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Item 4 of the Agenda

Draft EPSAS Screening Report IPSAS 31 – Intangible assets

*Paper by PwC in cooperation with Eurostat
- for discussion -*

This document was commissioned by Eurostat. It analyses the consistency of the named IPSAS standard with the draft EPSAS framework, with a view to informing future EPSAS standard setting. This version was prepared taking into account comments received from the participants of the Cell on Principles related to EPSAS Standards.

EPSAS screening report

IPSAS 31 - Intangible assets

October 2020

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Background

Objectives

Reference is made to the general introduction to the EPSAS screening reports that covers the following elements:

- Key objectives of EPSAS.
- Standard setting process in the public sector.
- Purpose and scope of the screening reports.
- Approach of the screening reports.
- European public good.
- Common elements considered when preparing the reports.

General introduction to IPSAS 31

IPSAS 31 is based on International Accounting Standard (IAS) IAS 38 'Intangible Assets', issued by the International Accounting Standards Committee, the predecessor of the International Accounting Standards Board (IASB). In developing IPSAS 31, the International Public Sector Accounting Standards Board (IPSASB) applied its 'Process for Reviewing and Modifying IASB Documents' that identifies public sector modifications where appropriate. This approach enables the IPSASB to build on best practices in private sector financial reporting, while ensuring that the unique features of the public sector are addressed.

IPSAS 31 addresses the general accounting requirements for intangible assets and is the relevant standard dealing with most of the situations regarding intangibles. Impairment rules are explained in detail in two standards: IPSAS 21 'Impairment of non-cash generating assets' and IPSAS 26 'Impairment of cash-generating assets'. Other than these, the recent IPSAS 40 'Public sector combinations' standard addresses the accounting for intangible assets in the specific context of an acquisition of a business. This type of transaction is rare in the public sector.

The objective of IPSAS 31 is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another standard. IPSAS 31 requires an entity to recognise an intangible asset if, and only if, specified criteria are met. The standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

Intangible assets may not be amongst the largest items on the government balance sheet; however, they represent one of the categories of assets with public sector specificities. Government entities expend resources, or incur liabilities, on the acquisition, development, maintenance, or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new

processes, or systems, licenses, intellectual property, and trademarks (including brand names and publishing titles).

Classes of intangible assets are carried either at historical cost less accumulated amortisation and any accumulated impairment losses (the cost model), or at a revalued amount less any accumulated amortisation and subsequent accumulated impairment losses (the revaluation model). Application of the revaluation model is expected to be rare.

Scope of the report

The present screening report analyses the recognition, measurement, presentation and disclosure requirements of intangible assets. This report does not anticipate the conclusions of the discussions that are taking place in the context of accounting for natural resources in the public sector that will be addressed by the IPSASB during the 2019-2023 period and that might have an impact on the accounting of items of intangible assets.

IPSASB developments in that area will need to be monitored as part of the EPSAS standard setting. This topic is however not addressed in this report. Similarly, practical guidelines upon first-time implementation of EPSAS are outside the scope of the present EPSAS screening report too.

Reference to EFRAG assessment

No specific individual technical assessment of IAS 38 'Intangible assets', the IFRS equivalent of IPSAS 31, was carried out by the EFRAG, and therefore no specific individual endorsement report was produced.

The EFRAG however provided on 19 June 2002 a positive assessment of all IAS standards existing at 1 March 2002, including IAS 38, as part of the overall introduction of IAS within the EU.

Reference to EPSAS issue papers¹

The PwC study of 2014² analysed the suitability of the IPSAS standards as a basis for developing EPSAS. Member States have been asked to provide their comments on the application of IPSAS in an open way. Out of the 147 comments received from the Member States, three were related to intangible assets. Two of the three comments related to the complexity of implementation, and one comment mentioned that IPSAS 31 'Intangible assets' does not sufficiently address the specificities of a government. The PwC report does not see this concern as problematic for the development of EPSAS but recommends treating it at a later stage of the EPSAS

¹ EPSAS Issues papers are available on <https://ec.europa.eu/eurostat/web/epsas/key-documents/technical-developments>

² Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards (Ref. 2013/S 107-182395)

standard-setting process, leveraging from further discussions at IPSASB level and best accounting practices developed by certain Member States. IPSAS 31 'Intangible assets' has been categorised among the standards that might be implemented with minor or no adaptation.

In the course of developing the technical proposal on EPSAS, Eurostat commissioned a series of twenty technical issues papers (IPs), which analyse the key public sector specific accounting issues. The papers were discussed at EPSAS Working Group meetings during 2016-2018. The papers are all publicly available on Eurostat's website.

