

AASB Staff Issues Paper: Potential Inconsistencies between AASB 13 *Fair Value Measurement* and other Australian Accounting Standards

Introduction

- 1 This issues paper discusses two potential inconsistencies between AASB 13 and other Australian Accounting Standards noted in the process of developing the issues paper on the relationship between current replacement cost as a measure of fair value and depreciated replacement cost as a measure of value in use (Agenda Paper 16.3 for this meeting). This paper asks whether Board members agree that potential inconsistencies exist and, if so, seeks direction on the nature and priority of the actions to take.
- 2 Extracts from relevant Australian Accounting Standards and IPSASs are contained in the appendix to Agenda Paper 16.3 for this meeting.

Potential Inconsistencies

‘Obsolescence’ and ‘Depreciation/Amortisation’

- 3 As mentioned in paragraph 31(b) of Agenda Paper 16.3 for this meeting, in the context of applying the ‘cost approach’ to estimate the fair value of a non-financial asset, paragraph B9 of AASB 13 says:

“Obsolescence ... is broader than depreciation for financial reporting purposes (an allocation of historical cost)”.

- 4 AASB staff note that IFRS 13 is worded consistently with FASB Accounting Standards Codification Topic 820 *Fair Value Measurement*, and that depreciable assets generally are not revalued by entities applying FASB Statements. However, in jurisdictions (like Australia) in which assets have been revalued using depreciated replacement cost as the best estimate of fair value, staff think it is incorrect to:
 - (a) equate depreciation with an allocation of *historical* cost; and, consequently,
 - (b) say obsolescence is broader than depreciation for financial reporting purposes.

- 5 Paragraph B9 of AASB 13 says:

“Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence ...”.

- 6 AASB staff think each of these components of obsolescence is encompassed by the descriptions, in paragraph 56 of AASB 116 *Property, Plant and Equipment* and paragraph 90 of AASB 138 *Intangible Assets* (respectively), of factors considered in determining the useful life (and thus depreciation/amortisation) of an asset¹. In this regard, AASB staff think ‘economic (external) obsolescence’ (referred to in

¹ However, physical deterioration (referred to in paragraph B9 of AASB 13) is not mentioned in AASB 138 because it does not arise for intangible assets.

AASB 13) is encompassed by ‘commercial obsolescence’ in AASB 116 and AASB 138. AASB staff think it is clear that, in substance, obsolescence is encompassed by—and thus substantively the same as—depreciation/amortisation, despite:

- (a) the statement in paragraph B9 of AASB 13 quoted in paragraph 3 above; and
- (b) the complication that the description of ‘obsolescence’ in AASB 13 quoted in paragraph 5 above is circular (i.e. it describes obsolescence as including different types of obsolescence).

7 The relationship between ‘obsolescence’ in AASB 13 and ‘depreciation/amortisation’ in AASB 116 and AASB 138 has been the subject of a small number of technical enquiries by constituents to AASB staff.

8 AASB staff think it is important to, in due course, clarify that obsolescence is substantively the same as depreciation/amortisation. In relation to the due process to follow, AASB staff do not regard the relationship between obsolescence and depreciation/amortisation to be a NFP-specific issue, and therefore think the Board’s *Process for Modifying IFRSs for PBE/NFP* should not be invoked in responding to the concern outlined in paragraph 4 above. (It may be argued that, in Australia, revaluations of property, plant and equipment by reference to assets’ CRC seem to occur more frequently in the public sector than in the private sector. However, such revaluations in the public sector are often made by government business enterprises and thus do not seem to be NFP-specific in their application.) Therefore, AASB staff think any amendments to AASB 13 or other Board guidance would need to be pursued by referring the issue to the IASB for amendment of IFRS 13 as part of the IASB’s Annual Improvements process.

Questions for Board members

Q1 Do you agree with the AASB staff views in paragraphs 6 and 8 above that:

- (a) obsolescence is substantively the same as depreciation/amortisation? and
- (b) the potential inconsistency between IFRS 13 and other IFRSs described in paragraph 4 above should be referred to the IASB shortly for consideration as part of the IASB’s Annual Improvements process?

Whether Current Replacement Cost (‘CRC’) is gross or net of accumulated obsolescence/depreciation/amortisation

9 AASB staff note that ‘CRC’ seems to be used inconsistently in AASB 13 and AASB 136. Specifically:

- (a) AASB 13, in Appendix A and paragraph B9, strongly implies ‘CRC’ is net of (accumulated) obsolescence²; and

² See paragraphs A2(d) and (e) of the appendix to Agenda Paper 16.3.

- (b) AASB 136, in paragraphs Aus6.2 and Aus32.2, uses ‘CRC’ in a gross context³ (i.e. before deducting accumulated depreciation/amortisation, which, as indicated in paragraphs 3 – 8 above, AASB staff think is substantively the same as accumulated obsolescence).
- 10 AASB staff think the inconsistency noted in paragraph 9 above is unintentional. AASB staff recommend that the Board considers a strategy for addressing the removal of the inconsistency described in paragraph 9 jointly with considering which actions to take to address the issue in Agenda Paper 16.3 for this meeting.
- 11 AASB staff note one possible way of removing that inconsistency would be to:
- (a) replace the references to ‘depreciated replacement cost’ in paragraphs Aus6.1 and Aus6.2 of AASB 136 with ‘replacement cost’; and
- (b) replace the references to ‘current replacement cost’ in paragraphs Aus6.2 and Aus32.2 of AASB 136 with ‘gross replacement cost’.
- 12 AASB staff observe that the approach described in paragraph 11 above could be modified by replacing the references to ‘depreciation’ in AASB 136 with ‘obsolescence’. This would be consistent with the AASB’s staff’s view set out in paragraph 8 above. However, while ‘depreciation’ remains to be used in IAS 16, removing reference to that term from AASB 136 would achieve consistency with one Standard at the expense of consistency with another. Therefore, AASB staff do not think there is a compelling case for replacing the references to ‘depreciation’ in AASB 136 with ‘obsolescence’.
- 13 AASB staff do not support the approach described in paragraph 11 above, because introducing a notion of ‘gross replacement cost’ to AASB 136 would:
- (a) add complexity to the guidance on DRC in that Standard;
- (b) give priority to a newer notion of replacement cost over a well-established notion based on previous IFRSs, without an obvious sound reason for the change; and
- (c) be inconsistent with IPSAS 21 *Impairment of Non-cash-generating Assets*, which states that DRC is net of accumulated depreciation⁴ and with a significant range of academic accounting literature and professional pronouncements dealing with replacement cost measurement.
- 14 Therefore, AASB staff recommend:
- (a) clarifying—either in an AASB staff paper, or by amending an ‘Aus’ paragraph in AASB 136 (e.g. adding a footnote to paragraph Aus6.2)—that the meaning of ‘CRC’ in AASB 13 and AASB 136 is different; and
- (b) requesting the IASB to revert to using expression consistent with the former guidance in IAS 16 *Property, Plant and Equipment*.

³ See paragraphs A3(d) and (e) of the appendix to Agenda Paper 16.3.

⁴ See paragraph A7(f) of the appendix to Agenda Paper 16.3.

- 15 In relation to paragraph 14 above, AASB staff think that, if the Board decided to propose amending an 'Aus' paragraph in AASB 136, the Board's *Process for Modifying IFRSs for PBE/NFP* should not be invoked, because the issue relates to a NFP-specific modification of IAS 36 developed consistently with the principles later embodied in that *Process*.

Question for Board members

- Q2** Do you agree with the AASB staff recommendation in paragraph 14 above for addressing the inconsistency described in paragraph 9 above?