

Amendments to HKAS 16 and 38 - Clarification of Acceptable Methods of Depreciation and Amortisation

Introduction

Paragraph 60 of HKAS 16 “Property, Plant and Equipment” and paragraph 97 of HKAS 38 “Intangible Assets” require that the depreciation and amortisation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed.

The amendments to HKAS 16 clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate. The amendments to HKAS 38 clarify that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain limited circumstances.

Effective Date

The amendments are effective retrospectively for annual periods beginning on or after 1 January 2016 with earlier application permitted.

Summary of Amendments

The amendments to HKAS 16 and 38 explain that expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset. The Basis for Conclusions further states that the diminishing balance method is an accepted depreciation and amortisation methodology, which is capable of reflecting an accelerated consumption of the future economic benefits embodied in the asset.

The amendments to HKAS 16 clarify that a depreciation method that is based on revenue generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of 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 upon the way in which an asset is consumed.



The amendments to HKAS 38 clarify that there is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible 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 upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:

- (a) in which the intangible asset is expressed as a measure of revenue; or
- (b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

In choosing an appropriate amortisation method, an entity could determine the predominant limiting factor that is inherent in the intangible asset. The predominant limiting factor could be predetermined time, number of units produced or a fixed amount of revenue to be generated. When the predominant limiting factor is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortisation.

For example, an entity could acquire a concession to explore and extract gold from a gold mine. The expiry of the contract might be based on a fixed amount of total revenue to be generated from the extraction and not be based on time or on the amount of gold extracted. In this example, the revenue that is to be generated might 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 is to be determined.



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