

Proceeds before Intended Use – Proposed amendments to IAS 16 - Draft comment letter

Comments should be submitted by 13 October 2017 by using the '[Express your views](#)' page on EFRAG website or by clicking [here](#).

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

[Date]

Dear Mr Hoogervorst,

Re: IASB ED/2017/4 *Property, Plant and Equipment - Proceeds before Intended Use (Proposed amendments to IAS 16)*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the exposure draft ED/2017/4 *Property, Plant and Equipment - Proceeds before Intended Use (Proposed amendments to IAS 16)*, issued by the IASB on 20 June 2017 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG welcomes and supports the amendment proposed in the ED, as we believe it will reduce diversity in practice and, therefore, improve the quality of financial reporting under IFRS in regard to property, plant and equipment. However, EFRAG sees no need to include a definition for 'testing' as the proposed amendments do not distinguish between net proceeds from selling items produced during the testing phase from any other proceeds prior to the item of property, plant and equipment being available for use.

EFRAG's detailed comments and response to the question in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Joachim Jacobs or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's response to the question raised in the ED

Notes to constituents

- 1 *IAS 16 states that the cost of an item of property, plant and equipment (PPE) includes costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Paragraph 17 of IAS 16 provides examples of directly attributable costs which include 'costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition'.*
- 2 *The IASB observed that for some entities the amount of proceeds deducted from the cost of an item of PPE can be significant, exceeding the costs of testing. The IASB also noted that there is diversity in practice in applying the requirements of paragraph 17 of IAS 16 with some entities limiting the amount of proceeds deducted to the costs of testing and others deducting the full amount.*
- 3 *The ED is proposing amendments to IAS 16 that would prohibit deducting from the cost of an item of PPE the proceeds from selling items produced while making that item of PPE available for use. Specifically, the IASB is proposing that the entity recognises the proceeds from selling any such items, and the cost of producing those items, in profit or loss in accordance with applicable Standards (generally IFRS 15 Revenue from Contracts with Customers and IAS 2 Inventories).*
- 4 *The ED is also proposing to define testing as: 'assessing whether the technical and physical performance of the asset is such that the asset is capable of being used in the production or supply of goods or services, for rental to others, or for administrative purposes'.*
- 5 *In order to apply the proposed amendments, the IASB included some guidance in paragraphs BC9–BC11 of the ED to:*
 - (a) *assist entities in assessing whether particular costs incurred are costs of inventories (applying IAS 2), costs of testing (applying IAS 16) or costs the entity would be required to recognise in profit or loss (such as abnormal amounts of wasted material);*
 - (b) *clarify the meaning of 'testing', as specified in paragraph 17 of IAS 16; and*
 - (c) *clarify that the inventory costs resulting from testing do not include depreciation of the item of PPE because an item of PPE is not depreciated before it is available for use.*
- 6 *Additionally, the ED is proposing to require an entity to apply the proposed ED only to items of PPE made available for use from the beginning of the earliest comparative period presented when first applying the ED.*

Question – Proposed amendment

The IASB is proposing to amend IAS 16 to prohibit deducting from the cost of property, plant and equipment any proceeds from selling items produced while bringing that property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity would recognise those sales proceeds in profit or loss.

Do you agree with this proposal? Why or why not? If not, what alternative would you propose, and why?

EFRAG's response

EFRAG supports the proposal of the IASB to prohibit the deduction of proceeds generated in the process of making an item of property, plant and equipment (PPE) ready for its intended use by management from the cost of that item.

EFRAG agrees that those proceeds and related costs should be accounted for in accordance with other applicable Standards, generally IFRS 15 *Revenue from Contracts with Customers* and IAS 2 *Inventories*.

However, EFRAG sees no need to include a definition for 'testing'.

EFRAG supports the proposed transitional provision because EFRAG considers that the cost and complexity of restating items of PPE that are operating before the start of the earliest period presented would outweigh any benefits of full retrospective application.

Question to Constituents

- 7 EFRAG's response is based on the IASB's identification of diversity in practice. In your experience:
- (a) Is the issue of selling items produced during the testing phase of making an item of PPE ready for its intended use widespread?
 - (b) If widespread, are the amounts generated from such sales material?
 - (c) How frequently do proceeds generated from selling items produced during the testing phase exceed the cost of testing?
 - (d) EFRAG notes that the ED does not propose any corresponding amendment to IAS 38 *Intangible Assets* (which does not refer to proceeds of selling items produced during testing). If such proceeds often arise in practice, are the amounts material and how are these amounts accounted for?

The proposed amendment

- 8 EFRAG supports the IASB's initiative to address the issue in order to reduce the identified diversity in practice, and consequently to improve financial reporting.
- 9 However, EFRAG notes that the proposed amendments prohibit the deduction of proceeds from selling items produced while making the item of PPE ready for its intended use by management from the cost of PPE. The proposed amendments do not distinguish between proceeds generated during the testing phase from all other proceeds generated before the asset is ready for its intended use. Hence, EFRAG sees no need to define the meaning of 'testing' as it will not assist in applying the proposals in the ED.

- 10 EFRAG acknowledges that judgement would have to be applied in distinguishing the costs that relate to income earned from all other costs incurred before an item of PPE is available for use. However, EFRAG considers that the judgement required will not exceed the judgements already required in applying IAS 16 when an entity develops PPE that takes some time to make available for use. EFRAG therefore supports the recognition of proceeds as revenue but acknowledges that diversity could arise in the allocation (and hence quantification) of the related costs.
- 11 EFRAG considers that more relevant information would be provided to users of financial statements about an entity's revenue if all relevant revenue is recognised in accordance with IFRS 15. Further, by not offsetting proceeds from incidental sales against the cost of PPE, the PPE will be recognised at the full cost of construction.
- 12 EFRAG notes that paragraph 21 of IAS 16 refers to incidental operations and associated income and expenses. We consider that the final sentence of that paragraph should be amended to avoid confusion with proposed paragraph 20A. That is, we recommend that the IASB clarify that proceeds and associated costs arising before an item of property, plant and equipment is ready for its intended use, whether arising from incidental operations or from activities that are not incidental such as testing, should be recognised in profit or loss in accordance with applicable Standards.

Transitional provisions

- 13 In the case of this amendment, EFRAG agrees with the IASB's proposal to limit retrospective application of the amendments to items of PPE made available for use from the beginning of the earliest period presented. In this case, EFRAG does not support full retrospective application of the ED as this would require an entity to go back to initial recognition for each relevant item of PPE in order to ascertain whether any proceeds from selling items produced before the asset was available for use were deducted from the cost of the asset and then adjust the PPE, income and expenses. EFRAG considers that full retrospective application would be burdensome for entities to apply and that any benefits of restatement are likely to be outweighed by the costs.