STAFF PAPER

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Project	**Narrow-scope amendment: IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*—Clarification of acceptable methods of depreciation and amortisation**
Paper topic	Summary of the Interpretations Committee's recommendations

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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 contained a proposal to amend IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* to prohibit a depreciation or amortisation method that uses revenue generated from an activity that includes the use of an asset.

2. At the July 2013 meeting, the Interpretations Committee was presented with a summary and an analysis of the 98 comment letters received on the ED. This summary is included in Agenda Paper 6 of July 2013.

3. The members of the Interpretations Committee discussed the comments received and directed the staff to develop the proposed amendment further, in order to clarify the principle in paragraph 60 of IAS 16 for depreciating assets and the principle in paragraph 97 of IAS 38 for amortising intangible assets.

4. At the September 2013 meeting, the Interpretations Committee discussed the staff recommendations to finalise the amendment to IAS 16 and IAS 38. These recommendations can be found in Agenda Paper 2 of September 2013.

5. A majority of the members of the Interpretations Committee thought that the IASB should proceed to finalise the proposed amendment, but a number of the members expressed some concerns about the proposed amendments. We will address these concerns in the body of this paper when referring to the Interpretations Committee's recommendations on the proposed amendments.

Purpose of this paper

6. The purpose of this paper is:

   (a) to present to the IASB the Interpretations Committee's recommendations on the proposed amendments to IAS 16 and IAS 38 that it discussed at its meetings in July 2013 and September 2013; and

   (b) to obtain an IASB decision on the finalisation of these proposed amendments.

Summary of the Interpretations Committee discussion

7. In the paragraphs that follow we present:

   (a) Section 1: a summary of the proposed amendments to IAS 16 and IAS 38 as originally proposed by the IASB;

   (b) Section 2: a summary of the main comments received from respondents. For a detailed description of the comments received and the source of those comments, the IASB should refer to Agenda Paper 6 presented to the Interpretations Committee at the July 2013 meeting; and

   (c) Section 3: a summary of the discussion held by the Interpretations Committee at the July and September 2013 meetings and a summary of the changes that the Interpretations Committee recommends for the finalisation of the proposed amendments in response to the comments received.

Section 1: Summary of the proposed amendments included in the ED

8. The IASB received a request to clarify the meaning of the term 'consumption of the expected future economic benefits embodied in the asset' when determining the appropriate amortisation method for intangible assets of service concession arrangements (SCA) that are within the scope of IFRIC 12 *Service Concession Arrangements*. This issue related to the application of paragraphs 97 and 98 of IAS 38. The IASB was asked to consider whether a revenue-based amortisation method better reflected the economic reality of the underlying contractual terms.

9. The IASB analysed the issue raised within the context of the guidance for amortisation methods in IAS 38 and for depreciation methods in IAS 16 and considered adding some proposed amendments to both Standards to clarify the use of a revenue-based method.

10. The IASB decided to publish an ED that includes a proposal to add paragraph 62A to IAS 16 and add paragraph 98A to 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. This is because a method that uses revenue reflects a pattern in which future economic benefits are expected to be generated by the entity from the use of the asset.

11. Paragraphs BC3 and BC5 in the Basis for Conclusions (BC) of the ED indicated that there were some limited circumstances in which revenue data would be correlated with production data. The revenue data 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.

12. The BC used broadcasting rights as an example for which to acknowledge that straight-line amortisation would not be appropriate and opened the possibility of revenue-based amortisation being used in rare cases in which revenue had a linear relationship to viewer numbers.

13. The ED also includes a proposal to add paragraph 62B to IAS 16 and paragraph 98B to IAS 38 to clarify the application of the diminishing balance method. The 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.

14. Lastly, the ED includes a proposal to require the retrospective application of the proposed amendments to IAS 16 and IAS 38.

