

The costs and benefits of implementing *Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38*

Introduction

- 1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of *Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38* ('the Amendments').
- 2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. The results of the consultations that EFRAG has carried out seem to confirm this. Therefore, as explained more fully in the main sections of this report, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Amendments in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

EFRAG's endorsement advice

- 3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

A summary of the Amendments

Background

- 4 There has been uncertainty in practice as to whether depreciation of a tangible asset and amortisation of an intangible asset based on revenue would be in compliance with the requirements of the related standards. The Amendments clarify:
 - (a) in IAS 16 *Property, Plant and Equipment*, that a method of depreciation that is based on revenue generated from an activity that includes the use of an asset 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 as required by the standard; and

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- (b) in IAS 38 *Intangible Assets*, that there is a rebuttable presumption that an amortisation method based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate.
- 5 This presumption can be rebutted – and therefore the revenue to be generated can be an appropriate basis for amortisation of an intangible asset – only in the limited circumstances:
- (a) in which the intangible asset is expressed as a measure of revenue; or
 - (b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.
- 6 Furthermore, the Amendments clarify in both Standards that expected future reductions in the selling price of an item that was produced using an asset in the scope of IAS 16 and IAS 38 could indicate the expectation of technical or commercial obsolescence of the asset, which might affect the estimates on both the pattern of consumption of future economic benefits and the useful life of an asset.

When do the Amendments become effective?

- 7 The Amendments should be applied prospectively for annual periods beginning on or after 1 January 2016, with early application permitted.

EFRAG's initial analysis of the costs and benefits of the Amendments

- 8 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing the Amendments, both in year one and in subsequent years.
- 9 EFRAG observed that the Amendments that affect paragraph 56 of IAS 16 *Property, Plant and Equipment* and paragraph 92 of IAS 38 *Intangible Assets* aim to clarify current requirements in both Standards and are unlikely to result in changes in intended outcomes of current practice for most preparers and users.
- 10 Based on EFRAG's assessment, the application of the Amendments that involve changes to the current amortisation requirements in IAS 38 will have a cost and/or benefit impact on preparers and/or users of financial information because those amendments change current accounting practice to a small degree; accordingly EFRAG performed a specific assessment on the implementation of the introduction of a rebuttable presumption in IAS 38 and on the limited circumstances where it can be rebutted.
- 11 The results of EFRAG's initial assessment can be summarised as follows:
- (a) *Costs* – EFRAG's initial assessment was that the Amendments are likely to result in some one-off costs and insignificant ongoing costs for preparers while they are likely to result in insignificant one-off and ongoing costs for users.
 - (b) *Benefits* – EFRAG's initial assessment was that users and preparers are likely to benefit from the Amendments, as the information resulting from them will (a) remove inconsistency in determining the amortisation method of intangible assets and therefore reduce complexity; and (b) increase relevance, reliability and comparability of financial information and therefore enhances users' analysis.
- 12 EFRAG published its initial assessment and supporting analysis on 17 June 2014. It invited comments on the material by 17 July 2014. In response, EFRAG received seven comment letters. Two respondents agreed with EFRAG's assessment of the

benefits of implementing the Amendments and the associated costs involved for users and preparers. Three respondents commented on the EFRAG's initial assessment on costs and benefits. The other two respondents did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing the Amendments in the EU, but supported EFRAG's recommendation that Amendments be adopted for use in Europe.

EFRAG's final analysis of the costs and benefits of the Amendments

- 13 Based on its initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of the Amendments and – in particular – of the implementation of the introduction of a rebuttable presumption in IAS 38 and on the limited circumstances where it can be rebutted is presented in the paragraphs below.

Cost for preparers

- 14 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.
- 15 EFRAG believes that for some entities in industries in which the amendments are relevant (e.g. film/television industry), the amendments could lead to one-off costs for preparers if they have to change their previous method of amortisation. However, EFRAG believes that these costs are justified because that contributes to the overarching goal of achieving greater consistency, understandability and comparability.
- 16 Furthermore, EFRAG believes that the reduction in the degree of subjectivity that results from the Amendments is likely to reduce the overall costs both upon the implementation phase and on an ongoing basis for those preparers that are permitted to rebut the presumption in IAS 38.
- 17 EFRAG also notes that in rebutting the presumption in paragraph 98A entities will have to apply a degree of judgement when assessing (a) the predominant limiting factor that is inherent in the intangible asset; and (b) if revenue and the consumption of the economic benefits of the intangible asset are highly correlated. EFRAG acknowledges that the costs for preparers could increase in performing this judgement exercise.
- 18 However EFRAG notes that in a principle-based amortisation model the use of judgement is an inherent factor and it is already required in several Standards. EFRAG believes that the level of judgement required by the Amendments to rebut the presumption in paragraph 98A is not so significant that it would result in significant costs for preparers.
- 19 In addition EFRAG believe that this increase in costs for preparers would be mitigated by the benefits of the Amendments because they are designed to ensure greater consistency in applying the general amortisation requirement for intangible assets. As a result they are expected to contribute to greater relevance of the information provided.
- 20 Overall, EFRAG's assessment is that the Amendments are likely to result in some one-off and insignificant ongoing costs for preparers related to implementation of the Amendments.

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Costs for users

- 21 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.
- 22 Users are expected to incur some incremental costs to understand and incorporate the new requirements, resulting from the Amendments in circumstances where entities rebut the presumption in paragraph 98A, into their analyses.
- 23 However, EFRAG believes that there are additional factors to consider:
- (a) The reduction in the degree of subjectivity when an entity applies the exception is likely to provide users with information that is reliable and overall more comparable and, as a result, generate cost savings to users;
 - (b) If the relevance and comparability of information is adversely affected by requiring entities to produce financial information on a basis that does not reflect actual facts, users may need to perform additional work to understand the effects of amortisation charges on the performance of entities;
 - (c) The Amendments will permit entities to determine the amortisation method differently where the patterns of consumption of the economic benefit embodied in the intangible asset are not economically similar. In EFRAG's view, this prevents the undue use of the straight line method of amortisation where it does not reflect the appropriate pattern of consumption and results in financial information that is more useful to users; and
 - (d) Current disclosure requirements both in IAS 38 and in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* address the impact of the Amendments and result in financial information that is understandable in the limited circumstances where entities rebut this presumption.
- 24 Overall, EFRAG's assessment is that the Amendments are likely to result in insignificant costs for users.

Benefits for preparers and users

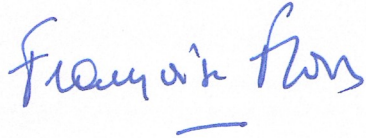
- 25 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.
- 26 EFRAG's assessment is that the Amendments will result in benefits for those preparers that will be permitted to rebut the presumption as explained in paragraph 15 above, while other preparers remain unaffected.
- 27 Furthermore, requiring prospective application of the Amendments will provide relief to those preparers that will be in a position to rebut the presumption in paragraph 98A.
- 28 Users are also likely to benefit from the Amendments to the extent that the information they obtain is less subjective, and as a result more reliable and comparable.
- 29 Overall, EFRAG's assessment is that users and preparers are likely to benefit from the Amendments, as the information resulting from them will (a) remove inconsistency in determining the amortisation method of intangible assets and therefore reduce complexity; and (b) increase relevance, reliability and comparability of financial information and therefore enhances users' analysis.

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Conclusion

- 30 EFRAG's overall assessment is that the overall benefits of Amendments are likely to outweigh costs associated with applying them.

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