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The Chairman
Australian Accounting Standards Board
PO BOX 204
Collins Street
West Victoria 8007

17 April 2013

Dear Mr Stevenson

Ernst & Young's global submission to the IASB on the Exposure Draft of Clarification of Acceptable Methods of Depreciation and Amortisation - Proposed amendments to IAS 16 and IAS

Please find enclosed Ernst & Young's global submission to the IASB on the above Exposure Draft.

Yours sincerely

A handwritten signature in cursive script that reads 'Ernst & Young'.

Ernst & Young

Encl:

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

2 April 2013

Dear IASB members

Invitation to comment - *Exposure Draft of Clarification of Acceptable Methods of Depreciation and Amortisation - Proposed amendments to IAS 16 and IAS 38*

The global organisation of Ernst & Young is pleased to submit its comments on the above Exposure Draft.

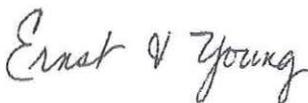
We support the principle in the proposed amendment that revenue-based depreciation/amortisation is not an acceptable method of depreciation/amortisation because revenue reflects the pattern in which economic benefits are generated rather than consumed. However, we believe the wording in the proposed amendment could be clearer and we have proposed changes to clarify the Board's intentions.

We acknowledge that in rare circumstances and certain industries, such as the media and entertainment industry, entities cannot estimate the consumption of economic benefits and the straight-line method does not appropriately reflect the expected consumption of the asset, so revenue is used as a proxy. These industries have assets whose benefits may be consumed more at the beginning of the asset's life and a revenue basis approximates the asset's consumption. We believe the Board should revisit these specific situations and, specifically, provide guidance on the circumstances where revenue might approximate consumption (i.e., when revenue can be used as a proxy).

We have included a detailed discussion of our comments in the appendix to this letter.

Should you wish to discuss the contents of this letter with us, please contact Ruth Picker at +44 (0)20 7951 3497.

Yours faithfully



Appendix

Exposure Draft - *Clarification of Acceptable Methods of Depreciation and Amortisation - Proposed amendments to IAS 16 and IAS 38*

Questions

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?
2. Do you have any other comments on the proposal?

Responses

Question 1

We support the principle in the proposed amendment that revenue-based depreciation/amortisation is not an acceptable method of depreciation/amortisation because revenue reflects the pattern in which economic benefits are generated rather than consumed.

Question 2

We have three other comments on the proposal.

A

The proposed paragraph 62A of IAS 16 and paragraph 98A of IAS 38 clarify that a revenue-based depreciation/amortisation method is not appropriate. The final sentence in the paragraphs reiterates the principle established in previous paragraphs, which contain support for this exclusion. This final sentence, in our view, does not add any substance to the paragraph, but instead supports the previous sentence. It would be more appropriate for this supporting sentence to be included in the Basis for Conclusions (BC). However, the last sentence in BC1 contains the same discussion. Therefore, we recommend the deletion of this sentence from the proposed paragraphs, as it is already included in the BC.

Paragraph 62A of IAS 16 would then read:

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.~~

Similarly, paragraph 98A of IAS 38 would read:

A method that uses revenue generated from an activity that includes the use of an asset is not an appropriate amortisation method for that intangible asset, because it reflects a pattern of the future 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.~~

B

The proposed paragraphs 62B of IAS 16 and 98B of IAS 38 address two concepts:

- i. They clarify that technical or commercial obsolescence of the product is relevant for estimating the pattern of consumption of future economic benefits and useful life of the asset when applying the diminishing balance method. We presume technical or commercial obsolescence is applicable for all depreciation/amortisation methods, in which case the proposed sentence appears to be redundant because the principle is already expressed in paragraphs 56 of IAS 16 and 90 and 91 of IAS 38.
- ii. The second sentences of the paragraphs clarify that "a future reduction in unit selling price of the product could be an indication of the diminution of the future economic benefits of the asset as a result of technical or commercial obsolescence." The use of 'selling price' in this sentence appears to conflict paragraphs 62A of IAS 16 and 98A of IAS 38, which state that revenue generated is not an appropriate measure of depreciation/amortisation. We believe this sentence does not clearly express the intended principle and would conflict with the principle in the previous paragraph.