Section 2: Summary of the main comments received from respondents

15. At the July 2013 meeting it was reported that:

    (a) A majority of respondents agreed with the proposal to prohibit a revenue-based depreciation method for tangible assets, but expressed many concerns about prescribing such a prohibition for intangible assets, because they thought that there are certain circumstances in which a revenue-based method could be used as a reliable proxy to reflect the consumption of an intangible asset's future economic benefits;

    (b) a number of respondents disagreed with the proposal to amend IAS 16 and IAS 38, mainly because they considered that the guidance in IAS 16 and IAS 38 was sufficient and further guidance was not needed; and

    (c) a small number of the respondents agreed with the proposal to amend IAS 16 and IAS 38, because they thought that this proposal would further clarify the requirements in IAS 16 and IAS 38 regarding the choice of a depreciation or amortisation method.

Ambiguity between the guidance in the body of the Standard and the BC

16. Many respondents perceived a contradiction between the core guidance in the Standard and the explanations in the BC, because they observed that:

(a) while the 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,

(b) 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. The IASB noted that this limited circumstance would be when the use of a revenue-based method gives the same result as the units of production method.

Revenue as a "proxy" for consumption

17. Respondents had interpreted the explanations in the Basis for Conclusions as allowing the use of revenue as an approximation (or proxy) of the pattern of consumption of an asset and questioned why such guidance had not been included within the main body of the Standard.

18. A few of those respondents observed that, particularly for amortising intangible assets, the IASB should not restrict the use of a revenue-based method, because they think that this method represents the most appropriate approach to reflect the consumption of an intangible asset's future economic benefits.

19. A few of these respondents observed that a way to remove the apparent inconsistency between the guidance in the body of the Standard (IAS 16 and IAS 38) and the Basis for Conclusions would be to state within the body of the Standard that in limited circumstances revenue could be used as a reliable proxy for consumption. This suggestion to allow the use of revenue as a "proxy" for consumption was particularly supported by a few respondents from the media and the construction sector.

20. For instance, respondents from the construction sector observed that the nature of the intangible asset that is inherent in a service concession arrangement represents a 'right to charge users' or a 'right to collect tolls from users' and consequently,

the consumption of the economic benefits embodied in this intangible asset should be based on:

(a) the use of the concession right rather than on the use of the underlying asset; and should be

(b) a function of both toll rates and expected traffic volume (ie a "revenue" approach), rather than being based only on expected traffic volume (the "units of production" approach).

21. The following extract from one of the comment letters received[1] on the ED illustrates the views above (emphasis added) :

> For a highway concession asset within the scope of IFRIC 12, the concession right represents the right to charge users of the highway (IFRIC 12 para 17), or a right to collect tolls from road users (IFRIC 12 IE 14). The intangible asset is therefore not a right to operate the highway, nor a right to use the highway.
>
> **If the nature of the intangible asset is "a right to charge users of the public service", or "a right to collect tolls from road users", and if the rates the operator is allowed to charge the users is contractually fixed in the arrangement, and not dictated by market forces or by negotiation with the grantor on a periodic basis throughout the concession period, it is clear that the economic benefits embodied in the "right to charge users" is a function of both the toll rate and the number of vehicles using the highway**. **Accordingly, any method of amortisation of this right without taking into consideration this contractually predetermined toll rates will not be a reflection of the consumption of the economic benefits**.

[1] Comment letter sent by Stephen Oong.

22. Respondents from the media sector pointed out that the consumption of economic benefits inherent in certain intangible assets (ie acquired rights) may often not be determinable by reference to physical outputs or general wear and tear. Consequently, neither a straight-line amortisation method nor a units of production method was considered appropriate, in some cases, to reflect the pattern of consumption. The following extract from one of the comment letters[2] received on the ED illustrates this view (emphasis added):

> When programming titles are broadcast, showings are interrupted by breaks during which media company airs advertising spots (“advertising breaks”). **Cash earned from advertisers constitutes the primary source of revenues in advertising-financed free TV.** The amount of revenues (i.e. what advertisers are willing to pay) will depend on a number of factors, among others:
>
> - timing of broadcasting (prime-time vs. non-prime-time);
> - reputation and audience reach of TV station, i.e. the number of viewers potentially reachable by the broadcast;
> - the broadcast itself (i.e. the initial prime-time broadcast on a premium channel will generate higher viewer share and thus be more valuable to advertisers than the last non-prime-time broadcast on a smaller channel).
>
> **As a consequence, there is a strong correlation between the number viewers reached per broadcast and the amounts of revenues earned, and both quantities (total number of viewers and total revenues to be earned) are finite. The initial broadcast will**

[2] Comment letter sent by ProSiebenSat.1 Media AG.

usually attract the largest audience share and thus be substantially more valuable (carry more economic benefits) than later ones.

