

IFRS News

Shedding light on the IASB's activities*

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REACH – frequently asked questions

This supplement provides a high-level summary of REACH and the accounting implications, and provides answers to some frequently asked questions (FAQs). For more detailed guidance we recommend you contact your local PricewaterhouseCoopers office.

Background

REACH (**R**egistration, **E**valuation, **A**uthorization and **R**estriction of **C**hemicals) is a recently enacted legislation in the European Union (EU) that, when it became effective on 1 June, 2007, replaced some 60 existing regulations on chemicals. Amongst other obligations REACH requires the registration of existing and new chemicals and substances currently or newly introduced to the European market. The registration of these substances will require manufacturers, importers, and downstream users to provide detailed information to the EU authorities concerning the properties and uses of the substances and their risks to both human health and the environment. The registration documentation and results of testing will be evaluated by the European Chemicals Agency (Agency) and substances that exceed pre-defined risk thresholds may no longer be produced or traded.

Failure of an entity to register a chemical means that the entity may not manufacture or import this chemical.

The legislation impacts entities in a number of significant areas including, but not limited to, R&D, IT, supply chain management, sales, financial and non-financial reporting and disclosure. From a market perspective, the requirement that companies provide detailed information about the chemicals they manufacture or use in production could result in the release of trade secrets to direct competitors. Additionally, the impact of non-compliance could result in the loss of key customers, the need to find acceptable substitutions for manufactured products, and possible supply chain disruptions both up and downstream.

Overview of REACH requirements

The REACH regulation distinguishes between phase-in and non-phase-in substances. **Non-phase-in substances** are the so called “new substances”, marketed after September 1981, for which testing was already required to some extent prior to their placement on the market. **Phase-in substances** are the so called “existing substances”, mainly those that are listed in the European Inventory of Existing Commercial Chemical Substances (until September 1981), or those that have been manufactured in the Community, but not placed on the Community market, from September 1981. For phase-in substances there is a lack of information since there were no requirements for them to be tested before their placement on the market.

To enable the companies concerned to gather the information required by REACH for phase-in substances (except for substances of high concern, which need to be registered early), the regulation provides for a **transition period** during which the companies are still allowed to manufacture/import a chemical/substance without being registered, provided the companies pre-registered the phase-in substance.

Pre-registration of phase-in substances has to take place between 1 June and 1 December 2008: Pre-registration consists of a notice to the Agency that phase-in chemicals are used giving the name of the entity, the chemical/substance involved and the proposed quantity. Pre-registration permits an entity:

- a) to submit a registration dossier at a later date (transition deadlines depending on tonnage, i.e. an entity only needs to

submit a complete registration dossier by 2013 for a phase-in chemical pre-registered, where the quantity manufactured is between 100 tonnes and 1,000 p.a., and

- b) to access details to gather information about other potential registrants to build up a registration consortium

Registration means that a manufacturer or importer has provided a registration dossier to the Agency and not received any indication that this dossier is incomplete. Given the number of registrations expected, only a simple electronic completeness check will be performed by the Agency at the early stage. If the registration is not rejected within a deadline set by the Agency, then the registrant may begin (for non-phase-in substances) or continue (for phase-in substances) to manufacture or import the substance. However, this does not imply any form of approval by the Agency of the assessment or use of the substance.

The registration dossier has to contain the following **registration documents**:

Role	Tonnage >1t and <10t	Tonnage >10t
Manufacturer/ importer	Technical dossier	Technical dossier & chemical safety report
Downstream user	Safety data sheet	Chemical safety report

The **technical dossier** contains information on the properties, uses and on the classification of a substance as well as guidance on safe use.

A **chemical safety report** documents the hazards and classification of a substance and the assessment as to whether the substance is of a specific category (e.g. carcinogenic or persistent, bio accumulative and toxic). The report also describes exposure scenarios for specific uses of substances of these categories during their life cycle and how the manufacturer/importer controls the risks (i.e. risk management measures and operational conditions).

A **safety data sheet** passes the information about how to use the chemicals safely from the manufacturer along the supply chain. The safety data sheet of a chemical should give information about how to use this chemical safely and should comprise information for every identified use of the chemical (exposure scenarios).

Under the REACH regulation downstream users are required to consider the safety of their uses of substances, based primarily on information from their suppliers (which is included in the safety data sheet prepared by the manufacturer/importer), and to apply appropriate risk management measures. To fulfil this requirement, downstream users will need to communicate with their suppliers, to get the information they need in the safety data sheet supplied to them. In particular they will have to

check that their use(s) are “covered” by the safety data sheet, i.e. that they use a substance within the conditions described in the exposure scenarios and apply these conditions.

Downstream users may be any industrial user of chemicals, whether formulators of preparations (e.g. paint producers) or users of chemicals such as oils and lubricants in other industrial processes or producers of manufactured articles such as electronic components.

Entities will have to pay a **registration fee** for each substance registered with the Agency.

