Project	**Tentative agenda decisions**
Topic	**Compliance costs for REACH**

Background

1. The IFRIC received a request to add an issue to its agenda to provide guidance on the treatment of costs incurred to comply with the requirements of the European Regulation on the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH).

2. At its meeting in July 2008, the IFRIC agreed with the staff's recommendation that it should tentatively add this issue to its agenda. At its meeting in November 2008, the IFRIC considered further whether this issue meets the criteria for being added to the IFRIC agenda. For that purpose, the IFRIC considered key features of REACH, accounting standards and practices, and accounting issues and alternative views under IFRSs. At the meeting in March 2009, the IFRIC considered the results of staff research on the rights an entity acquires under the Regulation as well as the staff's analysis of what requirements of IFRSs might apply (see Appendix A). However, the IFRIC did not reach a decision on whether to add the issue to its agenda.

3. In order to determine whether it can specify an appropriate scope for this project, the IFRIC asked the staff to identify the characteristics of registration or licensing costs that produce future economic benefits and to determine whether and in what circumstances such costs are capitalised in practice. The staff were also directed to determine whether divergence in accounting for REACH costs has emerged in practice.

Purpose of this meeting

4. Purpose of this meeting is to decide whether this issue meets the criteria for being added to the IFRIC agenda. It should be noted that in-depth technical discussions should be performed **after** the IFRIC decides to add the issue to the agenda.

Staff Analysis

Survey of the IFRIC members - Research on divergence in practice

5. To identify whether there is currently divergence in practice, the staff asked the IFRIC members and a national stand setter to provide information about experience in their own organisations and/or country networks. We believed that this would provide us with an indication of whether divergence in practice exists that requires interpretation or other action. The questions and summarised responses are set out in Appendix B.

Question 1– REACH costs

6. From the responses received, divergence does not seem to exist in practice so far because most companies seem to expense the REACH costs as incurred and do not capitalise. It appears that some have based their decision to expense the costs on materiality, however, this consideration might change as the costs ramp up in the future. In this regard, it should be remembered that pre-registration (ie "mapping" of chemical products and the substances used) of the chemicals started on 1 June 2008 and was just completed by November 30, 2008. Costs in relation to pre-registration were normally insignificant. Registration (ie "real" registration with technical dossiers and safety testing data) has just started in late 2008 and should be completed by 2018.

7. It was noted in the survey that the big practical issue would be the appropriate identification of costs related to REACH that are to be capitalised. For example, it would be easy to consider if costs for laboratory tests or direct registration costs are to be capitalised, but more complex to determine if other ancillary costs (ie software implementation) are to be capitalised.

8. It is also noted that most top German chemical companies do not discuss in their financial statements how they treat the REACH costs.

9. Some would expect that divergence outside the firms' networks is likely based on discussions with others and review of other firms' published guidance.

Question 2– other registration costs

10. IFRIC members have not seen significant divergence in practice with respect to other types of registration costs. Generally such costs seem to be expensed because they are not material. If costs are significant, companies specifically demonstrate that such costs meet the recognition and measurement criteria of IAS 38. People use their judgment to determine whether costs should be expensed or capitalised in accordance with IAS 38.

11. The comments received by IFRIC members were that the guidance in IAS 38 was adequate. The comment was also made that "of course there will be a certain amount of divergence in practice because determining whether a cost qualifies for capitalisation involves the exercise of judgment, and everyone's judgment will be different. … "

Staff's view

12. In the staff's view, the survey results are broadly consistent with the staff's analysis made in March 2009 (Appendix A to this paper). That is, IAS 38 provides sufficiently clear intangible asset definition and recognition criteria to apply to the costs incurred in relation to the REACH regulation, and meeting these criteria, including the requirement to demonstrate future economic benefits, is a matter of judgement. The only difference noted is that practice also takes materiality into consideration. Most companies have expensed the costs partly because the costs had been insignificant so far. The other reasons for expensing the costs were not apparent from the survey. However, the staff would expect that they are due to judgment regarding the intangible assets recognition criteria (ie consideration as to the recovery of the costs in the future).

13. The staff agrees with the respondent to the survey who stated that there will be a certain amount of divergence in practice in relation to other registration costs and ancillary costs incurred in relation to REACH because determining whether a cost qualifies for capitalisation involves the exercise of judgment, and everyone's judgment will be different. **In the staff's view, divergence in**

practice caused by *the exercise of judgement* based on *the clear IFRSs* would *not* trigger the development of interpretation. Consequently, development of an interpretation or any other action for REACH costs and any other registration costs will result in providing detailed guidance on the application of IAS 38 to a specific set of circumstances. In previous discussions, the IFRIC indicated that the issue should be added to the agenda only if it would result in more general interpretive guidance that could be useful in a variety of situations.

