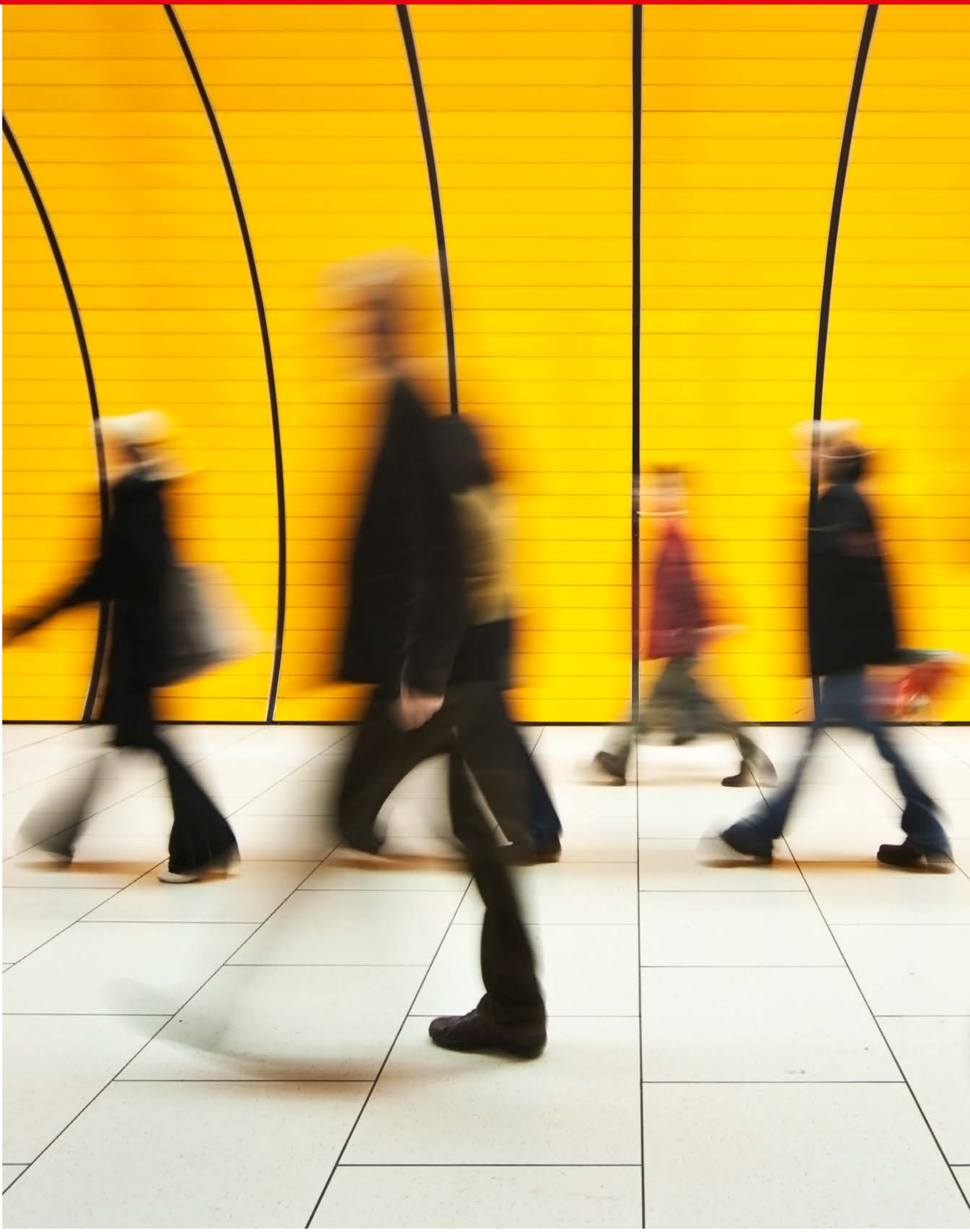
Lastly, changing behaviour for reporting will be as important as changing the reporting requirements to improve the overall quality of R&D reporting. Few companies would want to be the first movers. The availability of guidance, potentially from standard setters, on what information investors want about R&D and how to prepare it may break the barrier to disclosure and convince companies to provide more decision-useful information. When competitors start disclosing the information and realising the benefits, more companies will follow. Hence, availability of guidance will be essential to changing preparers' behaviour.

Aaron's presentation concluded with an interesting comment from a roundtable participant on the importance of R&D reporting: 'transparency in R&D reporting is not only to attract investors, but what's really important is connecting the R&D expenditure to the company's strategies – if the R&D can be monetised [and] save costs in which areas or in which product'.

The above account offers a glimpse into the research that ACCA and the Adam Smith Business School at University of Glasgow are together conducting to study the information gap in R&D reporting. The full report on this research was published on ACCA's Professional Insights website in 2023.

2.4 Reporting of R&D – the disclosure or information gap

Ioannis (Yannis) Tsalavoutas, Adam Smith Business School, University of Glasgow



Yannis Tsalavoutas is a professor of accounting at Adam Smith Business School, University of Glasgow, UK. He is the founder and leader of the Adam Smith Observatory of Corporate Reporting Practices at the University of Glasgow. Yannis is a member of the ACCA Global Forum for Corporate Reporting, the Institute of Chartered Accountants of Scotland – Corporate & Financial Reporting Panel, and the UKEB Academic Advisory Group. He is the editor of the Journal of International Financial Management & Accounting and serves as section editor for accounting and finance for the European Management Journal and as a member of the editorial board of Accounting in Europe, the Journal of International Accounting, Auditing and Taxation, and The British Accounting Review. Yannis has extensively researched issues relating to financial accounting and reporting that are of interest to practitioners, investors and the academic community. Yannis' research focuses on companies' reporting practices under IFRS across different jurisdictions and the economic consequences that may arise from divergence in practice. He is also interested in uncovering the role of corporate governance in companies' financial reporting practices.

