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Prospective application of changes in estimated useful lives of PP&E and intangible assets (IAS 8, IAS 16, IAS 38)

Dear Members of the IFRS Interpretations Committee,

I'm writing to submit an enquiry about the interpretation of "prospective" application of changes in accounting estimates in the context of the useful lives of PP&E and intangible assets. I believe there is diversity in the application of IAS 8 in this area and that this can have a material effect on affected entities.

The question arises when:

- the revised estimate is determined as part of the entity's annual review of estimated useful lives carried out around the annual reporting date; and
- there is no discrete transaction or identifiable event that establishes a particular date on which the estimate changed. Instead, the revised estimate results from the accumulation of information and experience.

In that fact pattern, from what date should the revised estimate affect depreciation or amortisation recognised in the annual financial statements?

Based on my observations, two views have developed:

- **View 1: Date-of-change approach:** the revised estimate affects depreciation or amortisation only from the date on which management reaches the revised estimate. Where the estimate is revised as part of an annual review completed near the financial year-end, this approach results in the revised estimate affecting depreciation or amortisation from the beginning of the next annual reporting period.
- **View 2: Whole-of-current-annual-period approach**: the revised estimate is reflected in the measurement of depreciation or amortisation for the whole annual reporting period in which the estimate is revised, including through a catch-up adjustment for amounts attributable to earlier parts of that annual period.

I ask the Committee to clarify which interpretation is required by IFRS Accounting Standards in the fact pattern described above.

Technical background

IAS 16.51 requires an entity to review the useful life of an asset at least at each financial year-end and, if expectations differ from previous estimates, to account for the change as a change in an accounting estimate in accordance with IAS 8.

IAS 38 contains corresponding requirements. The amortisation period and amortisation method are also reviewed at least at each financial year-end, and changes resulting from a revised expected useful life are accounted for as changes in accounting estimates under IAS 8 (IAS 38.104).

IAS 8.32 states that developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information. Depreciation expense for an item of PP&E is specifically identified as an example of an accounting estimate (IAS 8.32(d)). IAS 8.34 explains that an accounting estimate may need to be revised if the circumstances on which the estimate was based change, or as a result of new information, new developments or more experience.

IAS 8.36 requires the effect of a change in an accounting estimate to be recognised prospectively by including it in profit or loss in:

- the period of the change, if the change affects that period only; or
- the period of the change and future periods, if the change affects both.

IAS 8.38 then explains prospective recognition using two different time-related formulations that, in the submitted fact pattern, can lead to different conclusions. First, it states that prospective recognition means applying the change to transactions, other events and conditions "**from the date of that change**". Secondly, the same paragraph states specifically that a change in the estimated useful life of, or expected pattern of consumption of economic benefits embodied in, a depreciable asset affects depreciation expense "**for the current period and for each future period**" during the asset's remaining useful life. IAS 8.38 further states that the effect relating to the current period is recognised as income or expense in the current period.

Why the question arises

Where a discrete event directly changes an estimate, IAS 8.38 can be applied naturally. For example, if a new legal restriction enacted on 1 October results in a shorter expected useful life, the date of the relevant change can be identified.

In practice, though, changes identified through annual reviews mandated by IAS 16.51 and IAS 38.104 don't necessarily result from an event occurring on a single identifiable date. Expected useful life may change progressively because of experience with the asset, evolving expectations regarding technological or commercial obsolescence, changes in anticipated utilisation or other information accumulated during the year.

In those circumstances, it is unclear whether the date on which management completes its reassessment is itself “the date of that change” for the purposes of IAS 8.38, or whether the revised estimate should form part of the measurement of depreciation or amortisation for the current annual reporting period.

View 1: the revised estimate applies from the date on which the estimate changes

Under View 1, prospective recognition means applying the revised estimate from the date of the change, i.e. the date on which management revises the estimate. Accordingly, when an estimated useful life is revised at or very close to the reporting date, applying the change from that date would naturally result in little or no effect on depreciation or amortisation in the current year.

The references in IAS 8.36 and IAS 8.38 to the “period of the change” and the “current period” identify the reporting period in which the effect of the change is recognised. They do not require the revised estimate to be applied to the entirety of that reporting period. IAS 16.51 and IAS 38.104 do not state otherwise – those paragraphs prescribe the minimum frequency with which the relevant estimates must be reviewed, but do not state that the outcome of a financial year-end review is deemed to take effect from the beginning of that financial year.

View 2: the revised estimate applies to the whole current annual period

Under View 2, greater weight is placed on IAS 8.36 and the specific example in IAS 8.38, which states that a change in useful life affects depreciation expense for the current period as well as future periods. Where the annual review under IAS 16.51 or IAS 38.104 concludes that expectations differ from previous estimates, View 2 regards the revised estimate as an input into the measurement of depreciation or amortisation expense for the whole annual reporting period being reported.

This interpretation is also supported by IAS 8.32, which requires accounting estimates to be developed using judgements or assumptions based on the latest available, reliable information. If, when preparing the annual financial statements, management has concluded that its previous estimate no longer represents its current expectation, View 2 questions why a material portion of the current annual expense should nevertheless be measured using that outdated estimate.

Where no objectively identifiable date of change exists, a proponent of View 2 reads “the date of that change” in IAS 8.38 together with the financial year-end review required by IAS 16.51 and IAS 38.104. On this reading, the financial year-end is the measurement point at which the revised estimate is determined and used to measure depreciation or amortisation expense for the annual reporting period as a whole. This remains consistent with the concept of prospective application, which requires the change to be reflected in the current period under IAS 8.36 without restating any previous annual reporting periods.

Relevance of IAS 34

This question is of particular significance for public interest entities that prepare interim financial statements in accordance with IAS 34 because those entities recognise and measure depreciation and amortisation expense at each interim reporting date. A change in estimated useful life identified later in the annual reporting period therefore raises the additional question of how that revised estimate interacts with amounts already recognised in earlier interim periods.

Proponents of View 1 would argue that, consistently with the prospective application principle, estimates recognised in previously issued interim financial statements are not subsequently adjusted. IAS 34.36 observes that changes in estimates are reflected in subsequent interim periods without retrospectively adjusting amounts reported in prior interim periods. This is consistent with applying the revised useful life only from the date on which the estimate changes.

Proponents of View 2, however, would point to the year-to-date measurement principle in IAS 34. IAS 34 acknowledges that year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year, while also requiring that the frequency of an entity's reporting shall not affect the measurement of its annual results (IAS 34.28-29). On this view, the fact that previously issued interim financial statements remain unchanged does not prevent the revised estimate from affecting the measurement of depreciation or amortisation for the annual period as a whole, including through a catch-up adjustment in a subsequent interim period.

Evidence of diversity in practice

Entities applying the date-of-change approach (View 1)

Below are examples of companies that revised the estimated useful lives of their assets as part of the annual review but deferred the effect to the next financial year.

British American Tobacco

During the annual reporting period ended 31 December 2023, British American Tobacco, a FTSE 100 constituent, revised the useful lives of certain combustible trademarks and related assets[1]. Management explained that the revision reflected “the ongoing challenging macro-economic conditions and revised forecast in the U.S.” and acknowledged that “the date at which the redesignation to definite-lived is made is judgemental”. Amortisation based on the revised useful lives began on 1 January 2024, i.e. in the next financial year:

[1] https://www.bat.com/content/dam/batcom/global/main-nav/investors-and-reporting/reporting/combined-annual-and-esg-report/BAT_Annual_Report_on_Form_20-F_2023.pdf

Intangible assets other than goodwill

The intangible assets shown on the Group balance sheet consist mainly of trademarks and similar intangibles, including certain intellectual property, acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks and similar assets are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Other trademarks and similar assets are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement, but increases in trademark values are not recognised. With effect from 1 January 2024, the Group's indefinite-lived combustible trademarks and similar assets will be amortised on a straight-lined basis over periods not exceeding 30 years. The revision in useful economic life reflects the ongoing challenging macro-economic conditions and revised forecast in the U.S., with an expected increase in amortisation expense of £1.4 billion per annum. The Group's non-combustible trademarks will remain as indefinite-lived assets.

Impairment of trademarks and assessment of useful economic lives

Concurrent to the impairment assessment, and reflecting Management's revised volume projections, Management concluded that it was appropriate to redesignate Newport, Camel, Natural American Spirit and Pall Mall as definite-lived from 1 January 2024 (2023: indefinite-lived, 2022: indefinite-lived) with an estimated life of between 20-30 years.

It was also concluded that it remains appropriate to continue to recognise Grizzly and Camel snus as indefinite-lived brands given the expected continued performance of the traditional oral sector.

Corporate costs are allocated to the brand budgets based on either specific allocations, where appropriate, or based on revenue. As the trademarks and similar intangibles with indefinite lives relate to the acquisition of Reynolds American, the brand budgets used in the value-in-use calculations have also been incorporated into the budget information used in the impairment testing of Reynolds American goodwill.

The value-in-use calculations for the Reynolds American cash-generating unit and the indefinite-lived brands have been prepared based on a five-year risk-adjusted cash flow forecast, incorporating the probability weighted scenarios above. After this forecast, for the Reynolds American cash-generating unit and for the indefinite-lived brands Grizzly and Camel Snus, a probability weighted growth rate of 1.0% (2022: 1.0%) is applied.

In order to support the long-term growth rates for Newport, Camel, Natural American Spirit and Pall Mall, a cash flow forecast has also been prepared on a discrete basis, reflecting the revised useful economic lives from 1 January 2024. The long-term growth rates implied by these value-in-use calculations with cash flows capped at 30 years or 20 years, as appropriate, are -4.7% (2022: 0.89%) for Newport, -7.4% (2022: 0.93%) for Camel, -1.15% (2022: 1.0%) for Natural American Spirit and -13.7% (2022: 1.0%) for Pall Mall.

As a result of the revised forecasts, an impairment charge of £22,992 million has been recognised in relation to the brands.

Management recognise that the date at which the redesignation to definite-lived is made is judgemental and have determined that amortisation will commence from 1 January 2024. From 2024, amortisation will be charged on a straight-line basis with the increase in annual amortisation expense expected to be £1.4 billion (US$1.8 billion) per annum.

Proponents of View 2 would argue that deferring the amortisation of the combustible trademarks to 2024 understated BAT's amortisation expense for 2023 by £1.4 billion, or approximately 11% of the company's Adjusted profit from operations (a key MPM).

Mærsk

Mærsk, an OMX Copenhagen 25 constituent, revised the useful lives of its vessels during the annual review process carried out at the end of FY 2025[2]. Management explains that the change in estimate will be applied "prospectively" under IAS 8, which, in management's view, means from the beginning of the next financial year:

> **Change in accounting estimate**
> As a result of the annual useful life review at the end of 2025, the useful lives of vessels will increase from 20 years to 25 years and will be applied prospectively as a change in accounting estimate, effective 1 January 2026. The change is expected to result in reduced depreciation of around USD 700m in 2026. The change in useful lives has not impacted the financial position or results for 2025 or any previous periods.

Again, proponents of View 2 would argue that measuring depreciation expense for 2025 using the outdated estimated useful lives overstated annual depreciation by USD 700 million, or approximately 25% of the company's underlying profit for 2025.

Mercedes-Benz Group

The final example illustrating View 1 is less significant in purely quantitative terms. However, ESMA highlighted it in its report *The Heat is On: Disclosures of Climate-Related Matters in the Financial Statements*[3]:

[2] https://ml-eu.globenewswire.com/Resource/Download/61eb6ba2-916f-4254-8af6-4b2ff2717858
[3] https://www.esma.europa.eu/sites/default/files/2023-10/ESMA32-1283113657-1041_Report_-_Disclosures_of_Climate_Related_Matters_in_the_Financial_Statements.pdf

ESMA
European Securities and Markets Authority

4.3.2 From principles to practice: relevant examples from selected issuers

37. In the following example, automotive company Mercedes Benz Group AG provides information on how useful lives of certain assets have been impacted by the transition from internal combustion engines to electric vehicles.

EXAMPLE 15 – MERCEDES BENZ GROUP AG

Pages 214; 228

ESMA emphasis added in *Orange*

Intangible assets

(…)

Other intangible assets with finite useful lives are generally amortized on a straight-line basis over their useful lives (three to ten years). The amortization period for intangible assets with finite useful lives is reviewed at least at each year-end. **Possible impacts from the transformation of the automotive industry, such as the transition to electric drive systems, are also taken into account.** Changes in expected useful lives are treated as changes in accounting estimates. The amortization expense on intangible assets with finite useful lives is recorded in functional costs.

As part of the periodic review of the useful lives of intangible assets, the planned transition to fully electric vehicles made it necessary to reassess the useful lives of the capitalized development expenditure as of year-end 2021 and to adjust them for individual vehicle projects. This change in estimates has been applied from 1 January 2022. The positive effect on earnings before interest and taxes (EBIT) amounted to €0.2 billion in 2022. A positive effect on EBIT of €0.2 billion is also expected for 2023.

(…)

Quantitative disclosure of the effect of reassessing useful lives due to the transition to electric drive systems.

Entities applying the whole-of-current-annual-period approach (View 2)

Below are examples of companies applying View 2 despite the practical inconvenience of recalculating depreciation and amortisation expense with effect from the beginning of the current year.

RWE

During the annual review of the useful lives of PP&E in FY 2024, RWE, a DAX 40 constituent, extended the useful lives of wind assets from up to 25 years to up to 30 years[4]. Management explains that the change was accounted for prospectively, which, in its view, means from the beginning of the current annual reporting period:

> During the review of useful lives, the useful life span of wind assets was adjusted to a period of up to 30 years (previously: up to 25 years) in the reporting year. This adjustment was carried out in a prospective manner. As a result of this, the scheduled depreciation of wind assets declined by €99 million in 2024. An effect of a similar magnitude is expected in the coming years.

Although the disclosure doesn't specify the exact date, this can be inferred from the fact that the effect of the change in estimate for the current year is expected to be of a similar magnitude to that for the coming years. Furthermore, there is no equivalent disclosure for FY 2023, which indicates that the review took place during FY 2024.

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[4] https://www.rwe.com/-/media/RWE/documents/05-investor-relations/finanzkalendar-und-veroeffentlichungen/2024-gj/2025-03-20-rwe-annual-report-2024.pdf

Iberdrola

During the annual review of the useful lives of assets conducted in FY 2021, Iberdrola, an IBEX 35 constituent, extended the useful lives of wind turbines of less than 1 MW and photovoltaic installations from 25 years to 30 years[5]. For Iberdrola's management, the prospective application of that change meant application for the full financial year:

3.e) Depreciation of property, plant and equipment in use

Every year, the IBERDROLA Group reviews the useful life of its assets based on internal and external information sources. Based on this review, the IBERDROLA Group considers that the best estimate of the useful life of wind turbines of less than 1 MW and photovoltaic installations is 30 years (compared to the 25 years previously estimated). The impact of this change in estimate has thus been included under "Amortisation, depreciation and provisions" in the 2021 consolidated Income statement. The effect of this change, which, in accordance with accounting standards, has been applied prospectively as from 1 January 2021, has been to reduce depreciation by EUR 54 million.

The financial statements for 2020 confirm that such reviews are carried out at the end of the year and that the revised estimate that was accounted for with effect from 1 January 2021 was not identified in 2020[6]:

At each financial year end, IBERDROLA reviews and adjusts, where necessary, the assets' residual values, useful lives and depreciation method, prospectively adjusting them, as appropriate.

Coca-Cola HBC

In 2021, Coca-Cola HBC, a FTSE 100 constituent, revised the estimated useful lives of certain production equipment[7]. The revised useful lives were applied from 1 January 2021, the beginning of the annual reporting period:

Change in accounting estimate

In the current financial year, the Group has applied a change in the estimate of useful lives applicable to certain categories of production equipment, included within the plant and equipment asset category (Note 14). As a result, effective 1 January 2021, the expected useful life of the specific categories of production equipment was extended by five years. The change was driven by the reassessment of the expected period of usage and has resulted in an approximately €33 million decrease in the depreciation expense in the current year. This is primarily reflected in the 'Cost of goods sold' line of the consolidated income statement.

There's no corresponding disclosure in the 2020 financial statements that would imply that the useful lives were revised in 2020 but the effect was deferred to 2021.

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[5] https://www.iberdrola.com/documents/20125/1606413/gsm22_FinancialStatements_AuditorsReport_Consolidated2021.pdf

[6] https://www.iberdrola.com/documents/20125/42397/gsm21_FinancialStatements_AuditorsReport_Individual.pdf/66153773-0671-d423-485a-bf0494b19384?t=1631263495144

[7] https://www.coca-colahellenic.com/content/dam/cch/us/images/oar2021/downloads/integrated-annual-report-2021.pdf.downloadasset.pdf

Application question for the Committee

In summary, I'd like to ask the Committee to consider the following question:

> *When an entity changes the estimated useful life of an item of PP&E or an intangible asset as a result of the annual review required by IAS 16.51 or IAS 38.104, and no discrete transaction or identifiable event establishes a particular date on which the underlying economics changed, how does the entity determine the date from which the effect of the change is recognised prospectively in applying IAS 8.36-38?*

Yours sincerely,

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