One EPSAS IP issued in 2018 addressed the topic of intangible assets. Taking into consideration the analyses provided in the IP and the initial views exchanged with Member States' public sector accounting experts during the Working Group meetings, Eurostat drew tentative conclusions that may serve, together with the IPs themselves, as considerations for future standard setting.

Based on the additional analysis performed in the context of this IP, the following are identified as the main difficulties/issues that arise when accounting for intangible assets:

- Information gathering and preparation of the opening balance sheet.
- Reliable measurement of internally developed intangible assets.
- Identification and treatment of intangible assets related to rights arising from sovereign power, including emission rights and the rights arising from the electromagnetic spectrum.
- Accounting policy choice between the cost model and the revaluation model.
- Presentation of intangible assets.

Eurostat tentatively concluded the following:

- Whilst IPSAS 31 provided a suitable reference for the future EPSAS standard, it seemed that more specific guidance was needed for rights related to sovereign powers, such as emission trading schemes and electromagnetic spectra.
- Although the cost model was preferred by several participants, Eurostat suggested not ruling out the revaluation model, since the condition concerning the existence of an active market might not be such a problem to overcome in practice.
- It seemed helpful to follow the sub-classification of intangible assets of ESA 2010.
- It was worth studying further the issue of the treatment of research and development; in particular the differences in practice between the treatments in financial accounting and ESA 2010.

Screening of IPSAS 31 ‘Intangible assets’ against criteria set in the draft EPSAS framework

Introduction

The EPSAS criteria listed in the draft EPSAS framework have been used to perform an assessment of IPSAS 31 ‘Intangible assets’, published in 2010 by the IPSASB.

In order to develop recommendations, one should first consider whether IPSAS 31 would meet the qualitative characteristics of the draft EPSAS CF, i.e. whether it would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information and would not be contrary to the true and fair view principle.

This report considers recognition, classification and measurement as well as presentation and disclosure requirements applicable to intangible assets for each of the qualitative characteristics of the draft EPSAS CF.

Further, this paper includes a high-level comparison between the requirements of IPSAS 31 and other international accounting and financial reporting frameworks applied by the public sector entities in various jurisdictions, such as IFRS, ESA 2010 and EU Accounting Rules, bearing in mind the objective of alignment, reduction of cost of implementation and compliance cost.

Finally, the paper assesses whether IPSAS 28 would be conducive to the European public good.

The findings are presented below, and the conclusion is included in the next section of this report.

Conformity with Qualitative Characteristics

Relevance

Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of GPFRs. Financial and non-financial information can make a difference when it has confirmatory value, predictive value, or both.

The objective of IPSAS 31 is to prescribe the accounting treatment for intangible assets so that users of financial statements can discern information about an entity's investment in its intangible assets and the changes in such investment.

The principal issues in accounting for intangible assets are:

- the recognition of the assets,
- the determination of their carrying amounts,
- the amortisation charges and impairment losses to be recognised in relation to them and
- the revaluation of the assets.

An intangible asset is defined in IPSAS 31 as an identifiable non-monetary asset without physical substance.

Intangible assets can either be acquired from third parties or generated internally. Typical examples of intangible assets include IT software and databases, trademarks and licenses, and certain development costs (e.g. the cost to develop an ERP system or a certain technology). Public sector entities currently mainly recognise intangible assets such as software, both acquired and internally developed, and may also recognise expenditure incurred on the development of military applications.

Notwithstanding their specific nature, intangible items can generate future economic benefits or contribute to the future service potential of an organisation. As such they can be recognised as an asset and amortised if they meet certain recognition criteria. Given the inherent nature of intangible assets, such recognition criteria are typically much stricter than for physical assets.

Under IPSAS 31, an intangible item should be recognised as an intangible asset if, and only if, all of the following criteria are met (IPSAS 31 paragraphs 19 and 28):

- It is identifiable, i.e. it is either separable (it can be sold, transferred, rented, licensed or exchanged) or it arises from binding arrangements.
- It is probable that the future economic benefits or service potential will flow to the entity.
- The cost of the asset can be measured reliably.

For internally generated intangible assets, the future economic benefits or service potential must actively be demonstrated. Additional recognition criteria therefore apply as only costs incurred in the development phase of an asset and which meet strict criteria are capitalised; costs incurred in the research phase (prior to achieving the development phase) as well as in the maintenance phase (after the development is completed) must be expensed.

Costs incurred in the development phase can only be capitalised if the entity can demonstrate all of the following (IPSAS 31 paragraph 55):

- The technical feasibility of completing the intangible asset so that it will be available for use or sale.
- Its intention to complete the intangible asset and use or sell it.

