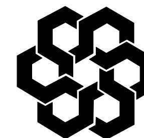

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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers.

INFORMATION FOR OBSERVERS

Board Meeting: **23 January 2007, London**

Project: **Intangible Assets**

Subject: **Draft Agenda Proposal (Agenda paper 3B)**

INTRODUCTION

1. This paper sets out proposals for a project on intangible assets to be added to the Board's technical agenda. The purpose of the paper is to facilitate a decision to be made at the Board's December 2007 meeting on the scope and timing of such a project. This purpose is consistent with the Memorandum of Understanding (MoU) between the FASB and the IASB.

2. This paper has been developed by the Australian Accounting Standards Board (AASB) staff (referred to in this paper as the project proposal team) for the IASB. Accordingly, unless otherwise indicated, references in this paper to the Board are to the IASB. This paper has not been developed formally as a joint IASB and FASB paper. Nevertheless, at its request, the FASB has been kept informed of its development. In addition, the paper contemplates the FASB taking an active role in the project once it is accepted onto the IASB's active agenda.

SCOPE OF THE PROPOSED PROJECT

3. There are a range of topics that could be the subject of an Intangible Assets agenda project. The following outlines the possible broad topics, and identifies those which have the greatest potential for improving existing requirements for intangible assets in the short-term (that is, within the timeframe of a typical technical agenda project).

   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. The requirements for internally generated intangible assets have not been subject to review for some time (refer to paragraph 28), and are inconsistent in some important respects with current and past thinking reflected in the requirements for the initial accounting for the same type of intangible assets acquired in a business combination, and the initial accounting for internally generated tangible assets such as property, plant and equipment.

   Topic B: initial accounting for intangible assets acquired in a business combination: This topic is not a suitable topic as a focus for the Intangible Assets agenda project as it has been subject to relatively recent review, as reflected in IFRS 3 *Business Combinations*, that resulted from the Business Combinations Phase I project, 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 distinction 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 *Intangible Assets* have prevailed in those jurisdictions since 2001. However, it would be

premature to undertake post-implementation research until there is greater implementation experience with the relatively new IFRS requirements in a broad range of jurisdictions.

Topic C: subsequent accounting for intangible assets: This topic has the potential for improvements to current requirements in the short-term, for example in relation to the question of the circumstances under which revaluations to fair value should be allowed. Current requirements, although consistent across all intangible assets irrespective of the manner in which they were acquired, are inconsistent with the subsequent accounting for tangible assets. The topic is a natural progression from *Topic A: initial accounting for intangible assets acquired other than in a business combination*, which includes the initial identification of intangible assets. Therefore, although *Topic A* should be addressed first, *Topic C* should be included within the scope of the project contemplated.

Topic D: initial and subsequent accounting for goodwill: This topic would not be a fruitful line of research at this stage, given the degree to which current accounting for acquired and internally generated goodwill is entrenched under both IFRSs and US GAAP. Furthermore, like *Topic C: subsequent accounting for intangible assets*, the accounting for acquired goodwill has recently been the subject of comprehensive review, as part of the Business Combinations Phases I and II projects, and therefore it would be premature to undertake a post-implementation review.

4. Based on the above, topics offering the greatest potential for short-term improvements to current requirements relating to intangible assets are *Topic A: initial accounting for intangible assets acquired other than in a business combination* and *Topic C: subsequent accounting for intangible assets*. This is consistent with the outcome of the Board's discussion at its October 2006 meeting (agenda item 11).

5. Work on *Topic A: initial accounting for intangible assets acquired other than in a business combination* should include consideration of the feasibility of

developing a single model that applies to the initial accounting for all intangible assets, irrespective of the manner in which they are acquired. 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 work relating to *Topic A* should focus on the feasibility of extending the principles reflected in those requirements to the same types 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. Consistent with rejecting *Topic B: initial accounting for intangible assets acquired in a business combination* as a line of enquiry at this stage, the current principles for the accounting for intangible assets acquired in a business combination should be accepted without question for the purpose of the project on the basis that they reflect current thinking. The project proposal team's work to-date on assessing the feasibility of applying the principles applied to the initial identification, recognition and measurement of intangible assets acquired in a business combination to internally generated intangible assets is considered further in the separate draft preliminary technical paper that accompanies this agenda proposal. The draft preliminary technical paper contains a discussion of the issues and the project proposal team's preliminary views.