Agenda criteria assessment

14. The staff is of the view that this issue does not meet the agenda criteria because:

    (a) IAS 38 provides sufficiently clear intangible asset recognition criteria to apply to the costs incurred in relation to the REACH regulation and any other registration costs without developing a specific interpretation. Development of an interpretation will result in providing detailed guidance on the application of IAS 38 to a specific set of circumstances.

    (b) The survey did **not** indicate that there are significantly divergent interpretations (either emerging or already existing in practice) *caused by **unclear** IFRSs*, although the staff notes that there might be some divergence **as a result of the exercise of the judgement and materiality considerations**.

Recommendation and questions for the IFRIC
1. Based on the agenda criteria assessment above, the staff recommends that the IFRIC not add this issue to its agenda. Do you agree with the staff's recommendation? If not, why? 2. The proposed wording for the tentative agenda decision is set out in Appendix C. Do you have any comments on the wording?

Appendix A – Extracts from the IFRIC agenda paper in March 2009

II. What rights does the registration give the registrants?

7. With special kind help by European Commission chemical unit staff and Reinhard Biebel, the staff followed up the questions below to clarify the specifics of the new regulation. Some questions were raised in the previous IFRIC meetings.

What rights does registration give a registrant?

8. Registration gives a registrant the right to place in the market, import and manufacture chemical substances.

Does registration give a registrant an exclusive right to manufacture or import a substance?

9. Unlike patent rights that gives the first registrant the exclusive right, subsequent registrants or other registrants in joint submission always have the same right to manufacture or import the same substance that the former registrant has registered. Subsequent registrants need to pay registration fees to the Agency and reimburse the testing costs to the former registrant.

Is registration essentially a license to manufacture or import a substance?

10. In EC staff's view, a licence is marketable. A registration is company-specific (linked with the legal entity) and therefore is not transferable and non-marketable. Each one needs to register. In this sense, the EC staff thinks it may not be a license.

11. A registration can be acquired through an acquisition or merger of the registrant's related business. After the merger, the name of the acquiring company should be notified to the Agency but new registration process is not required.

Is there any difference in the right that registration gives a registrant between an existing substance and a new substance?

12. There is no difference in the right that registration gives a registrant between an existing substance and a new substance.

How long is the registration effective?

13. The registration is effective forever. It is unlimited but there is an obligation to provide updates to the agency in case data or amount of use changes.

How can costs be shared with other registrants?

14. Costs incurred as a result of REACH might be reduced by sharing costs with other entities – the REACH legislation provides a legal framework for cost sharing. Costs might be shared in two ways:

    (a) registrants may submit a registration jointly, sharing testing and other data collection costs. In this case costs will be shared before the registration is filed.

    (b) an early registrant possessing registration for a substance can require cost reimbursement from a later registrant, who applies for a registration after the early registrant has already received its registration.

Can a new registrant get its own registration on the same substance?

15. A new registrant gets its own registration on the same substance. The new registrant needs to contact the lead registrant to add its name to the list of registration.

Can a new registrant get the same right of the registration as that of a former registrant?

16. A new registrant gets same right of the registration as that of a former registrant.

Summary of the section

17. Characteristics of right acquired by registration are:

    (a) Right is not exclusive but limited to registrants only.

    (b) Right is substance-specific.

    (c) Right is company-specific. It is not transferable and non-marketable.

    (d) Right is permanent but needs updates to the agency in case data or volumes change.

    (e) There is no difference in right acquired:

        (i) between new substances and existing substances.

        (ii) between testing by the registrant itself and acquiring testing data from early registrant.

(iii) between early registrant and late registrant.

Do REACH costs meet intangible assets recognition criteria?

18. In this section, the staff provides its analysis of whether costs would meet intangible assets recognition criteria in accordance with IAS 38 *Intangible Assets.*

19. Paragraph 8 of IAS 8 defines "An *intangible asset* is an identifiable non-monetary asset without physical substance." Paragraph 10 of IAS 38 sets out criteria for the definition of intangible assets (ie. **identifiability, control and future economic benefits**). Paragraph 21(a) sets out general recognition criteria for intangible assets: **probability** that the expected future economic benefits will flow to the entity. Both criteria should be met for the costs to be recognised as intangible assets.

Indentifiability

20. Paragraph 12 of IAS 39 states

"An asset is identifiable if it either:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations."

