

## Draft Comment Letter

Comments should be submitted by 11 March 2013 to [Commentletters@efrag.org](mailto:Commentletters@efrag.org)

[xx] March 2013

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sir/Madam,

**Re: Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation***

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft, *Clarification of Acceptable Methods of Depreciation and Amortisation (Proposed Amendments to IAS 16 and IAS 38)*, issued by the IASB on 4 December 2012 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

EFRAG supports the IASB's efforts to clarify the current requirements regarding the use of revenue-based methods of depreciation and amortisation. However, we believe that the IASB should remove the seeming contradiction between the standard and the Basis for Conclusions by reflecting the reasoning – that there are circumstances where revenue might be an appropriate proxy for the use of an asset – presented in paragraphs BC3 to BC5 in the body of the standard.

Our detailed comments and responses to the questions in the ED are set out in the appendix.

If you would like to discuss our comments further, please do not hesitate to contact Giorgio Acunzo or me.

Yours sincerely,

Françoise Flores  
**EFRAG Chairman**

## APPENDIX 1

### EFRAG's responses to the questions raised in the ED

#### 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?

#### Question 2

Do you have any other comments on the proposals?

#### Notes to constituents

- 1 The IASB was requested to clarify the meaning of the term 'consumption of the expected future economic benefits embodied in the asset' in paragraph 98 of IAS 38 Intangible Assets and in paragraph 62 of IAS 16 Property, Plant and Equipment when determining the amortisation (depreciation) rate for intangible (tangible) assets.*
- 2 The IASB noted that revenue-based depreciation or amortisation method is one that is derived from an interaction between units (i.e. quantity) and price, and that takes into account the expected future changes in price as the depreciation basis to allocate the amount of an asset that is to be depreciated or amortised.*
- 3 Currently IFRS requires that depreciation or amortisation charges should be determined using methods that reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.*
- 4 Accordingly, the IASB proposed to clarify that a revenue-based depreciation or amortisation method is not appropriate because it reflects a pattern of economic benefits being generated from operating the business (of which the asset is part) rather than the economic benefits being consumed through the use of the asset.*
- 5 The IASB considered that the future economic benefits embodied in an asset are consumed by an entity principally through its use as described in paragraph 56 of IAS 16. In addition, the IASB noted that the use of an asset can be assessed by reference to the asset's expected capacity or physical output as described in paragraph 56(a) of IAS 16.*
- 6 However, the IASB acknowledged in the Basis for Conclusions that there are – contrary to the requirement proposed in paragraph 62A of IAS 16 and paragraph 98A of IAS 38 – limited circumstances in which revenue could be used to reflect the pattern in which the future economic benefits of the asset are expected to be consumed (i.e. intellectual property assets such as acquired rights to broadcast a film).*
- 7 Furthermore, the IASB noted in the Basis for Conclusions that in these limited circumstances when revenue could be used, the use of a revenue-based method gives the same result as the use of a unit of production method. The IASB provided in the Basis for Conclusion an example where advertising revenues could*

*serve as an equivalent for viewer numbers in the broadcast industry to the extent that advertising revenue has a linear relationship with viewer numbers.*

- 8 *The IASB also proposes to clarify that expected future reductions in the unit selling price of the product or service output of the asset could be an indicator of the diminution of the future economic benefits of the asset as a result of technical or commercial obsolescence and thereby relevant when applying the diminishing balance method.*
- 9 *Finally, the IASB decided to make consistent the phrase 'units of production method' and has therefore amended those instances of phrases 'unit of production method'.*

#### **EFRAG's response**

**EFRAG supports the IASB's efforts to clarify the current requirements. However, we believe that the IASB should improve the drafting of the amendments and provide all relevant guidance in the standards rather than in the basis for conclusions.**