Determining the method of amortisation depends on how one defines the term "economic benefits" inherent in the asset, in other words, what one regards as the appropriate unit of account to reflect the consumption of economic benefits. For multi-broadcast programming assets, the following units of account may be identified:

- the contract period ("passage of time"); or
- the contractually agreed number of broadcasts ("units of production"); or
- the number of viewers reached / revenues generated per broadcast in relation to total viewers reached / revenues generated ("units of production").

An amortisation method based on the passage of time, i.e. straight-line amortisation would, in our view, lead to a conceptual conflict between IAS 38 and IAS 36 *Impairment of Assets*: Given that (as outlined above) multi-broadcast programming assets generate a substantial proportion of their total cash-flows in the initial broadcasts, using straight-line amortisation could lead to the need for an impairment under IAS 36 after the initial one or two broadcasts, if the amortised cost would not be recoverable by the future cash-inflows generated in later broadcasts. **As a consequence, we believe that using straight-line amortisation would not reflect the economic substance of such assets.**

Amortising over the contractually agreed number of broadcasts would in practice lead to a similar conflict between IAS 38 and IAS 36, even though the timing of "impairment" could be different than under the straight-line method. As outlined above, each broadcast as a "unit of production" has different inherent economic values (revenues / cash flows generated). Later broadcasts would become unattractive for program planners (as the higher amortisation required would be covered by lower revenues), who would thus be dis-incentivised to broadcast such titles, which would remain on stock and would have to be written down (impaired) as they become obsolescent.

Using either method laid out above for financial reporting purposes would thus lead to a disconnection between the economic future value inherent in the assets from a management perspective and external reporting. As a consequence, financial reporting figures thus derived could - if used for internal purposes - generate conceptually wrong incentive structures, lead to misallocations of economic resources and thus ultimately damage shareholder value.

By contrast, revenues generated by multi-broadcast programming assets in each broadcast also reflect the way in which the overall economic benefits inherent in such assets are consumed. There is also a strong correlation between price- independent variables (number of viewers) and price-dependent ones (revenues).

23. Some other respondents pointed out that in the case of acquired rights to broadcast programmes for a number of times in several markets (multi-broadcast programming assets), the application of a units of production method was not practicable because the units of production are various and not homogeneous (eg number of tickets sold in theatres, DVDs sold, viewings on view on demand, and

so on). The following extract from one of the comment letters received[3] on the ED illustrates this view (emphasis added):

> **As mentioned previously, we acknowledge that, by stating that "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", the Basis for Conclusions of the Exposure Draft resolves the issue for the broadcasting activities of the entities belonging to the Media sector but this is unfortunately not the case for their production and distribution activities**.
>
> **For instance, production rights generally allow exploitation of the programme on various different markets (e.g. cinema theatres, VOD, Pay TV, free TV, catch-up TV, internet...) and, because of the specificities of each of these markets, the number of viewers does not necessarily represent an appropriate basis of the pattern in which the benefits for those rights are expected to be consumed**. We believe that alternative amortisation methods such as straight-line method, diminishing-balance method or units-of-production method would not represent an appropriate basis either and that **only revenue-based methods would reflect appropriate allocation of a depreciable amount to periods based on the expected consumption of the future economic benefits embodied in an asset** as required by IAS 38.97 and IAS 38.98.
>
> We also point out that replacing a revenue based amortisation method by an alternative amortisation method could result in more subjectivity in the determination and assessment of the criteria to be retained for the pattern in

[3] Comment letter sent by the RTL Group.

which the benefits for those rights are expected to be consumed.

24. Respondents from the media sector also emphasised the fact that the guidance in US GAAP explicitly allows the use of a revenue-based method in for amortising certain intangible assets and so not allowing the use of such method in IFRS would potentially create inconsistent accounting. 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®.*

Guidance in regard to the diminishing balance method

25. Respondents were confused by the addition of paragraphs 62B to IAS 16 and 98B to IAS 38 to clarify that reductions in the selling price could signal the existence of obsolescence. Some could not see the point of their inclusion, while others questioned why the proposed guidance was specific to the application of the diminishing balance method.