6. The acceptance without question of the current principles for accounting for intangible assets acquired in a business combination (including the definition of an intangible asset, the principles for identifying intangible assets and their recognition and measurement) is a fundamental assumption underlying this project proposal. If this assumption is rejected, the scope and approach of this project proposal would need to be reconsidered.

7. For completeness, *Topic A: initial accounting for intangible assets acquired other than in a business combination* should also consider the implications of extending the principles for the initial accounting for tangible assets, as reflected in IAS 16 *Property, Plant and Equipment*, to intangible assets acquired other than in a business combination.

8. The current requirements for the subsequent accounting for intangible assets (the subject of *Topic C*) have not been considered by the IASB or FASB recently, even for intangible assets acquired in a business combination. Work on *Topic C* can be undertaken in the light of the results of the work on *Topic A: initial accounting for intangible assets acquired other than in a business combination*. The work should consider the issues within the context of the *Framework*. It should also consider the feasibility of extending the principles applied to the subsequent accounting for assets other than intangible assets (that is, tangible assets), on the basis that, although tangibility describes the nature of an asset, it should not necessarily result in a different accounting treatment.

9. The project proposal team believes that minor amendments to IAS 38 would not be sufficient to significantly improve the initial accounting for intangible assets acquired other than in a business combination or the subsequent accounting for intangible assets. Consequently, this paper proposes a fundamental review.

10. The proposed project would work towards developing a draft Discussion Paper to be issued jointly by the IASB and FASB in September 2009. Given the significance of the changes to IAS 38 that are anticipated, the project proposal team is of the view that it is not appropriate to move directly to an Exposure Draft.

11. The following:
    - considers whether the proposed project would meet the IASB's agenda criteria (paragraphs 13 to 48); and
    - sets out a proposed project plan (paragraphs 52 to 62).

12. In summary, the project proposal team's recommendations are:
- **that the commencement of an Intangible Assets project with a scope of initial accounting for intangible assets acquired other than in a business combination and subsequent accounting for intangible assets is approved, with the initial target of issuing a Discussion Paper by September 2009 setting out preliminary views on the issues; and**

- **that the proposed project plan is approved (paragraphs 52 to 62).**

IASB AGENDA CRITERIA

13. The Board's due process handbook (March 2006) sets out five criteria to be considered in deciding whether to add a potential item to the agenda:
    - the relevance to users of the information involved and the reliability of information that could be provided;
    - existing guidance available;
    - the possibility of increasing convergence;
    - the quality of the standards to be developed; and
    - resource constraints.

Criterion 1: The relevance to users of the information involved and the reliability of information that could be provided

Importance of intangible assets

14. Given the non-recognition of many intangible assets, it is difficult to estimate the magnitude of intangible assets. However, their significance can be estimated indirectly. The National Science Foundation Division of Science Resources Statistics reports that: "U.S. R&D grew to $291.9 billion in 2003 after declining in 2002 for the first time since 1953", and notes that the business sector "performed 70% of U.S. R&D in 2004".[1] The Organisation for Economic Co-operation and Development (OECD) reports that OECD-wide investment in research and development reached $US 729 billion in 2004. It goes on to report that: "Recent growth in R&D spending have been highest in the United States (4% a year between 2002 and 2004), followed by Japan (2.1% a year between 2000 and 2004) and EU25 (2.3% a year between 2000 and 2003)."[2]

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[1] 'InfoBrief' (January 2006 "U.S. R&D Continues to Rebound in 2004", page 1) issued by the National Science Foundation, Directorate for Social, Behavioral, and Economic Sciences, Division of Science Resources Statistics. InfoBrief (January 2006) goes on to report that: "Although spending on R&D in the United States far exceeds spending in any other country, several nations report higher R&D/GDP ratios." (pages 4-5)

[2] OECD Science, Technology and Industry Outlook, Highlights, 2006, page 1. The reference to 'EU25' is to the twenty-five European Union countries at the time of the report.

