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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **19 October 2006, London**

Project: **Intangible Assets Research Project**

Subject: **Scope and Approach (Agenda Paper 11A)**

This Paper is written in the context of the February 2006 Memorandum of Understanding between the FASB and the IASB. It outlines a project that would result in a staff paper that supports an agenda proposal relating to intangible assets. In particular, the staff paper will discuss the feasibility of a project that would extend the principles for the initial accounting for intangible assets acquired in a business combination to the same kind of intangible assets acquired other than in a business combination.

INTRODUCTION

1. The Memorandum of Understanding (MoU) between the FASB and the IASB dated 27 February 2006 notes that the progress expected to be achieved by 2008 on the Intangible Assets research project is:

   > "To have considered the results of the IASB's research project and made a decision about the scope and timing of a potential agenda project."

2. The project will be led by the Australian Accounting Standards Board and progressed initially as an IASB project, with FASB being kept informed of progress, rather than as formally a joint IASB/FASB project.

SCOPE OF THE PROJECT

3. To satisfy the MoU the focus of the project is on those areas that have the greatest potential for improving existing requirements for intangible assets in the short-term.

4. There are a range of topics that could be the subject of this research project. The following outlines the possible broad topics, and identifies that which is most suitable as a focus for this project for the purposes of the MoU:

Topic A: *initial accounting for intangible assets acquired other than in a business combination (internally generated and separately purchased intangible assets):* This topic has the greatest potential for improvements to current requirements relating to intangible assets in the short term. This is particularly so in light of the fact that the requirements for internally generated intangible assets have not been subject to review for some time, and are inconsistent with current and past thinking reflected in the requirements for the initial accounting for the same kind of intangible assets acquired in a business combination.

Topic B: *initial accounting for intangible assets acquired in a business combination:* This topic has been subject to relatively recent review, as reflected in IFRS 3 *Business Combinations* and SFAS 141 *Business Combinations*. There would be merit in reviewing the current requirements, and the emerging requirements from the Business Combinations Phase II project, particularly in asking the question of whether the line between goodwill and intangible assets is appropriate. This research could involve a post-implementation review of IFRS 3 and SFAS 141. Some preliminary post-implementation review could be conducted in the US and Canada given that business combinations requirements substantially the same as those in IFRS 3 and IAS 38 have prevailed in those jurisdictions since 2001. However, it would be premature to undertake post-implementation research until there is sufficient implementation experience with the relatively new IFRS requirements. Accordingly, topic B is not a suitable topic as a focus for the Intangible Assets research project for the purposes of the MoU.

Topic C: *subsequent accounting for intangible assets:* This topic has the potential to improve the current requirements, for example in relation to the question of the circumstances under which revaluations to fair value should be allowed, but improvements are unlikely to be achievable in the short-term. Furthermore, topic A, which includes the initial identification of intangible assets, should be addressed before contemplating research work on subsequent accounting.

Topic D: *initial and subsequent accounting for goodwill:* Given the degree to which current accounting for acquired and internally generated goodwill is entrenched under both IFRSs and US GAAP, this topic would not be a fruitful line of research in the context of the MoU.

5. Accordingly, the research project will focus on Topic A *initial accounting for intangible assets acquired other than in a business combination.* The issues to be addressed comprise definition/identification, recognition, measurement and disclosure/presentation, with a particular emphasis on issues relating to identification and measurement. Given that current requirements for the initial accounting for intangible assets acquired in a business combination reflect recent thinking of the IASB and FASB, the project will focus on extending the principles[1] reflected in those requirements to the same kind of intangible assets acquired other than in a business combination. However, the project should not be seen as an extension of the Business Combinations project. The current principles for the accounting for intangible assets acquired in a business combination are accepted without question for the purpose of this project on the basis that they reflect current thinking.

6. In relation to measurement, the project will consider alternative measurement bases, including fair value and cost. The project will not draw a conclusion as to how, conceptually, intangible assets acquired other than in business combinations

1 Phase I of the IASB's Business Combinations project focused on, amongst other things, accounting for intangible assets and goodwill acquired in a business combination. It did not specifically consider the implications of its conclusions for internally generated intangible assets or intangible assets purchased separately from a business combination.

should be initially measured. That conceptual question can be addressed in a separate project in which the broader question of how intangible assets should be initially or subsequently measured is addressed. However, the project will draw a standards-level conclusion as to how intangible assets acquired other than in business combinations should be initially measured, having regard to the way in which intangible assets acquired in business combinations are initially measured.[2]

7. The project will consider the measurement issues at a standards-level, because the IASB's conceptual-level Measurement project (which is part of the broader joint IASB and FASB Conceptual Framework project) is not sufficiently advanced at the time of commencing the project. Later projects can consider the issues from a conceptual-level at a time when the IASB's conceptual-level Measurement project is sufficiently advanced.

APPROACH

Literature review

8. The project will make use of published research to provide an initial context for the purposes of examining and considering the issues. Published works to be drawn upon include Hand and Lev's (2003) *Intangible Assets: Values, Measures and Risks*,[3] Lev's (2001) *Intangibles: Management, Measurement and Reporting*,[4] and the FASB's (2001) report *Business and Financial Reporting, Challenges from the New Economy*.[5]

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2 Although the current requirements for the subsequent accounting for intangible assets acquired other than in business combinations are in need of review, they are currently the same as the requirements for intangible assets acquired in business combinations and therefore should be reviewed together, as implied in topic C.