Transition and effective date of the proposed amendment

26. Respondents to the ED disagreed with the IASB's proposal to require retrospective application of the proposed amendment, because they noted 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.

27. Among those who disagree, a small group urged the IASB to rethink the proposal to require retrospective application, because it may be too onerous in some circumstances: for example, when entities have been applying a revenue-based

method (ie entities with service concession arrangements or entities in the media sector).

28. A small number of respondents supported the retrospective application of the proposed amendment because they think that:

(a) it should not be too onerous, because IAS 8 takes into consideration situations in which 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.

Section 3: The Interpretations Committee's discussion

29. The discussion held by the Interpretations Committee at the July 2013 and September 2013 meetings, can be summarised in the following topics:

(a) whether any ambiguity between the guidance in the body of the Standard and the explanations in the BC should be eliminated;

(b) how to define a revenue-based method;

(c) whether a revenue-based method should be prohibited in all circumstances;

(d) use of an intangible asset in multiple activities;

(e) whether any guidance should be provided on the diminishing balance method; and

(f) the transition and effective date of the proposed amendment

30. We will address these issues in paragraphs below.

Whether there is any ambiguity between the guidance in the Standard and the explanations in the BC should be eliminated

31. There was general agreement among the Interpretation Committee members that the guidance in the body of the Standard, which prohibits the use of a revenue-based depreciation or amortisation method in all circumstances, and the explanations in the BC, which some had interpreted as allowing the use of a revenue-based method in some limited circumstances, might appear to be contradictory. There was broad agreement among Interpretations Committee members that this ambiguity should be eliminated. However, there were mixed views on how to eliminate that ambiguity, as explained in the paragraphs below.

How to define a revenue-based method

32. There were mixed views among the Interpretations Committee members on how to define a revenue-based depreciation method.

33. A revenue-based depreciation or amortisation method is defined in paragraph BC1 in the Basis for Conclusions of the ED as follows:

> 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.

34. A majority of members supported, in principle, the definition included in the ED of a revenue-based depreciation or amortisation method but suggested further edits. We have included these further edits in the Basis for Conclusions for IAS 16 (paragraph BC33D) and in IAS 38 (paragraph BC75D) in Appendix A of this paper).

35. Some other members thought that the proposed definition in the ED should place emphasis instead on the fact that a revenue-based method is "*a method based on expected sales*".

36. These members also think that the IASB should provide an explanation of the distinction between "generation" and "consumption" of economic benefits embodied in an asset because in their view the proposed Basis for Conclusions is not helping constituents to understand this difference.

Whether a revenue-based method should be prohibited in all circumstances

Views in favour of prohibiting the use of a revenue-based method in all circumstances

37. A majority of the Interpretations Committee members reaffirmed their view that revenue cannot be used as a proxy for consumption, because this would be inconsistent with the principle for depreciation and amortisation, which states that a depreciation or amortisation method shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. A method that is based on revenue generated from an activity that includes the use of an asset is, in contrast, a method based on the generation of future benefits from use of the asset and is therefore inconsistent with the principle for depreciation and amortisation.

38. They also thought that the proposed amendment should avoid introducing examples from which it could be interpreted that revenue could be used as a 'proxy' for consumption. In this respect they made specific reference to the explanations in the BC of the proposed ED referring to limited circumstances in which there is a perfect correlation between the use of a revenue-based method and the use of the units of production method.

39. Some members added that the only circumstance in which revenue would be appropriate to reflect the basis of the expected pattern of consumption of an asset would be when the right implicit in an asset is based on the amount of revenue

generated. For example, the following case extracted from one of the comment letters received on the ED[4] illustrates this view (emphasis added):

> <u>Example 2 - Mining Rights</u>
>
> Company A acquired a concession to explore and extract gold from a gold mine. **The grantor wanted to keep the gold price risk, so, instead of fixing a contract in a time basis or in amount of gold-extracted basis, the duration of the contract is based on the amount of gross revenue obtained from the extraction. Suppose the agreed upon fixed amount is US$ 2 billion**.
>
> Company A is given rights to explore the mine until it extracts US$ 2 billion of gold. The risk of the price variation of gold is with the grantor. That is, if gold is valued at US$ 1,000 per ounce, Company A would be able to extract 2 million ounces. If the price rises to US$ 2,000 per ounce, Company A would be able to extract 1 million ounces.
>
> **Company A is required to amortize the concession, which was recognized as an intangible asset, according to the consumption of the contractual rights which would be based on the expected pattern of revenue earned**.

