

2 April 2013

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

IASB ED/2012/5 *Clarification of Acceptable Methods of Depreciation and Amortisation*

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the Exposure Draft ED/2012/5 *Clarification of Acceptable Methods of Depreciation and Amortisation*. In formulating its views, the AOSSG sought the views of its constituents within each jurisdiction.

The AOSSG currently has 26 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan and Vietnam.

To the extent feasible, this submission to the IASB reflects in broad terms the collective views of AOSSG members. Each member standard-setter may also choose to make a separate submission that is consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asian-Oceanian region. This submission has been circulated to all AOSSG members for their comment after having been initially developed through the AOSSG Chair's Advisory Committee.

Some AOSSG members support the ED/2012/5 key proposal to prohibit applying a revenue-based depreciation or amortisation method. These members also recommend that the IASB clarifies its reasons for that proposal, particularly because some of the discussion in paragraphs BC3-BC5 of ED/2012/5 seems potentially inconsistent with the proposal.

Some other AOSSG members have concerns with the ED/2012/5 proposals. They note the underlying principle for recognising depreciation or amortisation as stated in paragraph 60 of IAS 16 *Property, Plant and Equipment* and paragraph 97 of IAS 38 *Intangible Assets* is to reflect the pattern in which the asset's future economic benefits are expected to be consumed by the reporting entity. These members consider that it is inappropriate for

ED/2012/5 to conclude that the revenue-based method is not an appropriate method in the absence of a clear meaning for ‘consumption of economic benefits’.

The AOSSG also considers it essential that the IASB proceeds expeditiously with its proposal, having issued an ED on this issue and identified it as a clarification. Otherwise, IFRS adopters may misconstrue the requirements of IAS 16 and IAS 38 in relation to revenue-based depreciation or amortisation methods.

Our views are explained in more detail in the Appendix.

If you have any queries regarding any matters in this submission, please contact me.

Yours sincerely

A handwritten signature in black ink that reads 'K.M. Stevenson'. The signature is written in a cursive style with a large, sweeping 'S' at the end.

Kevin M. Stevenson
AOSSG Chair

APPENDIX

Detailed comments on the IASB ED/2012/5 *Clarification of Acceptable Methods of Depreciation and Amortisation*

Question 1 of ED/2012/5

Support for the IASB's key proposal to prohibit a depreciation or amortisation method that uses revenue generated from an activity that includes the use of an asset

1. Some AOSSG members support the IASB's key proposal referred to above, because they consider that:
 - (a) an asset's future economic benefits represent its *ability* to produce outputs that generate future cash inflows (generally, revenue), which is distinct from the future cash inflows themselves; and
 - (b) although an asset's ability to produce outputs that generate future cash inflows is consumed over time with the aim of generating revenue, it is not necessarily consumed in proportion to revenue. For example, revenue reflects prices obtained for an asset's outputs, but prices are not a relevant factor in determining the amount of consumption of an asset's ability to produce outputs that generate future cash inflows.
2. For the following reasons, these AOSSG members recommend that the IASB clarifies its reasons for its key proposal in its Basis for Conclusions:
 - (a) Paragraph BC2 of ED/2012/5 seems to emphasise a 'unit of account' issue (namely, the distinction between generating revenue by operating a business and depreciation/amortisation arising from the consumption of future economic benefits embodied in individual assets). However, these members consider their reasons for supporting the IASB's proposal (in paragraph 1 above) are more pertinent and generally implicit in the IASB's proposal. These members suggest that, if the IASB agrees with the reasons in paragraph 1 above, the IASB should state them explicitly.
 - (b) Some of the discussion in paragraphs BC3-BC5 of ED/2012/5 seems potentially inconsistent with the key proposal:
 - (i) These AOSSG members consider that their reasons (in paragraph 1 above) for supporting the ED's key proposal would lead to a different conclusion than that in paragraphs BC4-BC5 regarding the pattern of amortisation of acquired rights to broadcast a film. Paragraph BC5 says "... the number of viewers attracted could be used as a reasonable basis for the pattern in which the benefits for those rights are expected to be consumed". These members disagree that the pattern of consumption of future economic benefits embodied in the right would be based on the number of viewers, because the right's ability to produce outputs that

generate future cash inflows does not necessarily diminish proportionately with the number of viewers. These AOSSG members are concerned that, in illustrating paragraph BC3, paragraphs BC4-BC5 appear potentially to create an exception to the key proposal in ED/2012/5 specifically in relation to one industry.