Yannis' presentation at the symposium focused on the reporting of R&D, which is the subject of a research project that Yannis has conducted with Dionysia Dionysiou (University of Stirling), Richard Slack (Durham University) and Fanis Tsoligkas (Bath University), funded by ACCA (Dionysiou et al. 2023).

Motivation of the research – Wider context and related literature

As Yannis explained, there has been a lot of work on R&D that focuses on whether firms capitalise or expense R&D costs and the market reactions on this issue. Despite this, research on issues related to R&D disclosures has been scant.

Since the development of the *IAS 38 Intangible Assets* in 1998, there has been a debate about whether development costs should be capitalised or expensed. At the time, the International Accounting Standards Committee (IASC) provided support for capitalising development costs when certain criteria were met. In the last decade, there have been claims that financial statements may not reflect the intangible assets as drivers of value, leading to a potential consequential loss of their value-relevance (Bernanke 2011; Haskel and Westlake 2017; Lev and Gu 2016; Lev 2018). In the academic literature, studies demonstrate that the proportion of firms that capitalise some development costs is consistently smaller than those expensing all R&D costs (eg Kreß et al. 2019; Mazzi et al. 2019a) and that greater levels of development costs' capitalisation would be expected, depending on firm and country characteristics (Mazzi et al. 2019b). According to Mazzi et al. (2022), investors do indeed observe a prevalence of expensing in companies' financial statements.

> **THE STUDY OF MAZZI ET AL. (2022) FINDS THAT INVESTORS SUPPORT THE NEED FOR MORE AND IMPROVED GENERAL DISCLOSURE ON R&D AND CURRENTLY CONSIDER THE CASH SPENT TO BE THE MOST OBJECTIVE MEASURE OF R&D INVESTMENT.**

Positioning the current research project in a wider context, Yannis mentioned that the IASB has been under pressure to reflect on the issue of intangible assets. Because of the continuous debate on intangibles and the need for improvement of the IAS 38 standard, the IASB decided to include the accounting for, and recognition of, intangible assets in its work plan for 2022 to 2026. At the same time, the European Financial Reporting Advisory Group (EFRAG) has received comments on the discussion paper that focus on different possible approaches for better information on intangibles (EFRAG 2023). Therefore, the aim of the current research is to contribute to the conversation on intangible assets. Currently, the only disclosure requirement in IAS 38 is that the relevant amounts involved (ie material capitalised or expensed amounts) are to be disclosed separately. The study of Mazzi et al. (2022) finds that investors support the need for more and improved general disclosure on R&D and currently consider the cash spent to be the most objective measure of R&D investment.

Yannis said that previous academic work has excluded a significantly large number of firm-year observations, taking them to indicate that the firms concerned are R&D inactive (Mazzi et al. 2019b; Dionysiou et al. 2021). This prompts one to ask how these firms produce their new products or introduce their new services. Is it possible that none of these firms engage in R&D activities? Drawing on the literature, Koh and Reeb (2015: 73) report that *'A perusal of a subsample of the 3000+ NYSE-listed firms in our sample shows that a substantial number fails to provide any information regarding their corporate R&D efforts. Specifically, 1,737 NYSE-listed firms do not report any information on R&D, while 373 of them report zero R&D'. Considering whether it is possible that none of these firms engage in R&D, Koh and Reeb (2015) reveal that '10.5% of the non-reporting-R&D-firms receive patents, with several of these firms receiving dozens of patents each year'.* (2015: 73). This means that firms might engage in R&D activities while not reporting the costs as separate amounts.

Key findings in ACCA and Mazzi et al.'s research

Reflecting on the results of Mazzi et al. (2019b) – a study co-written by Yannis and colleagues and funded by ACCA – Yannis stated that the second phase of that study examined the disclosures of 'R&D-active' firms. The sample included 3,711 firm-year observations from more than 20 countries for the 10-year period from 2006 to 2015. The authors developed a keyword list of 116 R&D-related terms and identified the number of times these terms featured within the annual reports as a whole, and separately in the narrative sections and the financial statements. The results were analysed in relation to expensers and capitalisers and in line with the R&D intensity. While the importance of intangible assets such as R&D is known, the results of the Mazzi et al. (2019b) study show that firms do not disclose a high quantity of R&D-related information. Unsurprisingly, the results suggest that capitaliser firms tend to disclose R&D information marginally more frequently than expensers.

The current project

Building on the Mazzi et al. (2019b) study, the current research project funded by ACCA focuses on seemingly R&D-inactive firms, ie firms that do not report any R&D asset or R&D expense separately. Extending the Mazzi et al. (2019b) keyword list, the current study identifies the volume and frequency of certain R&D-related terms and their location in annual reports. As Yannis explained, the objective of the study is to understand the context in which R&D-inactive companies refer to R&D in their annual reports, despite not having reported a related amount separately.

