ASCG Implementation Guidance 2 (IFRS)* (near final)

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Accounting for Costs of Registration in accordance with the EU REACH Regulation

*ASCG Implementation Guidance 2 (IFRS) was published on 2 November 2009 as AIC Application Advice IFRS (2009/01).

***The Implementation Guidance was adopted by the IFRS Committee at its meeting on 12 July 2013 with revised title and with amendments.**

Introduction

Accounting Standards Committee of Germany

The Accounting Standards Committee of Germany (ASCG) has been mandated to develop principles for financial reporting in consolidated financial statements, to advise the legislature on the development of financial reporting, to represent the Federal Republic of Germany on international accountancy bodies and to develop interpretations of international financial reporting standards within the meaning of section 315a(1) of the *Handelsgesetzbuch* (HGB – German Commercial Code).

Note on application

'ASCG Implementation Guidance (IFRS)' or 'Implementation Guidance' differs from interpretations of the international financial reporting standards within the meaning of section 315a(1) of the HGB (ASCG Interpretations (IFRS)) in that it is not interpretative, but instead offers guidance on international accounting issues by providing descriptive guidance and clarifications on the appropriate application of IFRSs. Such pronouncements may address issues that extend beyond those of predominantly national relevance.

Implementation Guidance is adopted after careful consideration of all relevant circumstances, in particular taking account of all effective IFRSs, the IASB Framework, any Observer Notes and the deliberations of the IFRS Interpretations Committee, as well as the comments received, and after holding public hearings.

Implementation Guidance adopted by the ASCG applies unless and until other specific pronouncements to the contrary are issued by the IFRS Interpretations Committee or the IASB. It serves as guidance for the accounting treatment of the relevant issues in financial statements prepared in accordance with applicable pronouncements of the IASB.

Entities in Germany which state that their financial statements have been prepared in accordance with IFRSs are recommended to consider the Implementation Guidance when assessing individual cases.

Editor

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Relevant IFRSs:

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*
IAS 38, *Intangible Assets*

Background

At its meeting on 9 July 2009, the IFRS Interpretations Committee decided not to add the development of an Interpretation on accounting issues relating to costs incurred to comply with the requirements of the EU Regulation concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) to its agenda.

The IFRS Interpretations Committee justified this decision by noting that IAS 38, Intangible Assets includes definitions and recognition criteria for intangible assets that provide sufficient guidance for entities to account for the costs of complying with the REACH Regulation (see IFRIC UPDATE July 2009, p. 4).

However, as the ASCG takes the view that a number of clarifications relating to REACH would still be helpful, it has developed the present Implementation Guidance. It is designed to provide guidance to entities that prepare their financial statements in accordance with IFRSs. The explanations are based in part on the Observer Notes[1] and their discussion by the IFRS Interpretations Committee.

Issue

REACH is an EU Regulation on chemicals that came into effect on 1 June 2007. As an EU Regulation, it is effective immediately and with equal force in all EU member states. The Regulation essentially harmonises the previous legislation governing chemicals.

The Regulation is designed to ensure a high level of protection of human health and the environment and is based on the principle that it is the responsibility of manufacturers, importers and downstream users to ensure that they manufacture, place on the market, or use such substances that do not adversely affect human health or the environment.

This objective will primarily be achieved by requiring manufacturers and importers to identify the hazardous properties of substances and assess their effects on human health and the environment (registration). An authorisation procedure will be introduced for particularly hazardous substances. In addition, manufacturers and importers will be required to provide information about hazardous properties and the safe use of substances. More detailed information about the key provisions of the Regulation is presented in Appendix 1 to this Implementation Guidance.

Registration gives the registered entity the right to import and/or manufacture a substance[2] and to place it on the market in the EU.

[1] The web links to the IFRIC Observer Notes are given in Appendix 2 to this Implementation Guidance.
[2] Please refer to Appendix 1 for a clarification of this term.

Costs incurred in connection with REACH can be reduced by sharing them with other entities. The EU Regulation provides a corresponding legal framework for data sharing and for avoiding unnecessary testing.