#### *Acceptable methods of depreciation and amortisation*

- 10 EFRAG supports the IASB's efforts to clarify the current requirements regarding the use of revenue-based methods of depreciation and amortisation. We believe that proposed amendments are consistent with current IFRSs and clarify that IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* require that depreciation and amortisation should reflect the '*pattern in which the asset's future economic benefits are expected to be consumed by the entity*' rather than the economic benefits resulting from the consumption of the asset.
- 11 However, EFRAG believes that the IASB should improve the drafting of paragraph 62A of IAS 16 and paragraph 98A of IAS 38. As drafted, these paragraphs seem to preclude the use of revenue-based depreciation and amortisation methods in all circumstances, while the Basis for Conclusions recognises that there are circumstances where revenue might be an appropriate proxy for the use of an asset.
- 12 In EFRAG's view a revenue-based depreciation or amortisation method could be – when it is a close proxy – the method that best depicts, according to management's estimation, the expected pattern of consumption of the future economic benefit embodied in assets. Therefore, the IASB should remove the seeming contradiction between the standard and the Basis for Conclusions by reflecting the reasoning presented in paragraphs BC3 to BC5 in the body of the standard.
- 13 We also note that as there is no observable physical consumption of intangible assets as well as of certain tangible assets, it is generally necessary to determine the use of the asset by reference to its output. In most cases, we believe that output can be quantified by reference of the volume of production. However, in some cases volume cannot readily be observed and reference is made to the cash flows generated from the use of the asset. EFRAG believes that the IASB should clarify under which circumstances entities are permitted to base their amortisation on measures other than observable volumes and include a detailed explanation of the supporting rationale in the Basis for Conclusions.

## *IASB ED: Clarification of Acceptable Methods of Depreciation and Amortisation*

- 14 In addition, EFRAG believes that the IASB should provide an illustrative example in IAS 38 that explains how the clarification applies to particular intangible assets such as film rights.

### *Use of Bases for Conclusions*

- 15 EFRAG believes that the IASB should include all relevant accounting guidance in the standards and not in the Bases for Conclusions, which should only reflect the arguments that the IASB considered in forming its views.
- 16 EFRAG notes in this context that European constituents will not benefit from guidance provided in the Bases for Conclusion as these are not part of IFRSs as endorsed in the European Union.
- 17 Finally, we would like to note that it is not clear from the ED where the IASB intends to add the Basis for Conclusions (e.g. IAS 16, IAS 38 or both) once it finalises this project.

### *Diminishing balance method*

- 18 EFRAG notes that the IASB has proposed to amend IAS 16 and IAS 38 to clarify that expected future reductions in the unit selling price of the product or service output of the asset could be an indicator of the diminution of the future economic benefits of the asset as a result of technical or commercial obsolescence and thereby relevant when applying the diminishing balance method.
- 19 EFRAG believes that the IASB should improve the wording of the Basis for Conclusions to explain better to constituents the reasons for making this amendment to the standards, which was introduced late in the process.
- 20 In addition, EFRAG notes that the references to 'technical or commercial obsolescence' in paragraph 62B in IAS 16 and paragraph 98B in IAS 38 create a degree of overlap with the requirements of IAS 36 *Impairment of Assets*. This leaves unclear whether an event should lead to an adjustment in depreciation and amortisation patterns, or should result in an impairment charge. Therefore, EFRAG believes that additional guidance, if any, should not be introduced as paragraph 62B in IAS 16 and paragraph 98B in IAS 38, but rather in IAS 36.

### *Effective date and transition*

- 21 EFRAG agrees with the retrospective application of the amendments as this ensures comparability.

### *Consistent terminology*

- 22 In EFRAG's view, any amendment to the standards using the IASB's full due process brings with it costs for the IASB and its constituents. Therefore, EFRAG believes that the IASB should focus its limited resources on making only those changes to standards that are expected to affect accounting under IFRS. However, if the IASB wishes to make these changes to the standards, we would suggest:
  - (a) to consider making these changes as editorial changes; and
  - (b) to make ensure that the references to 'unit of production' are also updated in the other standards in which they occur (i.e. IFRS 1 *First-time Adoption of*

*IASB ED: Clarification of Acceptable Methods of Depreciation and Amortisation*

*International Financial Reporting Standards, IAS 2 Inventories and IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine).*