In its first phase, the study concentrated on listed firms from all countries that have adopted IFRS (or converged national standards to IFRS) for the financial period 2017–2021. The researchers identified and classified 33,502 firm-year observations as indicating that the firms concerned were 'R&D active' (47% of the full sample). When there are no R&D-related amounts shown separately in the financial statements, they identified and classified 38,285 firm-year observations as indicating that these firms were 'R&D inactive' (53% of the full sample). Of the firm-year observations of firms classified as R&D inactive, 35,265 (49% of the full sample) are from reports by firms that have never been R&D active. From the firm-year observations classified as R&D active, 30,249 (42% of the full sample) are from the reports of firms that have been active across all the years examined. Firms yielding the remaining 6,273 firm-year observations are classified as 'switchers', meaning that they have changed from R&D inactive to R&D active or vice versa at least once during the sample period. In fact, the researchers identified 1,271 instances of switches from active to inactive (2% of the full sample) and 712 instances of switches from inactive to active (1% of the full sample), across the years examined.

Next, Yannis presented a graph showing the percentage of seemingly R&D-inactive firms; this percentage is also known as the 'exclusion rate'. The graph revealed some countries with significantly high percentages of R&D inactivity – in some cases, the exclusion rate was more than 90%. Yannis talked about the case of Israel and Denmark, the two countries with the highest proportion of GDP spending on R&D activities. As he noted, one would expect a lot of R&D activity in these countries but, as the results of the current project show, there is a very high proportion of exclusion ratings in Israel and Denmark. Finland, Germany, and Belgium are also countries with a high proportion of GDP in proportion to R&D. The current study finds an exclusion rate of 40% for these countries.

Surprisingly, the study's results point to China and Korea as the two outliers in the countries' sample, each with a very small exclusion rate. In particular, in the case of China, only 11.51% of firms would be classified as R&D inactive. The context here is important: in 2012 the Chinese government and the Securities Commission introduced a regulation enforcing the disclosure of R&D information. Before 2012, the exclusion rate was rather higher than that found in this recent study's results. As Yannis explained, although the introduction of this regulation was aimed at increasing reporting of disclosures, it pushed listed firms to disclose the actual amount of R&D separately in their financial statements.

Looking at the industries in which firms in the study sample operate, Yannis observed that it was interesting to see high percentages of 'R&D inactive' in sectors in which firms engage with R&D activity, such as healthcare, technology and telecommunications.

On the research design of the second phase of the project, Yannis noted that the study revisits the keywords list found in Mazzi et al. (2019b) and extends it by adding 33 further terms, resulting in a list of 149 R&D-related terms. It then ranks all seemingly R&D-inactive firms in each country–year–industry cluster by their size (market capitalisation). The study design ensured good representation across countries. The research team collected English-language annual reports and split them into two parts: narratives and financial statements. The study applied automated content analysis and captured the number of times keywords feature in these documents.

A KEY FINDING OF THE RESEARCH PROJECT IS THAT, FROM FIRM-YEAR OBSERVATIONS, THERE ARE A LARGE NUMBER OF R&D-INACTIVE FIRMS WHOSE REPORTS USE R&D-RELATED TERMS AS FREQUENTLY AS R&D-ACTIVE FIRMS.

A key finding of the research project is that, from firm-year observations, there are a large number of R&D-inactive firms whose reports use R&D-related terms as frequently as R&D-active firms. In fact, for some R&D-inactive firms, the count of R&D-related terms is voluminous. The results show that the mean (median) number of R&D-related disclosures for (i) financial statements (back-end) is 6 (3), with a maximum of 143, (ii) narratives (front-end) is 12 (5), with a maximum of 598, and (iii) annual reports as a whole is 15 (8), with a maximum of 606. This contrasts with the findings of Mazzi et al. (2019b), who report that the mean (median) count of R&D-related terms in the financial statements of R&D-active firms is 9 (15), while that for narratives is 15 (9) and that for the annual report as a whole is 25 (17). So for some apparently R&D-inactive firms, use of these terms would suggest that they are in fact R&D active.

The study examines whether companies in the countries analysed report software development assets as the reason for making R&D disclosures. The study finds that in some countries (such as Australia, Canada, Finland, Hong, Kong and Indonesia), where the proportion of software development assets is not very high, firms still use a lot of R&D terms in their reports. In contrast, firms in other countries, such as Brazil and Greece, report a lot on software development assets. Israel, Netherlands and Spain are among the countries with the highest percentages of observations of software development assets.

A review of the industries shows that firms in basic materials have a small proportion of software development assets, yet they still report a lot of R&D information.

As Yannis explained, the study separates firms in the sample into three groups (referred to as High, Low and Minimal disclosers), documenting a great concentration of firms in the High and Minimal disclosure groups for both narratives and financial statements. For those firm-year observations in the High disclosure group, the term used most frequently is 'development cost' and other frequently mentioned terms include: 'regulatory approval'; 'generate future economic benefit'; 'intention to complete'; and 'research activity'. In fact, eight terms (ie research and development; ability to use; internally generated; technical feasibility; development phase; prototype; research phase; ability to sell) are those frequently mentioned in IAS 38, mostly in relation to the criteria to be considered for the capitalisation of development costs. Yannis then noted that all industries present a high proportion of firms at the top end, which discuss R&D a lot but do not recognise amounts separately in the financial statements.

Next, Yannis presented some examples of firms that discuss R&D in their reports but do not disclose the amounts spent separately.

In the conclusion of his presentation, Yannis stated that the study finds that almost one-third of the seemingly R&D-inactive firms provide similar disclosure levels to R&D-active firms. This is an alarming issue given the possibility that investors and governments are missing information that should be disclosed in firms' accounts. Yannis suggested that a review of the definition and application guidance of R&D, given the current context, would be fruitful, as much has changed since the introduction of the standard in 1998. He also encouraged the IASB to note the example of China and its 2012 regulation, which led to increased R&D disclosures, and consider whether a similar practice could lead to any improvements on the reporting of intangibles. Finally, Yannis pointed to the issue of the materiality concept and its application under IFRS in the area of R&D and the need to examine why it is considered material that firms discuss R&D, but not material enough to require that they show the R&D amount separately in their accounts.