- Its ability to use or sell the intangible asset.
- How the intangible asset will generate probable future economic benefits or service potential. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
- The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
- Its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Some heritage assets have future economic benefits or service potential other than their heritage value. As an exception to the general recognition principles, IPSAS 31 does not require an entity to recognise intangible heritage assets that would otherwise meet the definition of, and recognition criteria for, intangible asset. Heritage assets are further discussed under QC 'Completeness'.

Under IPSAS 31, no intangible asset is recognised with regards to the capital commitments of an entity because no resource presently controlled by the entity as a result of past events or transactions can be demonstrated.

The recognition principles in the standard are consistent with the definition of an asset in the draft EPSAS CF. As a reminder, an asset is a resource presently controlled by the entity as a result of past events or transactions. A resource is an item with service potential or the ability to generate economic benefits. Service potential is the capacity to provide services that contribute to achieving the entity's objectives. Economic benefits are cash inflows or a reduction in cash outflows.

Nonetheless, IPSAS 31 includes additional criteria to be met in order to capitalise an intangible asset: the asset should be identifiable, i.e. it is either separable (i.e. it can be sold, transferred, rented, licensed or exchanged) or it arises from legal or contractual rights. Regarding internally generated intangible assets, costs incurred in the development phase can only be capitalised if the entity can demonstrate additional features (see above). In fact, these criteria are not contradictory to the recognition principles of EPSAS CF but provide supplemental requirements compared to it.

Items of intangible assets are measured initially at cost. The cost of a separately acquired intangible asset comprises its purchase price and any directly attributable cost of preparing the asset for its intended use (e.g. employee benefit costs). The cost of an internally generated intangible asset is the total of directly attributable costs incurred since the point when all the criteria are met for capitalisation.

Costs that are strictly excluded from capitalisation as intangible assets include internally generated goodwill, internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance, as well as start-up, training, relocation/reorganisation, advertising and promotional costs.

The information about intangible assets as required by IPSAS 31 is relevant because it helps the users estimate the future economic benefits or service potential of intangible assets that are owned or used for the long term by a public sector entity. In addition, it has a confirmatory value because it shows the level of investment made in the past in the long-term assets that are being used in the public sector. Looking at the components of the cost of an item of intangible asset, the purchase price and the direct costs attributable to the acquisition have a confirmatory value about the service potential of an asset.

Subsequent to initial recognition intangible assets are measured at either cost less accumulated amortisation and any accumulated impairment losses, or at a revalued amount being its fair value at the date of the revaluation less any subsequent accumulated amortisation and subsequent accumulated impairment losses.

Intangible assets may have either finite or indefinite useful lives. In case of some intangible assets (this may for example happen for certain brands), it may not be possible to define the period over which the future economic benefits or service potential of an intangible asset will be consumed. These intangibles are deemed to have an indefinite useful life; they are not amortised but tested for impairment at least annually.

If the revaluation model is chosen, an intangible asset should, after initial recognition, be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and impairment. Fair value should be determined by reference to an active market, which is rare for intangible assets. Revaluations should be made with such regularity that at reporting date the carrying amount of the asset does not differ materially from its fair value.

If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortization and impairment losses.

The revaluation model has both confirmatory and predictive values, however as already mentioned the circumstances in which it can be applied are rare.

For assets acquired through non-exchange transactions or assets at a revalued amount, the benefits of the forward-looking fair value information (used to determine the fair value at the date of acquisition or revalued amount) however outweigh the cost and complexity of the valuation techniques and uncertainty of the underlying assumptions.

According to the above each public sector entity therefore has an accounting policy choice to make. The choice of either the cost model or the revaluation model (with the recording of revaluation surpluses in equity) may have an impact on the extent to which information can be reconciled with budgetary reporting. In practice, the cost model is applied nearly without exception for subsequent measurement by public sector entities reporting under IPSAS.

Based on the above, IPSAS 31 provides users of financial statements with relevant information on intangible assets. An entity reporting under IPSAS must also disclose specific information as defined in the standard.

The relevance might however be enhanced if the accounting treatment of intangible assets that are specific to the public sector, such as emission rights and rights arising from the electromagnetic spectrum, were specifically addressed in the standard.

Faithful representation / Reliability

To be reliable, financial and non-financial information must provide a faithful representation of the substance of economic and other phenomena that it purports to represent. The notion of faithful representation and reliability in the draft EPSAS CF is linked to the qualitative characteristics of completeness, prudence, neutrality, verifiability, substance over form and being free from material error. These characteristics are separately discussed below.

The revaluation model can only be used in those cases where the fair value can be determined by reference to an active market. Such a requirement reinforces the reliability of the information that is provided when the revaluation method is selected.