15. Ernst & Young undertook a study in Australia which included consideration of the impact of adopting IAS 38 in Australia.[3] Prior to the adoption of IAS 38 in Australia, Australian Accounting Standards contemplated a wider range of circumstances in which intangible assets would be recognised and revalued. The study found that the reported equity for the consumer staples sector was expected to decrease by 22% on transition to IFRS and by 25% in the first IFRS comparative year, due mainly to the de-recognition of intangible assets. Consequently, the study characterised the impact of the de-recognition of previously recognised internally generated intangible assets and reversal of amortisation of indefinite lived intangibles as having a 'medium' impact.

16. Studies of market-to-book ratios (the ratio of market capitalisation to the carrying amount of net assets of an entity) indicate that market capitalisation substantially exceeds the book value of net assets of many listed entities.[4] Although there are a number of possible explanations for this, it may be speculated that some, if not most of this difference, can be explained by the fact that many intangible assets are not being recognised. Upton observes that:

> We may have a new economy, or our new tools may have given us an appreciation of factors that were always important. It doesn't much matter which. The more important question is how to improve business and financial reporting.[5]

17. To the extent that assets that are intangible assets acquired in business combinations are now being identified and recognised under IFRS 3 and

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[3] "The Impacts of AIFRS on Australian companies: A study of the financial statement disclosures by Australia's top 100 listed companies", Ernst & Young, December 2005.

[4] Baruch Lev reports that the mean market-to-book ratio of the S&P 500 companies has continuously increased since the early 1980s, reaching the value of approximately 6.0 in March 2001 (see Lev, Baruch, *Intangibles: Management, Measurement, and Reporting*, The Brookings Institution Press, Washington, D.C., 2001, page 8). Vivien Beattie and Sarah Jane Thomson, considering the market-to-book ratios of the FTSE 100 in the UK, concluded that: "… around 60 percent of the firms' value was not reflected in the balance sheet". They also noted that: "There was a clear link between the market-to-book ratio of a firm and the industry in which it is traded. The average ratios for the pharmaceutical and media companies in the sample were relatively high (5.6 and 4.4 respectively), which is not surprising given the knowledge-intensive nature of their industries" (Beattie, V. and S.J. Thomson, 'Intangibles and the OFR', *Financial Management*, June 2005, pp. 29-30).

[5] Upton, Wayne S., *Business and Financial Reporting, Challenges from the New Economy*, Financial Accounting Series Special Report, Financial Accounting Standards Board, April 2001, page 9.

SFAS 141 were not recognised by the acquirees prior to acquisition is also indicative of the level of intangible assets held by entities.

18. Intangible assets are integral to the operations of a large number of entities across a range of industries and jurisdictions. Examples include:
    - pharmaceutical companies (for example, research and development, and drug patents);
    - technology companies, including web-based entities such as internet search engine developers and providers, and software development companies;
    - media companies (for example, mastheads);
    - consumer product companies (for example, brands and trademarks); and
    - financial services companies (for example, mortgage servicing rights and investment management rights).

    Most business entities and public bodies would be expected to have at least one type of intangible asset, such as customer lists, customer contracts and related customer relationships, non-contractual customer relationships, licence agreements and internally developed software. Accordingly, accounting for intangible assets affects entities across all fields of activity and jurisdictions and is therefore internationally relevant.

19. Concerns about the current regime of accounting for intangible assets is evident from the fact that accounting for intangible assets is identified in the MoU between the FASB and IASB. This indicates the urgency and priority of the issues, at least in the minds of the drafters of the MoU. The issues are pervasive, affecting many entities and jurisdictions. The current regime can be criticised due to, for example, the non-recognition of otherwise recognisable intangible assets. The adverse consequences of these criticisms (see below) arise frequently and are material, and will persist if not resolved.

Improved relevance and reliability of information

20. The current requirements in IAS 38 relating to intangible assets place significant limitations on the types of intangible assets that entities are permitted

to recognise and the subsequent measurement and remeasurement of those assets. For example:

- IAS 38 imposes significant limitations on the initial recognition of internally generated intangible assets because of problems in identifying whether and when there is an identifiable asset that will generate expected future economic benefits, and because of problems in determining the cost of such an asset. IAS 38 prohibits the recognition of assets arising from research, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance. Furthermore, IAS 38 limits the recognition of assets arising from development to those that meet certain criteria (including the entity being able to demonstrate technical and commercial feasibility of completion). Therefore, amounts attributed to development only reflect a fraction of total expenditure on development, which may only include costs incurred just prior to the commercialisation of the item in question; and
- after initial recognition, under IAS 38 an entity is permitted to carry an intangible asset at cost or fair value, but can only use fair value when it can be determined by reference to an active market. As indicated in paragraph 78 of IAS 38, it is uncommon for active markets to exist for internally generated intangible assets. Depending on how the terms 'uncommon' and 'active' are interpreted, a significant proportion of the current value of intangible assets cannot be recognised. The current limitations on revaluations imposed by IAS 38 are inconsistent with contemporary accounting thought, including that reflected in the principles in SFAS 157 *Fair Value Measurements*.

21. A study undertaken by Barth and Clinch[6] investigated whether relevance, reliability and timeliness of asset revaluations in Australia differ across types of assets, including investments, property, plant and equipment, and intangible assets. Australia was the focus of the study because, as noted in paragraph 15

[6] Barth, M.E. and G. Clinch (1999), 'Revalued financial, tangible, and intangible assets: associations with share prices and non-market-based value estimates', *Journal of Accounting Research*, Volume 36, pp. 199-233.

above, prior to adoption of IFRS, Australian Accounting Standards contemplated the recognition and revaluation of intangible assets in a wider range of circumstances than contemplated in the relevant Accounting Standards in other jurisdictions. The study found that revalued amounts in excess of historical cost are value relevant, where 'value relevant' is described as "the amount has a significant relation in the predicted direction with share prices or the non-market-based estimate of firm value" (page 200). The finding supports the view that the recognition, measurement and remeasurement of intangible assets are important from a capital markets perspective.

22. The recognition of intangible assets that satisfy the asset recognition criteria specified in the *Framework*, which is a broader range of intangible assets than can currently be recognised under IAS 38, would improve the relevance and reliability of information in general purpose financial reports. Furthermore, the removal of the current difference in treatment of intangible assets acquired in a business combination and internally generated intangible assets (and between internally generated tangible and intangible assets) would lead to consistent accounting for circumstances that are economically very similar. The development of an intangible assets standard based on conceptually sound and consistent principles could result in financial statements that more faithfully represent the assets, and therefore the financial position, of an entity.

23. Users have consistently asked for more recognition of intangible assets other than those acquired in a business combination. For example, in its 1993 publication *Financial Reporting in the 1990s and Beyond*, the Association for Investment Management and Research (AIMR) concluded that: "… financial reporting can be modified so as at least to recognize more of the economic reality of intangible assets than it does now" (page 52). More recently, inadequacies in the current requirements were noted by the CFA Institute (formerly the AIMR) in its publication *A Comprehensive Business Reporting Model: Financial Reporting for Investors* (24 October 2005):

> Today, many companies in global markets are driven by the creation and use of intangible assets. Indeed, much of the major economic growth worldwide is attributable to such assets. The current reporting model is deficient in its requirements for transparent recognition and disclosure for these assets. Investors must have the information they need to understand, analyze, and value intangibles-dependent companies. (page 3)

24. Given the importance of intangible assets to a wide range of entities and jurisdictions, the improved relevance and reliability of reporting of intangible assets would be a major improvement in financial reporting. The retention of the status quo would perpetuate the risk that users make suboptimal decisions.

Criterion 2: Existing guidance available

25. Guidance in the form of IAS 38 is currently available that addresses the initial and subsequent accounting for intangible assets. However, there are differing views as to whether this guidance is appropriate in the current environment.

26. Some regard the current requirements as appropriate in the current environment on the basis that they believe:

    (a) Many internally generated intangible assets, particularly those that arise from the day-to-day operations of an entity and are therefore unplanned, should not be recognised due to the absence of an attributable transaction to trigger their initial recognition or signify control.

    (b) There are difficulties in reliably measuring and remeasuring intangible assets. Accordingly, the current prudent approach reflected in the existing IAS 38 is appropriate.

    (c) Investors would not act differently even if internally generated intangible assets were to be recognised, because information about such assets is available from other sources, such as through note disclosures or management briefings, and therefore it is not necessary to recognise them. Similarly, it is not necessary to contemplate the revaluation of recognised intangible assets beyond the circumstances contemplated in IAS 38.