- (ii) These AOSSG members broadly agree with the last sentence of paragraph BC3, but consider it would be better to refer to the potential for the pattern of revenue from an asset to *coincide* with the asset's pattern of depreciation or amortisation. (Otherwise, that sentence in paragraph BC3 could be read to imply that revenue is the driver for the pattern of depreciation or amortisation, when using a units of production method.) These members suggest that the point in that sentence would be better made by using the following illustration:

Entity A uses a machine in a mining operation, and the machine has a variable pattern of output. As minerals prices (and thus revenues) change, Entity A changes the rate of production from the machine. Therefore, expected revenues are the key determinant of the rate of usage of the machine. However, the pattern of depreciation of the machine, measured using a units of production method, reflects the usage of the machine, not the expected revenues, even though the two might coincide.

These members consider that this example is more representative of the issues that a wider range of entities may encounter, and could usefully replace the narrower film broadcast rights example discussed in paragraphs BC4-BC5.

Concerns about the IASB's key proposal to prohibit a depreciation or amortisation method that uses revenue generated from an activity that includes the use of an asset

3. Some AOSSG members have concerns about the IASB's key proposal. These members consider the underlying principle for recognising depreciation and/or amortisation as stated in paragraph 60 of IAS 16 and paragraph 97 of IAS 38 is to reflect the pattern in which the asset's future economic benefits are expected to be consumed by the reporting entity. These members note that the meaning of 'consumption of economic benefits' is not clarified in ED/2012/5; instead ED/2012/5 concludes that a revenue-based method is not an appropriate method because it reflects the generation of economic benefits.
4. Paragraph 17 of IAS 38 explains that future economic benefits flowing from an intangible asset may include *revenue from the sale of products or services*, cost savings or other benefits resulting from the use of the asset by the entity. Paragraph 106 of IAS 38 states that the pattern of future economic benefit *expected to flow to an entity* may change over time and, if there is such a change, the amortisation method should be changed to reflect the changed pattern. An example is given in the same paragraph; namely: use of the rights represented by a license is deferred

pending action on other components of the business plan resulting in economic benefits that flow from the asset potentially not being received until later periods. These members consider that paragraph 106 of IAS 38 focuses on the generation of future economic benefits.

5. Accordingly, these members believe it is important to clarify what is meant by ‘consumption of economic benefits’ and how it is different from ‘generation of economic benefits’. This is particularly critical for intangible assets where the unit of production may not be readily observable, and revenues generated by consuming such intangible assets could inadvertently be interpreted as an acceptable method of amortisation.
6. In some jurisdictions in Asia-Oceania, such as Malaysia, it is common for the contractual tariff rate of service concession arrangements to be lower at the beginning of the concession term and to increase periodically throughout the concession term so as not to burden the public from a cost point of view. This feature generally results in lower revenue at the beginning of the concession term with an increasing trend over the concession term. Many service concession operators believe that the increased tariff rate forms an integral part of and contributes to the future economic benefit of such intangible assets, and therefore should be considered when selecting an appropriate amortisation method.
7. In addition, these members believe the IASB’s acknowledgement in the Basis for Conclusions that a revenue-based method could be used in limited circumstance has added complexity to the issue because the Basis does not form part of ED/2012/5. Paragraph BC5 states that advertising revenue could be used to determine the pattern of amortisation to the extent that advertising revenue has a linear relationship with the number of views. These members also consider paragraph BC5 to be inconsistent with the proposed amendment that a revenue-based method is not an appropriate method, a view that is also expressed in paragraph 2(b)(i) above. If the IASB proceeds with the proposed amendments, these members would suggest that the IASB rationalise the underlying principle for why advertising revenue is an appropriate basis for the media industry. Other members suggest that the intention in paragraph BC 5 of ED/2012/5 should be incorporated into the Standard so as to clarify that the revenue-based method could be used in limited circumstances.
8. In conclusion, the members who have concerns about the IASB’s key proposal strongly urge the IASB to consider providing guidance on the definition of ‘consumption of future economic benefits’ when determining the appropriate depreciation or amortisation method. That guidance should acknowledge that there are assets with no observable physical output and where volume cannot readily be observed, but reference could be made to the cash flows generated from the use of the assets.
9. However, if the IASB proceeds with the proposed amendments, these members would recommend that the IASB:

- (a) clarify paragraph 106 of IAS 38 and the rationale for why a revenue-based method is allowed for the media industry;
- (b) provide application guidance on the amortisation method for film rights to be incorporated as part of the amendment to the standard.

