STAFF PAPER

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IFRS Interpretations Committee Meeting

IFRS IC March 2012 and November 2011 **|** IASB April 2012 and October 2012

Project	***Annual Improvements to IFRSs 2010–2012 Cycle* (ED/2012/1) comment letter analysis**
Paper topic	IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*—Clarification of methods of depreciation and amortisation

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Introduction

1. In December 2012 the IASB published the Exposure Draft (ED) *Clarification of Acceptable Methods of Depreciation and Amortisation* (ED/2012/5), which contains a proposal to amend IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

2. More specifically, the IASB proposes to prohibit a depreciation or amortisation method that uses revenue generated from an activity that includes the use of an asset.[1]

3. The comment period ended on 2 April 2013. We received 98 comment letters.

4. **Appendix A–B** of this paper contains:

   (a) a full list of respondents to the invitation to comment; and

   (b) a breakdown of respondent categories by type and geography.

[1] The IASB discussed this issue at its October 2012 meeting (Agenda Paper 9B) and at its April 2012 meeting (Agenda Papers 9 and 9A). The IFRS Interpretations Committee discussed this issue at its March 2012 meeting (refer to Agenda Paper 6) and at its November 2011 meeting (refer to Agenda Paper 13).

Purpose of this paper

5. The objective of this paper is to:

   (a) present a summary of the comment letters received on the ED; and

   (b) provide a recommendation to the IFRS Interpretations Committee ('the Interpretations Committee') for the next steps.

6. This paper does not include changes for finalising the proposed amendment. We plan to bring a new draft of the proposed amendments to a future meeting, which will be based on the Interpretations Committee's deliberations on our recommendations at the July 2013 meeting. In **Appendix C** we have reproduced, for ease of reference, the content of the ED.

Questions asked

7. The ED asked respondents whether they:

   (a) were in agreement with the IASB's proposal to amend IAS 16 and IAS 38 to prohibit a depreciation or amortisation method that uses revenue generated from an activity that includes the use of an asset; and

   (b) had any other comments on the proposals.

8. The responses to those questions, as well as other feedback provided in the comment letters, are summarised below.

Proposal to prohibit a revenue-based depreciation or amortisation method

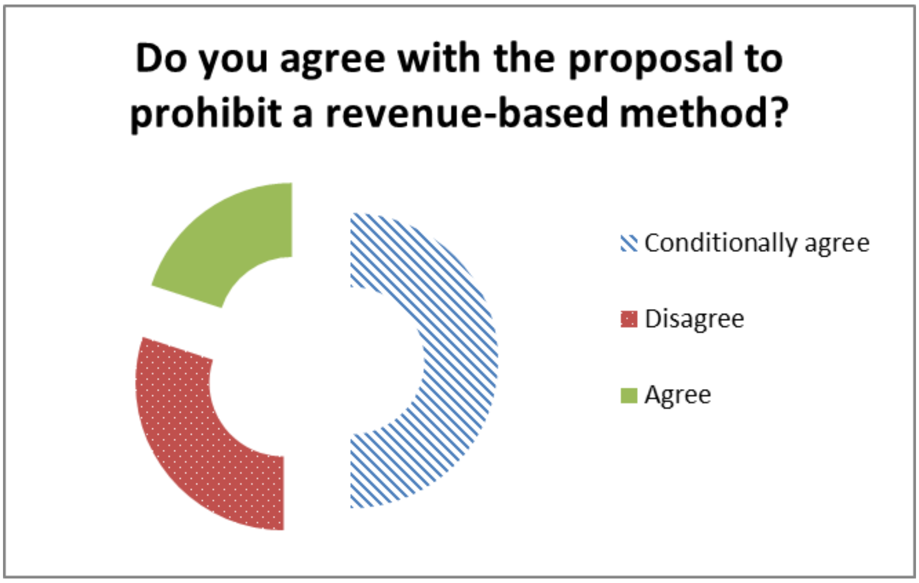
9. Based on our comment letter analysis of the IASB's proposal to prohibit the use of a revenue-based depreciation or amortisation method we found out that:

   (a) approximately **half** of respondents expressed a **conditional agreement** on the proposal;

   (b) **less than a third disagreed** with the proposal; and

   (c) less than a **quarter** of the respondents **agreed** with the proposal.

10. The diagram below illustrates these responses.



11. Respondents who **agreed**, did so because they think that this proposal will further clarify the requirement's in IAS 16 and IAS 38 regarding the choice of a depreciation or amortisation method.

12. Respondents who **disagreed** expressed the following views:

(a) the current guidance in IAS 16 and IAS 38 implicitly bans the use of a revenue-based method and adding more guidance is unnecessary since:[2]

(i) the generation of revenues is a measure of output and not a measure of consumption of economic benefits; and

(ii) expected revenue incorporates price changes that are not directly linked to the consumption of the related asset but to the dynamics of the market for the product or service output.

(b) the proposed amendment is too prescriptive in nature and seems to be rules-based rather than principles-based;[3]

(c) the issue analysed in the ED would be more suitably addressed as part of the *Conceptual Framework* project or even as a separate research project on depreciation or amortisation;[4]

[2] CL 95 ICAEW and CL 83 The Swedish Financial Reporting Board.

[3] CL 8 FRC UK and CL 41 McLachlan &Tiffin.

(d) the choice of the best depreciation or amortisation method should be a matter of judgment based on the existing guidance;[5]

(e) revenue is used in practice as a proxy for consumption and the use of a revenue-based method should not be prohibited (refer to *Issue 2– revenue is used in practice as a proxy for consumption* in paragraphs 18–37 below). Some particular concerns in this respect were:

(i) the proposed amendment would create divergence between IFRS and US GAAP for the companies belonging to the media sector; and

(ii) the proposal has ignored the economic substance underlying the contractual rights and obligations of a concession agreement.

13. Respondents who expressed a **conditional agreement** agreed in principle with the proposal to prohibit a revenue-based depreciation or amortisation method, but expressed some concerns that we have summarised in the following list:

(a) **Issue 1:** the guidance in the body of the Standard contradicts the guidance in the basis for conclusions (paragraphs 15–17);

(b) **Issue 2:** revenue is used in practice as a proxy for consumption (paragraphs 18–37);

(c) **Issue 3:** the meaning of the term ‘consumption of economic benefits’ is unclear (paragraphs 38–40);

(d) **Issue 4:** the proposed guidance in regards to the application of the diminishing balance method is confusing (paragraphs 41–45);

(e) **Issue 5:** the proposed guidance should not be applied on a retrospective basis (paragraphs 46–49); and

(f) **Issue 6:** the statement “when it was acquired” in paragraph 62A of IAS 16 and in paragraph 98A of IAS 38 should be deleted (paragraphs 50–51).

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[4] CL 8 FRC.

[5] CL 8 FRC, CL 74 ABCR, CL 78 ACCA, CL 80 Mazars and CL 97 OIC.

14. We will analyse the issues above in the subsequent paragraphs.

Summary of the comments received on the ED

Issue 1: *The guidance in the body of the Standard contradicts the guidance in the basis for conclusions*

15. More than a third of the respondents to the ED noted a contradiction between the proposed guidance in the main Standard and the proposed Basis for Conclusions (BC).[6] They observed that while proposed paragraph 62A of IAS 16 and paragraph 98A of IAS 38 prohibit the use of a revenue-based depreciation or amortisation method in all circumstances, paragraphs BC3 and BC5 of the ED state that in some limited circumstances a revenue-based method could provide a reasonable approximation of the consumption of the expected economic benefits embodied in the assets.

