KPMG IFRG Limited
1-2 Dorset Rise
London EC4Y 8EN
United Kingdom

Tel +44 (0) 20 7694 8871
Fax +44 (0) 20 7694 8429
DX 38050 Blackfriars
mary.tokar@kpmgifrg.com

Ms. Stephenie Fox
Technical Director
International Public Sector Accounting
Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto Ontario Canada M5V 3H2

Our ref MT/288

Contact Mary Tokar

23 September 2009

Dear Ms. Fox,

We appreciate the opportunity to respond to the International Public Sector Accounting Standards Board's (IPSASB or the Board) Exposure Draft 40 (ED) entitled *Intangible Assets.* This letter expresses the views of KPMG International and its member firms.

We strongly support the IPSASB's issuance of an International Public Sector Accounting Standard (IPSAS) addressing intangible assets. We believe this IPSAS will enhance the consistency of reporting intangible assets among public sector entities around the world. However, we do have a number of comments on the proposals put forth in the ED. These comments address the specific matter for comment identified in the ED, as well as certain other aspects of the ED. Our comments are provided below.

Specific Matter for Comment

Do you agree that the changes made to IAS 38, in particular the scope exclusions set out in paragraphs 2 and 4, and the additional public sector guidance are:

- *Necessary in the circumstances?*
- *Appropriately reflected in the revised wording?*

We generally agree that the power to grant rights and the power to tax should not be recognized as assets in the financial statements of public sector entities. However, we have concerns over the approach the Board has used to reach this proposal in the ED and the lack of basis provided in the ED for the approach.

Paragraph 2 of the ED states the following:

> "The power to grant rights and the power to tax do not satisfy the specified criteria for recognition as an intangible asset. Accordingly, they are excluded from the scope of this Standard in paragraph 4(f)."

KPMG IFRG Limited, a UK company limited by guarantee, is a member of KPMG International, a Swiss cooperative

Registered in England No 5253019
Registered office: Aquis Court, 31 Fishpool Street, St Albans, Hertfordshire AL3 4RF

There is no basis provided in the IPSAS as to why the power to grant rights and the power to tax do not satisfy the recognition criteria. There is also limited discussion in the Basis for Conclusions of the ED supporting this proposal. We believe whether these powers are recognizable as assets (and are, therefore, intangible assets) is a challenging conceptual question that is fundamental to public sector financial reporting.

We also believe that the Board's proposal for not recognizing these powers as assets—that they do not meet the recognition criteria for intangible assets—can be questioned, particularly for the power to tax. Consider a newly created sales tax with a short-term expiration such that the fair value of the tax could be reliably measured. We believe that one can argue that the public sector entity's power to levy this tax can meet the recognition criteria for intangible assets. Specifically, it would appear probable that future economic benefits from this tax will flow to the public sector entity as cash will be received from the collection of the tax. It also would appear, as indicated above, that the fair value of the power to levy this tax can be measured reliably using the present value of the expected future tax receipts. Given the subjectivity of the Board's conclusion related to this proposal, we believe a more developed discussion of why these powers do not meet the recognition criteria should be provided.

However, we also believe a more fundamental question that needs to be addressed is whether these types of powers should be considered assets of a public sector entity in the first instance. We believe that a determination that these powers do not meet the definition of an asset would have far more conceptual credibility than a directive statement, at this point largely unsupported, that these powers do not meet the principles-based recognition criteria for intangible assets. We believe the question of whether or not these types of powers should be considered assets of a public sector entity should be specifically addressed as the Board develops the definitions of financial statement elements as part of its Conceptual Framework project. In the interim, we support the exclusion of these powers from the scope of the IPSAS without statement as to whether or not they meet the definition of an asset or as to whether or not they meet the recognition criteria for intangible assets, particularly if the Board cannot develop a sound conceptual basis why, in all cases, these powers do not meet these recognition criteria.

We also believe that there may be other regulatory powers beyond the power to grant rights and the power to tax that could be considered intangible assets, for example, the power of eminent domain. The Board should consider broadening its discussion of excluded assets to encompass all regulatory powers created through statute or the inherent nature of public sector entities.