Question 2 of ED/2012/5 – Other comments

Proposed new paragraphs 62A-62B of IAS 16 and 98A-98B of IAS 38

10. Some AOSSG members generally support proposed new paragraphs 62A-62B of IAS 16 and 98A-98B of IAS 38. These members have the following drafting comments regarding those new paragraphs.
 - (a) The last sentences of proposed new paragraph 62A of IAS 16 and paragraph 98A of IAS 38 say that paragraph 60 of IAS 16 and paragraph 97 of IAS 38 establish consumption of the benefits inherent in the asset *when it was acquired* as the principle for depreciation/amortisation (emphasis added). However, paragraph 60 of IAS 16 and paragraph 97 of IAS 38 do not refer to ‘when it (the asset) was acquired’. Accordingly, for consistency with the manner in which the principles in paragraph 60 of IAS 16 and paragraph 97 of IAS 38 are expressed, it is suggested that, in paragraph 62A of IAS 16 and paragraph 98A of IAS 38, the words “benefits that were inherent in the asset when it was acquired” should be replaced with the words “benefits inherent in the asset”.
 - (b) The first sentences of proposed paragraph 62A of IAS 16 and proposed paragraph 98A of IAS 38 refer to ‘future economic benefits being generated’ and ‘economic benefits being generated’ respectively. It is recommended that those references be made consistent. In this regard, it is suggested that proposed paragraph 62A of IAS 16 be conformed with proposed paragraph 98A of IAS 38 (that is, referring to ‘a pattern of economic benefits being generated’ rather than to ‘a pattern of future economic benefits being generated’). This is because ‘future economic benefits’ is regarded as referring to a stock rather than an inflow (note that, in the latter part of each of those sentences, ‘future economic benefits’ is appropriately used to refer to a stock).
11. Other members suggest that the IASB should articulate the rationale for adding the proposed new paragraphs 62A-62B of IAS 16 and 98A-98B of IAS 38 in the Basis for Conclusions. These members would also suggest that the IASB should clarify if information about the expected future reduction in the unit selling price of a product or service output from the asset is relevant in estimating the useful life of an asset when depreciation or amortisation methods other than the diminishing balance method are used.

Transition

12. Some AOSSG members do not support the proposal to require retrospective application of the amended paragraphs on the basis that depreciation/amortisation is

itself an accounting estimate; and a change in accounting estimate should be accounted for prospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In addition, these members believe the proposed amendments would be inconsistent with the requirement in paragraph 61 of IAS 16 that “if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the [depreciation] method shall be changed ... [and] accounted for as a change in accounting estimate” (i.e. prospectively). These members suggest the IASB considers allowing prospective application in view of the significant potential impacts of the change, similar to the approach that the Board considered in developing the Proposed Annual Improvements to IFRSs 2010-2012 cycle, Proposed Amendment to IAS 1 *Presentation of Financial Statements*.

13. On the other hand, some AOSSG members support the proposal to require retrospective application of the changed paragraphs in IAS 16 and IAS 38 (i.e. to treat the changes as a change in accounting policy). These members observe that:
 - (a) consistent with IAS 8, retrospective application would not be required to the extent that it is impracticable. Therefore, these members consider that requiring the proposed amendments to be applied retrospectively should not be unduly onerous.
 - (b) the existing requirement in paragraph 61 of IAS 16 (as mentioned in paragraph 12 above) requires prospective treatment of a change in depreciation method if there has been a significant change in the entity’s circumstances (an economic event). In contrast, a change in depreciation method resulting from the proposed amendment to IAS 16 would reflect a change of treatment only, and would not account for an economic event. These members consider that this distinction justifies treating a changed depreciation or amortisation method upon adopting the proposed amendments to IAS 16 and IAS 38 as a change in accounting policy, with retrospective application under IAS 8.
14. Some AOSSG members particularly support the proposal to permit early application of the changed paragraphs in IAS 16 and IAS 38 because they consider the proposed amendments would improve financial reporting, and the improved information should be available to users as soon as possible. They believe this overrides any concerns about the implications of early application for the comparability of financial information during the transition period.