STAFF PAPER

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Board Meeting

Project	**Agenda Consultation 2015**		
Paper topic	Extractive Activities / Intangible Assets / Research & Development		
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Introduction

1. This paper summarises feedback received on the extractive activities / intangible assets / Research & Development (R&D) research project (the Project) in the Board's Request for Views *2015 Agenda Consultation*. There are no questions for the Board in this paper.

2. The paper includes the following sections:

   (a) description of the Project and current status;

   (b) high-level summary of the feedback;

   (c) who thinks what and why?

Description of the Project and current status

3. The Project is currently an inactive project on the Board's research agenda.

4. A team of national standard-setters from Australia, Canada, Norway and South Africa undertook research on extractive activities (such as mining and the extraction of oil or gas). The research focused on the following questions:

   (a) how to estimate and classify the quantities of minerals or oil and gas discovered;

   (b) how to account for minerals or oil and gas properties;

(c) how minerals or oil and gas properties should be measured; and

(d) what information about extractive activities should be disclosed?

5. The Board published the team's findings in April 2010. In October 2010, the Board considered the comments received and decided not to do any additional work until after the 2011–2012 Agenda Consultation. That Agenda Consultation highlighted broader concerns about the accounting for R&D activity and the recognition and measurement of intangible assets. These issues have parallels with some issues arising in extractive activities.

6. However, in response to the feedback from the 2011–2012 Agenda Consultation, the Board assigned a low priority to the Project. As a result, the Board has not carried out any further research to date.

Background

7. The Board issued IFRS 6 *Exploration for and Evaluation of Mineral Resources* in 2004. IFRS 6 permits an entity to develop an accounting policy for exploration and evaluation assets without specifically considering the requirements of paragraphs 11 and 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (ie the IAS 8 hierarchy). This exception from the IAS 8 hierarchy permits an entity to continue to use the accounting policies it applied immediately before adopting IFRS 6. Some entities applying IFRS 6 capitalise exploration costs and others expense such costs.

8. IFRS 6 also varies the recognition of impairment for exploration and evaluation assets from that in IAS 36 *Impairment of Assets*, but measures the impairment in accordance with the method in IAS 36 once an impairment is identified. The Board identified the exemption from the IAS 8 hierarchy in IFRS 6 as temporary at the time that IFRS 6 was issued.

9. Until the issue of IFRS 6, there were no IFRS Standards that specifically addressed the accounting for, exploration for and evaluation of, mineral resources. IAS 38 *Intangible Assets* excludes the accounting for such activities from its scope. In addition, 'mineral rights and mineral resources such as oil, natural gas and similar non-regenerative resources' are excluded from the scope of IAS 16 *Property, Plant and Equipment*.

High level summary of feedback

10. 65 of the 119 comment letters received provided some comment on the Project. Of these, 35 respondents assessed the Project as low priority and/or recommended that the Board remove the Project from its agenda. A further 14 respondents assessed the Project as medium priority and 13 assessed it as a high priority.

11. 8 users taking part in the online survey assessed the Project as high priority, compared with 18 users who assessed the Project as medium priority and 30 users who assessed it as low priority.

12. Many of the comments received in explanation of the priority assessments given, focused either on the extractive activities part of the Project, or on the intangible assets / R&D part of the Project. A summary of these is presented below.

Intangible assets / R&D

13. There are three principal arguments made by those proposing a high priority for an intangible assets / R&D part of the Project:

    (a) intangible assets are of increasing importance, yet there is limited recognition of these assets on company balance sheets. This was described by one as the 'missing intangible assets';

    (b) there is inconsistency in the accounting treatment of acquired intangible assets and those that are internally generated; and

    (c) some disagree with the requirement to capitalise development costs, in contrast with the requirements of both United States Generally Accepted Accounting Principles (US GAAP) and Japanese GAAP, which require development costs to be expensed.

14. Two respondents supporting work in response to the issue of 'missing intangible assets' suggested that a project on disclosures about intangible assets could be a first step towards addressing the concerns identified.

15. Some of the respondents who assessed intangible assets / R&D as a low priority also cited the observations in 13(a) and (b) above, but nevertheless considered the need for standard-setting action to be a lower priority. One respondent who

assessed the intangible assets / R&D aspects as low priority noted that they observe IAS 38 to be operational and do not see a necessity to make changes at present.

Extractive activities

16. The two principal arguments made by those who have assessed the extractive activities aspects of the Project as a high priority are:

    (a) the importance of the industry in some jurisdictions, including a concern that as more less-industrialised countries adopt IFRS Standards, the need for guidance will grow; and

    (b) IFRS 6 is a limited-scope temporary IFRS Standard and has permitted a diversity of practice to persist.

17. Some of the respondents who assessed the extractive activities aspects of the Project as low or medium priority acknowledged the diversity that exists at present, but noted that most users are able to understand the accounting policies applied, or that when considered in the light of regulatory requirements, financial reporting in respect of extractive activities was observed to be working well.

Who thinks what and why?

Users

18. Two users / user representative groups commented on the Project in their comment letters. The Investment Association [CL28] assessed the intangible assets part of the Project as high priority. It thinks that the 'research project should look at the inconsistencies between the treatment of acquired and internally generated intangibles, their recognition and the accounting for research and development costs'. It also notes that 'there is a shift from long term infrastructure companies to more short term technological companies with more intangibles'. It quotes research by Ernst & Young in 2010, which 'found that in 2009 the net assets of S&P 500 companies represented only 19% of the market capitalisation compared to 90% in the 1970s'. It noted that intangible [assets] are not necessarily captured by accounting requirements.

19. The Corporate Reporting Users Forum (CRUF) [CL114] assessed the importance of the extractive activities as medium priority, but without further explanation. It also assessed intangible assets as medium priority, noting that 'creation and amortisation of intangible assets resulting from acquisitions is … widely regarded as unsatisfactory' – which is in contrast to the concerns raised by others about so-called 'missing intangible assets'.

20. One of the users responding to the online survey highlighted the accounting and reporting for brands as being important. This user noted that 'brands can grow or shrink significantly and are a key component of the health and value of the company'.

Preparers

21. The only preparer that assessed the Project as high importance was Sanofi-aventis [CL116]. This preparer thought that the intangible assets / R&D part of the Project should be moved to the IFRS Standards-level programme. It suggested that the Project consider the difference between IFRS Standards and US GAAP, noting that 'acquired and internally generated R&D is capitalised under IAS 38 whereas it is expensed under US GAAP'. It suggested that the Board might work with US Standard-setter, the Financial Accounting Standards Board (FASB) on this to facilitate convergence, which it noted 'might be convergence of US GAAP towards IFRS'.

22. Another preparer / preparer representative group to comment on the difference between IFRS Standards and US GAAP for intangible assets, including R&D, was Keidanren (a Japanese business federation) [CL59]. In contrast to Sanofi-aventis, Keidanren suggested that 'development expenditure should be expensed as incurred, as provided for by Japanese and US GAAPs'. Keidanren proposed this change because it thinks that the six criteria for asset recognition in IAS 38 'lack objectivity and may not ensure comparability among entities', and that an intangible asset might be recognised 'even if it is not necessarily probable for the asset to provide economic benefits'.

Securities regulators

23. Three securities regulator organisations commented on the Project and each assessed it as medium priority. The International Organisation of Securities Commissions (IOSCO) [CL115] noted that the extractive industry may not be a significant industry in all jurisdictions; however, 'in those jurisdictions where it is significant, the lack of IFRS guidance leads to potential comparability and enforcement issues'.

24. The European Securities and Markets Authority (ESMA) [CL11] noted that guidance on extractive activities 'would be helpful for consistency of application of IFRS'. ESMA also noted that 'a comprehensive review of the guidance for Intangible Assets and accounting for Research and Development is desirable', but it went on to express the view that 'these projects could be added to the medium to long-term research agenda (beyond the time horizon of the 2015 Agenda Consultation)'.

Standard setters

25. 23 accounting standard-setters (or similar bodies) commented on the Project, of which 15 assessed it as low priority and/or suggested it be removed from the Board's agenda. Most of the comments received on the Project, from standard-setters, related to the intangibles and R&D part of the Project.