    (d) The subjectivity involved in identifying, recognising, measuring and remeasuring intangible assets, particularly in the absence of an active

market, a separate transaction or a business combination, could expose financial reporting to a high degree of manipulation.

27. Some regard the current requirements as inappropriate in the current environment because:

    (a) They believe the current requirements potentially undermine the relevance and reliability (faithful representation) of general purpose financial reports. Application of those requirements results in failure to recognise items that satisfy the asset definition and recognition criteria specified in the *Framework*. Accordingly, users are deprived of information relevant to an assessment of the financial performance and position of an entity, and to an assessment of management's accountability for the assets under their control. This outcome can, for instance, undermine the integrity of stock markets by creating information asymmetries causing systematic undervaluation (or ill-informed speculation) of intangible intensive entities, and encouraging insider trading. It can also impact on society more generally by imposing prohibitively/unnecessarily high costs of capital on 'start-up' enterprises.[7]

    (b) In relation to initial accounting, the current requirements treat internally generated intangible assets differently from intangible assets acquired in a business combination. For example, brands internally generated by an acquiree cannot be recognised by the acquiree, but are required to be recognised by the acquirer subsequent to acquisition. This leads to lack of comparability across entities. Furthermore, it may encourage entities to 'contrive' transactions to facilitate the recognition of intangible assets or transact in a way that avoids recognition.

    (c) Also in relation to initial accounting, the current requirements treat internally generated intangible assets differently from internally generated tangible assets. The prohibition on the recognition of an

[7] See Lev (2001), pages 95 to 102.

intangible asset arising from research and the limited circumstances under which intangible assets arising from development are recognised are not only inconsistent with the *Framework*, they are also inconsistent with the principles in IAS 16, which contemplates capitalisation of costs from commencement of construction of a tangible asset.

(d) In relation to subsequent accounting, the current requirements limit the circumstances under which fair value measurement/the revaluation model is available for intangible assets compared with other assets such as property, plant and equipment, biological assets, investment property and financial instruments. That is, IAS 38 requires the presence of an active market before remeasurement to fair value is permitted, whereas other assets are not subject to such a restriction before they can be remeasured at fair value.

(e) The current requirements are based on the concept of prudence that is very different from the identification, recognition, measurement and remeasurement approaches that underpin the Board's other standards and the principles emerging through other projects (including Fair Value Measurements, Business Combinations Phase II and Insurance).

(f) The current requirements in IAS 38 differ in principle from those in IAS 16, which results in arbitrage between the two Standards in relation to items that potentially bridge both Standards, such as computer software.

28. The information IAS 38 generates about intangible assets acquired other than in a business combination fails to adequately reflect an entity's economic resources or the results of its operations and, accordingly, fails to meet the needs of users. Many of the basic principles reflected in IAS 38 are outdated, such as those relating to the recognition and measurement of research and development. These principles can be traced back to Exposure Draft 9 International Accounting Standard Proposed Statement – *Accounting for*

Research and Development Costs, issued for comment on 1 February 1977. Therefore, although IAS 38 is a relatively new accounting standard (it was first issued in 1998), with a number of its requirements derived from the proposals in IASB Exposure Draft E60 *Proposed International Accounting Standard – Intangible Assets* (issued for comment in November 1997), it is timely that it be subject to a fundamental review in relation to its requirements for intangible assets acquired other than in a business combination and the subsequent accounting for intangible assets.

Criterion 3: The possibility of increasing convergence

29. The main driver of the project is improvement rather than convergence. Many accounting standard setters have either moved or are currently moving to adopt IAS 38 in its current form. That will itself facilitate convergence to a common Accounting Standard. However, as noted in criterion 2, it may be that the current requirements are inappropriate.

30. There will be some convergence benefits from the project to the extent current national requirements remain diverse and the improvements to IAS 38 would contribute to jurisdictions being willing to adopt IASB standards. The current requirements of national standard setters that have not adopted IASB standards differ from IAS 38. For example, some (US, Japan) require development costs to be expensed as incurred whereas the IASB requires development costs to be capitalised if, and only if, an entity can demonstrate it has met specific criteria (including technical and commercial feasibility of completion). There are also differences in detail, such as the definitions of research and development, that lead to differences in accounting outcomes.