40. A majority of the Interpretations Committee members also agreed with including additional guidance in IAS 38 on choosing an amortisation method. They observed that the objective of this guidance would be to direct the entity to determine the "limiting factor" that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might limit the entity's use of the intangible asset to a predetermined number of years (ie time) or to a number of units produced or, as it was discussed above,

[4] Extracted from the comment letter sent by IOSCO.

to an amount of revenue earned. The Interpretations Committee members did not suggest including this guidance in IAS 16 because they do not think it is needed.

Suggested path forward by those who advocate prohibiting the use revenue based method in all circumstances (Majority view)

41. Members who advocate prohibiting the use of a revenue-based method in *all* circumstances recommend the IASB to:

    (a) state that paragraph 60 of IAS 16 and paragraph 97 of IAS 38 establish the consumption of the benefits inherent in the asset as the principle for depreciation/amortisation;

    (b) state that a revenue-based method is not an appropriate depreciation/amortisation method because it reflects a pattern of *generation* of the asset's future economic benefits, rather than a pattern of *consumption* of the future economic benefits embodied in the asset;

    (c) state that the resulting depreciation and/or amortisation charge results from an estimation process and represents a measurement of the consumption of the economic benefits inherent in the asset;

    (d) avoid creating rules for the limited circumstances in which revenue data would be correlated with production data to avoid a misinterpretation that revenue can be used as a "proxy" for consumption in other circumstances. This would mean eliminating the explanations in the proposed BC introducing limited circumstances in which a revenue-based method gives the same result as a units of production method;

    (e) include additional guidance in IAS 38 on choosing an amortisation method. The objective of this guidance would be to guide the entity to determine the limiting factor that is inherent in the intangible asset. Identification of such a "limiting factor" would serve as the starting point for the identification of the amortisation method, but the entity would not be limited to using this as the basis for the amortisation method. For instance, the contract that sets out the entity's rights over its use of an intangible asset might limit the entity's use of the intangible asset to a predetermined number of years (ie time) or to a number of units produced or, as discussed above, to an amount of revenue earned; and

(f) explicitly state that the amortisation of an intangible asset could be based on the expected pattern of revenue generated only in cases in which the right implicit in an intangible asset is limited by the amount of revenue generated.

Views against prohibiting the use of a revenue-based method in all circumstances

42. Some Interpretations Committee members thought that prohibiting the use of a revenue-based method in *all* circumstances appeared to be too restrictive, in particular because some respondents to the ED had highlighted some circumstances in which certain industries might use revenue as a proxy for consumption.

43. These members observe that this concern has been raised predominantly by the film and the media industry, who have noted that the use of a revenue-based method as a proxy for reflecting consumption in determining the amortisation of some specific intangible assets is common and supported in some jurisdictions (such as in Europe and the US). These members think that changing this basis of amortisation in this industry might be complex and/or costly and think, furthermore, that the IASB has not been able to prove that a revenue-based method used as a proxy is inappropriate or misleading or that it warrants some changes.

44. These Interpretations Committee members observe that the prohibition from using a revenue-based method in all circumstances (including as a proxy for reflecting consumption) would create complexities for determining a depreciation/amortisation pattern, without improving the faithfulness of the amounts reported.

45. These members observe that one of the reasons that the IASB has given for prohibiting a revenue-based method has been the fact that the price component of revenue is sometimes affected by inflation and that inflation has no bearing upon the way in which the asset is worn out or used up. While these members agree with the view that reflecting inflation would not be consistent with the principle of reflecting the pattern of consumption of the economic benefits embodied in an asset, they disagree that this reason is sufficient to prohibit the use of revenue as a "proxy" for consumption in *all* circumstances and they believe that the focus should instead be on prohibiting reflecting inflation in the depreciation/amortisation pattern.

46. They think that in those cases, in which a pattern based on revenue best reflects the consumption of an asset, the use of a revenue-based method should not be prohibited, particularly in jurisdictions with low inflation[5]. If the IASB believes that there is another component or element of sales that should not be reflected in that pattern, this should be explained more clearly.

47. These members also think that if, since inception, a right embodied in an intangible asset has been contractually expressed to specify predetermined future changes in prices (other than inflation), those expected future changes in prices might affect how the asset is used up or worn out. Consequently, it might be appropriate to reflect such a fact in the amortisation pattern of the intangible asset.

48. These members illustrate their view with an example. Let us assume that an entity has purchased a licence that it can use for 10 years to operate services. This entity operates in a regulated environment and the price at which the services are sold is constrained by the licence. In this case the price at which the services can be sold during the first 5 years will be half the price during the last 5 years. The entity operates in an environment with low inflation.

49. In these Interpretations Committee members' view, in determining the amortisation pattern of that licence, it would be appropriate to consider the

[5] These Interpretations Committee members did not discuss further how "low inflation" could be defined.

combination of *both* the expected quantity of services to be sold and the expected future changes in price, taking into consideration that the entity in this example operates in an environment with low inflation.

50. In the Interpretations Committee members' view, this approach would best reflect the consumption of economic benefits embodied in the asset because, on initial recognition of the licence, there was an expectation that the economic benefits would be affected by the future changes in price. In addition, it would be consistent with the fact that the life cycle of a product/service encompasses an interaction between quantities and prices since inception and that a depreciation/amortisation pattern is supposed to reflect the pattern of consumption of a product's life cycle.

51. These Interpretations Committee members disagree with the view that there should be an outright prohibition against the pattern of amortisation/depreciation of an asset taking into account expected future changes in prices (other than inflation). The requirement in IAS 16 and IAS 38 to review systematically the residual value and expected useful life of assets inherently leads to including in the depreciation/amortisation pattern new events and circumstances (changes in the life cycle, technology, competition, economic growth, etc.). These members believe that changes in future prices may affect the way in which an asset is worn out or used up. The IASB has not made clear why some changes occurring during the useful life of an asset need to be taken into account in determining the depreciation pattern whereas some others do not.

52. Some members also disagreed with the proposal of introducing a reference to a "limiting factor" because they observed that there is no explanation of what a "limiting factor" is or on how it affects the determination of the pattern of consumption of the economic benefits embodied in an asset.

53. In this respect they thought that including this guidance might suggest, for example, that if the use of an intangible asset is set for a predetermined number of years, then the amortisation method must necessarily reflect the passage of time. In these members' opinion this might be the case for intangible assets arising from

concession arrangements, which some could interpret as meaning that because they have predetermined terms they should be amortised by using a straight-line method.

Path forward suggested by those who oppose prohibiting the use of a revenue-based method in all circumstances

54. Interpretations Committee members who *do not think* that the IASB should prohibit the use of a revenue-based method as a "proxy" in *all* circumstances had some alternative proposals to recommend to the IASB. These proposals are explained below.

55. The first proposal (Proposal 1) is to:

    (a) explicitly state in the Standard that judgement is required to determine the method that best depicts the consumption of the economic benefits embodied in an asset that is within the scope of IAS 16 and IAS 38. This judgement may require consideration of different methods and explaining why one is considered superior to the others; and

    (b) explain that a revenue-based method is not in itself consistent with the principle of amortisation/depreciation, because it reflects the generation of future economic benefits rather than consumption. They do not object to this being made clear in the Standard, if the IASB wants to do so.

56. A second alternative proposal (Proposal 2) would be to specify, in addition to what is recommended for Proposal 1, that a depreciation/amortisation pattern that reflects a material effect of inflation (explicit or implicit) is not consistent with the principle of reflecting the consumption of the economic benefits embodied in an asset.

57. A third alternative proposal (Proposal 3) would be to clarify, in addition to what is recommended for Proposal 1, the meaning of consumption versus generation of benefits.

58. A fourth alternative proposal (Proposal 4) would be to:

(a) specify that judgement is required in the choice of a depreciation or amortisation method; and

(b) specify that a depreciation/amortisation pattern that reflects a material effect of inflation (explicit or implicit) is not consistent with the principle of reflecting the consumption of the economic benefits embodied in an asset.

59. A fifth alternative and last proposal (Proposal 5) would be to combine all the individual proposals suggested above.

Use of an intangible asset in multiple activities

60. During their discussion at the July 2013 meeting some Interpretations Committee members acknowledged that it could be very difficult to find a single amortisation basis for an intangible asset that is used to generate several different cash flow streams in different markets. This discussion was based on the examples provided by some respondents from the media industry about multi-broadcast programming assets.

61. To address this concern one member of the Interpretations Committee observed that when economic benefits embodied in an intangible asset arise from multiple activities a possible solution could be to:

(a) allocate the cost of the intangible asset to separate identifiable components, based on the way the asset is used or is expected to be used in the business (this could be done, for example, by allocating the cost of the intangible asset based on the relative fair value of the identifiable components); and

(b) amortise the separate components of the intangible asset that are used in different activities by using amortisation patterns and useful economic lives that reflect the pattern of consumption of economic benefits to each component.

62. This member noted that the notion of separating a single asset or transaction into its separate identifiable components to reflect the way in which the asset is consumed, or to reflect the substance of the transaction, was not a new notion, either in business or in IFRS (because it is routinely done for property, plant and equipment).

63. At the September 2013 meeting a majority of the members of the Interpretations Committee rejected the proposal to provide guidance for the componentisation of an intangible asset that is used in multiple activities. This is because they thought that the concept of dividing a single intangible asset into several rights for amortisation purposes:

    (a) goes beyond what is described in paragraph 13 of IAS 16. This is because the rights embodied in an intangible asset are often interdependent and not as separable as the components identified for tangible assets;

    (b) should require proper debate and exposure; and

    (c) should be analysed as part of a specific project in IAS 38.

Suggested path forward

64. The members of the Interpretations Committee agreed not to provide guidance on the componentisation of an intangible asset.

65. Notwithstanding the decision not to provide guidance on the componentisation of an intangible asset, a number of Interpretations Committee members observed that an entity could apply a componentisation approach if it wanted to do so, leaving the entity to apply judgement in determining how to identify the respective components.

Whether any guidance should be provided on the diminishing balance method

66. A majority of Interpretation Committee members observed that the addition of paragraph 62B to IAS 16 and of paragraph 98B to IAS 38 does not achieve the

IASB's objective 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.

67. These Interpretations Committee members think that the IASB should instead amend:

(a) paragraph 56(c) of IAS 16 to state that technical or commercial obsolescence could also be indicated by, or arise from, a change in the market demand as indicated by a future expected reduction in the unit selling price for the product or service output of the asset; and

(b) paragraph 92 of IAS 38 to explain that future reductions in the selling price could indicate the existence of commercial obsolescence, which in turn reflects a reduction in the economic benefits consumed from the asset.

Transition and application of the proposed amendment

68. The Interpretations Committee agreed with the respondents' suggestion to require the prospective application of the proposed amendments to IAS 16 and IAS 38. This is because applying the proposed amendment on a prospective basis, rather than on a retrospective basis, is in line with existing requirements for changes in accounting estimates in paragraphs 32–38 of IAS 8. This would also be consistent with the requirements for revisions of estimates in paragraph 61 of IAS 16 and in paragraph 102 of IAS 38.

Suggested path forward

69. Consequently, the Interpretations Committee recommends to the IASB that it should require the proposed amendment to be applied prospectively rather than retrospectively.

Summary of recommendations from the Interpretations Committee to the IASB

70. The following page contains a summary of the recommendations from the Interpretations Committee to the IASB, which are based on the comments received and on the discussions that took place in July and September 2013.

