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Australian Accounting
Standards Board

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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

IASB ED/2012/5 Clarification of Acceptable Methods of Depreciation and Amortisation

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on the above-named Exposure Draft (ED). In formulating its comments, the AASB considered the views received from Australian constituents. The comment letters received are published on the AASB's website.

The AASB supports the ED's key proposal to prohibit applying a revenue-based depreciation or amortisation method. However, it recommends that the IASB clarifies its reasons for that proposal in its Basis for Conclusions, particularly because some of the discussion in paragraphs BC3 – BC5 of the Basis for Conclusions on the ED seems potentially inconsistent with the proposal (see elaboration in the comments in Appendix A).

The AASB also considers it essential that the IASB, having issued an ED on this issue, proceeds expeditiously with its proposal. Otherwise, IFRS adopters may misconstrue IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* as presently permitting a revenue-based depreciation or amortisation method.

The AASB's responses to the questions for respondents in the ED are set out in Appendix A.

If you have any questions regarding this letter, please do not hesitate to contact Jim Paul (jpaul@asb.gov.au) or me.

Yours sincerely

Kevin M. Stevenson
Chairman and CEO

APPENDIX A

AASB's responses to the Questions for Respondents to IASB ED/2012/5

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?

The AASB supports the IASB's key proposal (referred to in Question 1), because it considers that:

- (a) an asset's future economic benefits represent its *ability* to produce outputs that generate future cash inflows (generally, revenue), which is distinct from the future cash inflows; and
- (b) although an asset's ability to produce outputs that generate future cash inflows is consumed over time with the aim of generating revenue, it is not necessarily consumed in proportion to revenue. For example, revenue reflects prices contracted for an asset's outputs, but prices are not a relevant factor in determining the amount of consumption of an asset's ability to produce outputs that generate future cash inflows.

For the following reasons, the AASB recommends the IASB clarifies its reasons for its key proposal in its Basis for Conclusions:

- (a) paragraph BC2 of the Basis for Conclusions on the ED seems to emphasise a 'unit of account' issue (namely, the distinction between generating revenue by operating a business and depreciation/amortisation arising from the consumption of future economic benefits embodied in individual assets). However, the AASB considers its reasons for supporting the IASB's proposal (in the paragraph immediately above) are more pertinent and generally implicit in the IASB's proposal. The AASB suggests that, if the IASB agrees with those above-mentioned reasons, the IASB should state them explicitly; and
- (b) some of the discussion in paragraphs BC3 – BC5 of the Basis for Conclusions on the ED seems potentially inconsistent with the key proposal (see elaboration below).

The AASB considers that its above-mentioned reasons for supporting the ED's key proposal would lead to a different conclusion than that in paragraphs BC4 – BC5 regarding the pattern of amortisation of acquired rights to broadcast a film. Paragraph BC5 says "... 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 AASB disagrees that the pattern of consumption of future economic benefits embodied in the right might be based on the number of viewers, because the right's ability to produce outputs that generate future

cash inflows does not necessarily diminish proportionately with the number of viewers. The AASB is concerned that, in illustrating paragraph BC3, paragraphs BC4 – BC5 appear potentially to create an exception to the ED’s key proposal specifically in relation to one industry.

The AASB broadly agrees with the last sentence of paragraph BC3 of the Basis for Conclusions, but considers it would be better to refer to the potential for the pattern of revenue from an asset to *coincide* with the asset’s pattern of depreciation or amortisation. (Otherwise, that sentence in paragraph BC3 could be read to imply that revenue is the driver for the pattern of depreciation or amortisation, when using a units of production method.) The AASB suggests that the point in that sentence would be made better by using the following illustration:

Entity A uses a machine in a mining operation, and the machine has a variable pattern of output. As minerals prices (and thus revenues) change, Entity A changes the rate of production from the machine. Therefore, expected revenues are the key determinant of the rate of usage of the machine. However, the pattern of depreciation of the machine, measured using a units of production method, reflects the usage of the machine, not the expected revenues, even though the two might coincide.

The AASB considers that this example is more representative of the issues that a wider range of entities may encounter, and could usefully replace the narrower film broadcast rights example discussed in paragraphs BC4 – BC5.

Question 2

Do you have any other comments on the proposals?

Proposed new paragraphs 62A – 62B of IAS 16 and 98A – 98B of IAS 38

The AASB generally supports proposed new paragraphs 62A – 62B of IAS 16 and 98A – 98B of IAS 38. The AASB has the following drafting comments regarding those new paragraphs.

The AASB notes that the last sentence of each of proposed new paragraph 62A of IAS 16 and proposed new paragraph 98A of IAS 38 say that paragraph 60 of IAS 16 and paragraph 97 of IAS 38 establish consumption of the benefits inherent in the asset *when it was acquired* as the principle for depreciation/amortisation (emphasis added). However, paragraph 60 of IAS 16 and paragraph 97 of IAS 38 do not refer to ‘when the asset was acquired’. Accordingly, for consistency with how the principles in paragraph 60 of IAS 16 and paragraph 97 of IAS 38 are expressed, the AASB suggests, in paragraph 62A of IAS 16 and paragraph 98A of IAS 38, replacing “benefits that were inherent in the asset when it was acquired” with “benefits inherent in the asset”.

The AASB notes that the first sentence of each of proposed paragraph 62A of IAS 16 and proposed paragraph 98A of IAS 38 refer differently to “future economic benefits being generated” and “economic benefits being generated”. The AASB recommends making

those references consistent. In this regard, the AASB suggests conforming proposed paragraph 62A of IAS 16 to proposed paragraph 98A of IAS 38 (that is, referring to “a pattern of economic benefits being generated” rather than to “a pattern of future economic benefits being generated”). This is because the AASB regards ‘future economic benefits’ as referring to a stock rather than an inflow (note that, in the latter part of each of those sentences, “future economic benefits” is appropriately used to refer to a stock).

Transition

The AASB supports the proposal to require retrospective application of the changed paragraphs in IAS 16 and IAS 38 (i.e. to treat the changes as a change in accounting policy). The AASB observes that, consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, retrospective application would not be required to the extent that it is impracticable. Therefore, the AASB considers that requiring the proposed amendments to be applied retrospectively should not be unduly onerous.

The AASB notes that some have argued that retrospective application of the changed paragraphs in IAS 16 and IAS 38 would be inconsistent with the requirement in paragraph 61 of IAS 16 that “if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the [depreciation] method shall be changed ... [and] accounted for as a change in accounting estimate” (i.e. prospectively).

The AASB observes that the abovementioned existing requirement in paragraph 61 of IAS 16 requires prospective treatment of a change in depreciation method if there has been a significant change in the entity’s circumstances (an economic event). In contrast, a change in depreciation method resulting from the proposed amendment to IAS 16 would reflect a change of treatment only, and not account for an economic event. The AASB considers that this distinction justifies treating a changed depreciation or amortisation method upon adopting the proposed amendments to IAS 16 and IAS 38 as a change in accounting policy, with retrospective application under IAS 8.

The AASB also particularly supports the proposal to permit early application of the changed paragraphs in IAS 16 and IAS 38 because it considers the proposed amendments to IAS 16 and IAS 38 would improve financial reporting, and therefore the improved information should be available to users as soon as possible, without being impeded by any concerns about the implications of early application for the comparability of financial information during the transition period.