IASB CLARIFIES ACCEPTABLE METHODS OF DEPRECIATION AND AMORTISATION

ON 12 MAY 2014, THE INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB) ISSUED AMENDMENTS TO IAS 16 *PROPERTY, PLANT AND EQUIPMENT* AND IAS 38 *INTANGIBLE ASSETS* WHICH CLARIFY ACCEPTABLE METHODS OF DEPRECIATION AND AMORTISATION.

Changes to IAS 16

Paragraph 62A has been added to IAS 16 to clarify that use of revenue-based methods for calculating depreciation is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of economic benefits embodied in the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing on the way in which an asset is consumed.

Changes to IAS 38

Similar changes have been made to IAS 38 with the introduction of paragraph 98A, except that this paragraph includes a rebuttable presumption that can be overcome only in the following limited circumstances:

- The intangible assets is expressed as a measure of revenue
- It can be demonstrated that revenue and the consumption of economic benefits of the intangible asset are highly correlated.

The following examples are provided in paragraph 98C of cases where a revenue-based amortisation basis may be appropriate:

- Concession to explore and extract from a gold mine expires when total cumulative revenue from extraction of gold reaches $2 billion, rather than expiring on a set date or ounces of production
- Right to operate a toll road expires when tolls generated from operating the toll road reach $100 million, rather than at a set date or based on number of vehicles.

These revenue thresholds are referred to in the amendments as 'predominant limiting factors'. When revenue is the 'predominant limiting factor' in the contract for use of the intangible asset, revenue generated may be an appropriate basis for amortising the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortisation can be determined.

Effective date

The amendments apply prospectively to annual periods beginning on or after 1 January 2016, with early adoption permitted.

How do we account for a change in method of depreciation or amortisation?

If you currently adopt a revenue-based depreciation/amortisation method, on first-time adoption of these amendments on 1 January 2016, you will <u>not</u> be required to go back and retrospectively recalculate depreciation and amortisation using a non-revenue based method. Instead, you will merely apply the new method from 1 January 2016. This is because IAS 16, paragraph 61 and IAS 38, paragraph 104 stipulate that changes in the depreciation/amortisation methods are accounted for as **changes in accounting estimates** under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. IAS 8, paragraph 36 requires that changes in accounting estimates are accounted for prospectively.

This treatment is in line with the prospective transitional requirements in this standard. IAS 8, paragraph 39, also requires disclosure of the following for changes in accounting estimates:

- Nature of the change
- Amount of change that has an effect on the current period
- Amount of change(s) that will affect future period(s) (unless impracticable to estimate, in which case that fact must be disclosed).

How should we depreciate/amortise new assets?

For new assets acquired during the current financial year, we recommend that you do <u>not</u> adopt a revenue-based depreciation/amortisation method because these changes are merely clarifying current practice, and it will save you having to change to another method in 2016.

Even though a revenue-based depreciation/amortisation method is permitted until 2016, it is our view that persisting with a policy that is about to be prohibited is unusual. We therefore recommend that you consider changing your depreciation and amortisation methods for existing assets. These changes in methods will be recognised as changes in estimates under IAS 8 and no retrospective adjustments to assets balances will be required. However, IAS 8, paragraph 39 disclosures will be required as described above.