Staff paper

Agenda reference: 3

IFRS® Interpretations Committee meeting

Date	**November 2024**
Project	**Recognition of Intangible Assets Resulting from Climate-related Commitments (IAS 38)**
Topic	**Initial consideration**
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about whether an entity's expenditures for carbon credits and research and development activities meet the requirements in IAS 38 *Intangible Assets* to be recognised as intangible assets.

2. The objective of this paper is:

   (a) to provide the Committee with a summary of the matter;

   (b) to present our research and analysis; and

   (c) to ask the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure

3. This paper includes:

   (a) background and summary of submission;

(b) findings from information request;

(c) staff analysis; and

(d) staff recommendation.

4. Appendix A to this paper provides suggested wording for the tentative agenda decision.

5. The submission is reproduced in Agenda Paper 3A for this meeting.

Background and summary of submission

6. In April 2024 the Committee published an agenda decision about Climate-related Commitments (IAS 37) (April 2024 agenda decision). In that agenda decision, the Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine:

(a) whether an entity's commitment to reduce or offset its greenhouse gas emissions creates a constructive obligation for the entity;

(b) the circumstances in which the entity recognises a provision for the costs of fulfilling a constructive obligation to reduce or offset its greenhouse gas emissions; and

(c) if a provision is recognised, whether the corresponding amount is recognised as an expense or as an asset when the provision is recognised.

7. With respect to the conclusion in paragraph 6(c) of this paper, the April 2024 agenda decision states:

> The Committee observed that if a provision is recognised, the corresponding amount is recognised as an expense, rather than as an asset, unless it gives rise to—or forms part of the cost of—

an item that qualifies for recognition as an asset in accordance with an IFRS Accounting Standard.

8. The submission focuses on expenditures an entity incurs in achieving its climate-related commitments and asks whether these expenditures qualify to be recognised as intangible assets applying IAS 38. Specifically, the submission focuses on expenditures for (a) carbon credits and (b) research and development activities.

9. The following is a summary of the fact pattern described in the submission (the submission is reproduced in Agenda Paper 3A for this meeting):

(a) an entity made a commitment in 2020 and 2021 to other parties to reduce a percentage of its carbon emissions by 2030 (referred to as a '2030 commitment');

(b) the entity has taken 'affirmative actions' and, in its view, has created an established pattern of practice to achieve its 2030 commitment. These affirmative actions include: (i) creating a transition plan; (ii) engaging with 'net zero focused investors'; (iii) publishing its commitment and plans on its website; (iv) joining coalitions with a mission to collaborate to achieve emissions reductions; (v) stating its emission reduction targets in its financial statements and in presentations to investors and others; and (vi) allocating capital to reduce its emissions by buying carbon credits and investing in 'innovation programs' purposed to find solutions to reduce emissions to meet its 2030 commitment.

(c) the entity's 'innovation programs' will typically involve creating teams of people with know-how, expertise and other intellectual property to create and develop solutions for emissions reductions specific to the entity or its sector and will result in the creation of intellectual capital.

(d) the entity's investors, insurers and bankers have made their own transition commitments relying on the entity's actions.

(a) the entity, at its 2023 fiscal year-end, concludes that its 2030 commitment and subsequent affirmative actions have created a constructive or legal obligation applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.[1]

10. The submitter asks whether in the fact pattern described in the submission, the entity's expenditures for carbon credits and research and development activities—through innovation programs that result in the creation of intellectual capital—meet the requirements in IAS 38 to be recognised as intangible assets.

Findings from information request

11. We sent an information request to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms. We had also made the submission available on our website.

12. In response to its Third Agenda Consultation, the IASB added to its reserve list a project on pollutant pricing mechanisms (PPMs), some of which include the use of carbon credits. The IASB has been conducting horizon-scanning activities, including performing research and engaging with stakeholders, to assess the prevalence and significance of PPMs.[2] The horizon-scanning activities have identified that there is diversity in the accounting for PPMs, and that it is difficult to assess the materiality of these mechanisms to entities.[3] The IASB expects to consider at a future meeting the results of its horizon-scanning activities and to decide whether to start a project on the accounting for PPMs before the next agenda consultation.

[1] As described in the April 2024 agenda decision, if an entity has a constructive or legal obligation, the entity considers the additional criteria in paragraph 14 of IAS 37 in determining whether it recognises a provision for the costs of fulfilling that obligation.

