EFRAG

European Financial Reporting Advisory Group

Jonathan Faull
Director General, Internal Market and Services
European Commission
1049 Brussels

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Dear Mr Faull

Adoption of Clarification of *Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on *Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38* ('the Amendments'), which were issued by the IASB on 12 May 2014. They were issued as an Exposure Draft in December 2012 and EFRAG commented on that draft.

The objective of the Amendments is to clarify that the use of revenue-based methods to calculate the depreciation of an asset is not to be assumed appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset.

The Amendments also clarify that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. However, this presumption can be rebutted in certain limited circumstances.

The Amendments are effective for annual periods beginning on or after 1 January 2016, although entities are permitted to apply them earlier.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued its initial assessment for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendments and has concluded that they meet the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that they:

- are not contrary to the principle of 'true and fair view' set out in Article 4(3) of Council Directive 2013/34/EU; and
- meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments and, accordingly, EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Françoise Flores
EFRAG Chairman

APPENDIX

BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38 *('the Amendments').*

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Does the accounting that results from the application of the Amendments meet the technical criteria for EU endorsement?

1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendments:

(a) are not contrary to the principle of 'true and fair view' set out in Article4(3) of Council Directive 2013/34/EU; and

(b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

2 EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt the Amendments.

Approach adopted for technical evaluation of the Amendments

3 EFRAG observed that 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 (that affect paragraph 56 and add paragraph 62A in IAS 16 *Property, Plant and Equipment*, and that affect paragraph 92 of IAS 38 *Intangible Assets)* are not deemed to result in changes in intended outcomes of current practice. Therefore these amendments are not discussed specifically in this appendix. In performing its overall assessment, EFRAG focused on the impact of the new requirements introduced by the Amendments that involve changes to the current amortisation requirements in IAS 38.

Relevance

4 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

5 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or *whether it would result in th*e omission of relevant information.

6 EFRAG notes that the Amendments produce supplementary guidance 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.

7 In EFRAG's view, only in rare circumstances would an entity produce information that is not relevant. Such circumstances might arise when an entity does not have sufficient evidence to rebut the presumption, even though it might be more appropriate to do so.

8 EFRAG's overall assessment is that the Amendments would result in the provision of relevant information; and therefore they satisfy the relevance criterion.

Reliability

9 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

10 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness

11 EFRAG understands that the Amendments reduce subjectivity by providing guidance to entities that find it difficult to determine the pattern in which the intangible asset's future economic benefits are expected to be consumed. They also clarify when the use of revenue as a basis for amortisation faithfully represents the pattern of consumption of economic benefits.

12 Furthermore, the Amendments shall be applied prospectively. In EFRAG's view, prospective application of these amendments results in financial information that is unbiased because it prevents the undue use of hindsight; therefore, the Amendments ensure a minimum level of reliability.

13 EFRAG's overall assessment is that the Amendments would raise no concerns about risk of error or bias; and therefore they satisfy the reliability criterion.

Comparability

14 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

15 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

16 EFRAG believes that the Amendments will bring more consistency in determining the amortisation method because they clarify the circumstances where the presumption can be rebutted, and thereby result in financial information that is comparable.

17 Furthermore, EFRAG believes that 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.

18 However, in the rare cases identified in paragraph 7, where information produced by the Amendments is not relevant, comparability would be reduced.

19 Therefore, EFRAG's overall assessment is that the Amendments satisfy the comparability criterion.

Understandability

20 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

21 Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

22 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.

23 In EFRAG's view, the Amendments will reduce complexity in applying the general amortisation requirement for intangible assets because they clarify the circumstances where the use of a revenue based amortisation method is permitted. Therefore, we believe that the Amendments result in financial information that is understandable.

24 Furthermore, in EFRAG's view, the current disclosure requirements both in IAS 38 and in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* will address the impact of the Amendments and result in financial information that is understandable in the limited circumstances where entities rebut this presumption.

25 In EFRAG's view, the Amendments do not introduce any new complexities that may impair understandability. Therefore, EFRAG's overall assessment is that the Amendments satisfy the understandability criterion in all material respects.

True and Fair

26 EFRAG's assessment is that the information resulting from the application of the Amendments would not be contrary to the true and fair view principle.

European public good

27 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt Amendments.

Conclusion

28 For the reasons set out above, EFRAG has concluded that the Amendments satisfy the technical criteria for EU endorsement and EFRAG should therefore recommend their endorsement.