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IN ANY COMMUNICATION PLEASE QUOTE OUR FILE NO.

檔案號碼 HQ 502/141 Pt.19

File No.:

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發出日期： 21 February 2013

Date of Issue:

Dear Mr. Riley,

**Invitation to Comment on IASB Exposure Draft
Clarification of Acceptable Methods of Depreciation and Amortisation:
Proposed Amendments to IAS 16 and IAS 38**

I refer to your letter dated 11 December 2012 inviting for comments to the above IASB Exposure Draft.

The Exposure Draft proposes to state explicitly in IAS 16 *Property, Plant and Equipment* (“PPE”) and IAS 38 *Intangible Assets* that a method using revenue generated from activity including use of an asset is not an appropriate depreciation or amortisation method. IASB reasons that such method 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.

The Exposure Draft however clarifies that when applying the diminishing balance method, an expected future reduction in the selling price of the product or service output of the asset could be an indication of technical or commercial obsolescence, and information about the obsolescence of the product or service output is relevant for estimating both the pattern of consumption of future economic benefits and the useful life of the asset.

The principle now laid down in IAS 16 and IAS 38 is that a depreciation or amortisation method shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity (i.e. paragraphs 60 and 97 respectively). Future economic benefits include revenue from the sale of the products or services, cost savings, or other benefits resulting from the use of the asset by the entity (i.e. paragraph 17 of IAS 38). Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits (i.e. paragraph 25 of IAS 38).

As can be seen from the principles above, the value of the PPE or intangible asset lies in the expectations about expected inflow of future economic benefits which the use of the asset will bring about. Revenue is a major constituent of the economic benefits. Depreciation or amortisation making reference to revenue both earned and expected to receive in future could reflect the extent to which value in the asset has been consumed and is consistent with the matching principle. I therefore think it a bit strict if the use of a revenue-based depreciation or amortisation method is prohibited. I believe a more liberal interpretation should be allowed for the term "consumption of future economic benefits embodied in the asset".

Having said the above, from taxation point of view however, the depreciation and amortisation method adopted for accounting will not have tax impact. In computing the assessable profits for taxation purpose, the amount of depreciation or amortisation charged in accounts, irrespective of its basis of calculation, will be added back, and the amount of depreciation allowance and other deductions to be allowed will be governed by the provisions of the Inland Revenue Ordinance.

It is hoped that the IASB will be able to identify best practice after considering views and inputs from stakeholders. In any event, I would appreciate it very much if you could keep me informed of the development in acceptable methods of depreciation or amortisation.

Yours sincerely,



(Mrs WU LAM Choi-wah)
for Commissioner of Inland Revenue