As for the other public sector changes and additions to IAS 38, we believe they generally are necessary and appropriately reflected in the ED. However, we believe that further public sector changes, particularly in the examples of how the provisions of the IPSAS would be applied, should be made. We believe there is a fundamental difference between the intangible assets held by commercial entities and those held by public sector entities. Intangible assets of commercial entities most often are used to support the generation of future cash flows from a product (brands, mastheads, customer lists), while intangible assets of public sector entities are

most often used to provide services (computer software, easements, land use rights) or to directly generate income (patents and trademarks). Because of this fundamental difference, some of the descriptions incorporated from IAS 38 seem to not be widely applicable to public sector entities. Certain examples of these instances will be provided in our comments on the various sections of the ED provided below.

Other Comments

In this section of our letter, we will provide comments on various other aspects of the ED. Our comments are organized by major section of the ED.

Scope

We generally agree with the proposed scope of the ED. However, we believe that, if the Board intends to provide explicit guidance in the IPSAS that the power to tax and the power to grant rights are not recognizable intangible assets, then it is unnecessary to include a statement that those powers are excluded from the scope of the IPSAS – and indeed this latter statement weakens the impact of the former. If the Board decides to remove the explicit statement that these powers are not recognizable intangible assets, then we would support their exclusion from the scope of the IPSAS, while the Board develops the definitions of financial statement elements as part of its Conceptual Framework project.

We also agree with the provisions related to the applicability of the proposed standard to intangible heritage assets. We believe that the characteristic of being a heritage asset is more essential to the accounting treatment of these assets than their intangible nature. Therefore, we believe more definitive guidance on the reporting of intangible heritage assets should not be provided until the completion of IPSASB's project on heritage assets. We believe the heritage assets project is important to public sector financial reporting and should be continued expeditiously.

Definitions

We believe that a definition for "binding arrangement" used in the "identifiable" criteria in paragraph 21 of the ED should be provided. It is unclear to us what that term is meant to represent in the context of that paragraph. For example, is a binding arrangement limited to a contract with a third party or could a public sector entity's own constitution or charter be considered a binding arrangement? Definition of this term is particularly important as it marks a difference in the wording of the similar criteria in IAS 38. Without a definition, the impact of this wording change on the practical application of these criteria is unclear.

Additionally, it appears the notion of future service potential has been inadvertently omitted from the definition of an asset in paragraph 17.

Intangible Assets

Paragraph 24, concerning the capitalization of skilled staff, is included as provided for IAS 38 and uses the same reasoning for not capitalizing the benefits of their skills as intangible assets. However, certain public sector entities can and do place legal restrictions on staff to prevent them from moving. If this ED carries this prohibition on capitalisation into the public sector, the argument for doing so will need to be developed.

Paragraph 25 discusses whether customer relationships meet the definition of an intangible asset. Based on the wording of that paragraph, it was unclear to us whether customer relationships meet the definition of an asset only if they are acquired through an exchange transaction, or if customer relationships meet the definition of an asset in all cases. If it is the latter, we would disagree with that position. Many public sector entities maintain monopolies over various services, such as, water utilities and refuse service, thereby creating “compelled” customer relationships. Additionally, property tax rolls would appear to be another example of “compelled” customer relationships. We do not believe that a public sector entity should recognize intangible assets created through their regulatory powers, in this case, the power to compel citizens to use their service or pay taxes. Therefore, in these cases, we do not believe customer relationships should be recognized as assets by public sector entities.

Paragraph 26 discusses the future economic benefits or service potential flowing from an intangible asset. The following example of future economic benefits or service potential is provided in this paragraph:

> “For example, the use of intellectual property in a production or service process may reduce future production or service costs rather than increase future revenues (e.g., an on-line system that allows citizens to renew driving licenses more quickly on-line, resulting in a reduction in office staff required to perform this function while increasing the speed of processing).”

This example focuses on how future economic benefits may flow from an intangible asset without the generation of revenue. However, it does not address future service potential. In fact, it could lead one to assume that the intangible asset must either generate revenue or reduce costs to meet the definition of an intangible asset. In the example of an on-line system for driving licenses, we believe this would meet the definition of an asset because of its future service capacity regardless of whether costs of providing these services were reduced.