31. Given the significance of intangible assets to many entities, these differences can give rise to very substantial differences in the financial reporting outcomes amongst entities in these jurisdictions.

32. Discussions held with national standard setters at the September 2006 National Standard Setters meeting indicate that there is widespread, although not

unanimous, agreement that a revision of the requirements in IAS 38 is due. Also, albeit with less support, there was some agreement with the basic principles that might underlie the new approach. The project proposal team believes that there is a good prospect that the proposed project on intangible assets will gain support from national standard setters and regulators and that a single standard would be adopted world-wide. In order to achieve this, it will be important that the project is a joint one with the FASB.

Joint project with FASB

33. To avoid exacerbating a reconciliation difference between IFRS and US GAAP, it is essential that any final standard is developed jointly with the FASB. It is therefore proposed that, subject to approval by the FASB, the project should be a joint project initially working towards a Discussion Paper that would incorporate the preliminary views of both the Board and the FASB.

Criterion 4: The quality of standards to be developed

34. The work the project proposal team has undertaken to-date (see the accompanying draft preliminary technical paper) indicates that it is feasible to develop an improved standard for intangible assets. The proposed project would analyse the nature of intangible assets, comparing it with other assets, and recommend different accounting treatments only where the different nature warrants it, thus improving the relevance and reliability of financial statements.

35. There are alternative solutions to the current requirements that would improve relevance, reliability, understandability and comparability in financial reporting of intangible assets, and it is likely that sufficient Board support and approval will be attainable for an improved standard.

Cross-cutting issues

Pre-condition of the project

36. As noted in paragraph 6 above, this project proposal is substantially predicated on acceptance of the principles in IFRS 3 relating to the definition, identification, recognition and initial measurement of intangible assets acquired

in a business combination. If that were brought into question, the scope and approach of the Intangible Assets project would need to be reconsidered.

Other cross-cutting issues

37. Many of the issues that arise in this project are closely related to issues in other projects. Those identified are:

(a) Identification of assets – the analysis of items for the purpose of identifying the existence of an asset depends on the *Framework* definitions, which are currently under review in the Conceptual Framework project. It would be appropriate for the analysis of intangible assets to follow the latest proposed definitions to the extent they are sufficiently developed.

(b) Recognition criteria – the asset recognition criteria are also being reviewed in the Conceptual Framework project. It would be appropriate for the analysis of intangible assets to follow the latest proposed recognition criteria to the extent they are sufficiently developed.

(c) Measurement – regard should be had to the conceptual measurement work being undertaken by the Board, although it should be acknowledged that it is unlikely to be sufficiently advanced at the time of commencing the project. Until the conceptual issues are resolved, the project should consider the issues from a standards-level perspective. Given the Board's existing standards, this includes consideration of fair value and cost as alternative measurement bases. This can also be justified on the basis that the fair value measurement of intangible assets acquired in a business combination is interpreted by some as fair value *per se* and by others as a surrogate for cost, and other assets such as property, plant and equipment, and investment property are required to be measured at cost or fair value.

(d) Business Combinations Phase II project – regard should be had to the emerging outcomes of the Business Combinations Phase II project in so

far as they have implications for intangible assets. The Business Combinations Phase II project is addressing issues relating to the identification of intangible assets and the reliably measurable recognition criterion and is drawing conclusions about the 'probable future economic benefits' criterion under fair value measurement. A 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.[8] This is consistent with the Board anticipating 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 intangible asset may arise from an unconditional right, with any conditional right reflected in the measurement.[9]

(e) Extractive Activities research project – regard should be had to the findings of the Extractive Activities Research project, which is addressing issues analogous to those being addressed for intangible assets. In IFRS 6 *Exploration for and Evaluation of Mineral Resources* (paragraph IN1(c)), 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)".

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

9 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."

(f) Amendments to Accounting Standards arising out of the mutually agreed international convergence project between the IASB and the FASB – regard should be had to the outcome of the Board's short-term convergence project. 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 IFRS/US GAAP differences in the short-term".[10]

(g) International Financial Reporting Interpretations Committee (IFRIC) projects dealing with intangible assets – regard should be had to related work of IFRIC so far as it relates to intangible assets. For instance, IFRIC 12 *Service Concession Arrangements* (issued November 2006) addresses service concession arrangements that 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 shall be recognised to the extent that the operator has an unconditional contractual right to receive cash or another financial asset from, or at the direction of, the grantor. The operator should recognise an intangible asset to the extent that it receives a right to charge users of the public service.