Key considerations surrounding registration and registration fees:

- Fees do not represent a patent for the production of a certain substance. They are more akin to a license fee to do business (i.e. to sell a product).
- Information included within the registration process, except for “know-how” relevant information, will be open to public inspection 12 years after effective date of REACH, which would allow competitors access to product information.
- Within the 12 years following the registration each further potential registrant will get information from the Agency about: who has registered and which information (i.e. tests) has been received by the Agency to facilitate data sharing. It enables the potential registrant to approach an entity already registered with the request of data sharing i.e. with regard to specific lab test results.
- Multiple companies will be able to register the same or similar substance either individually or by forming a registration consortium (cost sharing considerations).

For substances of very high concern (list to be produced by the Agency), an **authorisation** is required rather than registration for their use and their placing on the market. The agency will publish a list of substances meeting the criteria set up in REACH. Those using or making available such a substance will need to apply for an authorisation for each use of the substance including an analysis of possible substitutes. An authorisation will be granted if the applicant can demonstrate that the risk from the use of the substance is adequately controlled. If not then it may also be granted if the socio-economic benefits outweigh the risks and there are no suitable alternative substances or processes. All authorisations will be reviewed by the agency after a certain time which will be set on a case-by-case basis. If suitable substitutes have become available by the time of the review, the Agency may amend or withdraw the authorisation.

Lab testing required by the Agency: REACH requires that all substances registered with the Agency undergo a series of lab tests and studies to provide technical/scientific information surrounding the health and environmental risks associated with the substance. The kind and extent of testing requirements

varies according to the tonnage (> 1t, 10t, 100t or 1,000t) in which the substance is manufactured/imported and to the needs of the chemical safety assessment. As tests might be costly or involve testing on vertebrate animals, the kind and extent of testing will be closely monitored by the Agency.

Key considerations:

- Entities may elect to perform lab testing as part of a consortium, which may potentially reduce the cost of testing.
- Entities may have existing information which because of REACH has value and they can sell to other registrants who have an interest in a particular substance.
- Results of testing can be sold for fair value. Fair value can be negotiated between two parties or will ultimately be determined by the Agency.
- Lab results associated with testing on vertebrate animals must be shared with other (potential) registrants.
- Testing can be performed by independent certified professional technicians or by qualified in-house technicians.
- Even though the test results can be sold, the economic benefits associated with the sale are expected to decrease with the volume and similarity of substances being tested.

Software developed/purchased for Internal Use: As a result of REACH, companies will need to begin tracking the amount of certain substances produced/used in their supply chain process. For many companies, this will ultimately require upgrades to existing IT systems in order to properly identify the various substances that need to be registered.

Frequently Asked Questions

Recognition of a provision

Question 1:

Should a provision for the expected cost of registration be recognised?

Answer 1 (IFRS and US GAAP):

The assessment of the recognition criteria for a provision as set out in IAS 37/FAS 5 depends on the design of the enforcement-system to be implemented by the Member States. This design is not yet known and may differ from Member State to Member State. However we assume that in cases where a relevant manufacturer/importer fails to register it will have to pay a penalty but will not be required to register subsequently unless it wants to continue manufacturing/importing.

Under this assumption there is no present obligation of the manufacturer/importer arising from a past event to register the manufacture/import of a chemical. The manufacturer/importer can avoid the cost of registration by stopping the manufacture/import of a chemical although he cannot avoid

paying a penalty for not having registered.

We conclude that no provision need be set up for the cost of the registration but a provision may be set up for any penalty payable.

Capitalisation of an intangible asset

Question 2:

Is there an intangible asset on registration?

Answer 2 (IFRS):

According to IAS 38.8 an intangible asset is an identifiable non-monetary asset without physical substance; and an asset is a resource controlled by an entity as a result of past events; and from which future economic benefits are expected to flow to the entity.

- a) Control and future economic benefits (IAS 38.13-17): With registration a manufacturer/importer obtains the right to manufacture/import a specific chemical. Future economic benefits are expected to arise on the future manufacture/import. The right is controlled by the manufacturer/importer; other manufacturers/importers who seek to manufacture/import the same chemical are required to register by themselves.
- b) Identifiability: The asset arising from the registration cannot be separated from the entity (IAS 38.12(a)), but arises from a legal right (IAS 38.12(b)).
- c) The asset is non-monetary and without physical substance.

We conclude that the recognition criteria of IAS 38 are met.

Given the recognition criteria of IAS 38 are met, the intangible asset shall be measured initially at cost (IAS 38.24). The cost of the intangible asset comprises any directly attributable cost.

To determine which costs are to be capitalised the individual facts and circumstances should be reviewed thoroughly to determine whether the costs incurred are directly attributable to registration/authorisation and are reliably measurable. The **appendix** to this supplement contains a non-exhaustive list of costs which may be considered (internal and external costs). The entity must also determine from which point in time these costs are to be capitalised.

An assessment has to be made as to whether the company will finally complete the registration using the criteria of IAS 38.57(a)-(f) for recognition of development cost.

Answer 2 (US GAAP):

The compliance costs associated with the REACH legislation are numerous. Beyond the potential impact to the company, its suppliers and customers, and the market for compliance with

this legislation, companies will need to focus on the accounting treatment of the associated costs.