16. Many of these respondents think that the BC should not introduce limited exceptions because:

    (a) they contradict the guidance in the body of the Standard;[7] and

    (b) some preparers would not benefit from the limited exceptions included in the BC, such as:

        (i) European Union (EU) preparers, because the BC does not form part of the EU endorsed Standards;[8] and

        (ii) other jurisdictions that have adopted only the unaccompanied Standards.[9]

17. Respondents have mixed views about how the concerns above could be addressed:

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[6] We will be addressing specific comments from these respondents in the paragraphs below.

[7] CL 7 Chris Barnard, CL 11 Roche Group, CL 22 GASB, CL 25 ProSiebenSat.1 Media AG, CL 44 ICAS, CL 45 RTL Group S.A., CL 56 Kameswari, CL 63 Repsol, CL 66 Baker Tilly, CL 69 BDO, CL 73 European Insurance CFO Forum, CL 85 ANC, CL 91 EFRAG and CL 97 OIC.

[8] CL 44 ICAS, CL 63 Repsol and CL 66 Baker Tilly.

[9] CL 27 AcSB.

(a) The majority of the respondents think that the limited circumstances in which a revenue-based method can be used should be included within the body of the Standard (in both IAS 16 and IAS 38), mainly because, in their view, there are certain circumstances in which a revenue-based method could be used as a reliable proxy for the units-of-production method. This would avoid inconsistencies between the core guidance in the Standard and the explanations in the BC.

(b) A few respondents from specific sectors (mainly media and construction) think that the IASB should not restrict the use of revenue-based method for intangible assets in general. This is because, in their view, this method represents the most appropriate approach to reflect the consumption of an intangible asset's future economic benefits. They think that in limited circumstances a revenue-based method of depreciation or amortisation can be used and this should be reflected in the main body of the Standard. This aspect is further discussed in the next section of this paper (refer to *Issue 2 –revenue is used in practice as a proxy for consumption* in paragraphs 18-37 below).

(c) Some others think that the IASB should provide application guidance as to how the proposed core principle for choosing a method of depreciation or amortisation should be applied in practice.[10]

Issue 2: revenue is used in practice as a proxy for consumption

18. The BC in the ED notes that there are some limited circumstances in which revenue data would be correlated with production data and could therefore be used to reflect the pattern in which future economic benefits of the asset are expected to be consumed. This is when the use of a revenue-based method gives the same result as the use of a units-of-production method. Paragraphs BC3–BC5 in the ED use broadcasting rights as an example to acknowledge that straight-line amortisation would not be appropriate and open the possibility of revenue-based

[10] CL 11 Roche Group, CL 20 Business Europe, CL 32 ACTEO and CL 63 Repsol.

amortisation being used in rare cases when revenue has a linear relationship to viewer numbers.

Concerns raised– construction sector

19. The following section summarises the views expressed by respondents in different jurisdictions in regards to the application of a revenue-based method for service concession agreements (SCA).[11]

20. Respondents disagreed with the IASB's proposal to prohibit the use of a revenue-based method for SCAs mainly because they think that it has ignored the economic substance that underlies the contractual rights and obligations of the concession agreements.

21. This is because they observe that an intangible asset in a SCA:

    (a) has no physical nature and cannot be compared to a tangible asset; and

    (b) represents a service concession right (or license) granted by the grantor (ie public sector) to:

        (i) charge users (paragraph 17 of IFRIC 12 *Service Concession Arrangements*); and

        (ii) collect tolls from road users (paragraph IE14 of IFRIC 12) rather than a right to use the underlying asset (ie operate a highway).

22. In relation to (a) one respondent further observes that in the case of a tangible asset, it is clear that usage-based methods (ie a units-of-production method) more accurately reflect the way that the asset has been consumed.[12] However, for intangible assets, the pattern of consumption of economic benefits is not

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[11] We compiled the views expressed by the following respondents: CL 26 Puncak Niaga Holdings Berhad, CL 31 Stephen Oong, CL 39 Lingkaran Trans Kota Holdings Berhad (LITRAK), CL 33Assiciazione Italiana Societa Concessinarie Autostrade e Trafori (AISCAT), CL 48 Persatuan Syarikat-Syarikat Konsesi Lebuhraya Malaysia (PSKLM) [Association of Highway Concession Companies of Malaysia], CL 50 Projekt Lintasan Kota Holdings, CL 53 Konsortium Expressway Shah Alam Selangor Sdn Bhd (KESAS) [Concessionaire for the Shah Alam Expressway (SAE) or Lebuhraya Shah Alam], CL 55 Grand Saga Sdn Bhd Concessionaire for the Cheras-Kajang Expressway, CL 60 South African Institute of Chartered Accountants (SAICA), CL 65 Asian-Oceanian Standard-Setters Group (AOSSG), CL 74 Associagao Brasileira de Concessionarias de Rodovias (ABCR), CL 81 Grupo Costanera, CL 97 Organismo Italiano di Contabilità (OIC) [Italian Accounting Organisation].

[12] CL 60 SAICA.

immediately linked to a usage-based method because of their lack of physical substance, and instead there may be circumstances where the method of consumption is closely linked to the pattern of revenue generation.

23. A couple of respondents further note that the guidance in IAS 16 and IAS 38 for the choice of depreciation or amortisation method is different.[13] While paragraph 56 of IAS 16 states that a common way to identify a pattern of consumption of an asset is through its expected use, IAS 38 is silent in this respect and paragraph 90 of IAS 38 only refers to a list of factors for the determination of the useful life of an intangible asset.

24. In relation to (b) some respondents[14] claim that if the nature of an intangible asset that is inherent in an SCA is a 'right to charge users' or a 'right to collect tolls from users' and the underlying assets do not belong to the concessionaires, then the consumption of the economic benefits embodied in this intangible asset should be based on the use of the concession right rather than on the use of the underlying asset. Consequently, the amortisation method should be a function of toll rates and expected traffic volume rather than being based on the latter only. The respondents think that the revenue-based method should be allowed in such cases, because it would properly reflect the pattern of consumption of the economic benefits embodied in a concession right.

25. Some respondents claim that in certain jurisdictions, the pattern of increase of the concession rates does not have any correlation to the inflation index and the rates are predetermined at the start of the concession for the entire concession period by the grantor, who, besides the price, regulates how the service should be rendered[15].

26. One respondent, however, asserts that the expected income of an intangible asset (that represents the right to charge users a tariff) is most of the time adjusted by

[13] CL 19 ICAC and CL 33 AISCAT.

[14] CL 31 Stephen Oong, CL 33 AISCAT, CL 39 LITRAK, CL 48 PSKLM, CL 50 Projekt Lintasan Kota Holdings ,CL 53 SAE, CL 74 ABCR, CL 81 Grupo Costanera and CL 97 OIC.

[15] CL 39 LITRAK and CL 55 Grand Saga.

two components: the inflation rate and an annual tariff increase.[16] A couple of respondents further note that the 'tariff formula' that regulates price changes in the toll rates of SCAs includes a number of parameters that are focused on multiple targets, such as improvements in the quality of service, efficiency, safety or environmental impact, among others.[17]

27. One respondent[18] thinks that the amortisation of SCAs should be analysed as part of the Rate-regulated Activities project that is currently being discussed by the IASB.