Recognition and Measurement at Recognition

Paragraph 29 of the ED (which is almost identical to its counterpart, IAS 38.20) states that expenditures related to an intangible asset incurred after the initial recognition of an acquired intangible asset will only rarely be recognized in the carrying value of an asset. While we believe this to be true for most of the significant intangible assets held by commercial entities, we believe this not to be true for what we expect to be the most prevalent intangible asset

among public sector entities—computer software. We believe that modifications of computer software that add efficiency and/or functionality to the software would meet the definition of an intangible asset and the criteria for recognition and should be included in the carrying value of the software. To omit this from the discussion, we believe, is misleading in the context of public sector entities.

In paragraph 39(b) and elsewhere in the ED, we believe the phrase "operating losses", which is the phrase used in IAS 38, should be replaced by "operating deficit", to be more consistent with the nature of public sector entities.

We note that paragraph 42 is derived from paragraph 33 of IAS 38. However, there is no reference to the reliable measurement criterion, which is addressed in the last two sentences of IAS 38.33. We believe that this criterion should also be addressed in paragraph 42.

In paragraphs 43 and 44 of the ED, we believe the phrase "contractual and other legal rights" when describing identifiability should be replaced with "binding arrangements" based on the proposal in paragraph 21.

In paragraph 45, we believe examples that are more relevant to a public sector entity should be provided to illustrate the concept. Most public sector entities are not involved with magazine publishing or spring water marketing and the IASB has deleted these examples from IAS 38 (see *Improvements to IFRSs* published in April 2009).

Paragraph 49 discusses fair value estimation techniques that involve profitability of the asset and estimated future net cash flows from the asset. We believe that it should be specified that these approaches are appropriate for cash-generating intangible assets. We do not believe they would properly estimate the fair value of a non-cash-generating asset as described in IPSAS 21, *Impairment of Non-Cash Generating Assets*.

Also in paragraph 52, we believe that the second example (the donation of personal papers by a Nobel Prize winner) could be considered Intangible Heritage Assets. This could give rise to confusion when considering its fair value under paragraph 53 and whether it requires recognition in the first instance given the proposed guidance in paragraphs 10-14. Either this needs to be addressed in the ED or another example should be selected.

Exchanges of Assets in Exchange Transactions

In paragraph 54 and elsewhere in the ED, we believe the phrase "commercial substance", which is the phrase used in IAS 38, should be replaced by "substance", to be more consistent with the nature of public sector entities.

In paragraph 55(b), it was unclear whether the entity-specific value of the portion of the entity's operations affected by the transaction is a relevant measure to a public sector entity and how such value would be determined.

Internally Generated Intangible Assets

In paragraph 66(b), we believe that the word ‘sell’ is too narrow for the types of transactions that could occur in the public sector. We therefore recommend replacing the phrase “use or sell” with “use, sell or exchange”. Additionally, the examples of development activities in paragraphs 68 appear to be more applicable to commercial entities. We suggest developing examples that have broader application for public sector entities.

We suggest deleting paragraph 71. We believe this is an editorial comment that is not appropriate in the standards section of an IPSAS.

Recognition of an Expense

We believe that paragraph 80 of the ED could be better expressed as follows:

> “Paragraph 77 does not preclude an entity from recognizing a prepayment for goods or services as an asset, when payment has been made in advance of the entity receiving the right to access the goods or receiving the services, as appropriate.”

We note that paragraph 86(b) does not allow “the initial recognition of intangible assets at amounts other than cost”. However, we believe that this is not consistent with paragraph 33, which allows intangible assets acquired through a non-exchange transaction to be measured initially at fair value.

We note that paragraph 97 only allows a decrease recognized in the revaluation surplus to be transferred directly to accumulated surpluses / deficits when the surplus is realized. However, it is not clear why increases may not be treated this way, particularly when they are allowed to be so treated in IAS 38.

In paragraph 100(d), we believe the word “industry”, which is the phrase used in IAS 38, should be replaced by “operating sector”, to be more consistent with the nature of public sector entities.