IN THE CONCLUSION OF HIS PRESENTATION, YANNIS STATED THAT THE STUDY FINDS THAT ALMOST ONE-THIRD OF THE SEEMINGLY R&D-INACTIVE FIRMS PROVIDE SIMILAR DISCLOSURE LEVELS TO R&D-ACTIVE FIRMS. THIS IS AN ALARMING ISSUE GIVEN THE POSSIBILITY THAT INVESTORS AND GOVERNMENTS ARE MISSING INFORMATION THAT SHOULD BE DISCLOSED IN FIRMS' ACCOUNTS.

2.5 Panel discussion section

Silvia Gaia moderated an engaging discussion section, with the four presenters involved in answering some of the questions raised by the audience. The panel discussion focused first on questions related to goodwill and the impairment process and then on R&D.

The first question on goodwill was made by Rhoda Brown, who argued that, after acquisitions, the acquiring company will immediately change the company acquired (eg incorporating relevant segments into its own operations, combining operations), and this fact can impair the measurement of goodwill (which is measured only at the time of the acquisition). Thus, Rhoda asked the panel to provide their view on the importance of reconsidering the measurement of goodwill after the acquisition date. Anne replied by citing Seema's comments on the importance of looking at the big picture of intangible assets at the time of purchase price allocation. She argued that a solution, at the time of the purchase price allocation, could be to recognise individual internally developed intangible assets better in the balance sheet. Goodwill will then probably be of lower amounts and considered as merely the difference between the acquisition price and the fair value of assets and liabilities of the acquired company. Anne added that intangible assets are growing but they are not properly recognised under the current accounting rules. Because of this, the amount of goodwill is huge compared with the residual value. Seema added some more considerations on this point by referring to the three main components of goodwill. The first component is the overpayment for what has actually been acquired. The second component relates to the synergies that will take place through the acquisition. The third component is the acquired company's intangibles, which have not been recognised because they are not permitted to be recognised as they do not meet (totally or partially) the strict rules-based definitions of intangibles within current accounting requirements. Seema argued that it is difficult to lump these three components into one overall measure. The first component, the overpayment, could simply be recognised on day one and, after that, written off. By contrast, the other two components (the synergies and the intangibles) will potentially have their own useful economic lives, which will emerge over time and this would then lead to a discussion about them. Seema argued that the measurement problem is likely to stay unless we are able to separate these different components of goodwill.

A second question was posed by Diogenis Baboukardos (Audencia Business School), who asked about the usefulness of introducing a stricter impairment testing process for goodwill, its realisation and the role of auditors in case a stricter process is adopted. Seema replied that she agrees that the current impairment testing process

ANOTHER PROBLEM THAT THE UKEB IDENTIFIED WAS THAT SOME COMPANIES WERE NOT ABLE TO TRACK WHERE THE GOODWILL WENT, AND TO WHICH CASH-GENERATING UNIT IT WAS ACTUALLY ALLOCATED.

is quite problematic, as is also recognised by UKEB and the IASB. The IASB has, more specifically, recognised the issue of shielding, which occurs when goodwill is allocated to cash-generating units that incorporate internally generated assets and thus are likely to generate income or future income that will exceed the goodwill balance. Moreover, lots of companies allocate goodwill to a cash-generating unit that is too large to be able to demonstrate the impairment objectively, and these cash-generating units will always generate more income than the goodwill balance. Another problem that the UKEB identified was that some companies were not able to track where the goodwill went, and to which cash-generating unit it was actually allocated. This issue of tracking is problematic and, Seema argued, the IASB needs to deal with it.
A third problem of impairment testing has to do with the management bias or management optimism, which, Seema suggested, can be mitigated but not removed by changing the impairment-testing process. Seema cited some research showing that goodwill was impaired just because the old management, which was responsible for the acquisitions, left the company and new management came in, starting with cleaning (ie impairing) prior goodwill. For both Seema and the UKEB, additional disclosure on goodwill is key to addressing these issues. More specifically, Seema suggests the inclusion of an additional table that reports information on the individual significant acquisitions and the goodwill allocated to them, identifying the period of acquisitions so that, at least, investors can understand better (and question) the reason why old acquisitions have led to still unimpaired goodwill in the balance sheet. There can be some reason for the decision not to impair goodwill from very old acquisitions, but this reason should be disclosed. Diogenis added his opinion, in relation to Seema's arguments, on the fact that auditors are likely to know these problems and should do more to tackle them. Seema stated that these problems exist despite the auditing of information on goodwill, owing to the auditors' current inability to challenge

management optimism. The current impairment tests are limited, additional disclosures may actually help them. The other element is the whole cash-generating unit and Seema provided one example of a company that told the UKEB that it was not able to convince its auditors that its goodwill was impaired, because it could not demonstrate to them that the entire revenues generated from the cash-generating unit to which goodwill was allocated, were not attributable only to goodwill. Because of these difficulties, according to Seema, preparers are slightly more interested in amortisation because they believe that it would take away the pressure from the current discussion on these issues. Anne Jeny added some comments on the role of auditors, from her own research, arguing that at least the information disclosed in the key audit matters about audit risk linked to goodwill impairment testing is perceived as useful for financial analysts. More specifically, this information decreases the level of disagreement among financial analysts about goodwill impairments, and it also reduced the disagreements between management disclosure and financial analysts' disclosure on goodwill impairment. Thus, Anne proposed, the improvement of the audit report with the introduction of the extended audit report seems to have contributed positively to goodwill impairment. Aaron also gave his opinion on the role of auditors, which is not to design the cashflow projections that measure the recoverable amount but, rather, to check whether the company has done the impairment testing and to look at the assumptions used in the model that was applied, such as the discounted cashflow model. Aaron argued that if the auditors find certain assumptions to be a bit optimistic, then they should simply ask for disclosure, because once the company has disclosed something, then the users can assess the assumptions made by the company. He thinks that it would be wrong to put everything on the shoulders of the auditors, who simply have to fulfil their role (eg checking the sensitivity of the assumptions, and the disclosure in the financial statements) as best as they can, but cannot be considered to be responsible for management optimism on cashflow projections.

After this interesting discussion, the panel answered a question from Richard Slack (Durham University), who asked about the decision usefulness of accounting for goodwill if the market anticipates goodwill impairment and already incorporates this information. Anne Jeny replied by arguing that we know, from empirical research, that a part of goodwill impairment, though not all of it, is anticipated or already digested by capital market participants. Many studies have shown that goodwill disclosure is useful to market participants. It has a financial impact and affects accuracy and dispersion in analysts' forecasts. Disclosure of this kind of information matters, especially the one on future cashflow forecast. Anne added that, in an era of imperfect markets, there is a flow of information between investors, preparers and other users and she agrees with Richard that part of the information is already known by the markets. Still, disclosure on goodwill impairment matters and it is important to force preparers to challenge their assumptions and mitigate their over-optimism. Seema added that, as a general rule, we, and certainly the IASB, focus on financial reporting as being aimed at investors who are knowledgeable and have access to a lot of information, but other legislations are different. For instance, according to UK legislation, financial reporting is aimed at providing transparency to investors at large and not just listed market investors. Smaller investors, not necessarily institutional investors, are also involved in this large category of investors. Seema added that, certainly in the UK, financial reporting is aimed at providing transparency across the board, and that includes creditors

of the company as well as investors. She argued that one of the reasons we are discussing goodwill is the Carillion case. In the Carillion case, institutional investors did have the information on goodwill in the balance sheet and were mostly all out by the time Carillion collapsed. The stakeholders that were hurt were, in fact, the smaller investors and the creditors. Going back to the question on goodwill reporting, Seema suggests analysing goodwill reporting from a wider transparency point of view. Companies should provide information that is reliable and relevant and understandable, not just to large institutional investors, but to the smaller investors and to creditors, and give them the comfort that they can actually rely on that information to assess a company's long-term viability. As accountants, according to Seema, we tend to look at a very narrow regime, but we should sometimes look at the wider spectrum to understand the context.

COMPANIES SHOULD PROVIDE INFORMATION THAT IS RELIABLE AND RELEVANT AND UNDERSTANDABLE, NOT JUST TO LARGE INSTITUTIONAL INVESTORS, BUT TO THE SMALLER INVESTORS AND TO CREDITORS, AND GIVE THEM THE COMFORT THAT THEY CAN ACTUALLY RELY ON THAT INFORMATION TO ASSESS A COMPANY'S LONG-TERM VIABILITY.

Silvia then moved the panel discussion on to R&D, following a comment from Ahmed Aboud (University of Portsmouth) about the potential trade-off between the cost and benefit of disclosure, which could explain limited or non-reporting of R&D in the financial statements. Ioannis provided some more comments, going back to his earlier presentation. On the costs, for instance, some firms may devote two pages in their annual report to describing their R&D activities, their research teams located in different parts of the world, and the journals where they are publishing, but then these same firms fail to provide a separate amount (related to different R&D activities) in the financial statements. Ioannis thinks that this could be because these activities are not part of the firm's main business model, being side activities rather than their main operations. From the example provided, Ioannis argued that the information cost for displaying all this narrative information on R&D is quite high, perhaps higher than just showing the R&D amounts in the financial statements separately. On R&D, the current reporting setting is characterised by the absence of separate amounts displayed but the presence of ample narrative disclosure. Ioannis wondered why companies pursue this reporting strategy, given that users are interested in the amounts and would like to have as much information as possible. Ahmed also entered the discussion, pointing out that maybe including the amounts is the key thing that may potentially encourage new companies into the market and, thus, companies prefer not to disclose the amounts (which could make it clear how much they invest in R&D). Ahmed added that companies prefer broad and generic disclosure on R&D without providing details on the types of estimates and separate amounts. This could help companies to avoid new competition (which increases a specific type of proprietary costs) while still trying to convince the reader of their R&D skills. Ioannis replied that if the amount is material (as it seems to be, from this discussion), then the company should provide it separately because of the materiality issue and, thus, to comply with the standards on materiality. Diogenis added a potential explanation for failure to present separate amounts for R&D, stating that companies may want to signal that they engage with R&D and disclose this but still prefer not to disclose the actual cost, potentially to defer as much cost as possible to the future, so as to be able to recognise it as a development cost and hence capitalise it. In this way, companies disclose but without clear recognition of the amounts spent. Ioannis partially disagreed, arguing that the standard does not allow capitalising retrospectively so such explanation would be a violation of the standard. Seema then added that the standard is rules-based, which means that is does not permit the additional capitalisation mentioned before, unless development costs are considered, and only in specific circumstances. Because of a strict standard, it could be that companies are providing that additional information but, nonetheless, it is not perceived as being as useful as the company would like it to be. Aaron added that companies are unlikely to reallocate certain operating expenditures (eg the salaries of a team of engineers working on some research projects) because, given the current standard, they do not see the benefits of this reallocation. The definition of R&D in the standard seems outdated in relation to what companies are doing today. Ahmed then added that future research could help further investigation into the differences in the attributes of three categories of companies: those that provide narrative disclosure but not separate amounts, those that neither disclose nor provide the amounts and those that both disclose and provide the amounts.

