MALAYSIAN INSTITUTE OF ACCOUNTANTS
FINANCIAL REPORTING STANDARDS IMPLEMENTATION COMMITTEE
("FRSIC")

FRSIC Issue No. 3 [2007]

The Use of Projected Revenue Method to Amortise Expressway Development Expenditure

The issue:

Use of projected revenue as a basis of amortisation.

Current accounting practice as observed by the Submitter:

Many reporting entities, particularly entities with concession rights, depreciate/amortise depreciable assets based on the proportion of actual accumulated revenue earned to date against projected total revenue over concession period.

An example of accounting policy on amortisation of the Expressway Development Expenditure is enclosed as Appendix 1 and is summarised as follows:

The amortisation formula applied in the preparation of the financial statements to arrive at the annual amortisation charge for each financial period is as follows:

$$\frac{\text{Total revenue for the year}}{\text{(Actual toll revenue for the year + projected total toll revenue for the subsequent years to year 20XX)}} \times \text{(Net book value of EDE brought forward + Additions for the year)}$$

Issue arising:

Paragraph 60 of FRS 116 "Property, Plant and Equipment" or paragraph 97 of FRS 138 "Intangible Assets" require depreciation or amortization to reflect the pattern in which the asset's future economic benefits are expected to be consumed (as opposed to "earned") by the reporting entity.

Paragraph 96 of ED 53 "Framework for the Preparation and Presentation of Financial Statements" states that "When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures… These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire." Applying this concept, in order to allocate expenses over the accounting periods over which the economic benefits are consumed, the units of production method could be used; if the economic benefits were to expire, the expenditure could be allocated over the useful life. It may be argued that revenue could be used as the basis for depreciation or amortisation but only if there is no price increases and there

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is no element of government subsidies such that the basis is reflective of consumption.

To further explain this point, FRS 116.62 and FRS 138.97 indicate that the depreciation methods include straight-line method, the diminishing balance method results and the units of production method.

FRS 138.97 further elaborates that if the pattern of consumption of future economic benefits cannot be determined reliably, the straight-line method shall be used.

Therefore, the use of toll revenue / total revenue in the above amortisation formula may not be appropriate because pricing element such as increase in toll fares and government subsidies have been imputed into the calculation of toll revenue and these items are not a reflection of the manner in which the asset is used.

Illustration of amortisation using units of consumption (e.g. number of vehicles):

The following examples illustrate amortisation using revenue, which in the normal course of business has price increases, could not be used as the basis of allocating the economic benefits as such basis is not reflective of the pattern of consumption.

Example: A concession expenditure of RM 100 is incurred.

(A) Concession is amortised using units of consumption
(assume: total unit of consumption = 60)

	Year 1	Year 2	Year 3	Year 4
Units of consumption	5	10	15	30
Depreciation (RM)	5/60 x RM100 = 8	10/60 x RM100 = 17	15/60 x RM100 = 25	30/60 x RM100 = 50
% of depreciation over total expenditure	8%	17%	25%	50%

Conclusion: Amortisation method is appropriate as it reflects the pattern of consumption.

(B) Concession is amortised using revenue, no price increases. Low initial consumption.
(assume: 1 unit of consumption generate RM 2, no price increases throughout the period. Total revenue = RM120)

	Year 1	Year 2	Year 3	Year 4
Units of consumption	5	10	15	30
Revenue (RM)	10	20	30	60
Depreciation (RM)	10/120 x RM100 = 8	20/120 x RM100 = 17	30/120 x RM100 = 25	60/120 x RM100 = 50

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% of depreciation over total expenditure	8%	17%	25%	50%

Conclusion: Amortisation method is appropriate as it reflects the pattern of consumption.

C) Concession is amortised using revenue, with price increases. Low initial consumption.
(assume 1 unit of consumption generate RM 2 in year 1 and Year 2, RM 5 in Year 3 and Year 4; total revenue = RM 255)

	Year 1	Year 2	Year 3	Year 4
Units of consumption	5	10	15	30
Revenue (RM)	10	20	75	150
Depreciation (RM)	10/255 x RM100 = 4	20/255 x RM100 = 8	75/255 x RM100 = 29	150/255 x RM100 = 59
% of depreciation over total expenditure	4%	8%	29%	59%

Conclusion: Amortisation charges in the earlier years are low as compared to the later years, which is not reflective of the usage.

(D) Concession is amortised using revenue, with price increases. Constant consumption throughout the years.
(assume 1 unit of consumption generate RM 2 in year 1 and Year 2, RM 5 in Year 3 and Year 4; total revenue = RM210)

	Year 1	Year 2	Year 3	Year 4
Units of consumption	15	15	15	15
Revenue (RM)	30	30	75	75
Depreciation (RM)	30/210 x RM100 = 14	30/210 x RM100 = 14	75/210 x RM100 = 36	75/210 x RM100 = 36
% of depreciation over total expenditure	14%	14%	36%	36%

Conclusion: Although the usage of the economic benefits is constant, the amortisation using revenue is not reflective of the usage. The amortisation fluctuates in Year 3 and Year 4 despite the consumption remained unchanged.

Reasons for the FRSIC to address the issue:

Use of projected revenue as the basis of depreciation / amortisation could mean non-compliance with the MASB Approved Accounting Standards in Malaysia and International Financial Reporting Standards (IFRS).

However, there is a controversial that such basis could be used. There is a widespread usage of

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revenue (which includes price increases and government subsidies) as the basis of amortization. The implication of disallowing use of revenue as the basis of depreciation / amortisation could lead to concession companies reporting losses in the initial year of operation when the volume of usage is low and therefore revenue is low.

Therefore, it is imperative for FRSIC to address the issue and provide guidance.

Submitter's proposal or recommendation to address the issue:

It would be more appropriate to use:

- the units of production method i.e. the projected volume of vehicles as in the case of depreciating Expressway Development Expenditure, or
- time

to comply with FRS 116 or FRS 138.

The use of revenue which includes price increases or government subsidies is not appropriate as it would be deferring expenses into years when revenue is higher where in substance there is no change in pattern of consumption.

Submitted on:

26 January 2007

Corresponding FRSIC Consensus:

PROJECT WAS DISCONTINUED.

The FRSIC's deliberation: FRSIC has considered this issue but decided to discontinue the project because similar issue has been added to the agenda of the International Financial Reporting Standards Interpretations Committee ("IFRIC"). FRSIC will monitor the development of this issue at international level and will revisit the issue at national level, if necessary.

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