Ref: *248164*

17 June 2009

Robert Keys
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Dear Robert Keys

SAICA SUBMISSION ON DISCUSSION PAPER ON *INITIAL ACCOUNTING FOR INTERNALLY GENERATED INTANGIBLE ASSETS*

In response to your request for comments on the discussion paper on *Initial Accounting for Internally Generated Assets,* we have attached the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We would like to thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph

Project Director: Accounting

C.c. R Garnett (Board Member of the International Accounting Standards Board)
Moses Kgosana (Chairman of the Accounting Practices Board)
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SAICA SUBMISSION ON AASB DISCUSSION PAPER ON *INITIAL ACCOUNTING FOR INTERNALLY GENERATED INTANGIBLE ASSETS*

GENERAL COMMENTS

Introduction

We welcome the Australian Accounting Standards Board (AASB) draft technical paper that sets out the proposals on initial accounting for internally generated assets. We believe that the paper provides a significant contribution to the research project on accounting for intangible assets.

However, we are of the opinion that the views expressed in the paper do not adequately address a number of items. These include amongst others, the reasons why the International Accounting Standards Board (IASB) has been rejecting the proposed accounting on internally generated intangible assets, the project on the Conceptual Framework, the question of comparability between companies with different accounting policies and the possibility of revaluation accounting with the resulting possibility of manipulation in the estimation of fair value.

Our concerns are discussed in detail below.

IASB deliberations

The draft paper does not address the reasons why the International Accounting Standards Board (IASB) has been rejecting the proposed accounting on internally generated intangible assets, in their deliberations on intangible assets. We believe that the starting point of the paper should be to clearly state why the previous deliberations and conclusions (to not recognise internal intangible assets) should be changed. This could be strengthened by highlighting the potential inconsistencies between the definition of an asset in the current framework and the definition of an intangible asset in IAS 38 – *Intangible Assets*. Some of these arguments are made in paragraph 38 - 40 of this discussion paper.

Recognition and Probability of economic benefits

The distinction made between research phase and development phase in IAS 38 seems to imply that cost incurred while the entity is researching may not lead to the inflow of economic benefits, therefore it should be expensed. While paragraph 16(b) of IAS16 – *Property, Plant and Equipment,* states that that any costs necessary for bringing the asset to its operating manner should be capitalised. We believe this issue should also be addressed by the discussion paper.

We further propose that the paper should address whether a written contract or an expectation which can be measured reliably should be a necessity in determining the probability of inflow of economic benefits. Refer to a telecommunication entity example in the introduction above.

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The Conceptual Framework

Numerous conclusions in this paper are based on the current Framework. The IASB is currently working on a project to amend their Framework, and we believe that this AASB project should take into account the work that is currently being undertaken to amend the Framework. The consideration should also be given to other IASB discussion papers which are out for discussion, e.g. Revenue Recognition.

Applicability of IFRS 3 – *Business Combinations* on recognition criteria for intangible assets

One aspect that the paper should explore more fully is the extent to which the IFRS 3 recognition criteria for intangibles should be applicable to internally generated and acquired intangibles. The discussion paper should explore whether the measurability of cost and recognition criteria is only achievable through acquisition. This should be done by exploring whether the recognition criteria in both IFRS 3 and IAS 38 lead to the same principle in determining whether to recognise the asset or not. A good place to start in exploring this argument is IAS 16 whether both acquired and self developed assets are discussed.

Cost versus Fair Value Model

In our view, the discussion paper does not fully pronounce itself on what is the distinction between fair value and cost at initial recognition. Surely cost incurred at development equates to fair value. If the argument is that sometimes this may not be the case, due to the fact that the fair value may need to be estimated, and then the argument should be broader than intangible assets, it should also explore the measurement criteria as determined in IAS 16 paragraph 15, 16, 22, and 23, especially for self developed assets. The argument here in IAS 16, is that at initial recognition the asset is recognised based on the cost incurred not based on the potential revenue it may earn. The fair models discussed in the paper seem to suggest the latter. We believe this would lead to a contradiction with IAS 16 and to some extent IAS 38 which only allows this type of measurement subsequent to initial recognition, if the entity chooses the revaluation model. We therefore propose that the paper explore this issue. We believe that the measurement model in IFRS 3 are only adequate for acquired intangible asset because when somebody acquires an entity they attach a value to the capability of its potential future earnings, but we do not believe that the same measurement will be adequate for the business which is not held for sale.

The paper should also address the issue of subsequent measurement, it important to explore whether these potential assets should be carried at amortised cost and assess for impairment or whether they should be carried at fair value and what is the merit to do so. In these deliberations, the fact that fair value is not an exact number and therefore open to manipulation should also be considered.

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Proposed accounting to capitalise internally generated intangible assets

It is unclear from the paper whether the proposed accounting to capitalise internally generated intangible assets will be a requirement or whether it will be an accounting policy choice (to rather apply the current practice in terms of IFRS 3 and IAS 38). It would seem from the previous accounting practice in Australia, that it was not a **requirement** to recognise internally generated intangible assets under that financial reporting framework. (emphasis added). In our view, the previous Australian practice as illustrated in the draft document (where there is a choice) is not beneficial, as it will still result in non-comparability between entities.

OTHER COMMENTS

It is not clear what the relevance of the distinguishing between a planned and unplanned internally generated intangible is, especially if the definition of the asset requires that an entity controls the resource, for it meet a definition of an asset. It is therefore not clear how would one demonstrate control if the internally generated intangible asset was unplanned.

The examples in page 1 should also include telecommunication industries. For example, a Telecommunication entity using CDMA technology which encodes the SIM on the handset (mobile phone) may subsidise the cost of a handset by selling the handset at a loss. The economic rationale for the subsidy is to lock the customer to the entity's network for a determinable period of time. The argument being put across here is that the loss is the cost to acquire the customer relationship even though there is no signed contract with the customer.