38. Being cognisant of these cross-cutting issues should ensure that the project develops in a way that is consistent with other current projects. The development of an intangible assets standard that does not accord 'special accounting rules' for intangible assets or particular types of intangible assets,

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

but treats them consistently with other types of assets, would be a significant improvement to current IFRSs.

39. It is feasible to develop a technically sound solution within a reasonable time period without awaiting completion of other projects.

Cost benefit analysis

40. An important aspect of the quality of a standard is the balance between the benefits of the information produced in accordance with the standard and the costs to entities of providing such information. This cost/benefit balance will need to be borne in mind as the project develops. It is important that the Board can show that it has balanced the costs and benefits of the proposals that are being developed.

41. A new accounting model for intangible assets is more than likely to be more costly than existing models, particularly if the principles applying to intangible assets acquired in a business combination are adopted for internally generated intangible assets, and if subsequent revaluations were to be mandated for all intangible assets. The proposed approach would particularly result in more complex accounting for intangible assets that are currently not identified and therefore not recognised and measured.

42. Costs for preparers will include the costs of applying new requirements. Also, adapting to changed requirements may involve significant one-off systems costs. Greater recognition of intangible assets may also mean identification costs and may also result in additional ongoing costs. It is expected that costs would decrease over time as preparers and their advisors become more adept at identification, recognition and measurement once practice becomes entrenched. Furthermore, initial costs might not be substantive to the extent that entities have already identified and are managing intangible assets for internal management purposes.

43. The benefits will largely be in terms of financial statements that more clearly reflect intangible assets and thereby improved financial reporting. The removal

of current inconsistencies between the accounting for items that are recognised as assets and others that are not, based on the manner in which they were acquired or their tangibility or marketability, would represent a major improvement in the quality of reporting.

44. Although the purpose of this project is primarily to improve existing standards rather than convergence, removal of the existing differences between different national standards and IFRSs will increase comparability and reduce the need for users to make estimated adjustments in analysing entities in different jurisdictions. In addition, this would reduce costs for entities reporting under more than one GAAP.

45. Although it is necessarily a subjective assessment, it is likely that the expected benefits to users of the improved financial reporting of intangible assets will exceed the costs of implementation.

Criterion 5: Resource constraints

46. There are many complex issues to be addressed in this project including:

    (a) development of an appropriate accounting model for internally generated intangible assets;

    (b) the relationship between this project and the cross-cutting issues referred to under Criterion 4. Many of the cross-cutting issues are areas where the Board is developing its thinking and may create difficulties for this project depending on their outcomes;

    (c) users' needs: results of fourteen interviews of Australian constituents conducted to-date suggest that certain users (financial analysts) are sceptical about entity-determined fair values. They desire disclosure of cost information to facilitate their own determination of value. As noted in paragraph 23, the CFA Institute notes that the current reporting model is deficient in its requirements for transparent recognition and disclosure

for intangible assets. Further research into users' needs may be necessary; and

(d) the involvement of FASB and other national standard setters. The issues will need to be considered by the FASB as the Discussion Paper is developed (if this is carried out as a joint project) or as the proposals are taken forward to an Exposure Draft; and it will also be important that other national standard setters are involved so that a broad consensus is achieved.

Addressing these issues will require a significant level of resources.

47. Resources planned to be initially allocated to this project are expected to be sufficient in the early stages of the project, but additional resources might be necessary as it develops, particularly if extensive research or field testing are required. However, the work performed to-date as part of the development of this project proposal as reflected in the accompanying draft preliminary technical paper, and the work undertaken as part of an earlier more comprehensive research proposal, provides a substantial basis for undertaking the research that will be required for this project without the need to start from scratch.

48. If a joint IASB and FASB project is approved, given the importance of the project, it should be conducted by a joint project team comprising IASB staff and FASB staff. The IASB should also consider involving members of staff from other interested accounting standard setters (including Australia).

Project proposal team recommendation

49. This is an important project that would address an area where the principles underlying the current requirements are inconsistent with the principles underlying other more recent standards and where users are deprived of potentially useful information.

