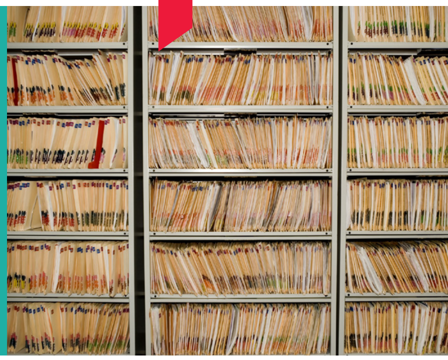
CLARIFICATION OF ACCEPTABLE METHODS OF DEPRECIATION AND AMORTISATION (AMENDMENTS TO IAS 16 AND IAS 38)

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2014/07



Background

In 2011 the IFRS Interpretations Committee (IFRS IC) received a request to clarify the meaning of the term '*consumption of the expected future economic benefits embodied in the asset*' in IAS 38 *Intangible Assets* paragraph 97, when determining the appropriate amortisation method.

The IFRS IC then referred the issue to the International Accounting Standards Board (IASB), suggesting that an amendment be made to both IAS 38 and IAS 16 *Property, Plant and Equipment* to clarify that revenue-based methods of depreciation and amortisation are not appropriate, as they do not reflect the pattern of economic benefits consumed from the use of the asset by the entity.

In December 2012 the IASB published Exposure Draft *ED/2012/5 Clarification of Acceptable Methods of Depreciation and Amortisation (Proposed Amendments to IAS 16 and IAS 38)*, that proposed to clarify that revenue-based methods of depreciation and amortisation are not appropriate, with a comment deadline of April 2013.

The IASB deliberated the comments received from constituents and subsequently released the final amendments to IAS 16 and IAS 38 in May 2014.

Summary

The amendments clarify that:

– For items of property, plant and equipment a revenue-based depreciation method is not appropriate
– For intangible assets there is a rebuttable presumption that amortisation based on revenue is not appropriate.

The presumption can be rebutted if either:

– The intangible asset is expressed as a measure of revenue; or
– Revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

The amendment also adds additional guidance regarding the determination of an appropriate amortisation method, referring to the 'predominant limiting factors' of the use of an asset, such as:

– A contractual term which specifies the period of time that an entity has the right to use an asset
– Number of units allowed to be produced
– Fixed total amount of revenue allowed to be received.

In addition, the IASB added two examples where revenue-based amortisation would be appropriate, being where the amount of revenue to be derived from a mining licence, and from the operation of a toll road, is limited to a fixed cumulative amount.

STATUS

Final

EFFECTIVE DATE

1 January 2016, with earlier application permitted

ACCOUNTING IMPACT

Prohibition of revenue based depreciation for property, plant and equipment (IAS 16).

Rebuttable presumption that revenue based amortisation is inappropriate for intangible assets (IAS 38).

Amendments to IAS 16

Paragraph 62A has been added to prohibit the use of revenue-based methods of depreciation for items of property, plant and equipment.

Paragraph 62A clarifies that this is because the revenue generated by an activity that includes the use of an item of property, plant and equipment generally reflects factors other than the consumption of the economic benefits of the item, factors such as:

- Other inputs and processes
- Selling activities and changes in sales
- Volumes and prices, and
- Inflation.

Paragraph 56, which includes guidance for the depreciation amount and depreciation period, has been expanded to state that expected future reductions in the selling price of items produced by an item of property, plant and equipment could indicate technical or commercial obsolescence (and therefore a reduction in the economic benefits embodied in the item), rather than a change in the depreciable amount or period of the item.

Amendments to IAS 38

Paragraphs 98A - 98C have been added to clarify that there is a presumption that revenue-based amortisation is not appropriate, and that this can only be rebutted in limited circumstances where either:

- The intangible asset is expressed as a measure of revenue, or
- Revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

Paragraph 98B clarifies that as a starting point to determining an appropriate amortisation method, and entity could determine the 'predominant limiting factor' inherent in the intangible asset, for example:

- A contractual term which specifies the period of time that an entity has the right to use an asset
- Number of units allowed to be produced
- Fixed total amount of revenue allowed to be received.

Paragraph 98C then clarifies that where an entity has identified that the achievement of a revenue threshold is the predominant limiting factor of an intangible asset, it may be possible to rebut the presumption that revenue-based amortisation is not appropriate.

Two examples are included in paragraph 98C to illustrate this, being intangible assets relating to a mining licence and from the operation of a toll road. In both cases, the revenue to be earned under the contracts and agreements related to those intangible assets is limited to a fixed cumulative amount.

Disclosures

The amendment does not introduce any additional disclosures to either IAS 16 or IAS 38.

Effective date and transition

The effective date for the amendments is for acquisitions in annual periods beginning on or after 1 January 2016, and is to be applied prospectively.

Early application is permitted. If the amendments are adopted early, this is required to be disclosed.

As the amendment is to be applied prospectively, no adjustment to previous financial statements will be made. Any changes to current depreciation or amortisation methods as a result of the amendment will be applied to the carrying amounts of the assets with effect from the date of initial application (the start of annual periods beginning on or after 1 January 2016), and are to be accounted for as a change in accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. This will require:

- Disclosure of the nature and amount of the change in accounting estimate(s) (IAS 8.39), and/or
- Potential associated changes to how those items are presented in the financial statements.

www.bdointernational.com

1405-05