Concerns raised—media sector

28. The following section summarises the concerns expressed by respondents in different jurisdictions in regards to the application of a revenue-based method for intangible assets that arise in the media sector.[19]

29. Some respondents affirm that the rationale in the BC for allowing the use of a revenue-based method in limited circumstances where there is a linear relationship between the revenue generated and the number of viewers may be appropriate for broadcasting activities but it may not be appropriate for some other type of rights (i.e. production and distribution rights) because:[20]

    (a) the number of viewers does not necessarily represent an appropriate basis of the pattern in which the benefits for those rights are received. For example, production and distribution rights are exploited in different markets that have unique characteristics;

    (b) media rights contracts could be structured in a range of different ways; and

[16] CL 81 Grupo Costanera

[17] CL 33 AISCAT and CL 74 ABCR

[18] CL 33AISCAT

[19] CL 8 FRC UK, CL 11 Roche Group, CL 25 ProSiebenSat.1 Media AG, CL 37 Ricardo Lopes Cardoso, CL 40 BP plc, CL 45 RTL Group RTL Group; CL 57 AASB, CL 65AOSSG, CL 72 E&Y, CL 80Mazars, CL 83 The Swedish Financial Reporting Board, CL 85ANC and CL87 PwC.

[20] CL 45 RTL Group, CL 57AASB, CL 60 SAICA, CL 65AOSSG and CL 85ANC.

(c) it would be difficult to demonstrate that both methods (revenue-based and units-of-production) would yield the same result.

30. Few respondents point out that some guidance in US GAAP explicitly allows the use of a revenue-based method in some circumstances and so not allowing the use of such method in IFRS would potentially create inconsistent accounting. [21] Examples of guidance in US GAAP that allows the use of a revenue-based method are:

(a) Topic 926 *Entertainment-Films* in the FASB Accounting Standards Codification®; and

(b) Topic 920 *Entertainment–Broadcasters* in the FASB Accounting Standards Codification®.

31. One respondent welcomes the inclusion of paragraphs BC3–BC5 because the revenues generated per broadcast in relation to the total viewers reached would appropriately reflect the pattern of consumption of economic benefits embodied in certain intangible assets, such as the acquired rights to broadcast programmes multiple times (ie multi-broadcast programming assets).[22] This respondent affirms that there is a strong correlation between the number of viewers reached per broadcast and the amount of revenue earned because the initial broadcast will usually attract the largest audience share and thus be substantially more valuable to advertisers (carry more economic benefits) than later ones.

32. This respondent observes that in the case of multi-broadcast programming assets, an amortisation method based on the passage of time (ie straight-line amortisation) or on the contractually agreed number of broadcasts (ie units-of-production) would not be appropriate as it would lead to the overvaluation of intangible assets and would therefore trigger the need to record an impairment under IAS 36 if the amortised cost is not recoverable by the future cash-inflows generated in later broadcasts.

[21] CL 45 RTL Group and CL 72 E&Y.

[22] CL 25 ProSiebenSat.1 Media AG.

33. In line with the argument above another respondent affirms that the consumption of the future economic benefits embodied in film rights is not determined by time, the number of exhibits or the number of viewers, but by the market price that exhibitors are willing to pay for the right to show the film.[23] For example, a film producer that recognises the costs incurred in the production of a film as an asset (ie an intellectual property asset) may rely on the forecasted revenue it expects to earn from the commercialisation of the film on various different markets, such as movie theatres, pay-per-view, home video, pay television, internet and free TV.

Suggested path forward

34. Some respondents think that the IASB should allow a revenue-based method in circumstances where an asset will generate the majority of its economic benefits in the early stages of its life and is expected to decline over time or when the generation of revenue is expected to be uneven.[24] Otherwise, they think that an entity would be forced to recognise an inevitable impairment loss during the life of the asset, because the depreciation or amortisation charged will not match the generation of economic benefits.

35. One respondent disagrees with the view of allowing a revenue-based method when a substantial proportion of the asset's economic benefits are consumed at the beginning of its useful life because other methods of depreciation or amortisation, such as the declining balance method or the units-of-production method could achieve a similar pattern of depreciation or amortisation.[25]

Other concerns expressed in other industries

36. One respondent in the airline industry points out that in its jurisdiction, intangible assets recognised as a result of the service concession agreement are amortised based on the forecasted passenger numbers over the concession period, despite the strong correlation that exists between the number of passengers and the revenue received.[26] This respondent questions whether it is the intention of the IASB to

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[23] CL 37 Ricardo Lopes Cardoso.

[24] CL 40 BP plc, CL 72 E&Y.

[25] CL 87 PwC.

[26] CL 67 Budapest Airport.

have any impact on the current amortisation method of the concession asset, which is based on passenger numbers, not revenue.

37. Another respondent from the insurance sector asserts that Insurance Contract Deferred Acquisition Costs (DAC) are amortised on the basis of expected profitability of the underlying insurance contracts and believe that this approach incorporates a revenue based parameter. This respondent notes that under the current proposals in IFRS 4 *Insurance Contracts*, the insurance DAC will not be recognised as an intangible asset anymore but certain acquisition costs will be reflected in the projection of the insurance contract liability. This respondent is concerned that that the proposed amendments to IAS 38 might create an inconsistency with regards to the treatment of intangible insurance assets[27].

__Issue 3:__ the meaning of the term 'consumption of economic benefits' is unclear

38. The IASB proposes adding paragraph 62A of IAS 16 and paragraph 98A of IAS 38 to prohibit a depreciation or amortisation method that uses revenue generated from an activity that includes the use of a tangible or an intangible asset, because it does not reflect the pattern in which an asset's future economic benefits are expected to be consumed by the entity.

39. Around a dozen respondents think that the notion of 'consumption of economic benefits' should be defined, and they urge the IASB to consider providing guidance in this respect.[28]

40. Within those respondents:

    (a) one respondent notes that defining this notion would be particularly relevant when it is difficult to determine the basis for amortisation of certain intangible assets.

    (b) a few respondents have a stricter view and think that explaining the meaning of 'consumption of economic benefits' should be the IASB's

[27] CL 73 European Insurance CFO Forum.

[28] CL 12 The Malaysian Institute of CPA, CL 39 Litrak, CL 49 Sprint, CL 55 Grand Saga, CL 57 AASB, CL 58 MASB, CL 60 SAICA, CL 65 AOSSG, CL 70 DSAK, CL 78 ACCA, CL 98 HKICPA.

only focus in clarifying the guidance in paragraph 62 of IAS 16 and paragraph 98 of IAS 38 to ensure that entities select an appropriate method of depreciation or amortisation.

(c) other respondents think that it is also important to clarify why the notion of 'consumption of economic benefits' is different from the one introduced by the proposed amendment of 'generation of economic benefits'.

<u>Issue 4:</u> The proposed guidance in regards to the diminishing balance method is confusing

41. Paragraph 62B of IAS 16 and paragraph 98B of IAS 38 in the ED clarify the application of the diminishing balance method, by explaining that an expected future reduction in the unit selling price of the product or service output of an asset could indicate technical or commercial obsolescence.

42. A number of respondents question the addition of those paragraphs and a majority of them maintain that the rationale behind the inclusion of them is unclear.[29]

43. Some others point out that it is unclear whether a reduction in the unit selling price of the product or service output would lead to:[30]

(a) an adjustment of the depreciation or amortisation charge; or

(b) an impairment according to IAS 36.

44. Some others do not agree that information about obsolescence is only relevant when applying a diminishing balance method of depreciation .[31] They assert that this information is also relevant when applying other methods.

45. Other individual comments expressed were:

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[29] CL 20 Business Europe, CL 27 AcSB, CL 38 ASC, CL 62 Deloitte, CL 63 Repsol, CL 64 ICPAK, CL 65 AOSSG, CL 69 BDO, CL 91 EFRAG.

[30] CL 22 GASB, CL 51 RSM International, CL 56 Kameswari, CL 77 SwissHoldings.