[2] PPMs were discussed with the Committee at its September 2024 meeting.

[3] Agenda paper 5C for the November 2024 meeting of the IFRS Advisory Council summarises the results of the horizon-scanning activities up to the date of the paper posting.

13. Because the IASB has already been conducting horizon scanning about PPMs, we did not include questions about the accounting for carbon credits in our information request. Our information request associated with the submission therefore asked only about the submitter's questions related to the accounting for expenditure on research and development activities.

14. As set out in the April 2024 agenda decision (and see paragraphs 6–7 of this paper), an entity's determination of whether it recognises a provision is separate from its determination of whether it recognises the corresponding amount as an expense or as an asset. Accordingly, and to gather more comprehensive information, we asked in our information request about the accounting for expenditure on research and development activities broadly. We therefore did not limit our question to only expenditure on research and development activities undertaken to meet climate-related commitments or in the context of whether or not an entity recognises a provision related to achieving its climate-related commitments.

15. The request asked respondents:

    (a) whether they have observed widespread differences in accounting for expenditure on research and development activities that have, or could have, a material effect on entities' financial statements; and

    (b) if the respondents have observed widespread and material differences:

        (i) how entities account for expenditure on research and development activities;

        (ii) what causes the differences—for example, whether differences result from entities applying judgement based on underlying facts and circumstances, or from diversity in interpretation of the relevant requirements in IFRS Accounting Standards; and

        (iii) whether the diversity is present and similar across all jurisdictions and industries or is only evident in particular jurisdictions or industries.

16. We received 22 responses—eight from national accounting standard-setters, seven from accounting firms and seven from securities regulators[4]. The responses represent informal opinions and do not necessarily reflect the official views of those respondents or their organisations.

Are there widespread and material differences in accounting?

17. Most respondents say they have not observed widespread and material differences in the accounting for expenditure on research and development activities. One national standard-setter says it is not able to identify whether there are differences in the accounting, nor to determine the extent to which any differences, if present, have or would have a material effect.

18. Three respondents (one national standard-setter and two accounting firms) say they observe some diversity in the accounting, and this diversity primarily relates to entities' application of judgement in different facts and circumstances and to different practices in different industries. For example:

    (a) entities make different judgements about when the research phase of an activity ends and when the development phase begins, and in their application of the recognition criteria in IAS 38 for internally generated intangible assets in different facts and circumstances.

    (b) differences in industry practices include:

        (i) the pharmaceutical and software industries have more precise rules and procedures for tracking costs as compared to other industries in which research and development is less important. In one jurisdiction, if there is not an accurate tracking of all costs to enable reliable measurement,

[4] Six of the seven securities regulators submitted their responses through an organisation representing securities regulators, which collated the individual responses. For this paper, we have analysed the responses individually.

entities do not capitalise the costs, resulting in fewer intangible assets being recognised.

(ii) an oil and gas entity might capitalise development costs as early as possible in a manner similar to its capitalisation of oil and gas exploration costs, while a pharmaceutical company might capitalise developments costs at a later stage of activity and only upon regulatory approval of a new product.

19. Although the information request asked about the accounting for expenditure on research and development activities broadly, some respondents commented specifically about expenditure an entity incurs in achieving its climate-related commitments as described in the submission. Of these respondents, none reported observing widespread and material differences in the accounting for innovation programs associated with climate-related commitments as described in the submitted fact pattern. One accounting firm says this is an emerging area and it has not yet observed many material transactions. Another accounting firm says that for expenditure on intellectual capital that results from innovation programs, there is no diversity in practice; entities recognise the expenditure as an expense because the recognition criteria for an asset are not met.

20. One accounting firm says that although it has not observed widespread and material diversity in the accounting for expenditure on research and development activities applying current requirements, it suggests that the IASB considers, as part of its intangible assets research project,[5] whether to provide additional guidance about development phase capitalisation criteria.

[5] The IASB has a research project on its work plan to comprehensively review the accounting requirements for intangibles. The project will assess whether the requirements of IAS 38 remain relevant and continue to fairly reflect current business models or whether the IASB should improve the requirements. Initial research will seek to define the scope of the project and explore how best to stage work on this topic to produce timely improvements to IFRS Accounting Standards.