The vast majority of public sector entities use historical cost as the measurement method for their items of intangible assets, even though it has constraints: for example, it does not reflect changes in the price level since the initial acquisition date. On the other hand, current value could provide relevant and reliable information for some classes of assets upon initial application of EPSAS (as a “deemed cost” basis), if historical acquisition cost is not available. The discussion about deemed cost approach upon initial application of EPSAS should not be mixed with the subsequent valuation of intangible assets and as such is not covered in this EPSAS screening report.

The disclosures of IPSAS 31 enhance a faithful representation of the economic phenomena.

Completeness

The information which fulfils the recognition criteria should be complete within the bounds of materiality and cost-benefit considerations.

Particular attention should be devoted on the fundamental discussion in the IPSASB Conceptual Framework on the criteria to be considered to determine when an intangible asset should be recognised, taking into account the unique characteristics of governments. Intangible assets differ from traditional ‘physical’ assets, as they cannot be held in the hand or tagged with an inventory system. Under their current accounting practices, many public sector entities expense intangible items that would otherwise meet the definition of an asset. Constituting a complete inventory of the intangible assets may constitute a challenge, especially for entities which transition from the cash basis accounting as the records may be incomplete or even inexistent.

Starting to capitalise such assets is not easy, especially in view of their specific intangible nature.

All assets that meet the definition of intangible assets are recognised, except for intangible heritage assets whose recognition is not required under IPSAS 31. Completeness of the financial statements is affected by this exception and the IPSASB project on heritage assets will address this issue. Pending final IPSASB literature on the topic, Eurostat tentatively concluded that heritage assets under the control of the reporting entity should be recognised in the financial statements.

Intangible assets represent one of the categories of assets which bear public sector specificities. The question arises whether a government may create assets as a result of its unique powers and rights, such the power to tax, the power to issue licenses or the power to regulate access to the benefits embodied in intangible resources like the electromagnetic spectrum. It is often difficult to determine when such powers give rise to a right that is a resource and asset of the entity. Although this decision might impair completeness, IPSAS 31 excludes from its scope powers and rights conferred by legislation, a constitution or equivalent means, i.e. sovereign power.

The standard requires disclosure and treatment of information for each class of intangible assets. A class is a grouping of assets of a similar nature or function in an entity's operations. The asset classes for intangible assets are not predefined under IPSAS.

The standard requires a reconciliation of the opening to the closing balance of the period showing additions and disposals, acquisitions through public sector acquisitions, amortisation, revaluations, exchange rate differences and other movements for each class of intangible assets. Reconciliation of opening to closing balances provides users with a complete overview of the transactions relating to intangible assets and of the changes in the carrying amount of the assets at each reporting date.

In case of internally generated assets, an entity might not be allowed to recognise a research and/or development expense as asset, if the activity does not meet the recognition requirements of the standard. However, in order to enhance the QC of 'Completeness', the entity should disclose the aggregate amount of research and development expenditure recognised as an expense during the period. (IPSAS 31 paragraph 125)

The overall assessment is that IPSAS 31 satisfies the completeness criterion of EPSAS CF.

Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated while liabilities or expenses are not understated.

An important element regarding measurement is the ability to demonstrate the probability to receive benefits from the use of the asset going forward, either under the form of service potential or economic benefits, in order to justify the amount that is recognised as an asset. Due to the nature of intangible assets (lack of physical substance), this aspect should be looked at more strictly. In this assessment, an entity uses judgement to measure the degree of certainty attached to the flow of future economic benefits or service potential that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence. For internally generated intangible assets only costs incurred in the development phase of an asset are capitalised which meet strict criteria. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

- (a) Identifying whether and when there is an identifiable asset that will generate expected future economic benefits or service potential; and
- (b) Determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations. (IPSAS 31 paragraph 49).

By proving the eligibility of development costs for capitalisation, several facts and circumstances should be considered (refer to IPSAS 31 paragraph 55), some of them are prone to judgement and assumptions especially related to the entity's ability to use or sell the intangible asset and how the intangible asset will generate probable future economic benefits or service potential (i.e. demonstration of the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset).

The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits or service potential embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in IPSAS 31. In addition, it is often difficult to attribute subsequent expenditure directly to an intangible asset rather than to the entity's operations as a whole. Therefore, only rarely will expenditure subsequent to initial recognition be recognised in the carrying amount of an asset. Consistently, subsequent expenditure on brands, mastheads, publishing titles, lists users of a service, and items similar in substance (whether externally acquired or internally generated) is always recognised in surplus or deficit as incurred. This treatment is not in contradiction to the definition of an asset under the draft EPSAS CF.

It is relevant to note, that the determination and annual reassessment of an intangible asset's indefinite useful life requires the exercise of judgement as there is uncertainty in estimating the useful life of an intangible asset on a prudent basis. The useful life of an intangible asset that is not being amortised should be reviewed each

reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. The area is further discussed under QC 'Verifiability'.

Information provided by measuring an item of intangible asset at historical cost is prudent, because historical cost uses information derived from the price of the transaction that gave rise to the asset. If an entity acquired an asset in a recent transaction on market terms, the entity expects that the asset will provide sufficient economic benefits so that the entity will at least recover the cost of the asset. Because historical cost is reduced to reflect consumption of an asset and its impairment, the amount expected to be recovered from an asset measured at historical cost is at least the carrying amount of the asset. This approach (under the condition of using an appropriate amortisation method) normally provides a relevant and prudent ongoing measurement basis for an item of intangible asset.

IPSAS 31 stipulates that an entity should apply the procedures described in IPSAS 21 'Impairment of non-cash-generating assets' and IPSAS 26 'Impairment of cash-generating assets' when an asset is impaired in order to make sure that the carrying amount of an asset is not overstated versus its economic value or service potential respectively. An impairment loss occurs when the carrying amount of the asset is no longer covered by its future service potential or the future economic benefits it expects from its use. Intangible assets with indefinite useful lives shall be tested for impairment at least annually.

For the application of the revaluation model under IPSAS 31, fair value should be determined by reference to an active market. It is uncommon for an active market to exist for an intangible asset. For example, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents, or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. Therefore the use of the fair value model is not expected to occur frequently. When the fair value model is used, revaluations should be made with such regularity that at the reporting date the carrying amount of the asset does not differ materially from its fair value.

Based on the overall assessment, IPSAS 31 satisfies the QC 'Prudence' of the EPSAS CF.

Neutrality

Information is neutral if it is free from bias. GPFs are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

The principles included in IPSAS 31 have been tested for many years in the private sector. Users perceived no negative impact of IAS 38 on the neutrality of the IFRS financial statements. The requirements to apply accounting policies consistently year

on year and to disclose such policies in the notes to the accounts reinforce the neutrality QC.

In a principles-based control model, the use of judgement is an inherent factor, and the disadvantage of applying principles instead of rules, is that there might be divergence in practice. The level of judgment required by IPSAS 31 is not so exceptional in nature that it would be impracticable to apply the standard in a consistent manner and achieve neutral presentation of the reporting entity.

Verifiability

Verifiability is the quality of information that helps assure users that GPFSS is based on supporting evidence in a way that it faithfully represents the substance of economic and other phenomena that it purports to represent.

Intangible assets have no physical substance, one of the key challenges is to identify the assets in the first place, and then maintain a detailed intangible asset register. The nature of intangible assets does not make it possible to visually inspect and, in the vast majority of the cases, easily trace the items back to the supporting evidence of ownership and control.

The measurement of certain intangible assets may involve some difficulties. Intangible assets are measured initially at cost under IPSAS; the initial cost of the asset may be difficult to assess in certain circumstances. The ability to measure the cost of an internally developed intangible asset reliably is dependent on the existence of adequate administrative processes as well as a good cost accounting system. The measurement of internally developed intangible assets requires the implementation of procedures which allow to capture the relevant accounting data throughout the administrative processes. It may for example be challenging to identify the cut-off point that distinguishes the research phase from the development phase of an internally developed project. Procedures (e.g. time sheets to apportion staff time worked on different projects), information flows as well as internal controls and systems may need to be adapted to gather information about the costs incurred in each phase. Not only external costs but also internal payroll costs of staff working on the development activities need to be considered and measured in accordance with the accounting principles laid down by the government entity. This may require the calculation of a unit cost (daily or hourly rate) to be used for the different levels of staff.

An item of intangible asset that qualifies for recognition as an asset is subsequently measured at cost or at a revalued amount.

At the time an intangible asset is recognised, the probability of expected future economic benefits or service potential should be based on management's best estimate, using reasonable and supportable assumptions that will exist over the useful life of the asset. The ability to sell the asset can, among other things, be demonstrated by the existence of a market for the output of the intangible asset, while the ability to use it internally can be demonstrated by its usefulness for the

entity. For internally generated intangible assets, the future economic benefits or service potential must actively be demonstrated.

Cost information relating to separately acquired intangibles is easily verifiable with supporting documents.

There may be economic, political, social, and legal factors influencing the useful life of an intangible asset that determine the period over which future economic benefits or service potential will be received by the entity. In terms of intangible assets with indefinite useful life, positive evidence supporting the continued assessment of an indefinite useful life must be obtained each period. If the underlying facts do not support this assessment, then the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with IPSAS 3.

Fair value information is generally less verifiable compared to cost, especially when fair value determination involves certain assumptions that are not observable on the market. As IPSAS 31 permits the use of the revaluation model only in those rare cases where fair value can be determined by reference to an active market, this issue does not apply for intangible assets.

Users can reconcile the intangible asset movements to other parts of the financial statements (cash flows from investing activities, non-cash transactions, movements in equity, etc.). The information on significant changes in the intangible assets is usually reflected in other parts of the financial statements.

A cohesiveness between various disclosure notes provides evidence of verifiable and reliable information. The screening exercise has not revealed any significant potential issues that could have a negative impact on the QC of 'Verifiability'.

Substance over form

Accounting policies are determined by classes of assets having similar economic characteristics. This allows the substance of transactions to be reflected in the accounting treatment for each class.

Measurement of items of intangible assets using IPSAS 31 requirements reflects the economic substance of assets that are held in the activities of a government for the long term, either by showing the amortisation historical cost of these assets (under the cost model) or the current value of the assets (for a limited number of assets with an active market). Both may be of relevance with regards to the accountability and decision-making objectives of financial statements.

Understandability

The 'Understandability' QC is achieved when information is presented in a manner that facilitates expert and non-expert users to comprehend its meaning.

The accounting treatment of intangible assets under IPSAS 31 provides understandable information to the users of the financial statements, especially under the cost model.

The requirement to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods improves understandability. There is a requirement to disclose the amortisation methods used and the useful lives / amortisation rates used for all classes of intangible asset recognised in the financial statements. For an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life should be disclosed. In giving these reasons, the entity should describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.

Application of the cost model normally results in asset carrying amounts and amounts of income and expenses that are more understandable than those generated by current market selling prices.

Based on our assessment, the principles of IPSAS 31 are straightforward, do not raise any significant concerns and introduce any complexities that may impair understandability.

Comparability

Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena in different reporting entities or in one reporting entity at different points in time. A key objective of EPSAS is to achieve the necessary level of financial transparency and comparability of financial reporting, between and within EU Member States.

A specific public sector topic is the treatment of emission allowance schemes. In accordance with the withdrawn IFRIC 3 interpretation 'Emission rights' these allowances are accounted for by participants as intangible assets. The absence of specific guidance on the above topics leads to diversity in accounting practices. These aspects may be discussed during the EPSAS standard-setting process, keeping in mind the comparability objective of the future EPSAS financial statements. One difficulty might be to gather a wide consensus on the most appropriate treatment under EPSAS concerning topics for which no guidance exists under internationally recognised standards or even for which no wide consensus was reached when they were discussed in the past (e.g. IFRIC 3 which addressed the accounting of emission rights by participants in the emission trading scheme was criticised when it was issued). Developing the necessary guidance regarding the accounting treatment of emission rights, both from the perspective of administrator and from the perspective of participants, would be helpful.

The lack of specific guidance under IPSAS concerning the accounting treatment applicable to certain transactions such as rights arising from the electromagnetic spectrum or emission trading schemes may affect the comparability of government financial statements within the EU.

The cost model or the revaluation model is an accounting policy choice applied to an entire class of intangible assets. Consistent application of a measurement model to

similar (groups of) assets is important in achieving both comparable and neutral presentation of intangible assets in the financial statements. It ensures to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates. As already mentioned, cases where the revaluation model can be applied for intangible assets are rare and the cost model is mostly used.

To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into a research phase and a development phase. Based on the standard, no intangible asset arising from research (or from the research phase of an internal project) shall be recognised as intangible, only as an expense when it is incurred. (IPSAS 31 paragraph 52). In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits or service potential. Due to judgemental nature of this assessment, reporting entities might define their internally generated intangible assets' phases at different point in time. Inconsistent application of the requirements could cause that entities account for their expenses incurring related to internally generated assets in manner that may not fully comparable between reporting entities.

The use of judgment and estimates (e.g. when estimating useful lives of assets and/or fair value) may to some extent impair the comparability of financial statements.

IPSAS 31 requires intangible assets to be presented on a separate line item on the statement of financial position. Further subclassification is generally given in the notes in a way that is appropriate to the circumstances of the reporting public sector entity. Such subclassification is useful when the line item 'Intangible assets' contains relatively significant items with very different nature. However, in practice various subclassifications may be used, for example based on the types of intangible assets that are most frequently encountered in practice, such as:

- Software and software development costs.
- Military development costs.
- Assets arising from the electromagnetic spectrum.
- Emission allowances.
- Other intangible assets.

Divergence in practice might impair comparability of reporting between EU Member States, that could be mitigated by consistent presentation principles relating to intangible assets.

Except for certain areas where accounting guidance is lacking and for the above accounting policy choice, application of the requirements of IPSAS 31 combined with appropriate disclosures in the notes about accounting estimates are likely to result in comparable application of the standard across the EU and by entities over time.

Overall, the guidance in IPSAS 31 should help with consistent interpretation and application of the accounting requirements and fulfil QC 'Comparability' of EPSAS CF.

Alignment with other frameworks

ESA 2010

Scope and definition

ESA 2010 lists assets that (may) have an intangible nature. Many of these assets would also be considered intangible assets under IPSAS under either IPSAS 31 'Intangible assets' or IPSAS 40 'Public sector combinations', although the terminology might differ. In broad terms, the provisions of the respective frameworks allow a pretty good alignment and limited scope differences between the EPSAS financial accounting based on IPSAS 31 and IPSAS 40 and the GFS reporting as defined by ESA 2010.

ESA 2010 makes a distinction between financial assets (denoted as AF) and non-financial assets (denoted as AN). Further a distinction is made between produced and non-produced non-financial assets. Produced non-financial assets (AN.1) are outputs from production processes. Non-produced non-financial assets (AN.2) are economic assets that come into existence other than through processes of production. They consist of natural assets, contracts, leases, licenses, permits, and goodwill and marketing assets (ESA 2010 7.24). Chapter 7 of the ESA 2010 manual identifies the following categories of assets that (may) have an intangible nature: intellectual property rights (AN 117), radio spectra (AN 2151), contracts, leases and licenses (AN 22) and purchases less sales of goodwill and marketing assets (AN 23).

Recognition and measurement

ESA 2010 requires that both research and development costs be capitalised to the extent that economic benefits are expected in the future, while it does not require the capitalisation of marketing expenditure, trademarks and brand names. IPSAS only permits such an assessment to be made during the development phase of an intangible asset and requires all costs to be expensed during the research phase.

Expenditures in intangible assets increase government deficit/reduce government surplus.

In terms of subsequent measurement, assets are measured at current market prices as if they were acquired at the balance sheet date under ESA 2010. The measurement approach under ESA 2010 closely agrees with the revaluation method under IPSAS when it is permitted (IPSAS only permit the use of the revaluation model when an active market exists for the intangible asset, which is expected to be

rare). Under IPSAS, any revaluation should also be done at the individual asset level while more global evaluations can be used for the ESA 2010 reporting.

A major difference between ESA 2010 and IPSAS stems from the calculation of their respective surplus/deficit calculations. Under ESA rules, acquisitions (or development) of intangible assets are recorded as capital expenditures within surplus/deficit (i.e. net lending/net borrowing under ESA 2010) in the period of acquisition. The full impact is taken in the year of acquisition. In contrast, under IPSAS, the impact on the statement of financial performance is taken over time through yearly depreciation expenses and/or impairments. Under ESA 2010 rules, the concept of impairment is not applied.

A possible convergence between IPSAS and ESA 2010 rules would be possible in rare cases only and would be valid for balance sheet measurement only.

IFRS³

IPSAS 31 is largely identical in terms of scope, definition, recognition and measurement principles to IAS 38, its IFRS equivalent. Differences exist in:

- IPSAS 31 includes a scope exclusion for the powers and rights conferred by legislation, a constitution, or by equivalent means.
- IPSAS 31 incorporates the guidance contained in the Standing Interpretation Committee's Interpretation 32, Intangible Assets - Web Site Costs as Application Guidance to illustrate the relevant accounting principles.
- IPSAS 31 does not require or prohibit the recognition of intangible heritage assets.
- IAS 38 contains guidance on intangible assets acquired by way of a government grant. Paragraphs 31 of IPSAS 31 modifies this guidance to refer to intangible assets acquired through non-exchange transactions.
- IAS 38 provides guidance on exchanges of assets when an exchange transaction lacks commercial substance. IPSAS 31 does not include this guidance.
- IPSAS 31 uses different terminology, in certain instances, from IAS 38.
- IPSAS 31 using the concept of service potential (in addition to the one of economic benefits) to assess the carrying amount of an asset under IPSAS as this concept is specific to public sector entities.

EU accounting rules

European Union Accounting Rules constitute the accounting framework of the European Union institutions, including the European Commission (EC) and its agencies. EAR 6 'Intangible Assets' retains the definitions and concepts of IPSAS 31

³ Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf

as regards the scope, recognition and measurement of intangible assets. In terms of subsequent measurement EAR only permit the use of the cost model.

European Public Good

Assessing whether IPSAS 31 is conducive to the European public good

The assessment of whether IPSAS 31 would be conducive to the European public good addresses the following items:

- a) Whether the standard will improve financial reporting;
- b) The costs and benefits associated with the standard; and
- c) Whether the standard could have an adverse effect to the European economy, including financial stability and economic growth.

These assessments will allow the EU authorities to draw a conclusion as to whether the standard is likely to be conducive to the European public good.

The analysis revealed no reasons why IPSAS 31 would not be conducive to the European public good:

- Recognition, classification, measurement, presentation and disclosure requirements of IPSAS 31 will provide useful information to the users of the GPFs and will improve the overall quality of financial reporting in the public sector. However, the question of whether an accounting policy choice should be imposed or permitted, or not, between the cost model and revaluation model, in those rare cases where fair value can be determined by reference to an active market, in general or for some classes of intangible assets in particular, should be answered bearing in mind the arguments developed earlier in the present report. In addition, heritage intangible assets should be recognised in the statement of financial position. Furthermore, developing additional guidance on the identifiability of internally generated assets and defining the accounting of intangible assets related to rights arising from sovereign power, including emission rights and the rights arising from the electromagnetic spectrum, would be useful. The revaluation model could for example be possible for freely transferable homogeneous classes of licenses or emission allowances in the context of an emission trading scheme (to the extent that an active market for the asset exists). The decision-making process for the model to select may consider the relevance of the information provided, the cost and difficulty linked to its application as well as the impact on the harmonisation objective of the EPSAS project. Finally, it is advisable to follow up IPSASB developments in the area of accounting for natural resources.
- Implementation of the standard may result in a one-off cost and should be relatively cost-neutral on an ongoing basis for preparers. It may require a relatively significant effort for some government entities to move from a cash-

based accounting environment given the data required to report these in accordance with accrual-based principles. Application of IPSAS 31 can be challenging, especially in respect of data collection when intangible items were not recognised as assets and adequate procedures under the previous government accounting rules were not in place. IPSAS 33 'First-time adoption of accrual basis IPSAS' addresses this practical issue by allowing first-time adopters to make use of an exemption in order to enable a smoother move towards IPSAS. This exemption consists in a three-year transitional relief period for the recognition and measurement intangible assets.

- The consistent presentation of intangible assets might further enhance the comparability of the reporting between EU Member States. IPSAS rules require intangible assets to be presented on a separate line item on the statement of financial position. Further subclassification is generally given in the notes in a way that is appropriate to the circumstances of the reporting public sector entity.
- Considering its conceptual merits, the standard will bring improved financial reporting when compared to heterogeneous reporting requirements currently applied in the EU. As such, its endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship. The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

Conclusion

Assessing IPSAS 31 against the criteria formulated in the draft EPSAS framework

The analysis has not revealed major conceptual issues with IPSAS 31 'Intangible assets' and has not identified any inconsistency between IPSAS 31 and the draft EPSAS framework.

Following the screening analysis summarised in the present report, the future standard setter could consider the following conclusions. The information resulting from the application of IPSAS 31:

- would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information needed for making economic decisions and achieving the necessary level of financial transparency and comparability of financial reporting in the European Union;
- would not be contrary to the true and fair view principle; and
- would be conducive to European public good.

However, in order to achieve consistent application of the new standard within the EU context and therefore better address the comparability objective of EPSAS financial statements, additional guidance and improvements in certain areas might be desirable.

- *Cost model versus revaluation model.* The accounting policy choice for the subsequent measurement of intangible assets (i.e. using either the cost model or the revaluation model) creates a potential risk of a lack of comparability between governments that may use different models for those types of assets whose fair value can be determined by reference to an active market. Such cases are expected to be rare in practice.
- *Judgment and comparability.* The use of judgment and estimates is inherent in the preparation of financial statements and may to some extent affect the comparability of financial statements.
- *Intangible heritage assets.* Intangible heritage assets that meet the definition of items of intangible assets should be recognised in the financial statements. IPSASB developments on this topic should be followed up.
- *Identification and treatment of intangible assets related to rights arising from sovereign power (including emission rights and the rights arising from the electromagnetic spectrum):* The absence of specific guidance on the above topics leads to diversity in accounting practices. It might be advisable to analyse

what should be the most appropriate treatment under EPSAS concerning topics for which no guidance exists under internationally recognised standards, particularly in relation to the following two specific types of intangibles: the rights arising from the electromagnetic spectrum and emission rights.

- *Presentation of intangible assets:* The need for a consistent presentation of intangible assets may be discussed in order to enhance comparability of the reporting between EU Member States. The asset classification used in the ESA 2010 reporting might be used as a source of inspiration for determining the intangible asset subcategories to be used in the EPSAS reporting in a standardised way by defining a subclassification of intangible assets which reflects the major types of intangibles that governments most usually have.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

The future standard setter could consider the conclusions of this assessment and likely net benefit of using the requirements of IPSAS 31 as a starting point in implementing the equivalent EPSAS, considering the need for additional guidance in certain areas and resolution of the matters identified in the present EPSAS screening report.