As a result of these two comments, we recommend the deletion of paragraphs 62B of IAS 16 and 98B of IAS 38 in their entirety.

C

We recommend that the Board clarify the BC in three ways.

i.

We acknowledge that certain industries, such as media and entertainment, use revenue as a proxy for the expected consumption of the asset. This is because entities benefit from the asset differently over time and therefore the straight-line method of amortisation or depreciation does not appropriately reflect the asset's consumption. We believe the usage of revenue as a proxy for consumption is rare but could be used if it approximates the consumption of the benefits of the asset.

The Board alludes to the use of revenue-based amortisation in practice in BC3 - BC5. However, it is unclear how the BC interacts with paragraphs 62A of IAS 16 and 98A of IAS 38, and in what situations revenue would approximate the asset's consumption.

To clarify the Board's intentions, we urge the Board to include a more robust and specific discussion of when revenue might be used as a proxy for determining the pattern of depreciation of an asset.

ii.

We believe the example used in BC4 and BC5 does not reflect practice. The example included in the BC intends to clarify when revenue can be used but we believe the example combines two separate issues:

- a. Film assets (e.g., a film studio's costs in creating a film) and
- b. Broadcast rights (e.g., a television network purchasing the rights to broadcast a program)

There are entities within the media and entertainment industry (e.g., film studios) that typically amortise intangible assets, such as film assets, based on a percentage of revenue earned to total revenue expected. This basis of amortisation is derived from explicit guidance in other jurisdictions (particularly US GAAP, ASC 926, *Entertainment-Films*). These entities (and the US Financial Accounting Standards Board) believe that revenue earned is a practical measure available and it reflects the use of the asset since revenue to date may be a close approximation of the number of viewers – effectively, a units-of-production method of amortisation. The pattern of amortisation using policies derived from ASC 926 could be consistent with the consumption of the benefits of the film asset described in BC4 (issue a above).

However, paragraphs BC4 and BC5 appear to refer to broadcasters (issue b above). Paragraph BC4 refers to 'acquired rights to broadcast a film'; television networks would be a typical example of entities that acquire such rights. Television networks earn advertising revenue when they broadcast the acquired rights and in some circumstances might believe that this advertising revenue has a linear relationship to viewer numbers, as described in BC5. As such, revenue may be used as a basis for determining amortisation of the acquired rights, which is consistent with US GAAP ASC 920 *Entertainment-Broadcasters*.

A possible solution to clarify these two different examples would be to add the following paragraph:

BC5A. In other circumstances, such as a producer or owner of rights to distribute or exploit films or other programming, the economic benefits of the film are consumed through various activities over time (e.g., licensing for cinematic exhibition, licensing to broadcasters, DVD production and distribution and merchandising). Like the broadcaster example, the producer or distributor of a film or other programming may consume a significant proportion of the economic benefits of a new film or programming in its early years followed by diminishing benefits in its later years. However, as a result of differing activities that are consuming the economic benefits of the film or other programming, it is difficult to determine a common unit of consumption. In rare cases such as these, a revenue-based method may be the most reliable method of estimating the consumption of benefits from the film or other programming.

iii.

In the *Improvements to IFRSs* issued in May 2008, the Board clarified that advertising costs could not be capitalised because of the inability to determine the probability of future economic benefits from airing an advertisement in the future. We believe the Board should clarify that the proposed amendments to IAS 16 and IAS 38 address the depreciation/amortisation of previously capitalised costs, not the initial measurement of costs. To ensure that the proposed amendments are not misunderstood as implicitly allowing capitalisation of advertising costs, we propose that the Board references paragraphs 69 and 69A of IAS 38 in the BC.