21. The right acquired by registration is not separable. As noted in section I, the right is not capable of being separated or divided from the entity as registration is company-specific. Nor is it capable of being sold, transferred, licensed, rented or exchanged. Therefore, registration would not meet condition (a).

22. However, registration would meet condition (b). The registration is a legal right as it is provided under EU law by an authority. Therefore, the staff is of the view that registration would meet *identifiability* criterion.

Control over a resource

23. Paragraph 13 of IAS 39 states "An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way."

24. Registration would meet the *control over a resource* criterion. The capacity of an entity to control the future economic benefits from the registration stems from legal rights as it is provided under EU law by an authority. Once registration is completed, the authority cannot arbitrarily withdraw the registration. Third parties do not have free access to the testing data.

Existence of future economic benefits

25. Paragraph 17 of IAS38 states "the future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues."

26. Registration would meet *existence of future economic benefits* criterion in the two ways:

    (a) The future economic benefits flowing from the registration results from the use of the registration because registration allows the entity to sell or manufacture the substances or products in the EU and generate a stream of future cash inflow. Without the registration, the substances or products can no longer be sold or manufactured in the EU.

    (b) An early registrant receives compensation of costs from later registrants.

27. (omitted)

28. (omitted)

Probability that the expected future economic benefits will flow to the entity

29. Paragraph 21 (a) of IAS 38 sets out general recognition criterion: it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity. Meeting this criterion would depend on the probability of regulatory approval (precisely speaking, a manufacturer or an importer has provided a registration dossier to the Agency and has not received any indication that it is incomplete) and also depend on the recovery of the costs. Ultimately, assessment of this criterion would be a matter of judgement. An assessment of each registration should be performed to assess the probability of the recovery of the costs by the future cash inflow generated from marketing of the products or substances.

Classification of intangible assets and other recognition criteria

30. Classification of intangible assets and further recognition criterion would depend on the following factors:

    (a) whether substances are new substances or existing substances

    (b) whether testing data are acquired from a former registrant

Whether substances are new substances or existing substances

31. When new substances are developed and registered, registration costs would be part of the development costs and should be recognised as internally developed intangible assets if they meet all the recognition requirements in paragraph 57 of IAS 38, including criterion (a): “the technical feasibility of completing the intangible asset so that it will be available for use or sale”.

32. The registration cost of an internally generated intangible asset would be the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57 of IAS 38. The cost of an internally generated intangible asset would comprise all directly attributable costs in accordance with paragraph 66 of IAS38.

33. When existing substances are registered, the substances had been already on the market prior to the implementation of REACH regulation. Some guidance produced by major accounting firms indicates some alternative views:
    View 1: Those costs should be expensed as incurred as they would represent subsequent development costs of an existing product in accordance with

paragraph 20 of IAS 38.

View 2: Those costs should be recognised as internally generated intangible assets if they meet the criteria in paragraphs 21, 22 and 57 of IAS 38.

View 3: Those costs should be recognised as separately acquired intangible assets similar to a product-specific license.

34. The staff is of the view that the registration costs for existing substances would also meet the asset recognition criterion when taking any views above, that is even if taking view 1, the costs do not have to be expensed as incurred.

35. Paragraph 20 of IAS 38 states that "it is often difficult to attribute subsequent expenditure **directly to a particular intangible asset rather than to the business as a whole**. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognised in the carrying amount of an asset". REACH costs are substance-specific and therefore directly relates to a particular intangible assets rather than to the business as a whole. Consequently, those costs could be recognised as assets even if they are considered to be subsequent development costs under View 1.

36. The existing substances are proved to be safe from the entity's previous marketing experience and would meet an asset recognition criterion in paragraphs 21, 22 and 57 of IAS 38 under View 2. For the same reason, those who believe view 3 think that compliance costs for existing substances are essentially a kind of acquisition costs of product/substance license.

Whether testing data are acquired from a former registrant

37. If testing data are acquired from a former registrant, those costs would be classified as separately acquired intangible assets. A later registrant acquires the testing costs which have normally already proven the probability of future economic benefits.

Conclusion of this section

38. From the discussion above, the staff is of the view that REACH costs would meet the intangible assets recognition criteria in accordance with IAS 38.

39. Some large firm's guidance available to the staff is generally consistent that REACH costs would meet intangible assets recognition criteria in accordance with IAS 38, although some alternative views exist for the costs for existing substances as noted in paragraph 33. However, as discussed in paragraph 34, the staff is of the view that the registration costs for existing substances would also meet asset recognition criterion when taking any alternative views.

[Appendix B and C are omitted from the Observer notes]