In line 3 of paragraph 104, we believe the phrase “contractual or other legal rights” should be replaced by “binding arrangements (including rights from contracts or other legal rights)”, to be more consistent with the remainder of the paragraph.

We believe that the examples given in paragraph 110, when residual value may not be zero, could also include when there is a commitment by a third party to continue obtaining service potential from the asset at the end of its useful life.

In paragraph 111, we believe that the second sentence should be expanded to say:

> "A residual value other than zero implies that one of the exceptions noted in paragraph 110 above applies, or that an entity expects to dispose of the intangible asset before the end of its economic life."

We believe that paragraph 112 should be expanded to include assets that provide service potential rather than economic benefits.

Intangible Assets with Indefinite Useful Lives

We believe the likelihood of a non-cash generating intangible asset suffering an impairment without the occurrence of one of the indicators requiring impairment testing as detailed in IPSAS 21 to be minimal because of the stable nature of achieving service potential without extenuating circumstances inherent in these intangible assets as compared to the potential volatility of achieving economic benefits inherent in cash-generating intangible assets. Therefore, we believe the amendment to IPSAS 21 that would require non-cash generating intangible assets with indefinite useful lives to be tested for impairment on an annual basis could place an undue burden on financial statement preparers to annually determine the recoverable service amount of these assets when it is likely there will be no impairment. We suggest the IPSASB reconsider this provision in the context of its cost to implement versus the benefit it provides to financial reporting.

Disclosures

We do not believe that intangible assets and related research and development activity are of the same level of concern to users of the financial statements of public sector entities as they are for users of commercial entities. Therefore, we do not believe the information provided through the disclosures proposed in paragraphs 133(a)-(c), 135(a)(iii), and 137 is essential to a user's understanding of the financial statements of a public sector entity and should be omitted.

Transition Provisions and Effective Date

Paragraph 140(c) of the ED requires that public sector entities reassess whether previously recorded and unrecorded intangible items meet the recognition criteria for intangible assets. We have concerns related to the practical application of this proposal for internally generated intangible assets that were previously unrecorded. We believe many public sector entities will not have the appropriate records to determine the aggregate expenses associated with these assets because much of the expenses will relate to internal costs as opposed to costs of external vendors which may be easier to identify through paid invoices. Additionally, even if public sector entities are able to determine the aggregate expenses associated with an internally generated intangible asset, we believe many public sector entities will be unable to discern whether those expenses relate to research or development impacting the recognizable cost of the asset. Therefore, we suggest that items that would meet the definition of a recognizable

internally generated intangible asset but were previously expensed should be permitted but not required to be reported as an intangible asset upon implementation of the IPSAS.

Application Guidance—Web Site Costs

As an overall comment, we believe the Board should provide application guidance that more broadly addresses internally generated computer software. We believe the distinction between research and development as proposed in the ED does not easily lend itself to the development of computer software. We believe providing such clarification only for web site costs misses issues that public sector entities will face in accounting for the broader population of software systems.

We have concerns with the guidance in AG8 that can be interpreted to limit recognition of web site costs as an intangible asset if it directly generates revenues or reduces costs. Web sites are often used by public sector entities to disseminate important information to its constituency, such as facts about available governmental services, reports that illustrate the public sector entity's accountability to its constituency and stewardship of assets, and news about the public sector entity. Web sites also are often used to facilitate transaction with the public sector entity for its constituents, including change of residency registration and certain tax collections. We believe these uses of web sites represent service potential to the public sector entity because it assists the entity in carrying out its mission and should result in the costs of a web site being capitalized as appropriate. We also do not think the guidance on reporting the costs of a web site that is solely or primarily for promoting and advertising its own services and products has the same applicability in a public sector context as in a commercial context and, therefore, we believe it should be deleted. This concept is also present in AG 9. We also noted that the references in AG8 to paragraphs in the IPSAS should be updated.

KPMG appreciates the opportunity to respond to this Exposure Draft. Please contact John Hummel at +1 202 533-3008, Archie Johnston at +1 604 527-3757, Greg Driscoll at +1 212 909-5421, or Mary Tokar at +44 207 694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited