

December 2012

Exposure Draft ED/2012/5

Clarification of Acceptable Methods of Depreciation and Amortisation

Proposed amendments to IAS 16 and IAS 38

Comments to be received by 2 April 2013

**Clarification of Acceptable Methods of
Depreciation and Amortisation
(Proposed amendments to IAS 16
and IAS 38)**

Comments to be received by 2 April 2013

Exposure Draft ED/2012/5 *Clarification of Acceptable Methods of Depreciation and Amortisation* (Proposed amendments to IAS 16 and IAS 38) is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form as amendments to IFRSs. Comments on the Exposure Draft and the Basis for Conclusions should be submitted in writing so as to be received by **2 April 2013**. Respondents are asked to send their comments electronically to the IASB website (www.ifrs.org), using the 'Comment on a proposal' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

The IASB, the IFRS Foundation, the authors and the publishers do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Copyright © 2012 IFRS Foundation®

ISBN: 978-1-907877-74-2

International Financial Reporting Standards (including International Accounting Standards and SIC and IFRIC Interpretations), Exposure Drafts, and other IASB publications are copyright of the IFRS Foundation. The approved text of International Financial Reporting Standards and other IASB publications is that published by the IASB in the English language. Copies may be obtained from the IFRS Foundation. Please address publications and copyright matters to:

IFRS Foundation Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@ifrs.org Web: www.ifrs.org

All rights reserved. Copies of the draft amendments and the accompanying documents may be made for the purpose of preparing comments to be submitted to the IASB, provided such copies are for personal or intra-organisational use only and are not sold or disseminated and provided each copy acknowledges the IFRS Foundation's copyright and sets out the IASB's address in full. Otherwise, no part of this publication may be translated, reprinted or reproduced or utilised in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without prior permission in writing from the IFRS Foundation.



The IFRS Foundation logo/the IASB logo/'Hexagon Device', 'IFRS Foundation', 'eIFRS', 'IAS', 'IASB', 'IASB Foundation', 'IASCF', 'IFRS for SMEs', 'IASs', 'IFRIC', 'IFRS', 'IFRSs', 'International Accounting Standards', 'International Financial Reporting Standards' and 'SIC' are Trade Marks of the IFRS Foundation.

CONTENTS

from page

INTRODUCTION AND INVITATION TO COMMENT

[DRAFT] AMENDMENTS TO IAS 16 *PROPERTY, PLANT AND EQUIPMENT*

[DRAFT] AMENDMENTS TO IAS 38 *INTANGIBLE ASSETS*

**[DRAFT] AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON IAS 38
*INTANGIBLE ASSETS***

**[DRAFT] AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON IFRIC 12
*SERVICE CONCESSION ARRANGEMENTS***

**APPROVAL BY THE BOARD OF *CLARIFICATION OF ACCEPTABLE METHODS
OF DEPRECIATION AND AMORTISATION* (PROPOSED AMENDMENTS TO
IAS 16 AND IAS 38) PUBLISHED IN DECEMBER 2012**

BASIS FOR CONCLUSIONS

Introduction and invitation to comment

Introduction

The International Accounting Standards Board (IASB) has published this Exposure Draft of the proposed amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

Paragraphs 60 of IAS 16 and 97 of IAS 38 establish 'consumption of economic benefits' as the principle for recognising depreciation or amortisation, whereby 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.

Paragraphs 62 of IAS 16 and 98 of IAS 38 state that a variety of depreciation and/or amortisation methods can be used in applying that principle to allocate the depreciable/amortisable amount of an asset on a systematic basis over its useful life. An entity selects the method that most closely reflects the expected pattern of consumption of the expected future economic benefits embodied in the asset.

This amendment proposes to clarify that when applying the guidance in paragraph 62 of IAS 16 and paragraph 98 of IAS 38, a revenue-based method should not be used to calculate the charge for depreciation and/or amortisation, because that method reflects a pattern of economic benefits being generated from the asset, rather than the expected pattern of consumption of the future economic benefits embodied in the asset. The proposed amendment also provides some further guidance in the application of the diminishing balance method.

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

Invitation to comment

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

- (a) comment on the questions as stated;
- (b) indicate the specific paragraph or group of paragraphs to which they relate;
- (c) contain a clear rationale; and
- (d) include any alternative that the IASB should consider, if applicable.

The IASB is not requesting comments on matters in IAS 16 or in IAS 38 that are not addressed in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **2 April 2013**.

Questions for respondents

Question 1

The IASB proposes 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. This is because it reflects a pattern of future economic benefits being generated from the asset, rather than reflecting the expected pattern of consumption of the future economic benefits embodied in the asset. Do you agree? Why or why not?

Question 2

Do you have any other comments on the proposals?

[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.
- 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 when it was acquired as the principle for depreciation.
- 62B 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.

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*

In paragraph 98, the phrase 'unit of production method' has been amended to 'units of production method'. Paragraphs 98A–98B and 130G are added. 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], amended paragraph 98 and added paragraphs 98A–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.

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

In paragraph BC72A, the phrase ‘unit of production method’ has been amended to ‘units of production method’. 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 units 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***

In paragraph BC64, the phrase 'unit of production method' has been amended to 'units of production method'. 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.

Approval by the Board of *Clarification of Acceptable Methods of Depreciation and Amortisation* (Proposed amendments to IAS 16 and IAS 38) published in December 2012

The Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation* was approved for publication by the fifteen members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Martin Edelmann	
Jan Engström	
Patrick Finnegan	
Amaro Luiz de Oliveira Gomes	
Prabhakar Kalavacherla	
Patricia McConnell	
Takatsugu Ochi	
Paul Pacter	
Darrel Scott	
Chungwoo Suh	
Wei-Guo Zhang	

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’.