Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB members**	**Date:**	10 July 2014
From:	**Mitchell Bryce**	**Agenda Item:**	5.1 (M139)
Subject:	**Emerging Issue: Clarification of Acceptable Methods of Depreciation and Amortisation**	**File:**	

Action

Consider International Financial Reporting Standard *Clarification of Acceptable Methods of Depreciation and Amortisation* for incorporation into Australian Accounting Standards, including whether any not-for-profit amendments are required.

Attachment

Agenda Paper 5.2 *Clarification of Acceptable Methods of Depreciation and Amortisation* **[Board Only]**

Background

1 On 4 December 2012 the International Accounting Standards Board (IASB) issued Exposure Draft ED/2012/5 *Clarification of Acceptable Methods of Depreciation and Amortisation*. The AASB, shortly after, issued ED 231 (of the same title) for comment by 1 March 2013.[1] The ED proposed to clarify that a revenue-based method should not be used to calculate depreciation or amortisation when applying IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*, respectively.

2 The AASB made a submission to the IASB on 2 April 2013 in relation to the proposals in ED/2012/5.[2] In its submission, the AASB expressed support for the proposal to prohibit entities from applying a revenue-based depreciation or amortisation method. However, the AASB expressed concern that the ED's Basis for Conclusions[3] seemed to indicate providing an exception to that prohibition in limited circumstances.

3 On 12 May 2014 the IASB issued International Financial Reporting Standard *Clarification of Acceptable Methods of Depreciation and Amortisation* (Agenda Paper 5.2).

1 Six submissions were received from the AASB in relation to the proposals in ED 231.
2 http://www.aasb.gov.au/admin/file/content102/c3/M130_3.13_AASB_submission_on_IASB_ED_2012_5.pdf
3 Paragraphs BC3 – BC5.

Key differences between the ED and final IFRS

4 In contrast to ED/2012/5, the final amendment to IAS 38 introduces a rebuttable presumption that a revenue-based amortisation method is inappropriate (paragraph 98A). This presumption can be overcome when the intangible asset is expressed as a measure of revenue (paragraph 98A(a)) or when it can be demonstrated that revenue derived from the intangible asset and the consumption of the economic benefits of that asset are highly correlated (paragraph 98A(b)).

5 Paragraph 98C of the amended IAS 38 provides examples of circumstances in which revenue might be the appropriate basis for amortising an intangible asset. An example provided in paragraph 98C refers to an entity acquiring a concession to explore and extract gold from a mine where the expiry of the contract is based on a fixed amount of revenue generated from the extraction. Paragraph 98C indicates that, in this case, the revenue might be the predominant limiting factor in the contract for use of the intangible asset and, therefore, might be an appropriate basis for amortising the intangible asset.

6 The IASB changed the policy on transition from retrospective application (as proposed in its ED – with which the AASB expressed agreement on page 4 of its submission) to prospective application in the amendments to IAS 16 and IAS 38.

Staff Analysis and Recommendations

Rebuttable presumption

7 AASB staff are concerned with permitting a revenue-based method of amortisation except as a proxy for the consumption of the asset when there is no other reliable evidence available. This is because they think using a revenue-based method of amortisation in the circumstances identified in the amended IAS 38:

(a) would treat economic resources as being indistinct from the future benefits they are expected to generate—this would be inconsistent with the IASB's Conceptual Framework Discussion Paper[4] and the AASB's submission on IASB ED/2012/5. The AASB said in its submission to the IASB:

> "regarding the pattern of amortisation of acquired rights to broadcast a film … (t)he 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."

(b) would treat intangible assets as if they were financial assets (i.e. claims to cash or cash equivalents) – for example, allowing no more than a fixed amount of revenue to be generated from a right is not a promise to receive that revenue. Because intangible assets are not promises to receive revenue, assuming a linear relationship between their consumption and estimated revenue is not warranted;

(c) is based on an inappropriate notion that basing an asset's useful life on estimated revenues leads to basing the *pattern* of consumption of that asset on estimated revenues. This notion is not adopted in IAS 16 for depreciation of plant and equipment with a

[4] The IASB's preliminary view in paragraph 2.10(a)(i) of IASB DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* is that: "an asset is a resource (rather than the inflow of economic benefits that the resource may generate)".

useful life determined mainly by expected commercial obsolescence—that is, the amended IAS 38 applies a different notion to intangible assets than the notion IAS 16 applies to tangible assets; and

(d) might be applied to a potentially broad range of intangible assets, beyond those illustrated in paragraphs 98B – 98C of the amended IAS 38 (that is, a 'high correlation' between revenue and the consumption of an intangible asset's economic benefits could occur frequently).

8 AASB staff consider that, if the concerns in paragraph 7 above were warranted, the rebuttable presumption in the amended IAS 38 would nonetheless be an insufficiently significant or pervasive concern to warrant departing from incorporating the amendments to IAS 16 and IAS 38 into Australian Accounting Standards. In addition, AASB staff think the rebuttable presumption in the amended IAS 38 would be unlikely to cause a significant change to current practice.

Transition

9 Regarding paragraph 6 above, AASB staff agree with prospective application of the amendments to IAS 16 and IAS 38 because it is consistent with the pre-existing statements in paragraph 61 of IAS 16 and paragraph 104 of IAS 38 that a change in depreciation/amortisation method is a change in an accounting estimate.

10 For the reasons in paragraphs 8 and 9 above, AASB staff recommend incorporating the amendments in IFRS *Clarification of Acceptable Methods of Depreciation and Amortisation* in Australian Accounting Standards.

Not-for-profit

11 AASB staff have applied the 'factors to be considered before modifying an IFRS' incorporated within the *Process for Modifying IFRSs for PBE/NFP* in light of the six comment letters received from constituents on AASB ED 231. None of those comment letters identified not-for-profit-specific issues[5], and neither AASB staff nor NZASB staff are aware of any such issues. Accordingly, AASB staff recommend not to make any NFP-specific modifications of the amendments to IAS 16 and IAS 38 the Board incorporates in AASB 116 and AASB 138.

GAAP/GFS convergence

12 AASB staff have considered the implications of the amendments to IAS 16 and IAS 38 for GAAP/GFS harmonisation. AASB staff are unaware of any GAAP/GFS harmonisation differences that would arise from making the above-mentioned amendments to AASB 116 and AASB 138. AASB staff have contacted staff at the Australian Bureau of Statistics (ABS) to obtain their views on this issue and plan to orally update the Board on this issue at the Board meeting.

5 One commentator commented on the Australian-specific questions incorporated in the ED, and said they were not aware of any not-for-profit-specific or GAAP/GFS harmonisation issues.

Balloting

13 If the Board decides to incorporate the amendments to IAS 16 and IAS 38 in Australian Accounting Standards, AASB staff recommend the AASB proceeds to voting out-of-session on a ballot draft incorporating those amendments in Australian Accounting Standards.

Questions for the Board

1 Does the Board agree with the staff recommendation that the amendments should be incorporated, without any NFP-specific modifications, in Australian Accounting Standards?

2 Subject to any GAAP/GFS differences identified by ABS staff, does the Board agree with the staff analysis that the amendments would not give rise to any GAAP/GFS differences?

3 Does the Board agree with the staff recommendation to proceed to voting on a ballot draft incorporating the amendments to IAS 16 and IAS 38?

4 Do any Board members intend to dissent on the proposed amendments?