Substance Information Exchange Forums (SIEFs) are stipulated for 'phase-in substances'[3], which were required to be pre-registered in 2008. Based on the provisions of the EU REACH Regulation, the participants in a SIEF must share data involving tests – the Regulation contains a framework governing cost sharing.

For 'non-phase-in substances'[4] and phase-in substances that have not been pre-registered, an entity is required, prior to registration, to obtain information from the Agency about whether a registration has already been submitted for the same substance. An entity that wishes to obtain registration at a later date than a previous registrant for substances that were previously registered less than twelve years earlier in accordance with Article 26(3) of the EU REACH Regulation

- is required, in the case of information involving tests on vertebrate animals, and
- in other cases has the option,

to request from the previous registrant(s) the information required for its own registration. In accordance with Article 27(2) of the EU REACH Regulation, the potential and the previous registrant are required to make every effort to reach an agreement on the sharing of the information. Such an agreement may be replaced by submission of the matter to an arbitration board and acceptance of the arbitration order. The EU REACH Regulation codifies a framework governing financial compensation for shared information.

Entities that apply for registration later than other entities are required to compensate the previous registrant if they use a study or information of a previous registrant. The compensation represents a share of the costs incurred for studies required for registration. The entity that applies for registration at a later date using the study of the previous registrant receives a separate registration for the same substance.

Registration is issued for an unlimited period – however, the entity must notify updates to the Agency if there is a change in data or use. Registration is issued to a specified entity; it may not be transferred to other entities and cannot therefore be traded.

Registration can also be acquired as part of a business combination with, or purchase of, an entity that has received a corresponding registration. Following such a business combination, however, the name of the acquired entity must be notified to the Agency – re-registration is not required.

In terms of a registrant's rights from registration, it is irrelevant whether the substance already existed when the EU Regulation took effect or whether it was introduced after that date.

In contrast to patent rights, which grant an exclusive right to the first registered entity, REACH gives entities that are individually or jointly registered for a substance the same right to manufacture or import the substance and to place it on the market as the other entities registered for this substance.

The present ASCG Implementation Guidance 2 (IFRS) addresses the issue of how to account for costs incurred for registration in IFRS financial statements. A number of costs that are typically incurred in this context are presented in Appendix 1 to this Implementation Guidance in the section entitled 'Costs incurred in connection with REACH'.

Manufacturers, importers, or downstream users may only place substances of very high concern, which are listed in an annex to the EU REACH Regulation, on the market for a use or use it

[3] Please refer to Appendix 1 for a clarification of this term.
[4] Please refer to Appendix 1 for a clarification of this term.

themselves if that substance has been authorised, rather than registered. The discussions of accounting issues relating to registration presented in the following also apply to authorisation[5].

Guidance on Accounting Practice

1. Recognition of intangible assets

The IFRS Interpretations Committee Observer Notes[6] discussed the following accounting treatment of substances that were under development at the time the EU Regulation came into force and that are required to be registered: registration costs must be accounted for as part of the development costs. They must be recognised as internally developed intangible assets if they meet the criteria in IAS 38.57.

The following accounting options were discussed for substances that had already been placed on the market at the time the EU Regulation came into force and that are also required to be registered:

View 1: The costs must be recognised as subsequent development costs of an existing asset in accordance with IAS 38.20.

View 2: The costs must be recognised as internally developed intangible assets if they meet the criteria in IAS 38.18 and 38.57.

View 3: The costs must be recognised as separately acquired intangible assets – similar to product-specific licences – provided that the general recognition criteria are met.

Recognition as an intangible asset is the objective of all three views discussed by the IFRS Interpretations Committee. For this reason, there follows a general discussion of the question of whether the costs of registration meet the criteria for recognition as an asset in accordance with IFRSs.

IAS 38 definitions

In accordance with IAS 38.8, 'an intangible asset is an identifiable non-monetary asset without physical substance'. IAS 38.10 explains this definition in greater detail by requiring the following criteria to be met for the recognition of an intangible asset: 'identifiability, control over a resource and existence of future economic benefits'.

a) Identifiability

Registration of a substance under REACH meets criterion (b) in IAS 38.12, because registration is a right based on the EU Regulation and thus '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'.

b) Control

Registration meets the 'control over a resource' criterion in accordance with IAS 38.13. The capacity of an entity to control the future economic benefits arising from registration stems from legal rights that are enforceable in a court of law on the basis of the EU Regulation. Once registration is completed, the relevant authorities cannot arbitrarily withdraw the registration.