[31] CL 8 FRC UK, CL 17 Grant Thornton, CL 27 AcSB, CL 38 ASC, CL 51 RSM International, CL 66 Baker Tilly, CL 96 IOSCO, CL 97 OIC.

(a) it is unclear whether an expected increase in unit selling price could also be an indication of an increase in the future economic benefits of the asset;[32]

(b) the diminishing balance method should be defined;[33] and

(c) paragraphs BC3–BC5 lead to confusion that depreciation reflects a decline in value of the asset instead of being "a systematic allocation of the depreciable amount of an asset over its useful life".[34]

Issue 5: ***the proposed guidance should not be applied on a retrospective basis***

46. Around a quarter of respondents commented on the proposal to require the retrospective application of the proposed amendment to IAS 16 and IAS 38. More than two thirds of these respondents disagree with the IASB's proposal because they note that in accordance with paragraph 5 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, any change in the periodic consumption of an asset represents a change in an accounting estimate and should be accounted for prospectively, not retrospectively.

47. Among those who disagree, a small group urge the IASB to rethink the proposal to require retrospective application because it may be too onerous in some circumstances.[35] For example, when entities have been applying a revenue-based method (i.e. entities with SCAs or entities in the media sector). One respondent urges the IASB to clearly articulate its rationale for requiring retrospective application of the proposed amendment.[36]

48. A small number of respondents support the retrospective application of the proposed amendment because they think that:[37]

[32] CL 40 BP plc.

[33] CL 51 RSM.

[34] CL 89 Institute of Certified Public Accountants in Israel.

[35] CL 26 Puncak Niaga Holdings Berhad, CL 45 RTL Group and CL 62 Deloitte.

[36] CL 39 LITRAK.

[37] CL 10 Group of 100, CL 27 AcSB, CL 57 AASB, CL 70 DSAK and CL 91 EFRAG.

(a) it should not be too onerous as IAS 8 contemplates situations where retrospective application may be *impracticable* (paragraph 5 of IAS 8);

(b) the change derived from the proposed amendment is closer in nature to a change in an accounting policy; and

(c) retrospective application of the proposed amendments ensures comparability.

49. One respondent agrees with the proposal to require retrospective application, but disagrees that considering information about technical or commercial obsolescence when estimating the pattern of consumption of future economic benefits and the useful life of the asset should be applied retrospectively because in the respondent's view, this is a change in an estimate.[38]

Issue 6: ***the statement "when it was acquired" in paragraph 62A of IAS 16 and in paragraph 98A of IAS 38 should be deleted***

50. The proposed new paragraph 62A of IAS 16 and paragraph 98A of IAS 38 mention that paragraph 60 of IAS 16 and paragraph 97 of IAS 38 (respectively) establish the consumption of the benefits that were inherent in the asset (or the intangible asset) *when it was acquired* as the principle for depreciation (or amortisation). A dozen respondents noted some contradictions between this proposed guidance and other guidance in IAS 16 and IAS 38 because:[39]

(a) neither paragraph 60 of IAS 16 nor paragraph 97 of IAS 38 make reference to the time of acquisition (i.e. "when the asset was acquired");

(b) the proposed guidance in paragraph 62A of IAS 16 and paragraph 98A of IAS 38 could lead to inconsistencies with other guidance in IAS 16 and IAS 38 as it contradicts the guidance in:

[38] CL 27 AcSB.

[39] CL 1 EUBA, CL 8 FRC, CL 17 Grant Thornton, CL 20 Business Europe, CL 27 AcSB, CL 32 ACTEO, CL 51 RSM International Limited, CL 57 AASB, CL 61 Confederation of Swedish Enterprise, CL 65 AOSSG, CL 66 Baker Tilly, CL 83 The Swedish Financial Reporting Board.

(i) paragraphs 31–41 of IAS 16 when an entity chooses a revaluation model because the depreciable amount would be higher than the acquisition value of the asset;

(ii) paragraph 61 of IAS 16, which requires the depreciation method to be reviewed at least at each financial year-end for significant changes in the expected pattern of consumption of the future economic benefits embodied in the asset; and

(iii) paragraph 98 of IAS 38, which requires the amortisation method to be changed if there is a change in the expected pattern of consumption of the future economic benefits embodied in the asset.

51. A majority of respondents propose the IASB to delete the statement "when it was acquired" in paragraph 62A of IAS 16 and in paragraph 98A of IAS 38 to avoid confusion.

Staff analysis and recommendations

52. Our analysis of the comments received is discussed in detail below. We think that the Interpretations Committee should recommend the IASB to:

(a) eliminate any contradiction between the explanations in the BC and the guidance in the body of the Standard;

(b) make clear the prohibition of the use of a revenue-based method in all circumstances;

(c) remove the proposed guidance with regards to the diminishing balance method in proposed paragraph 62B of IAS 16 and paragraph 98B of IAS 38 and include, instead, a clarification to paragraph 56(c) of IAS 16 to state that technical or commercial obsolescence could also arise from "a future expected reduction in the unit selling price for the product or service output of the asset";

(d) delete the statement "when it was acquired" in paragraph 62A of IAS 16 and paragraph 98A of IAS 38; and

(e) apply the proposed amendment to IAS 16 prospectively.

Eliminate any contradiction between the explanations in the BC and the guidance in the body of the Standard

53. As noted in paragraphs 15–17 of this paper, a number of respondents expressed concern that the BC was introducing a limited exception to the general principle introduced in the Standard to prohibit the use of a revenue-based method in all circumstances.

54. In our view the explanations in the BC were not introducing a limited exception for the use of a revenue-based method. Instead, the explanation in the BC was intended to describe some limited circumstances in which revenue data would be correlated with production data and could therefore be used to reflect the pattern in which future economic benefits of the asset are expected to be consumed.

Suggested path forward

55. We have identified two alternatives in addressing this issue.

    (a) <u>Alternative A:</u> the explanations in the BC, introducing limited circumstances in which revenue data would be correlated with production data, should be included within the guidance in the body of Standard.

    (b) <u>Alternative B:</u> clarify that the use of a revenue-based method is prohibited in all circumstances, and remove the description included in the BC of the limited circumstances in which revenue data would be correlated with production data.

56. We acknowledge that the objective of the IASB has been to prohibit the use of a revenue-based method in all circumstances. During its deliberations, the IASB observed that methods selected on the basis of the pattern of generation of the expected future economic benefits embodied in the asset, such as the generation of future revenues or future profits, are not appropriate on the basis of the current guidance in IAS 16 and IAS 38. Moreover, they noted that the guidance in these

Standards enables the use of both time-based and units-of-production-based approaches but it does not allow for the use of approaches based on revenue.

57. However, during the drafting process of the proposed amendment, some constituents raised some concerns to the IASB about prohibiting such a method in cases where revenue would appropriately reflect the pattern of consumption of economic benefits embodied in certain intangible assets.

58. The IASB found some merit in the use of a revenue-based approach when it is used as a reliable approximation of the units-of-production method. However, as we have noted in our analysis, a few respondents expressed their concerns about the narrow circumstances identified by the IASB when revenue could be used as an approximation of the pattern of consumption of an asset.

59. We think that if it is the IASB's intention to prohibit a revenue-based approach it should do so in all circumstances and should not introduce examples or guidance that risk contradicting the main requirement.

60. Consequently, we support Alternative B. Our proposal is to eliminate any explanations in the BC that would appear to contradict the main guidance in the body of the Standard.

61. Alternatively, if the Interpretations Committee recognises that revenue may be, in some circumstances, a valid proxy for consumption, it should then include this presumption in the body of the Standard and not in the BC.

62. We will discuss in paragraphs below why we think that the IASB should include the prohibition to use a revenue-based approach (in all circumstances).

Question 1 for the IFRS Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB that it should clarify that the use of a revenue-based method is prohibited in all circumstances, thereby removing the description included in the BC of the limited circumstances in which revenue data would be correlated with production data? If not, why and what does the Interpretations Committee want to do instead?

Make clear the prohibition of the use of a revenue-based method in all circumstances

63. As noted in paragraphs 18–37 of this paper, many respondents from some specific sectors expressed their concerns about the prohibition to amortise intangible assets using a revenue-based method on the basis that the nature of tangible and intangible assets appear to be different and provided that the use of revenue as a proxy for consumption is a standard practice in some industries.

64. In addition, as noted in paragraphs 38–40 of this paper, a few respondents think that the notion of 'consumption of economic benefits' should be defined and they urge the IASB to consider providing guidance in this respect.

65. We observe that, at present, paragraph 60 of IAS 16 and paragraph 97 of IAS 38 are clear that the depreciation or amortisation method shall reflect the pattern in which the asset's (future) economic benefits are expected to be consumed by the entity. However, only IAS 16 (in paragraph 56) further clarifies that the 'use' of an asset can be assessed by reference to the asset's expected capacity or physical output and paragraph 56(b)–(e) of IAS 16 further mentions other factors that can be used to assist in the determination of the useful life of a tangible asset.

66. Paragraph 56 states that (emphasis added):

> 56 The future economic benefits embodied in an asset **are consumed by an entity principally through its use.** However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:
>
> (a) **expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output**.
>
> (b) **expected physical wear and tear**, which depends on operational factors such as the number of shifts for which the asset is to be

used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) **technical or commercial obsolescence** arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

67. IAS 38 does not clarify how the future economic benefits embodied in an intangible asset are typically consumed or which factors should be used to assist in the determination of a pattern of consumption of an intangible asset. Paragraph 90 of IAS 38 only mentions factors that may be considered in determining the useful life of an intangible asset.

68. We think that the lack of specific guidance in IAS 38 regarding what determines the pattern of consumption for intangible assets leads to some valid questions. For instance:

(a) what determines the pattern of consumption of an intangible asset (i.e. how is an intangible asset 'used up')?

(b) should intangible assets have the same pattern of consumption as tangible assets (i.e. should they be analysed in terms of their expected capacity or output)?

69. Comments from some respondents appear to suggest that intangible assets are 'used up' in a different way than tangible assets, and thus they deserve some consideration when choosing an appropriate amortisation treatment. However, after reading the responses, we were not able to find sufficient common ground in the views expressed or any particular arguments that would indicate a clear answer that would help us to determine the pattern of consumption for intangible assets and why this pattern is different from tangible assets.

70. Responses from the media sector suggest that assets with short useful lives and significant earning power in the early years are common and require an accelerated method of amortisation. A revenue-based approach has been used as a solution to match the revenue with the costs generated from some activities in this sector. However, we do not think that this is the only methodology that would achieve the desired objective of producing an accelerated pattern of amortisation.

71. For assets that require a heavy depreciation or amortisation at the beginning we think that the 'diminishing balance method' (also referred to as the 'reducing-balance' method and the 'declining-balance') and the 'sum- of-the-years'-digits' method are the best-known methodologies that achieve the goal of creating a decreasing charge of amortisation. In respect of these methodologies we note that US GAAP has the following commentary in Topic 360 *Property, Plant, and Equipment* (subtopic 10-35-7) in the FASB Accounting Standards Codification® states that (emphasis added):

> The declining-balance method is an example of one of the methods that meet the requirements of being systematic and rational. **If the expected productivity or revenue-earning power of the asset is relatively greater during the earlier years of its life, or maintenance charges tend to increase during later years, the declining-balance method may provide the most satisfactory allocation of cost. That conclusion also applies to other methods, including the sum-of-the-years'-digits method**, that produce substantially similar results.

72. Nevertheless, we did not receive evidence from respondents on the reasons why the declining-balance method and the sum-of-the-years'-digits method have not been adopted into practice within the media sector. Instead, we observe that a revenue-based approach has been applied in the media sector as a convenient practice, because based on our understanding of the use of this method (derived from some conversations with constituents and through the comment letters), a revenue-based method matches costs with revenue, which in turn leads to margins that are more stable.

73. In respect of intangible assets that arise from service concession arrangements, respondents also argue that revenue is a good approximation of the consumption of the future economic benefits generated by the concession right.

74. In the responses provided, some respondents point out that the economic benefits derived from an intangible asset SCA are a function of price (i.e. toll rates) and volume (i.e. traffic), which is an aspect that we cannot disagree with as this is the consideration that the operator receives for its services in accordance with paragraph 17 of IFRIC 12.

75. We, however, do not think that a revenue-based approach constitutes an appropriate reflection of how the intangible asset in an SCA is used up or consumed. This is because respondents have confirmed that the determination of toll rates (i.e. the 'price' component) involves the consideration of multiple parameters that do not necessarily coincide with the way that the intangible asset is used up, such as inflation rates (that are a function of the prices of other goods and services that may not be related to the SCA) or annual tariff increases due to improvements in the quality of service, efficiency or safety or environmental impact, among others. Moreover, we observe that toll rates are not within the control of the operator.

Suggested path forward

76. We have identified two alternatives to address this issue:

    (a) Alternative A: amend IAS 16 to prohibit the use of a revenue-based depreciation method and do not amend IAS 38.

    (b) Alternative B: continue with the proposal to make clear the prohibition of the use of a revenue-based methodology in both IAS 16 and IAS 38.

77. Under Alternative A, IAS 16 will be amended to prohibit the use of a revenue-based method. The proposal to amend IAS 38 will be placed on hold until the IASB conducts further research on the pattern of consumption of economic benefits of intangible assets. This analysis could be done as a narrow scope amendment to IAS 38.

78. Under Alternative B, the prohibition of the use of a revenue-based methodology would be made clear in both IAS 16 and IAS 38 in all circumstances.

79. We support Alternative B (i.e. prohibit the use of a revenue-based approach in all circumstances) because a revenue-based method is not a method based on consumption. We think that the Interpretations Committee should recommend the IASB to follow this approach.

Question 2 for the IFRS Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB that it should prohibit the use of a revenue-based method in IAS 16 and IAS 38 in all circumstances? If not, why and what does the Interpretations Committee want to do instead?

Remove the proposed guidance in regards to the diminishing balance method because it is confusing and include a clarification to paragraph 56(c) of IAS 16

80. As noted in paragraphs 41–45 of this paper some respondents question the addition of paragraph 62B of IAS 16 and paragraph 98B of IAS 38 to clarify the application of the diminishing balance method because they find the wording in these paragraphs confusing and cannot see the point of their inclusion. They also question why the guidance is specific to the application of the diminishing balance method.

81. We understand that the IASB's objective was to clarify that reductions in the selling price could signal the existence of obsolescence which in turn reflects a reduction in the economic benefits consumed from the asset.

Suggested path forward

82. We think that the best way to clarify the IASB's intent is to amend paragraph 56(c) of IAS 16 and not to add paragraph 62A in IAS 16 because the guidance in paragraph 56(c) already considers technical or commercial obsolescence as a factor to determine the useful life of an asset and further explains how obsolescence could arise in some cases.