- Generally, registration fees cannot be distinguished from the general costs of operating the business and should be expensed as incurred.
- Lab testing costs should typically be expensed as incurred because the costs generally would not represent a future economic benefit to the company that can be linked directly or indirectly with cash inflows.
- Costs associated with internally developed software to track information for REACH registration purposes should be capitalised or expensed in accordance with the guidance of SOP 98-1.
- Externally developed and purchased software should be capitalised at cost and depreciated over the estimated useful life of the technology. Estimation of the useful life of the software should approximate those lives used for other technology previously purchased by the company.

As the full impact of REACH may not be apparent until companies are significantly enveloped in the registration process, other miscellaneous costs may arise that have not been considered in the broad categories noted above.

Question 3:

Is there an intangible asset when registration has been obtained as part of a consortium?

Answer 3 (IFRS and US GAAP):

The forming of a consortium as a cost sharing vehicle is supported by REACH. The conclusions in Answer 2 above should be applied without regard to how registration has been obtained.

Question 4:

Is there an intangible asset arising upon authorisation?

Answer 4 (IFRS and US GAAP):

As with registration, upon authorisation a manufacturer/importer

obtains the right to manufacture/import a specific chemical. The main difference to registration is that the authorisation will be reviewed after a certain time and this may lead to an amendment or withdrawal of the authorisation for the use of the substance. Nevertheless the costs incurred in achieving authorisation should be reviewed in accordance with the conclusions of answer 2 above to determine which should be capitalised.

Appendix to REACH – frequently asked questions

The following table is a non-exhaustive list of costs which may be incurred (internal/external costs in expected time order). To determine (for IFRS) which costs are to be capitalised the individual facts and circumstances should be reviewed thoroughly with regard to the following:

1. Whether registration will be completed/authorisation will be obtained and thus economic benefits are likely to flow. (For some substances it may be difficult to confirm the probability of economic benefits until registration is achieved) ;
2. Whether the costs incurred are directly attributable to registration/authorisation;
3. Whether the costs directly attributable can be separately identified from the day to day costs of running the business;
4. Whether these costs are reliably measurable; and
5. Whether the additional recognition criteria for a separate internally generated intangible asset are fulfilled. The recognition criteria for *internally generated* intangible assets as set out in IAS 38.57 are:
 - technical feasibility
 - intention to complete the intangible asset and use or sell it
 - ability to use or sell the intangible asset
 - availability of adequate technical, financial or other resources to complete the development.

Type of cost	Answer (IFRS)
Cost incurred to decide which chemical needs to be registered.	These costs are not directly attributable to a registration and cannot be capitalised.
Cost of collecting existing data (i.e. test results, information about possible uses of a substance, exposure scenario).	These costs may be directly attributable to the registration/authorisation, but it may be difficult for an entity to separate the collection of information performed in the ordinary course of business from that performed in order to comply with REACH regulation. If this separation is not possible, the costs that are directly attributable to REACH are not reliably measurable (IAS 38.21(b), 38.51(b)) and therefore are to be expensed when incurred.
Internal cost incurred to perform lab tests which were not required before REACH legislation tests on existing chemicals .	As above.
Internal cost incurred to obtain results of lab tests on new chemicals.	As above.
External cost incurred by a downstream user to acquire information from an upstream user/manufacturer/importer.	These costs are generally directly attributable to the registration, if the information acquired serves only for registration and is of no use in day-to-day business.

Type of cost (<i>continued</i>)	Answer (IFRS) (<i>continued</i>)
<p>External cost incurred to acquire results of lab tests which were not required before REACH legislation on existing chemicals (i.e. from a certified institute, non-EU manufacturer).</p>	<p>These costs are generally directly attributable to the registration, if the results of the lab tests serve only for registration and are of no use in day-to-day business.</p> <p>If the results of the lab tests can also be used in day-to-day business, then – provided the entity controls the information – the lab test results acquired should be capitalised as a separate asset.</p>
<p>External cost to acquire results on lab tests of new chemicals (i.e. from a certified institute, non-EU manufacturer).</p>	<p>As above.</p>
<p>Cost paid to another registrant to obtain the right to use the lab test result submitted to the agency for its own registration (data sharing).</p>	<p>As above.</p>
<p>Cost paid to a consortium partner to obtain the right to form part of the registration consortium (i.e. to use the lab test result of this consortium partner) (data sharing).</p>	<p>As above.</p>
<p>Lawyers cost incurred for legal consulting on the forming of a consortium.</p>	<p>These costs should be capitalised if they are directly attributable to a specific registration. Costs incurred to consult lawyers with regard to the question whether a consortium shall be formed are not directly attributable to a registration.</p>
<p>Registration/authorisation fee.</p>	<p>This fee represents a nominal amount paid to the agency to be registered/obtain authorisation and therefore may be capitalised.</p>
<p>Software to track information required for REACH registration purposes.</p>	<p>If the costs meet the recognition criteria above then they may be capitalised.</p>

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