Additionally, third parties do not have free access to the testing data used for registration. The fact that a registrant for a particular substance must enter into the process described in the 'Issue' section to make available information to one or more other entities for shared or downstream use to enable registration does not impair control within the meaning of IAS 38.13 because the registrant continues to hold the rights from the registration.

[5] Note, however, that the probability of obtaining authorisation by the Commission may be lower than the probability of obtaining registration.

[6] The web links to the IFRS Interpretations Committee *Observer Notes* are given in Appendix 2 to this Implementation Guidance.

c) Future economic benefits

The future economic benefits of registration required by IAS 38.17 result from the fact that an entity can manufacture the registered substances or products in the EU, or import them into the EU, and can sell them directly or after further processing, thereby generating future cash inflows. The substances or products cannot (continue to) be manufactured or imported without registration.

Reference is made in this context to paragraph 11 of IAS 16, Property, Plant and Equipment. Costs incurred in connection with REACH have characteristics that are similar to those of assets installed for safety or environmental reasons. In accordance with IAS 16.11, such assets do not directly increase the future economic benefits, but they are recognised as assets because the entity would be unable to manufacture or sell certain products without them.

Where additional entities receive registrations for the same substance, those entities that register a particular substance first also receive compensation for the costs they have incurred if studies or information of the previous registrant are used by subsequent registrants.

Consequently, the ASCG takes the view that costs incurred in connection with REACH are identifiable and product-specific costs, ie they are not costs that are generally attributable to the maintenance of business operations, and that (subject to the assessment of the specific characteristics of individual cases described in the following) they therefore meet the criteria for recognition of an asset.

The ASCG takes the view that the initial and subsequent registration of existing substances essentially involves the acquisition of a separate intangible asset, specifically the right to import or manufacture a particular substance.

The ASCG takes the view that it is also reasonable to treat the costs incurred to register newly developed substances as part of the development costs.

IAS 38 recognition criteria

In accordance with IAS 38.21, ‘an intangible asset shall be recognised if, and only if: (a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and (b) the cost of the asset can be measured reliably’.

For the assessment of the probability of future economic benefits from registration and of the reliable measurement of the costs of registration, the ASCG takes the view that the general principles should be applied, taking into consideration the specific characteristics of each individual case. Depending on whether registration is deemed to be the acquisition of the right to import or manufacture a particular substance or to be part of the development costs incurred to manufacture a new substance, IAS 38.25 and IAS 38.26 must be applied to acquired intangible assets and IAS 38.57 (d) and (f) must be applied to internally developed intangible assets.

2. Measurement of intangible assets

With regard to the measurement of intangible assets resulting from costs incurred in connection with REACH, the ASCG refers to the relevant provisions of IAS 38, which should be applied taking into consideration the specific characteristics of each individual case. Depending on whether registration is deemed to be the acquisition of the right to import or manufacture a particular substance or to be part of the development costs incurred to manufacture a new substance, IAS 38.27 ff. must be applied to an acquired intangible assets and IAS 38.65 must be applied to internally developed intangible assets.

As a general principle, IAS 38.88 ff. must be applied in determining useful life with regard to the registration or authorisation of capitalised intangible assets.

A registration can be used without limit of time. Conversely, use of an authorisation is generally limited in time, although IAS 38.96 must be applied to the renewal of rights. In any case, the useful life of the underlying substance represents the maximum useful life of registration or authorisation.

If a previous registrant receives compensation from a subsequent registrant for the use of information used for the latter's registration, this remuneration must be recognised in profit or loss as income from the provision of data. The ASCG takes the view that such remuneration does not involve the (partial) disposal of the capitalised registration or development costs because the previous registrant continues to have the right to import or manufacture the substance.

However, the import or manufacture of this substance by another market participant may be an indicator of the possible impairment of the intangible asset.