Christian Stadler opened the discussion for the last point of the panel discussion section. He asked about the risk of boilerplate disclosure and the importance of analysing companies that comply very well with the IFRS standard's recommendations but without necessarily representing best practices in R&D. Referring to Ioannis' presentation, he pointed out that, for instance, South Korean reports tend to be pretty uniform and compliance-based while not necessarily being produced by the best-performing companies in R&D. Ioannis replied by arguing that Chinese firms tend to provide separate amounts, probably because of an extra regulation that requires them to do so.

Overall, the panel provided a very engaging and interesting debate on the topics of the symposium.

3. Discussions

At the 2023 FARSIG Symposium, four high-profile speakers provided different perspectives on accounting for intangibles, focusing on goodwill and R&D. During the presentations, the speakers provided a critical examination of key open questions on accounting for goodwill and intangibles, and R&D reporting.

The following main themes have been debated: the value-relevance and reliability of goodwill reporting; how to account for goodwill; the alternative accounting treatments for the impairment of goodwill; how to interpret the lack of reporting of R&D expense; the materiality of R&D expenses; and how to improve the transparency, relevance and fitness for representation in R&D reporting. These main themes are summarised and discussed in the following sections.

The value-relevance and reliability of goodwill reporting

The value-relevance of goodwill reporting has been debated for years. Anne Jeny discussed this in her presentation, highlighting that goodwill-related accounting numbers, such as goodwill balances and goodwill impairment losses, are generally value-relevant as they correlate with firm value and financial performance. She argued that goodwill reporting's value relevance has not been affected by the introduction of the impairment-only approach brought in by IFRS 3 and SFAS 142. Anne also said that goodwill impairment announcements are value relevant. In practice, markets often appear to anticipate large parts of the losses before goodwill impairment is announced. Despite this, Anne emphasised that it is well-documented that goodwill impairments provide room for the opportunistic use of managerial discretion, and there are many firms that do not book goodwill impairments in a timely manner. This aspect was also outlined by Seema Jamil-O'Neill, who, by presenting a research project conducted by the UKEB, highlighted that the average annual goodwill impairment charge reported by FTSE 350 companies over the period 2005–2021 was only about 2.85% of the average opening carrying amount of goodwill. The value relevance of goodwill reporting was also debated during the panel discussion. Richard Slack questioned the decision usefulness of accounting for goodwill if the market anticipates goodwill impairment and already incorporates this information. Despite this being true, Anne argued that not all the information is anticipated by the market and disclosure on goodwill impairment matters and it is important to force preparers to challenge their assumptions and mitigate their over-optimism. Seema also pointed out that market investors are not the only users of information. Less-sophisticated investors and other stakeholders (such as creditors) need companies to disclose information on goodwill.

How to improve goodwill impairment?

Goodwill impairment is considered to be one of the most complex accounting estimates: it is subject to significant managerial discretion and how it should be improved has been widely debated. Anne Jeny emphasised that the problems associated with impairment testing are mostly application issues. Since managerial opportunism is reduced when monitoring and enforcement are higher, she believes that the problems faced in current goodwill accounting may be solved with better enforcement and more intense monitoring, rather than by changing the standard. Anne also discussed the debate on the possibility of removing the requirement to test for goodwill impairment yearly, even if there are no indicators of possible impairment. She pointed out that carrying out the impairment test annually has the advantage that report users are informed about the valuation trend of the goodwill, which makes it possible to see if there is an opportunistic use. In her presentation, Seema Jamil-O'Neill also touched on aspects related to ways of improving the impairment process for goodwill. She suggested that the IASB might be interested in requiring companies to present the amount of total equity, excluding goodwill, in the statement of financial position to address the concerns related to the reliability of goodwill impairment.

The need to improve the process of goodwill impairment was also stressed during the panel discussion. Diogenis Baboukardos asked if companies should follow a stricter impairment testing process and what role auditors should play in this. Seema agreed that there are several issues with the current impairment testing process, and said she believes that additional disclosure on goodwill is key to addressing these issues. Nonetheless, she did not believe that auditors can solve these problems as they are not able to challenge management optimism. Aaron agreed as, on his view, auditors cannot be considered responsible for the managerial optimism on cashflow projections. Anne, however, argued that since investors and analysts consider the information disclosed in the key audit matters to be useful, auditors should report information on goodwill impairment in the extended audit report.

Alternative accounting treatment for the impairment of goodwill

The symposium also provided informed views on the possibility of moving away from the current impairment model for goodwill to either amortisation or a hybrid approach. Anne Jeny argued that reintroducing an amortisation of goodwill would be risky for companies, users of financial information, and regulators. This is because it is unclear what the economic meaning of goodwill amortisation would be and for how long goodwill should be amortised. She believes that amortisation will not remove managerial discretion, but it is likely to open the door to new ways for earnings management. She also suggested that reintroducing amortisation might lead to a loss of important information that is currently mandated under IAS 36. In her presentation, Seema Jamil-O'Neill illustrated the IASB Post Implementation Review of IFRS 3, which received responses in favour of the reintroduction of goodwill amortisation but also of some sort of separation between goodwill and other intangibles.