83. Consequently, our proposal to the Interpretations Committee is to recommend the IASB to amend paragraph 56(c) as shown below:

> The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:
>
> (a) …
>
> (c) technical or commercial obsolescence arising from changes or improvements in production, ~~or~~ from a change in the market demand <u>or from a future expected reduction in the unit selling price</u> for the product or service output of the asset.

84. We also propose deleting the guidance in paragraph 98B in IAS 38. We do not propose adding any further guidance to IAS 38. This is because we observe that paragraph 90 of IAS 38, which includes factors considered in determining the useful life of an intangible asset, is not specific about how obsolescence may arise, so we think that further guidance is not needed in this paragraph.

Question 3 for the IFRS Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB to eliminate paragraphs 62B in IAS 16 and paragraph 98B in IAS 38 and clarify in paragraph 56(c) of IAS 16 that technical or commercial obsolescence could also arise from a future expected reduction in the unit selling price for the product or service output? If not, why and what does the Interpretations Committee want to do instead?

Delete the statement "when it was acquired" in paragraph 62A of IAS 16 and in paragraph 98A of IAS 38

85. As noted in paragraphs 50–51 of this paper, some respondents propose the IASB to delete the statement "when it was acquired" in paragraph 62A of IAS 16 and in

paragraph 98A of IAS 38 because this statement contradicts other guidance in IAS 16 and IAS 38. These paragraphs are reproduced below (emphasis added):

> 62A A method that uses revenue generated from an activity that includes the use of an asset is not an appropriate depreciation method for that asset, because it reflects a pattern of the future economic benefits being generated from the asset, rather than a pattern of consumption of the future economic benefits embodied in the asset. Paragraph 60 establishes consumption of the benefits that were inherent in the asset <u>when it was acquired</u> as the principle for depreciation.
>
> 98A A method that uses revenue generated from an activity that includes the use of an intangible asset is not an appropriate amortisation method for that intangible asset, because it reflects a pattern of economic benefits being generated from the intangible asset, rather than a pattern of consumption of the future economic benefits embodied in the intangible asset. Paragraph 97 establishes consumption of the benefits that were inherent in the asset <u>when it was acquired</u> as the principle for amortisation

Suggested path forward

86. We agree with the respondents' comments and propose to delete the statement "when it was acquired" in the final drafting of the proposed amendment.

Question 4 for the IFRS Interpretations Committee
1. Does the Interpretations Committee agree to delete the statement "when it was acquired" in the final drafting of the proposed amendment. If not, why and what does the Interpretations Committee want to do instead?

The proposed amendment to IAS 16 should be applied prospectively

87. As noted in paragraphs 46 –49 of this paper, many respondents support the prospective application of the proposed amendment.

88. During its deliberations, the IASB agreed, in principle, that the application of the proposed amendment should follow the general principles in IAS 8 and entities should apply the proposed amendment prospectively in line with existing requirements for changes in accounting estimates in paragraphs 32–38 of IAS 8.

89. In the course of drafting the transition and effective date of the proposed amendment, we observed that a revenue-based method is not an accepted methodology (at least implicitly) under the current guidance in IAS 16 and IAS 38 and we concluded that applying the proposed amendment retrospectively could enable an entity to amend its information from prior periods.

90. Nevertheless we agree with the respondents' comments that applying the proposed amendment on a prospective basis in line with existing requirements for changes in accounting estimates in paragraphs 32–38 of IAS 8, rather than on a retrospective basis. This would also be consistent with the requirements in paragraph 61 of IAS 16 and in paragraph 102 of IAS 38 for revisions of estimates.

Suggested path forward

91. We think that the Interpretations Committee could recommend the IASB to reconsider the application of the proposed amendment to be prospective rather than retrospective due to the concerns raised. In addition, applying the proposed amendment on a prospective basis would be consistent with the requirements in IAS 16 and IAS 38 for revisions of estimates.

Question 5 for the IFRS Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB that the proposed amendment should be applied prospectively in accordance with IAS 8? If not, why and what does the Interpretations Committee want to do instead?

Appendix A-— List of respondents

ID	Respondent	Country
1	Ekonomická Univerzita v Bratislave (EUBA) [University of Economics in Bratislava]	Slovakia
2	Jairam Raghunatha Rao	Not specified
3	Agata Laura Marelli	Not specified
4	California Society of Certified Public Accountants (CalCPA)	United States
5	Mr L. Venkatesan	India
6	Saudi Organization for Certified Public Accountants (SOCPA)	Saudi Arabia
7	Mr Chris Barnard	Germany
8	Financial Reporting Council (FRC) [UK]	United Kingdom
9	Hydro-Quebec	Canada
10	Group of 100 Inc. [Australia]	Australia
11	Roche Group	Switzerland
12	Institut Akauntan Awam Bertauliah Malaysia [The Malaysian Institute of Certified Public Accountants (CPA)]	Malaysia
13	CPA Australia Ltd	Australia
14	Comitê de Pronunciamentos Contábeis (CPC) [Brazilian Committee for Accounting Pronouncements]	Brazil
15	The Hong Kong Association of Banks (HKAB)	China
16	South Western Society Of Chartered Accountants (SWSCA)	United Kingdom
17	Grant Thornton International Ltd	United Kingdom
18	Raad voor de Jaarverslaggeving [Dutch Accounting Standards Board (DASB)]	Netherlands
19	Instituto de Contabilidad y Auditoría de Cuentas (ICAC) [Accounting and Auditing Institute of Spain]	Spain
20	BusinessEurope	Belgium
21	The Linde Group	Germany
22	Deutsches Rechnungslegungs Standards Committee e.V. (DRSC) [German Accounting Standards Board (GASB)]	Germany
23	The Institute of Chartered Accountants of Nigeria (ICAN)	Nigeria
24	Syngenta International AG	Switzerland
25	ProSiebenSat.1 Media AG	Germany
26	Puncak Niaga Holdings Berhad	Malaysia

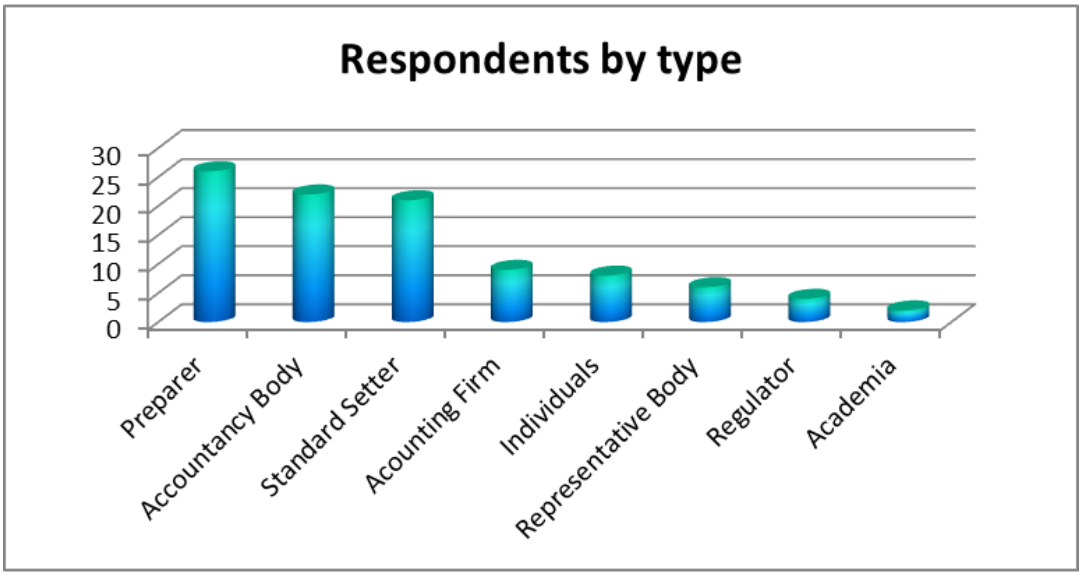
ID	Respondent	Country
27	Accounting Standards Board of Canada (AcSB)	Canada
28	School of Accountancy of University of the Witwatersrand	South Africa
29	The Institute for the Accountancy Profession in Sweden (FAR)	Sweden
30	Graham Walker	Not specified
31	Stephen Oong	Malaysia
32	Association pour la participation des entreprises françaises à l'harmonisation comptable internationale (ACTEO) [French association for the participation of businesses in the convergence of accounting standards]	France
33	Assiciazione Italiana Societa Concessinarie Autostrade e Trafori (AISCAT)	Italy
34	Institute of Chartered Accountants Ireland (ICAI)	Ireland
35	Grupo Latinoamericano de Emisores de Normas de Información Financiera (GLENIF) [Group of Latin-american Accounting Standard Setters (GLASS)]	Brazil
36	KPMG IFRG Limited	United Kingdom
37	Ricardo Lopes Cardoso	Brazil
38	Singapore Accounting Standards Council (ASC)	Singapore
39	Lingkaran Trans Kota Holdings Berhad (LITRAK)	Malaysia
40	BP p.l.c	United Kingdom
41	McLachlan & Tiffin	United Kingdom
42	Standard Chartered PLC	United Kingdom
43	Accounting Standards Board of Japan (ASBJ)	Japan
44	The Institute of Chartered Accountants of Scotland (ICAS)	United Kingdom
45	RTL Group S.A.	Luxembourg
46	International Association of Consultants, Valuators and Analysts (IACVA)	Canada
47	Institute of Certified Public Accountants of Rwanda (iCPAR)	Rwanda
48	Persatuan Syarikat-Syarikat Konsesi Lebuhraya Malaysia (PSKLM) [Association of Highway Concession Companies of Malaysia]	Malaysia
49	Sprint	United States
50	Projekt Lintasan Kota Holdings	Malaysia
51	RSM International Limited	United Kingdom
52	Federación de Colegios de Contadores Públicos de Venezuela (FCCPV) [Federation of Public Accountants in Venezuela]	Venezuela
53	Konsortium Expressway Shah Alam Selangor Sdn Bhd (KESAS) [Concessionaire for the Shah Alam Expressway (SAE) or Lebuhraya Shah Alam]	Malaysia
54	Korea Accounting Standards Board (KASB)	Korea, Republic of
55	Grand Saga Sdn Bhd Concessionaire for the Cheras-Kajang Expressway	Malaysia

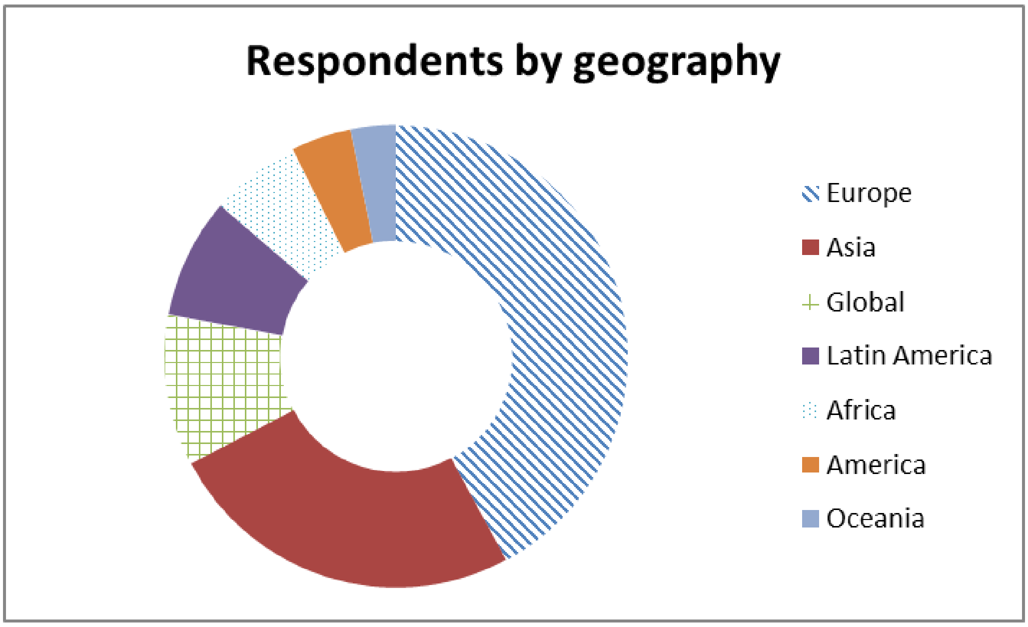
ID	Respondent	Country
56	Kameswari	Not specified
57	Australian Accounting Standards Board (AASB)	Australia
58	Malaysian Accounting Standards Board (MASB)	Malaysia
59	The Japanese Institute of Certified Public Accountants (JICPA)	Japan
60	South African Institute of Chartered Accountants (SAICA)	South Africa
61	Svenskt Naringsliv [Confederation of Swedish Enterprise]	Sweden
62	Deloitte	Global
63	Repsol	Spain
64	Institute of Certified Public Accountants of Kenya (ICPAK)	Kenya
65	Asian-Oceanian Standard-Setters Group (AOSSG)	Japan
66	Baker Tilly [Bromley UK]	United Kingdom
67	Budapest Airport	Hungary
68	Zambia Institute of Chartered Accountants (ZICA)	Zambia
69	BDO	United Kingdom
70	Dewan Standar Akuntansi Keuangan (DSAK) [Indonesian Financial Accounting Standard Board]	Indonesia
71	Vivendi	France
72	Ernst & Young	Global
73	European Insurance CFO Forum	United Kingdom
74	Associagao Brasileira de Concessionarias de Rodovias (ABCR)	Brazil
75	Norsk RegnskapsStiftelse (NASB) [Norwegian Accounting Standards Board]	Norway
76	Consejo Mexicano para la Investigación y Desarrollo de Normas de Informacion Financiera (CINIF) [Mexican Council for the implementation and the oversight of financial information]	Mexico
77	SwissHoldings [Federation of Industrial and Service Groups in Switzerland]	Switzerland
78	Association of Chartered Certified Accountants (ACCA)	United Kingdom
79	The Institute of Chartered Accountants of Pakistan (ICAP)	Pakistan
80	Mazars	France
81	Grupo Costanera	Chile
82	Chartered Institute of Public Finance and Accountancy (CIPFA)	United Kingdom

ID	Respondent	Country
83	Rådet för finansiell rapportering [The Swedish Financial Reporting Board]	Sweden
84	Ms Denise Silva Ferreira Juvenal	Brazil
85	Autorité des normes comptables (ANC) [French standard-setting body]	France
86	British Telecommunications plc (BT)	United Kingdom
87	PricewaterhouseCoopers (PwC)	Global
88	Larsen & Toubro Ltd	India
89	Institute of Certified Public Accountants in Israel	Israel
90	European Securities and Markets Authority (ESMA)	France
91	European Financial Reporting Advisory Group (EFRAG)	Belgium
92	The Corporate Reporting Users Forum (CRUF) [Japan]	Japan
93	Institute of Certified Public Accountants of Singapore (ICPAS)	Singapore
94	KL-KUALA SELANGOR EXPRESSWAY BERHAD (KLSEB)	Malaysia
95	The Institute of Chartered Accountants in England and Wales (ICAEW)	United Kingdom
96	Organización Internacional de Comisiones de Valores (OICV) [International Organisation of Securities Commissions (IOSCO)]	Spain
97	Organismo Italiano di Contabilità (OIC) [Italian Accounting Organisation]	Italy
98	Hong Kong Institute of Certified Public Accountants (HKICPA)	China

Appendix B –Respondents by type and geography

Respondent type	Africa	Asia	Europe	Latin America	America	Oceania	Global	Unspecified	Total
Preparer	0	8	13	2	2	1	0	0	**26**
Accountancy Body	5	5	9	1	1	1	0	0	**22**
Standard Setter	0	7	9	3	1	1	0	0	**21**
Accounting Firm	0	0	1	0	0	0	8	0	**9**
Individuals	0	2	1	2	0	0	0	3	**8**
Representative Body	0	1	5	0	0	0	0	0	**6**
Regulator	0	1	1	0	0	0	2	0	**4**
Academia	1	0	1	0	0	0	0	0	**2**
Total	**6**	**24**	**40**	**8**	**4**	**3**	**10**	**3**	**98**





Appendix C – Exposure Draft: *Clarification of Acceptable Methods of Depreciation and Amortisation*

We reproduce in the following paragraphs the IASB's proposal to amend IAS 16 and IAS 38 included in the ED/2012/5 and published in December 2012.

[Draft] Amendments to IAS 16 *Property, Plant and Equipment*

Paragraphs 62A–62B and 81G are added. Paragraph 62 is not proposed for amendment but is included here for ease of reference. New text is underlined.

Depreciation method

62 A variety of depreciation 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 units of production method. The straight-line method results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

<u>62A</u> <u>A method that uses revenue generated from an activity that includes the use of an asset is not an appropriate depreciation method for that asset, because it reflects a pattern of the future economic benefits being generated from the asset, rather than a pattern of consumption of the future economic benefits embodied in the asset. Paragraph 60 establishes consumption of the benefits that were inherent in the asset when it was acquired as the principle for depreciation.</u>

<u>62B</u> <u>When applying the diminishing balance method, information about technical or commercial obsolescence of the product or service output is relevant for estimating both the pattern of consumption of future economic benefits and the useful life of the asset. An expected future reduction in unit selling price of the product or service output of the asset could be an indication of the diminution of the future economic benefits of the asset as a result of technical or commercial obsolescence.</u>

Effective date and transition

81G *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to IAS 16 and IAS 38), issued in [date], added paragraphs 62A and 62B. An entity shall apply those paragraphs for annual periods beginning on or after [date] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted.

[Draft] Amendments to IAS 38 *Intangible Assets*

Paragraphs 98A–98B and 130G are added. Paragraph 98 is amended. New text is underlined.

Amortisation period and amortisation method

98 A variety of depreciation 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 units 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.

98A A method that uses revenue generated from an activity that includes the use of an intangible asset is not an appropriate amortisation method for that intangible asset, because it reflects a pattern of economic benefits being generated from the intangible asset, rather than a pattern of consumption of the future economic benefits embodied in the intangible asset. Paragraph 97 establishes consumption of the benefits that were inherent in the asset when it was acquired as the principle for amortisation.

98B When applying the diminishing balance method, information about technical or commercial obsolescence of the product or service output is relevant for estimating the pattern of consumption of future economic benefits of the asset and the useful life of the asset. A future expected reduction in unit selling price of the product or service output of the asset could be an indication of the diminution of the future economic benefits of the intangible asset as a result of technical or commercial obsolescence.

Effective date and transition

130G *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to IAS 16 and IAS 38), issued in [date], added paragraphs 98A and 98B. An entity shall apply those paragraphs for annual periods beginning on or after [date] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Depreciation and amortisation method

BC1 The IASB discussed whether it would be appropriate for plant and equipment to be depreciated and for intangible assets to be amortised using a revenue-based depreciation or amortisation method. A revenue-based depreciation or amortisation method is one that is derived from an interaction between units (ie quantity) and price, and that takes into account the expected future changes in price as the depreciation basis to allocate the amount of an asset that is to be depreciated or amortised. Paragraph 60 of IAS 16 and paragraph 97 of IAS 38 states that the depreciation or amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

BC2 The IASB proposes that a revenue-based depreciation or amortisation method should not be applied because it reflects a pattern of economic benefits being generated from operating the business (of which the asset is part) rather than the economic benefits being consumed through the use of the asset. The future economic benefits embodied in an asset are consumed by an entity principally through its use as described in paragraph 56 of IAS 16. The use of an asset can be assessed by reference to the asset's expected capacity or physical output as described in paragraph 56(a) of IAS 16. Other factors are mentioned in paragraph 56(b)–(d) of IAS 16 to assist in the determination of a pattern of consumption of an asset.

BC3 During its deliberations, the IASB considered the question of whether there could be limited circumstances in which revenue could be used to reflect the pattern in which the future economic benefits of the asset are expected to be consumed. The IASB noted that the limited circumstance when revenue could be used is when the use of a revenue-based method gives the same result as the use of a units of production method.

BC4 For example, some types of intellectual property assets (for example, acquired rights to broadcast a film) will initially incur a significant decline in value followed by a diminishing rate of decline (for example, when a film is initially shown and with each subsequent showing the value of the rights typically decrease quickly at first and then at a slower rate). The IASB noted that the use of a time-based straight-line amortisation method may not be appropriate in those cases because these rights have an inherent and fast initial pattern of decline in value.

BC5 The IASB observed that in those cases a measure such as the number of viewers attracted could be used as a reasonable basis for the pattern in which the benefits for those rights are expected to be consumed. In rare cases such as this, advertising revenue could serve as an equivalent for viewer numbers to the extent that advertising revenue has a linear relationship with viewer numbers.

BC6 The IASB also proposes to clarify that expected future reductions in the unit selling price of the product or service output of the asset could be an indicator of the diminution of the future economic benefits of the asset as a result of technical or commercial obsolescence (which is described as a factor for determining the useful life of an asset in paragraph 56(c) of IAS 16 and in paragraph 90(c) of IAS 38), and thereby relevant when applying the diminishing balance method.

BC7 The IASB decided to make consistent the phrase ‘units of production method’ and has therefore amended those instances of phrases ‘unit of production method’.

[Draft] Amendments to the Basis for Conclusions on IAS 38 *Intangible Assets*

Paragraph BC72A is amended. New text is underlined.

BC72A The last sentence of paragraph 98 previously stated, '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, this wording was perceived as preventing an entity from using the unit<u>s</u> of production method to amortise assets if it resulted in a lower amount of accumulated amortisation than the straight-line method. However, using the straight-line method could be inconsistent with the general requirement of paragraph 38 that the amortisation method should reflect the expected pattern of consumption of the expected future economic benefits embodied in an intangible asset. Consequently, the Board decided to delete the last sentence of paragraph 98.

[Draft] Amendments to the Basis for Conclusions on IFRIC 12 Service Concession Arrangements

Paragraph BC64 is amended. New text is underlined.

BC64 The IFRIC considered whether it would be appropriate for intangible assets under paragraph 26 to be amortised using an 'interest' method of amortisation, ie one that takes account of the time value of money in addition to the consumption of the intangible asset, treating the asset more like a monetary than a non-monetary asset. However, the

IFRIC concluded that there was nothing unique about these intangible assets that would justify use of a method of depreciation different from that used for other intangible assets. The IFRIC noted that paragraph 98 of IAS 38 provides for a number of amortisation methods for intangible assets with finite useful lives. These methods include the straight-line method, the diminishing balance method and the units 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.