26. One of the standard-setters that assessed the intangible assets and R&D part of the Project as a high priority was the Australian Accounting Standards Board (AASB) [CL38]. One that assessed the Project as low priority was the New Zealand Accounting Standards Board (NZASB) [CL26]. Both of these respondents commented on the increasing significance of intangible assets to the value of many entities, something that the NZASB referred to as the 'missing intangible assets' issue, because of the increasing gap between market value of some entities and their tangible net assets. Both of these respondents proposed that a disclosure project would be an appropriate first step in responding to the information needs of users in this area.

27. The Accounting Standards Board of Japan (ASBJ) [CL58] assessed the Project as high priority. It explained that 'many Japanese preparers question if the

requirement to capitalise [development] cost results in useful information to users'. The ASBJ also noted that, based on its research[1], it found diversity of practice as to recognition of development costs among entities using IFRS Standards.

28. One of the standard-setters that assessed the Project as low priority and commented on the extractives part of the Project was the Accounting Standards Board of Canada (AcSB) [CL37]. The AcSB noted that 'in terms of extractive activities, practice in Canada is working well given regulatory requirements for public companies' and went on to note that it did 'not see a need for more guidance in this area at this time'. In contrast, the Norsk RegnskapsStiftelse, Norwegian Accounting Standards Board, (NASB) [CL95], assessed the Project as high priority and proposed that the Board move the Project on extractive activities to active projects, noting that IFRS 6 is a temporary IFRS Standard and that there is diversity in practice. The NASB offered to contribute resources to the Project.

Auditors

29. A number of audit networks observed that there is a need to reduce diversity in practice in accounting for exploration assets in the extractive industries; however, each network to make such a comment rated the urgency as low. For example, Grant Thornton International Limited [CL22] explained its assessment by noting that 'the existing diversity appears to be well understood by most constituents'.

30. Another network, Deloitte Touche Tohmatsu Limited (DTTL) [CL89] also commented on the broader issue of intangible asset accounting, noting that IAS 38 is 'currently operational in practice and there is no necessity to make changes at present'. Consequently it too assigned a low priority / low urgency to the Project.

Accountancy bodies and others

31. There were mixed assessments of the Project from accountancy bodies, with some, such as Institut der Wirtschaftsprüfer in Deutschland e.V., Institute of Public Auditors in Germany (IDW) [CL27] and Korean Institute of Certified

[1] The ASBJ research studied the IFRS accounting by 63 companies for research and development costs. Most of these companies were European, but were involved in a range of industries.

Public Accountants (KICPA) [CL53], assessing the Project as low priority whereas others, such as the South African Institute of Chartered Accountants (SAICA) [CL23] and the Institute of Chartered Accountants in England and Wales (ICAEW) [CL107], assessed it as high priority and of high importance.

32. SAICA expressed concern about inconsistent accounting practices under IFRS 6. It stated that ‘as more of the less industrialised countries adopt IFRS [Standards], there is likely to be an even more increasing need for guidance for the extractive industries to ensure comparability’. It was also SAICA’s view that if the Board does not take the extractives part of the Project onto its active agenda then it should consider whether the exclusions relating to extractive activities in other IFRS Standards should remain.

33. ICAEW highlighted the importance of addressing what it sees as the inconsistency between the treatment of acquired and internally generated intangible assets.

34. The Committee for Mineral Reserves International Reporting Standards (CRIRSCO) [CL94] rated the Project as high priority. It noted that entities in the minerals industry commonly make ‘technical disclosure of Mineral Resources and Mineral Reserves accompanying financial disclosure in annual reports’. In addition, it stated that CRIRSCO is:

> dedicated to the maintenance of a uniform set of definitions and principles, and has prepared a Template that is used by its members to develop guides, codes and standards applicable in countries and regions around the world.

CRIRSCO said it ‘would welcome engagement with the IASB to incorporate the CRIRSCO Template with respect to Mineral Resources and Mineral Reserves Reporting’ as part of the Principles of Disclosure project.

Staff conclusion

35. The arguments made in respect of both the extractive activities part of the Project, and the intangible assets / R&D part of the Project lead us to conclude that there is not an urgency to address the issues identified.

36. We think that the observations made with respect to the exception from the IAS 8 hierarchy contained in IFRS 6, and the temporary nature of IFRS 6, mean that it should be identified as a future project when resources become available, but we do not expect these resources to be available until after the time horizon of the 2015 Agenda Consultation.