50. It is recommended that the Board approves the commencement of this project, jointly with the FASB if that Board also agrees, with the initial intention of issuing a Discussion Paper by September 2009 setting out preliminary views on the issues.

51. The rest of this paper sets out a proposed project plan, including an outline of the contents of a Discussion Paper. The accompanying draft preliminary technical paper includes preliminary discussion of the main issues and the project proposal team's preliminary views.

PROPOSED PROJECT PLAN

52. The initial objective of the project would be to produce a Discussion Paper by September 2009 exploring the issues and setting out the preliminary views of the Board (together with FASB preliminary views if a joint project is undertaken).

53. It is proposed that the Discussion Paper consider a single model for initial recognition and measurement of intangible assets, based on the model currently adopted for intangible assets acquired in a business combination, and subsequent accounting for intangible assets. This would apply to all intangible assets, removing the current distinction between intangible assets acquired in a business combination and intangible assets acquired in other ways.

54. The Discussion Paper would cover the following areas:

- Initial accounting for internally generated intangible assets
    - Definition/identification
    - Recognition
    - Measurement
        i. Cost
        ii. Fair value
    - Presentation/disclosure
- Initial accounting for separately purchased intangible assets
    - Definition/identification

    - Recognition
    - Measurement
        i. Cost
        ii. Fair value
    - Presentation/disclosure
- Subsequent accounting for intangible assets
    - Cost
        i. Indefinite life intangible assets (including impairment issues)
        ii. Finite life intangible assets
            1. useful life
            2. residual value
            3. pattern of use
    - Fair value

Initial discussion of these issues is set out in the accompanying draft preliminary technical paper.

Working Group

55. This is a major project with significant implications for the accounting treatment of a substantial class of asset. Consequently, the findings of this project could have a significant affect on the balance sheets and reported profits of a wide range of entities.

56. It is important that the Board demonstrates its willingness to understand the ramifications of the proposals from the beginning of the project. Consequently, the project proposal team suggests that a Working Group should be established to act in an advisory capacity. The purpose of the Working Group – covering users, preparers and regulators – would not be to develop proposals, but as a means of testing ideas and concepts developed by the Board and project staff. This would enable the Board to check the implications of the new accounting model being developed, and the practicality of the proposals, against the experience of a range of advisors with experience of intangible assets.

Work plan and timetable

57. There are many complex issues for the Board to discuss before it can reach conclusions to be published as its preliminary views in the Discussion Paper. The need to consider issues in tandem with the FASB will need to be borne in mind. Time must also be allowed for proposals to be discussed with the Working Group and for its comments to be summarised for the Board.

58. It is proposed that the project be carried out in three sections before being brought together into one Discussion Paper. Each section would be discussed at a Working Group meeting (lasting one or two days), followed by discussion at two (or more) meetings of each Board. The sections should be developed sequentially and allow issues raised in consideration of each later section to potentially amend the preliminary conclusions reached in earlier sections.

59. Accordingly, the following timetable is proposed:

IASB agenda decision	December 2007
Section 1: Initial accounting for internally generated intangible assets	Working Group May 2008, Board discussions June and September 2008
Section 2: Initial accounting for separately purchased intangible assets	Working Group September 2008, Board discussions November 2008 and January 2009
Section 3: Subsequent accounting for intangible assets	Working Group February 2009, Board discussions May and July 2009
Issue of Discussion Paper	September 2009

60. Meetings of Board advisors and discussions with resource groups would be held as appropriate, probably before papers are finalised for each Working Group meeting, and in advance of Board meetings where necessary. The Board discussion on each section would be followed by a pre-ballot draft of that section of the Discussion Paper, that would be subject to amendment depending on the outcome of later sections (see paragraph 58 above).

61. The above timings assume that no delays in the timing arise, that convenient dates for Working Group meetings can be found when planned, and that Board discussions reach conclusions within the two meetings planned for each group of issues. The timetable does not estimate the timing of an Exposure Draft or a

Standard given the length of time before the Discussion Paper is anticipated to be completed.

62. A more detailed timetable, together with more details on the issues that would be covered in each section of the project, is set out in Appendix 1. **[Appendix 1 omitted from observer notes]**

APPENDIX 1

[Appendix omitted from observer notes]