3. Recognition of provisions

There is no requirement to recognise a provision in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets, for expected future expenses in connection with REACH (in particular in connection with the costs of registration). There is no present obligation of the manufacturer or importer that arises from past events. Registration costs can be avoided in all cases by discontinuing the production or import of the chemicals.

A manufacturer or importer who infringes the REACH registration provisions is not obliged to subsequently register the substance(s). The general provisions of IAS 37 on the recognition of provisions must be applied to fines imposed because of infringements of the EU REACH Regulation.

Appendix 1 – Substantive provisions of REACH

Overview of REACH requirements

An overview of the substance of key aspects of REACH is presented in the following. To enhance the clarity of presentation, key terms are shown **bolded**. The explanations are generally based on those in the November 2008 IFRS Interpretations Committee Observer Note[7] (paras. 8 – 28) – the following text was modified where necessary to reflect the current legal situation as at the beginning of 2013 (Regulation (EC) No 1907/2006 of the European Parliament and of the Council of 18 December 2006 – most recently amended by Commission Regulation (EU) No 348/2013 of 17 April 2013; hereinafter the 'Regulation'). Additional information on the Regulation can be accessed using the web links shown in Appendix 2.

Concept of individual responsibility

REACH is based on the notion that the entities (manufacturers and importers of chemicals) themselves are best placed to ensure that the chemicals they manufacture and place on the European markets do not adversely affect human health and the environment. This requires the entities to have a certain level of knowledge about the properties of the substances and the management of potential risks. The primary focus of the authorities should be on ensuring that the entities meet their obligations and on intervening in the case of substances with a very high risk potential, or when intervention by the EU is necessary.

Chemicals falling with the scope of the Regulation; responsibility for registration

REACH has a very broad scope, extending to all **substances**[8] on their own that are manufactured, imported, used as intermediates, or placed on the market, and to those that are used in **preparations**[9] and in **articles**[10]. Waste is explicitly excluded from the scope of the Regulation[11].

[7] The web links to the IFRS Interpretations Committee Observer Notes are given in Appendix 2 to this Implementation Guidance.

[8] **Substance**: A chemical element and its compounds in the natural state or obtained by any manufacturing process, including any additive necessary to preserve its stability and any impurity deriving from the process

REACH also applies to foodstuffs that meet the definition of a substance on their own or in a preparation, although such substances are largely exempted from registration, evaluation and authorisation.

Substances that are used exclusively for product- and process-oriented research and development are exempted from REACH registration for a five-year period.

Article 3(20) of the EU REACH Regulation defines a substance as a **phase-in substance** if it meets at least one of the following criteria:

a) it is listed in the European Inventory of Existing Commercial Chemical Substances (EINECS),
b) it was manufactured in the Community, or in the countries acceding to the European Union on 1 January 1995, on 1 May 2004, or on 1 January 2007, but not placed on the market by the manufacturer or importer at least once in the 15 years before the entry into force of this Regulation, provided the manufacturer or importer has documentary evidence of this, or
c) it was placed on the market by the manufacturer or importer in the Community, or in the countries acceding to the European Union on 1 January 1995, on 1 May 2004, or on 1 January 2007, before entry into force of this Regulation and was considered as having been notified in accordance with the first indent of Article 8(1) of Directive 67/548/EEC in the version of Article 8(1) resulting from the amendment by Directive 79/831/EEC but does not meet the definition of a polymer as set out in this Regulation, provided the manufacturer or importer has documentary evidence of this, including evidence that the substance was placed on the market by a manufacturer or importer between 18 September 1981 and 31 October 1993 inclusively.

Non-phase-in substances are the opposite of phase-in substances. They do not benefit from the transitional regime available for phase-in substances under the REACH Regulation and must therefore be registered before production begins or before their import.

A **downstream user** is any natural or legal person established within the Community who uses a substance, either on its own or in a preparation, in the course of their industrial or professional activities, excluding manufacturers or importers. A distributor or a consumer is not a downstream user. A re-importer exempted under Article 2(7)(c) shall be regarded as a downstream user.

Downstream users are required to consider the safety of their use of the substances, based primarily on information from their suppliers, and to apply appropriate risk management measures.