She also discussed the potential benefits and limitations of introducing a hybrid model to account for goodwill and stakeholders' perceptions, by considering the results of a research project commissioned by the IASB. Seema argued that a hybrid model is feasible, as the research project showed that useful life can be reliably determined by considering, for example, the nature of the business, the period over which the synergies were realised, and the remaining life of the assembled workforce, and did not identify any significant negative impacts on financial stability, audit, processes or systems, or additional costs from a transition to a hybrid model. Stakeholder views on a transition to a hybrid model were mixed. Preparers thought that a hybrid model would lead to a more faithful representation of the consumption of benefits, reduce the impact of shielding, and improve comparability. On the other hand, investors' views were more mixed on, and less favourable to, a hybrid model. Despite the positive findings, the IASB decided against introducing amortisation as there was no compelling evidence that it would provide significant improvement to information for users.

How to interpret the lack of reporting of R&D expenses?

A key point that has emerged during the symposium is the presence of a substantial number of companies that do not report R&D expenses. Ioannis Tsalavoutas highlighted this in his presentation and raised important questions on how we should interpret this evidence: does it mean that they do not engage in R&D? Or do they engage in R&D activities, but do not report separate amounts for the costs? Interestingly, in their narrative sections, almost one-third of the apparently R&D-inactive firms provide similar disclosure levels to R&D-active firms. Ioannis argues that this is alarming as it indicates that investors and governments might be missing information that should be disclosed in firms' accounts. He suggested that the presence of so many apparently R&D-inactive companies might be because the R&D definition needs to be updated and because of the lack of stringent regulation on R&D disclosures, given that when R&D disclosure regulation was introduced in China the companies that reported R&D in their financial statements substantially increased.

Aaron Saw also discussed the feedback received from a study that ACCA has been conducting into R&D-inactive companies. Participants did not expect a high proportion of R&D-inactive companies in industries such as financial services, technology and telecommunications. Aaron suggested that the presence of such a high number of R&D-inactive companies might be because these companies record R&D as an expense rather than as a capitalised investment, even though companies should report such costs as a separate expense. During the panel discussion, Ahmed Aboud asked if the presence of so many companies that do not report R&D in the financial statements can be due to the presence of a potential trade-off between the cost and benefit of disclosure. Ioannis said that this is not necessarily the case. Several R&D-inactive companies provide long narrative R&D disclosures but do not report any R&D amounts in the financial statements. He believes that the cost of narrative disclosure of R&D is possibly higher than reporting it in the financial statement.

R&D expenses materiality

Another issue that was debated during the symposium is the materiality of R&D. IAS 38 requires disclosing the relevant amount of cost, if material, and disclosing whether it is expensed or capitalised. This requirement is only related to the amount, however, thus leaving it to the discretion of preparers to include whatever they deem to be relevant and fit for users. Aaron Saw covered this point in his presentation and pointed out that, according to the participants of the ACCA study, some companies think of materiality only in terms of the quantitative threshold, with a specific amount considered as not material from a numerical sense. He argued that companies should start thinking about the qualitative aspects of materiality and the nature (rather than the amount) of R&D that could influence economic decisions. Ioannis also discussed R&D materiality in his presentation, emphasising the need to examine why it is considered material that firms discuss R&D, but not thought sufficiently material to require the R&D amount to be shown separately in their accounts.

> **IAS 38 REQUIRES DISCLOSING THE RELEVANT AMOUNT OF COST, IF MATERIAL, AND DISCLOSING WHETHER IT IS EXPENSED OR CAPITALISED. THIS REQUIREMENT IS ONLY RELATED TO THE AMOUNT, HOWEVER, THUS LEAVING IT TO THE DISCRETION OF PREPARERS TO INCLUDE WHATEVER THEY DEEM TO BE RELEVANT AND FIT FOR USERS.**

How to improve the transparency, relevance, and fitness for representation in R&D reporting?

The importance of improving R&D reporting emerged during the symposium. Currently, as highlighted by Ioannis, the only disclosure requirement in the IAS 38 standard is that the relevant amounts involved (ie material capitalised or expensed amounts) are to be disclosed separately. Ioannis said that investors welcome more and improved disclosure about R&D and currently consider the cash spent to be the most objective measure of R&D investment. Aaron also discussed the current limitation of R&D reporting. He pointed out that a key issue is the lack of clarity in the definition of R&D. This is because what constitutes R&D is dependent on the sector. Activities involving relationships, human resources, and business processes may not be defined as R&D in the conventional, 'scientific', sense and thus are not reported.

> **ACTIVITIES INVOLVING RELATIONSHIPS, HUMAN RESOURCES, AND BUSINESS PROCESSES MAY NOT BE DEFINED AS R&D IN THE CONVENTIONAL, 'SCIENTIFIC', SENSE AND THUS ARE NOT REPORTED.**

Aaron also explained that companies do not have any incentive to allocate costs to R&D and disclose them separately. He said that, according to the study he conducted for ACCA, companies avoid reallocation to R&D-specific operating expenditures (eg staff salaries, rent, electricity, raw materials, use of disposable materials) although they form part of R&D. The costs arising from this reallocation process are higher than the benefits. Aaron argued that a clearer definition of R&D would also help in this reallocation process. Aaron also opined that too much discretion is left to preparers in R&D reporting: standards should require companies to provide more baseline information. This is particularly true when companies belong to a group, to allow users to understand in which part of the group/entity R&D is conducted. He also argued that it would be important to link R&D reporting with financial performance and to provide more disclosure on those recognised expenses that are related to the future. Aaron added that the current R&D guidelines in IAS 38 may not reflect the reality of how R&D is done. R&D reporting is usually an iterative process and is developed bit by bit. On the point of not disclosing this on a standalone basis, roundtable participants agreed on the importance of linking R&D to the business models and strategies of the company.