Summary of recommendations from the Interpretations Committee to the IASB

Description of the issue	Proposal in the ED	Majority view	Proposed amendment (based on the majority view)	Alternative view – individual proposals (based on the minority view)
Use of a revenue-based method	(a) add paragraph 62A to IAS 16 and add paragraph 98A of IAS 38 to prohibit a depreciation or amortisation method that uses revenue (b) include in the BC 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	(a) reaffirm the prohibition against using a revenue-based method in IAS 16 and in IAS 38 (b) emphasise the main principle for depreciating assets and for amortising intangible assets in IAS 16 and in IAS 38 (c) reaffirm that revenue is not a valid 'proxy' for consumption in IAS 16 and in IAS 38 (d) state in IAS 38 that the amortisation of an intangible asset could only be based on the expected pattern of revenue generated when the right implicit in an intangible asset is limited by the amount of revenue generated. (e) include additional guidance in IAS 38 on choosing an amortisation method (ie determine the limiting factor	(a) clarify in paragraphs 60A of IAS 16 and 97A of IAS 38, that paragraph 60 of IAS 16 and paragraph 97 of IAS 38 establish the principle for depreciation and amortisation (b) add paragraphs 62A in IAS 16 and 98A in IAS 38 to prohibit the use of a revenue-based method explaining why this method is prohibited (consumption vs generation concept) (c) add paragraph 98B in IAS 38 to include additional guidance in on choosing an amortisation method (ie the limiting factor) (d) add paragraph 98C in IAS 38 to clarify when an intangible asset could be based on the	(a) state that judgement is required in choosing a depreciation or amortisation method that best depicts the consumption of the economic benefits embodied in an asset and that these judgements should be disclosed (b) explain that a revenue-based method is not in itself consistent with the principle of amortisation/depreciation, because it reflects the generation of future economic benefits rather than consumption (c) specify that a depreciation/ amortisation pattern shall not reflect the

Description of the issue	Proposal in the ED	Majority view	Proposed amendment (based on the majority view)	Alternative view – individual proposals (based on the minority view)
		that is inherent in the intangible asset).	expected pattern of revenue generated	effect of inflation (explicit or implicit) because it is not consistent with the depreciation or amortisation principle The IASB could also clarify: (d) the meaning of consumption versus generation of benefits
Diminishing balance method guidance	Proposal to add paragraph 62B to IAS 16 and paragraph 98B to IAS 38 to clarify the application of the diminishing balance method (that reductions in the selling price could signal the existence of obsolescence)	Remove the proposed guidance with regard to the diminishing balance method (paragraph 62B in IAS 16 and paragraph 98B in IAS 38)	Include a clarification to: (a) paragraph 56(c) of IAS 16 to state that technical or commercial obsolescence could also be indicated by, or arise from, a change in the market demand as indicated by a future expected reduction in the unit selling price for the product or service output of the asset; and (b) paragraph 92 of IAS 38 to explain that future reductions in the selling price could indicate the existence of commercial obsolescence, which in turn	n/a

Description of the issue	Proposal in the ED	Majority view	Proposed amendment (based on the majority view)	Alternative view – individual proposals (based on the minority view)
			reflects a reduction in the economic benefits consumed from the asset	
Transition and application of the proposed amendments to IAS 16 and IAS 38	Proposal to require retrospective application of the proposed amendment to IAS 16 and IAS 38	Require prospective application of the proposed amendment to IAS 16 and IAS 38.	Require the prospective application of the proposed amendment to IAS 16 and IAS 38.	n/a

71. The Interpretations Committee members' recommended changes to the draft wording in the ED (based on the majority view) are included in **Agenda Paper 13B** of October 2013.

Questions for the IASB

Questions for the IASB
1. Does the IASB agree with the Interpretations Committee's recommendations about proceeding with the amendment to specify that revenue-based depreciation or amortisation methods are not consistent with the general principles in IAS 16 and IAS 38, which are that a depreciation or amortisation method should reflect the pattern of consumption of the economic benefits embodied in the asset, except when the right embedded in the asset is limited by the amount of revenue generated by using the asset? 2. Does the IASB agree to include guidance on "limiting factors" in IAS 38? 3. Does the IASB agree to remove the proposed guidance with regard to the diminishing balance method that we had in paragraph 62B of IAS 16 and paragraph 98B of IAS 38 in the ED and instead amend paragraph 56(c) of IAS 16 and amend paragraph 92 of IAS 38 to explain the effect of a reduction in the selling price? 4. Does the IASB agree that the proposed amendments to IAS 16 and IAS 38 should be applied prospectively?