Registration by manufacturers or importers before manufacturing substances or placing them on the market

Registration means that a manufacturer or an importer has provided a registration dossier to the Agency and has not received any indication that it is incomplete. This does not by itself mean that the dossier is in compliance with the legislation, nor does it mean that all the properties of the registered substance have been identified.

There is a general obligation for manufacturers and importers of substances to submit a registration to the Agency for each substance manufactured or imported in quantities of 1 tonne or more per year. To reduce the overall costs of the program, registrants can jointly submit information on the hazardous properties of the substance and its classification, and can, if they agree, also jointly submit the

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used, but excluding any solvent which may be separated without affecting the stability of the substance or changing its composition.

[9] **Preparation**: A mixture or solution composed of two or more substances.

[10] **Article**: An object which during production is given a special shape, surface, or design which determines its function to a greater degree than does its chemical composition.

[11] See the EU REACH Regulation on this aspect and in the following.

chemical safety report (joint submission). The intention is that registrants will save money by cooperating on the preparation of the dossier.

If an entity fails to register a substance, this entity is no longer allowed to manufacture or import this substance. Manufacturers and importers of substances must provide information on the substances they manufacture or import to their customers. They must assess the risks arising from the uses and must provide their customers with guidance on safe use.

'Registration' requires manufacturers and importers to submit:
- a **technical dossie**r[12], for substances manufactured or imported in quantities of 1 tonne or more, and
- a **chemical safety report**[13], for substances manufactured or imported in quantities of 10 tonnes or more.

Authorisation is required to use and place on the market substances of very high concern. These substances have hazardous properties of such high concern that it is essential to regulate them centrally through a mechanism that ensures that the risks related to their actual use are assessed, considered and then decided upon by the Community.

Authorisation will be granted if the applicant can demonstrate that the risk from the use of the substance is adequately controlled. If this is not the case, authorisation may still be granted if the socio-economic benefits outweigh the risks and there are no suitable alternative substances or processes.

Data sharing and cost sharing between registrants

To minimise testing on vertebrate animals, data sharing is required for studies on such animals. For other tests, **data sharing** is required if requested by other registrants. The previous registrants and potential registrants must make every effort to ensure that the costs of sharing the information are determined in a fair, transparent and non-discriminatory way.

Evaluation and restrictions by the authorities

The Agency **evaluates** testing proposals made by entities or to check compliance with the registration requirements. The Agency coordinates substance evaluation by the authorities to investigate chemicals with perceived risks. This assessment may be used later to prepare proposals for restrictions or authorisation.

The **restrictions** represent a regulatory procedure to ensure that the manufacture, placing on the market and use of certain dangerous substances is either subject to conditions or prohibited. The restrictions therefore act as a safety net to manage Community-wide risks that are otherwise not adequately controlled.

Costs incurred in connection with REACH

Entities must pay a **registration fee** for each substance registered with the Agency in accordance with the Regulation.

In addition to the registration fee, the entity may incur the following costs (note that these costs are not specified in detail in the Regulation, and the following is therefore a non-exhaustive list of costs):
- Preparing the technical dossier and the chemical safety report (eg internal and external documentation costs),

[12] The **technical dossier** contains information on the properties, uses and classification of a substance, as well as guidance on safe use.
[13] The **chemical safety report** for substances manufactured or imported in quantities of 10 tonnes or more documents potential hazards and the classification of a substance, as well as the assessment as to whether the substance is a very high risk substance.

- Undertaking the chemical safety assessment (eg internal and external laboratory tests),
- IT costs to track information required for REACH registration and supply chain management.

Appendix 2 – Web links

The German version of the EU Regulation can be accessed on the website of the *Umweltbundesamt* (German Federal Environment Agency) at 'www.reach-info.de/verordnungstext.htm' (the most recent German version of the consolidated text of the REACH Regulation is available at '*Konsolidierte Fassung REACH-Verordnung*'; this information is valid as at June 2013).

The IFRS Interpretations Committee Observer Notes on REACH of November 2008, March 2009 and May 2009 can be accessed as follows (information valid as at March 2013):

http://www.ifrs.org/Current-Projects/IFRIC-Projects/pages/meeting-archive.aspx