4. Conclusions

The 2023 FARSIG symposium on the 'Future of Financial Reporting' was held, with the support of ACCA, on a virtual platform, on 13 January 2023, against a background of continuing political, economic and social changes and continuing challenges to accounting and financial reporting.

Russia's war in Ukraine continues to dominate the global political scene, threatening economic and financial stability worldwide. Uncertainty about its evolution and global consequences represents a key area of concern (OECD 2023). In addition, geopolitical and geo-economic tensions are permeating the economic sphere as global competition between China and the United States is increasing (World Economic Forum 2023). The war in Ukraine, the related energy crisis, the increases in interest rates used to fight a continuing rise in inflation and the return of COVID-19 in China continue to depress economic development (International Monetary Fund 2023). In January 2023, the World Economic Outlook Update projections indicated a reduction in global growth to 2.9% in 2023, which is expected to fall further to a 3.1% reduction in 2024 (International Monetary Fund 2023). In most economies worldwide, the priority continues to be the achievement of sustained disinflation to fight the cost-of-living crisis (International Monetary Fund 2023). The crises in energy supply, cost of living and food supply, together with rising inflation, are among the top risks faced in 2023 that are expected to have damaging impacts on a global scale (World Economic Forum 2023).

While the COVID-19 pandemic crisis appears to be at an end, its negative effects on sustainability measures are leading to a devastating setback to the achievement of the UN Sustainable Development Goals (SDGs). The pandemic wiped away the progress achieved in recent years in eradicating poverty and pushed millions of people into extreme poverty. According to the UN, at the current rates, 574 million people, most of them from Africa, will still be living in poverty by 2030 (nearly 7% of the world's population) (Roberts 2022). Awareness of environmental issues other than climate change is increasing worldwide. Biodiversity preservation and ocean health have been given more prominence on the political agenda, and are catching up with climate change as a concern (Nipper 2023), with a day dedicated to ocean health and biodiversity conservation at COP27, which took place in Egypt in November 2022, and separate UN conferences being dedicated to these two important environmental themes: the 2022 UN Ocean Conference, co-hosted by the governments of Kenya and Portugal, took place on June 2022 in Lisbon, and the Biodiversity Conference, which took place in December 2022 in Montreal.

THIS EVOLVING SCENARIO ON SUSTAINABILITY REPORTING HAS LED TO THE 2023 FARSIG SYMPOSIUM ON THE 'FUTURE OF FINANCIAL REPORTING', WHICH DISCUSSED THE CURRENT DEBATE ON INTANGIBLE ASSETS.

As for accounting, there have also been some very important developments. As for non-financial reporting, there have been important updates in 2022/23. The European Union Corporate Sustainability Reporting Directive (EU CSRD) became effective in January 2023, and it requires large companies to report social and environmental issues in line with European Sustainability Reporting Standards (ESRS), a set of standards developed by the EFRAG. At the same time, the IFRS Foundation has formed the International Sustainability Standards Board (ISSB), which in 2022 released two exposure drafts: the IFRS S1 provides general requirements for sustainability-related financial disclosures and the IFRS S2 covers climate-related disclosures. From the financial reporting side, the IASB is working on several projects: the Post-implementation Review of IFRS 15; the Equity Method project; the Business Combinations – Disclosures, Goodwill and Impairment project aimed at introducing changes in the IAS 36 and IFRS 3 standards, the Primary Financial Statements project and the Disclosure Initiative.

This evolving scenario on sustainability reporting has led to the 2023 FARSIG symposium on the 'Future of Financial Reporting', which discussed the current debate on intangible assets. In particular, the speakers' presentations revolved around the following central themes on accounting for goodwill and R&D: the value-relevance and reliability of goodwill reporting; how companies should account for goodwill; the alternative accounting treatment for the impairment of goodwill; how to interpret the lack of reporting of R&D expense; the materiality of R&D expenses; and how to improve the transparency, relevance, and fitness for representation in R&D reporting.

The symposium has provided interesting contributions to the debate on the evolution of accounting for intangible assets. It has highlighted the value relevance of goodwill reporting and the importance of improving the accounting treatment for goodwill, by discussing possible alternative treatments to the current impairment test while also providing valuable suggestions on how the impairment test for goodwill can be improved. It also emphasised the importance of updating the standard that regulates the accounting treatment for R&D (IAS 38), by providing a clearer definition of R&D that fits the needs of companies operating in different industries and developing a concept of materiality that does not focus only on quantity but also on quality. The symposium also highlighted areas in which the information disclosed by companies on R&D can be improved, to enhance transparency and comparability. The symposium also stressed the importance of the idea that to improve accounting practices we should not necessarily focus on changing the standards, but rather on how they are applied.

The symposium discussed issues of key importance in financial and non-financial accounting and reporting. By debating the development of accounting for goodwill, the symposium has provided valuable contributions to the current project undertaken by the IASB, which is aimed at modifying the disclosure requirement for business combinations and changing the impairment test of cash-generating units, including goodwill. By discussing the current problems associated with R&D reporting, the symposium aims to attract the attention of regulators and practitioners on these issues.

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