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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 13 December 2006, London

Project: Annual improvement process

Topic: Unit of production method of amortisation
(Agenda Paper 10C)

1. When reviewing the Interpretation on service concessions, the Board asked that the following issue be considered via the annual improvements process (as agreed by the Board in July 2006).

Issue: Should IAS 38 *Intangible Assets* permit the use of the unit of production method of amortisation when it results in a lower amount of accumulated amortisation than the straight-line method?

2. The purpose of this paper is to propose that the above issue be added to the Board's annual improvements project, to provide analysis on that issue and to propose a solution.

Staff recommendation

3. The staff recommend that:

- the Board should add the issue described in paragraph 1 to the annual improvements project; and
- IAS 38 should be amended in accordance with the proposed drafting in paragraph 15 of this paper.

Structure of the paper

4. The main body of this paper presents background to this issue, staff analysis and proposed drafting of amendments.

Background

5. IAS 38 paragraph 98 states that there is ‘rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method’. In practice, ‘rarely, if ever’ is interpreted as never.
6. The IFRIC project on service concessions has highlighted situations where using the unit of production method of amortisation would be appropriate. However, where the expected pattern of consumption of the future economic benefits in the asset is weighted to the end of the assets life, paragraph 98 restricts an operator from using this method.
7. This issue was initially raised by constituents that enter into highly geared arrangements with grantors of service concession arrangements. Using a method other than the unit of production method often leads to losses in the early years of these arrangements. In the view of those constituents this does not reflect the commercial reality of the situation.

Staff analysis

8. The last sentence of paragraph 98 has been reproduced for reference purposes:

There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method.

9. When the International Accounting Standards Committee approved IAS 38, this sentence was designed to prevent entities (primarily in Australia) from using methods of depreciation such as the inverse sum of digits. However, as it is applied in practice, it currently restricts operators of service arrangements from using the unit of production method.
10. Paragraph 98 of IAS 38 states that the amortisation method to be used ‘is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset’. This creates an inconsistency for operators of some service arrangements. An operator can only use a method that matches the expected pattern of consumption when that method will produce an amount of accumulated amortisation equal to or greater than the straight-line method.
11. The staff believe that it would be appropriate to remove the words ‘if ever’ from the last sentence of paragraph 98 of IAS 38. This would change the interpretation of paragraph 98 from “never” to “rarely”. It would allow the use of the unit of production method in circumstances where it best represented the expected pattern of consumption of the expected future economic benefits embodied in an intangible asset while retaining an appropriate caution - the word “rarely”.

Staff recommendation

12. The staff recommend that IAS 38 should be amended in accordance with the proposed drafting in paragraph 15 of this paper.
13. **Does the Board agree?**

Drafting

14. The following changes are proposed to IAS 38 *Intangible Assets* should the Board agree with the staff recommendations:

98 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits. There is rarely, ~~if ever,~~ persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method.

Basis for Conclusions on Proposed Amendments to IAS 38 *Intangible Assets*

This Basis for Conclusions accompanies, but is not part of, the draft amendment.

Unit of production amortisation

BC1 In some service concession arrangements, an intangible asset for the right to charge users for public services is created. Paragraph 98 prevents an operator from using the unit of production method to amortise these assets as it results in a lower amount of accumulated amortisation than under the straight-line method. This can be inconsistent with the expected pattern of consumption of the expected future economic benefits embodied in an intangible asset. Therefore, the Board proposed to amend paragraph 98 to allow entities, in rare circumstances where it appropriately reflects the expected pattern of consumption of economic benefits, to use the unit of production method of amortisation even though it results in a lower amount of accumulated amortisation than under the straight-line method.