Staff analysis

Should the Committee add this matter to its standard-setting agenda?

Does the matter have widespread effect and have, or is expected to have, a material effect on those affected?[6]

21. Responses to our information request did not provide evidence of widespread and material diversity in how entities account for expenditure on research and development activities, including for innovation programs associated with climate-related commitments as described in the submitted fact pattern. Although a few respondents identified some differences in accounting as summarised in paragraph 18 of this paper, those differences are limited and largely arise from entities' application of judgement in accounting for different underlying fact patterns and from differences in practices between industries.

22. Therefore, we have not obtained evidence that the matter has widespread effect. Consequently, we recommend that the Committee not add a standard-setting project to the work plan and instead publish a tentative agenda decision that explains its reasons for not adding a standard-setting project.

23. Our recommendation is based on evidence we obtained to date from our information request. If the Committee agrees to publish a tentative agenda decision, stakeholders will have an opportunity to provide feedback on the tentative agenda decision, including to provide to the Committee any additional evidence that could lead to a different conclusion on whether the matter has widespread effect.

[6] Paragraph 5.16(a) of the *Due Process Handbook*.

Staff recommendation

24. Based on our assessment of the criteria in paragraph 5.16 of the *Due Process Handbook* (as discussed in paragraphs 21–23), we recommend not adding a standard-setting project to the work plan and instead publishing a tentative agenda decision that explains the Committee's reasons for not adding a standard-setting project.

25. Appendix A to this paper suggests wording for the tentative agenda decision.

Questions for the Committee
1. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan? 2. Does the Committee have any comments on the wording of the tentative agenda decision suggested in Appendix A to this paper?

Appendix A—suggested wording for the tentative agenda decision

Recognition of Intangible Assets Resulting from Climate-related Commitments (IAS 38)

The Committee received a request about whether an entity's expenditures for carbon credits and research and development activities meet the requirements in IAS 38 *Intangible Assets* to be recognised as intangible assets.

Fact pattern:

A summary of the fact pattern described in the submission is as follows:

(a) an entity made a commitment in 2020 and 2021 to other parties to reduce a percentage of its carbon emissions by 2030 (referred to as a '2030 commitment');

(b) the entity has taken 'affirmative actions' and, in its view, has created an established pattern of practice to achieve its 2030 commitment. These affirmative actions include: (i) creating a transition plan; (ii) engaging with 'net zero focused investors'; (iii) publishing its commitment and plans on its website; (iv) joining coalitions with a mission to collaborate to achieve emissions reductions; (v) stating its emission reduction targets in its financial statements and in presentations to investors and others; and (vi) allocating capital to reduce its emissions by buying carbon credits and investing in 'innovation programs' purposed to find solutions to reduce emissions to meet its 2030 commitment.

(c) the entity's 'innovation programs' will typically involve creating teams of people with know-how, expertise and other intellectual property to create and develop solutions for emissions reductions specific to the entity or its sector and will result in the creation of intellectual capital.

(d) the entity's investors, insurers and bankers have made their own transition commitments relying on the entity's actions.

(e) the entity, at its 2023 fiscal year-end, concludes that its 2030 commitment and subsequent affirmative actions have created a constructive or legal obligation applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The request asks whether the entity's investments in carbon credits and expenditures for research and development activities, resulting in intellectual capital from 'innovation programs' as described in the fact pattern, meet the requirements in IAS 38 to be recognised as intangible assets.

Additional background

In response to its Third Agenda Consultation, the IASB added to its reserve list a project on pollutant pricing mechanisms (PPMs), some of which include the use of carbon credits. The IASB has been conducting horizon-scanning activities, including performing research and engaging with stakeholders, to assess the prevalence and significance of PPMs. The IASB expects to consider at a future meeting the results of its horizon-scanning activities and to decide whether to start a project on the accounting for PPMs before the next agenda consultation.

Accordingly, the Committee concluded not to consider the submission's question about the accounting for carbon credits separately from the IASB's research on PPMs. The Committee instead considered only the submission's question about the accounting for expenditure on research and development activities.

Findings and conclusion

Evidence gathered by the Committee [to date] indicates no material diversity in accounting for expenditure on research and development activities. Based on its findings, the

Committee concluded that the matter described in the request does not have widespread effect. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.