

## IFRS in Focus

# IASB amends IAS 16 and IAS 38 to clarify acceptable methods of depreciation and amortisation

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This edition of IFRS in Focus outlines the recent amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* dealing with acceptable methods of depreciation and amortisation.

#### The Bottom Line

- The amended IAS 16 prohibits entities from using a revenue-based depreciation method for items of property, plant and equipment.
- The amended IAS 38 introduces a rebuttable presumption that revenue is not an appropriate basis for amortisation of an intangible asset. This presumption can only be rebutted in two limited circumstances: (a) the intangible asset is expressed as a measure of revenue; and (b) revenue and consumption of the intangible asset are highly correlated.
- Guidance is introduced to explain that expected future reductions in selling prices could be indicative of a reduction of the future economic benefits embodied in an asset.
- The amendments apply prospectively for annual periods beginning on or after 1 January 2016, with earlier application permitted.

#### Why have these amendments been issued?

The IASB received a request for guidance on how to determine an appropriate amortisation method for intangible assets of service concession arrangements (SCAs) under IFRIC 12 *Service Concession Arrangements*. The IASB determined that the issue does not only relate to SCAs but all tangible and intangible assets that have finite useful lives. Therefore, the Board decided to address the issue broadly by amending IAS 16 and IAS 38 to clarify which methods of depreciation and amortisation are acceptable.

#### When do the new requirements apply?

The amendments apply prospectively and are effective for annual periods beginning on or after 1 January 2016, with earlier application permitted. If an entity applies the amendments earlier, it shall disclose that fact.

The amendments do not contain specific transition guidance.

For more information please see the following websites:

[www.iasplus.com](http://www.iasplus.com)

[www.deloitte.com](http://www.deloitte.com)

## What are the changes introduced by the amendments?

### Amendments to IAS 16 *Property, Plant and Equipment*

The Board decided to amend IAS 16 to explicitly prohibit revenue-based depreciation for property, plant and equipment. Depreciation should reflect the expected pattern of consumption of the future economic benefits of the asset. A depreciation method based on revenue allocates an asset's depreciable amount based on revenues generated in an accounting period as a proportion of total expected revenues during the asset's useful life.

The amendments clarify that there are multiple factors that influence revenue and that not all of these factors are related to the way the asset is used or consumed. The amended guidance lists other inputs and processes, selling activities, changes in sales volumes and prices and inflation as examples of such factors. Revenue therefore reflects a pattern of economic benefits that are generated from operating the business rather than the economic benefits that are being consumed through use of the asset.

#### Observation

The Exposure Draft (ED) for these amendments proposed to state in the Basis for Conclusions that there are limited circumstances in which a revenue-based method would give the same result as a 'units of production' method. However, respondents to the ED found this to be contradictory with the proposed amendments to the Standard. The IASB therefore decided not to add this exception to the Basis for Conclusions of the final amendments.

The amendments also explain that future reductions in the selling prices of the output produced by using an asset could be an indicator of technical or commercial obsolescence of the asset and, therefore, of a reduction of the future economic benefits embodied in the asset. The Basis for Conclusions confirms that the diminishing balance method is capable of reflecting such a reduction in economic benefits.

### Amendments to IAS 38 *Intangible Assets*

The amendments to IAS 38 introduce a rebuttable presumption that a revenue-based amortisation method for intangible assets is inappropriate for the same reasons as set out above for the amendments to IAS 16.

However, under the amendments, this rebuttable presumption can be overcome in two limited circumstances when:

- the intangible asset is expressed as a measure of revenue, i.e. when the predominant limiting factor inherent in an intangible asset is the achievement of a contractually specified revenue threshold; or
- it can be demonstrated that revenue and the consumption of economic benefits of the intangible asset are highly correlated.

In these circumstances, revenue expected to be generated from the intangible asset can be an appropriate basis for amortisation of the intangible asset.

The amendments explain that the predominant limiting factor might be a predetermined amount of time, number of units produced or a fixed total amount of revenue to be generated. The amendments include two examples in which a revenue threshold is the predominant limiting factor inherent in an intangible asset: a concession to explore and extract gold from a gold mine and the right to operate a toll road, for which the contract expires when a fixed total amount of cumulative revenue from the sale of gold or tolls charged is reached, respectively. Identifying the predominant limiting factor that is inherent in an intangible asset could be a starting point for determining the appropriate basis for amortisation. However, another basis may be appropriate if it more closely reflects the expected pattern of consumption of economic benefits.

**Observation**

The amendments to IAS 38 related to amortisation methods based on revenue are less strict than the corresponding amendments to IAS 16. While the amended IAS 38 includes a rebuttable presumption, the amended IAS 16 prohibits revenue-based depreciation. The IASB noted that the circumstances in which a revenue-based amortisation method for intangible assets is acceptable are not likely to arise in respect of items of property, plant and equipment.

The amended IAS 38 contains the same guidance as that in the amended IAS 16 set out above, which explains that future reductions in selling prices of the output produced by using an asset may indicate a reduction of the future economic benefits embodied in the asset.

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