3 Hand, J. and Lev, B. (eds.), *Intangible Assets: Values, Measures and Risks*, Oxford University Press, London, 2003.

4 Lev, B., *Intangibles: Management, Measurement and Reporting*, The Brookings Institution Press, New York, 2001.

5 Upton, W. (2001), Financial Accounting Series: *Business and Financial Reporting, Challenges from the New Economy*, Financial Accounting Standards Board, Connecticut, USA.

Relationship to other IASB documents/projects

9. The project will consider the relevant issues in the context of the *Framework for the Preparation and Presentation of Financial Statements*, the emerging results of other pertinent projects (including the current review of the *Framework* and Business Combinations Phase II [see paragraph 11(a) below], once the outcomes are clear) and the requirements in Standards, including IFRS 3, to the extent they reflect current thinking on intangible assets.

Interviews

10. Project staff have interviewed people with experience in identifying, recognising and measuring intangible assets acquired other than in a business combination.[6] The outcome of those interviews will be reflected in the issues papers to be developed as part of the project.

Other Factors Pertinent to the Project

11. Other issues that may impact on the development of specific aspects of the project and that will be addressed as part of the project where and when appropriate include:

    (a) Phase II of the Business Combinations project. The most significant change in relation to intangible assets is the proposal to remove the reliably measurable recognition criterion so that the acquirer recognises, separately from goodwill, the acquisition-date fair value of intangible assets acquired in a business combination by meeting the definition of an intangible asset in IAS 38.[7] Consistent with this is that the IASB anticipates amendments to IAS 38 arising out of the Exposure Draft of *Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets* (June 2005). In particular, it proposes IAS 38 be amended to note that an

6 The interviews were with preparers and their advisors, valuers and users of financial reports. Interviewees were sought in Australia where Accounting Standards used to permit recognition and measurement of internally generated intangible assets in a broader range of circumstances than under current requirements.

7 See paragraph 40 of Exposure Draft of *Proposed Amendments to IFRS 3* Business Combinations and 'IASB Update', London, January 2006.

intangible asset may arise from an unconditional right, with any conditional right reflected in the measurement.[8]

(b) Amendments to Accounting Standards arising out of the mutually agreed international convergence project between the IASB and the FASB. For instance, at their joint meeting on 22 April 2004, the IASB and FASB agreed to the FASB undertaking a project to identify existing differences between US GAAP and IFRSs in relation to the accounting for research and development that might be eliminated. "The Boards noted that elimination of the differences between IFRSs and US GAAP could involve consideration of fundamental issues and that those issues were part of a longer-term research project being led by the Australian Accounting Standards Board. Nonetheless, the Boards agreed that they should explore possibilities to eliminate some IFRSs/US GAAP differences in the short-term."[9]

(c) International Financial Reporting Interpretations Committee (IFRIC) projects dealing with intangible assets. For instance, the IFRIC is finalising an Interpretation addressing service concession arrangements that would require the operator of a service concession arrangement to recognise a financial asset, an intangible asset or both, depending on the contractual terms of the arrangement. A financial asset should be recognised to the extent that the operator has an unconditional contractual right to receive cash from, or at the direction of, the grantor. The operator should recognise an intangible asset to the extent that it receives a licence to charge users of the public service.[10]

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8 BC18 of IASB Exposure Draft of *Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets* states "The Board acknowledged that if an intangible asset arising from an unconditional right accompanied by a conditional right is within the scope of IAS 38 and has not been acquired in a transaction, the requirements of IAS 38 impose a high recognition threshold. (If acquired in a business combination or otherwise, the intangible asset is recognised at fair value. Therefore, uncertainty about the conditional right is reflected in the measurement of the asset.) However, the Board decided that it was outside the scope of this project to revisit the requirements in IAS 38."

9 See the FASB, 'Project Updates – Short-Term International Convergence: Research and Development', *FASB Website* (http://www.fasb.org), 13 January 2006.

10 See IASB, 'IFRIC Update', London, September 2006.

(d) The concurrent development of IASB Standards addressing issues analogous to intangible assets. For instance, in IFRS 6 *Exploration for and Evaluation of Mineral Resources,* the IASB notes that "…accounting practices for exploration and evaluation assets under the requirements of other standard-setting bodies are diverse and often differ from practices in other sectors for expenditures that may be considered analogous (eg accounting practices for research and development costs in accordance with IAS 38)."[11]

12. The conclusions arising from the project need to be considered from an international convergence perspective.[12] The IASB is ideally placed to facilitate the development of a high quality global Accounting Standard on this topic. The papers developed as a part of the project will provide a basis for the IASB to consider seeking input from its constituents in pursuing such an Accounting Standard. In due course it is expected that the recommendations arising from the project will provide a context for recommending explicit amendments to IAS 38 *Intangible Assets*. However, as a research project, such specific recommendations are not the initial objective. Once a fundamental review of the requirements in IAS 38 enter the IASB active agenda, it is intended that the recommendations arising from this research project will provide a framework for that review.

11 See IASB, 'Extractive Activities Research Project', *IASB Website* (http://www.iasb.org), London, May 2006.

12 The fact that many accounting standard setters are currently moving to adopt IAS 38 in its current form will itself facilitate convergence to a common Accounting Standard. However, considering the Accounting Standard's arguably prudent approach, it may be that users would not be provided with an appropriate level of relevant information under such a converged approach.