SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
develop.influence.lead.

2 April 2013

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom
Email: CommentLetters@ifrs.org

Dear Sirs,

SAICA SUBMISSION ON THE EXPOSURE DRAFT ON *CLARIFICATION OF ACCEPTABLE METHODS*: PROPOSED AMENDMENTS TO IAS 16 – *PROPERTY, PLANT AND EQUIPMENT* AND IAS 38 – *INTANGIBLE ASSETS*

In response to your request for comments on the IASB's exposure draft on *Clarification of Acceptable Methods*: Proposed Amendments to IAS 16 – *Property, Plant and Equipment* and IAS 38 – *Intangible Assets*, attached is the comment letter prepared by Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC, which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours faithfully,

Sue Ludolph
Project Director – Financial Reporting

cc: Paul O'Flaherty (Chairman of the Accounting Practices Committee)

Integritas, 7 Zulberg Close, Bruma Lake, 2198 POSTAL ADDRESS PO Box 59875, Kengray, 2100, Johannesburg
TEL +27 11 621 6600 FAX +27 11 621 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za

SAICA SUBMISSION ON EXPOSURE DRAFT ON CLASSIFICATION OF ACCEPTABLE METHODS – PROPOSED AMENDMENTS TO IAS 16 - *PROPERTY, PLANT AND EQUIPMENT* & IAS 38 - *INTANGIBLE ASSETS*

GENERAL COMMENTS

Whilst we agree with the Board that revenue is not an appropriate basis to calculate the charge for depreciation or amortisation, we do not believe that this amendment by itself will have any significant impact in practice. Where revenue does approximate the method of consumption of the asset, an alternative basis will be found that gives a materially similar accounting result in order to comply with the amendment. In cases where revenue does not approximate the pattern of consumption of the asset there is no guidance in the amendment to ensure that entities select a more appropriate method of depreciation, rather than switch to some other method based on customer activity which could be equally flawed. We have provided some examples for consideration in our response to Question 1.

Therefore we believe it would be beneficial to clarify the principle of 'the consumption of future economic benefits' through the use of fact specific illustrative examples in order to promote the use of more representative methods of depreciation and amortisation.

SPECIFIC COMMENTS

Question 1

The IASB proposes to amend IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets to prohibit a depreciation or amortisation method that uses revenue generated from an activity that includes the use of an asset. This is because it reflects a pattern of future economic benefits being generated from the asset, rather than reflecting the expected pattern of consumption of the future economic benefits embodied in the asset. Do you agree? Why or why not?

We agree with the general principle that entities should not be allowed to default to a revenue-based method for depreciation and amortisation of assets.

Paragraph 60 of IAS 16 requires that the depreciation method used in relation to property, plant and equipment reflects the pattern in which the asset's future economic benefits are to be consumed by the entity. Selecting a depreciation method that is consistent with the pattern of consumption for items of property, plant and equipment is straightforward in most cases. In the case of this kind of tangible asset, there is a direct and visible link between using the asset in the production or supply of goods or services over more than one period, as envisioned in the IAS 16 definition. The use of tangible asset for this purpose consumes the future economic benefits related to the asset in an observable manner, and diminishes the asset's ability to produce economic benefits in future periods. It is therefore unlikely that a revenue-based method of depreciation would reflect the pattern in which the asset's future economic benefits are consumed by the entity more accurately than a usage-based method, such as the straight-line or unit of production method.

Paragraph 97 of IAS 38 similarly requires that the amortisation method used in relation to an intangible asset shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. In most circumstances however, there is not such a clearly observable link to the consumption of the economic benefits relating to the intangible asset, as the asset does not have physical substance. Intangible assets with finite useful lives are generally not consumed through repetitive use in the same way as tangible assets and the pattern of consumption is more likely to approximate the pattern of revenue recognition.

However, irrespective of whether the asset in question is tangible or intangible there are circumstances where the method of consumption of the asset closely approximates the pattern of revenue generation. In these circumstances the application of this amendment will lead to a change in the definition of an entity’s basis of depreciation or amortisation, but not significantly alter the pattern of cost recognition in profit or loss. Conversely there may be other cases where the pattern of consumption of the asset differs significantly from its associated revenue streams. In this case, the proposed amendment does little to provide additional guidance to entities and prevent an inappropriate basis of depreciation or amortisation. While revenue-based depreciation is prohibited, there is no prohibition on applying a depreciation method based on some other measure of customer activity which might be equally inappropriate.

Consider the following examples where the entities in question previously used a revenue based method of depreciation:

<u>Example 1 – Toll road operator</u>

A toll road operator now depreciates its road based on number and weight of vehicles that use the road. The number of vehicles driving on the road surface creates wear and tear that diminishes the road’s ability to serve its purpose of carrying traffic in future and heavier vehicles also cause more damage to the road. Revenue is earned by charging toll fees for the use of this road and is also based on the number and weight of the vehicles using the road, with trucks being charged more than motorcycles. In this case, the economic effects of depreciating the asset based on the number and class of vehicles that use the road is substantially the same as if a revenue-based method were to be used.

The proposed amendment will have little impact on the pattern of depreciation compared to a revenue-based model, which we consider to be correct, although the entity will have to disclose that the basis of depreciation is the number and weight of vehicles rather than revenue.

<u>Example 2 – Amusement park operator</u>

A rollercoaster ride in an amusement park is now depreciated based on the number of passengers who use the ride. However, the asset would be consumed in the same way if it carried one passenger, or a full load of passengers, and therefore the amount of “runs” would probably be more representative of the actual consumption of the asset. Each passenger is charged the same fee per ride meaning that depreciation based on passenger numbers is effectively the same as a revenue-based model. However, the amendment does not prohibit a passenger-based depreciation model and therefore does not address the fact that it would be as inappropriate as revenue in these circumstances.

Question 2

Do you have any other comments on the proposals?

We disagree with the inclusion of the media rights example in the Basis for Conclusions. As we have noted in the 'general comments' section, in our view this amendment will not have any significant impact in practice. Where revenue does approximate the method of consumption of the asset, an alternative basis will be found that gives a materially similar accounting result in order to comply with the amendment. In cases where revenue does not approximate the pattern of consumption of the asset there is no guidance in the amendment to ensure that entities select a more appropriate method of depreciation. Media rights contracts can be structured in a range of different ways and we are concerned that entities may use this guidance to continue using an amortisation model that closely approximates revenue even when this does not reflect the pattern of consumption of the asset.

We are in full agreement with the additional guidance proposed in respect of the reducing balance method of depreciation and amortisation.

#420154