

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of the EFRAG Board. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

IASB ED/2017/4 *Property, Plant and Equipment – Proceeds before Intended Use (Proposed amendments to IAS 16)*
Summary and analysis of the comment letters on EFRAG’s draft comment letter

Objective

- 1 The objective of this paper is to consider the feedback received in response to EFRAG’s draft comment letter 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’).

Structure of the paper

- 2 This comment letter analysis contains:
 - (a) Background;
 - (b) Summary of respondents;
 - (c) Summary of respondents’ views;
 - (d) Appendix 1 - detailed analysis of responses to questions in EFRAG’s draft comment letter; and
 - (e) Appendix 2 – list of respondents.

Background

- 3 The ED proposed a narrow-scope amendment to IAS 16 *Property, Plant and Equipment*. The proposal in the ED is to prohibit deducting sales proceeds from the cost of testing an item of property, plant and equipment (PPE) while that asset is being made available for use. Instead, entities would recognise in profit or loss those sales proceeds, and any other proceeds from selling items that are produced while making an item of PPE ready for its intended use, and costs of producing those items.
- 4 In its draft comment letter EFRAG supported the proposed amendment in the ED, as it will reduce diversity in practice and, therefore, improve the quality of financial reporting under IFRS in regard to PPE.
- 5 The ED proposed to include a definition of testing. EFRAG’s initial view was that IAS 16 should not include a definition of ‘testing’ as the proposed amendments do not distinguish between net proceeds from selling items produced during the testing phase from any other proceeds from selling items prior to the item of PPE being available for use.

Summary of respondents

- 6 At the time of writing, twelve comment letters have been received, eight were from national standard setters, three from preparer organisations and one from a regulator. The letters are summarised below.

Summary of respondents' views

- 7 Six respondents agreed with the proposed changes to IAS 16, whilst six did not agree.
- 8 The respondents that agreed, indicated that the proposed amendments to IAS 16 will improve consistency in the application of the notion of 'testing', as well as in the treatment of proceeds from selling items produced while bringing an asset to the location and condition to be capable of operating in the manner intended by management. These respondents considered that, on balance, the benefits arising from reducing diversity in practice outweigh the costs related to concerns about the practical implications of the proposal, including the need to clarify when an item of PPE should be regarded as available for use.
- 9 The six respondents that did not agree noted that the proposed amendments affect a wider range of industries than indicated by the IASB and that the costs incurred during the testing phase could be quite significant. Further, they considered that the proposed amendments could have unintended consequences. These respondents also questioned the appropriateness of applying IFRS 15 *Revenue from Contracts with Customers* to proceeds from testing and raised concerns that the proposed amendments could create inconsistencies with IAS 23 *Borrowing Costs* and IAS 2 *Inventories*. They also expressed their concerns around the practical difficulties of distinguishing costs that relates to revenue from all other costs of PPE and suggested that the IASB should clarify when an item of PPE is available for use or capable of operating in the manner intended by management.
- 10 Only two respondents commented on whether 'testing' should be defined. The respondents held opposing views, with one supporting the need for a definition and one opposing.

Appendix 1 - Detailed analysis of responses to questions in EFRAG's draft comment letter

Question

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 tentative position

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.

Summary of constituents' comments

- 11 On the proposals in the ED, six respondents agreed that the proposed amendments will reduce diversity in practice and, therefore, improve the quality of financial reporting under IFRS.
- 12 These respondents raised the following points:
 - (a) Two respondents considered that the IASB should clarify when an item of PPE should be regarded as available for use. These respondents consider it as a fundamental point and, as noted in the Basis for Conclusions, it is an area where there is currently diversity in practice.
 - (b) Another respondent acknowledged that the pragmatic solution has conceptual flaws which have been highlighted in the Alternative View. This respondent also recommended that the clarifications with respect to the notion of testing and depreciation of inventories should be included in the body of the standard, rather than in the Basis for Conclusions.
 - (c) Two respondents indicated that the proposed amendments would imply additional judgement for preparers, in order to distinguish between costs incurred for making an item of PPE ready for its intended use, which are included in the cost of the asset, and costs related to those proceeds, to be recognised in profit or loss. However, one respondent thought that the entities concerned will usually have a great deal of experience of making such judgments and should therefore have no difficulty in doing so.
 - (d) One respondent noted that the existing requirements in IAS 16 make it difficult for a user to have a clear picture of an entity's total revenue in the period because some sales proceeds might be offset against the cost of PPE. Those requirements also make it difficult to have a clear picture of the actual cost of

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

some items of PPE as the cost of those assets can be distorted by deducting sales proceeds before the assets are available for use.

- (e) One respondent highlighted that the proposed amendments are sound and represent the simplest solution to the problem addressed.
- 13 Six respondents did not agree with the proposed amendment, and gave the following reasons:
- (a) One respondent indicated that the proposed amendments affects all, rather than a few, industries in which PPE takes a long time to become available for use.
 - (b) One respondent noted that the testing period might be quite long, and the related expenditure incurred might be significant. Another respondent indicated that the costs of testing largely exceed proceeds which are marginal and incidental.
 - (c) Two respondents highlighted that testing by nature is not part of an entity's ordinary activities, and therefore the products from the testing process are not an output of an entity's ordinary activities. One respondent noted that if the proposed scope is retained, the amendments should address the case where proceeds are received for items that are not inventories, because they are not held for sale in the ordinary course of business and where the income does not represent revenue in the scope of IFRS 15 because it does not represent income from ordinary activities. Another respondent noted that the cut-off between construction and operation is important in determining whether proceeds generated should be accounted for as revenue or as a deduction against the cost of PPE.
 - (d) Two respondents commented that the proposed amendments could create inconsistency between other IFRS Standards such as IAS 23 *Borrowing Costs* and IAS 2 *Inventories*.
 - (e) One respondent indicated that the proposed amendments may raise new practical and conceptual issues as compared with the current situations and would not be simpler. This respondent raised concerns around the practical difficulties of distinguishing costs that relates to revenue from all other costs of PPE. The respondent also noted that users may encounter difficulties interpreting the profitability on revenue recognised on testing proceeds.
 - (f) Two respondents suggested that the IASB should clarify when an item of PPE is available for use or capable of operating in the manner intended by management. One respondent specifically questioned paragraph BC4 of the proposed amendments and indicated that entities are not using different methods to assess when an item of PPE is available for use. This respondent noted that the same principle applies but current guidance may not be sufficiently available to achieve a common practice.
 - (g) One respondent noted that for some assets the only costs of production is the use of the constructed asset and raised concerns that the exclusion of depreciation will produce revenue without any costs.
- 14 Only two respondents commented on whether 'testing' should be defined. These respondents held opposing views, with one supporting the need for a definition and one opposing the IASB introducing a definition.

Appendix 2 – List of respondents

- 15 Below is a list of the respondents to EFRAG's draft comment letter on IASB's ED/2017/4 *Property, Plant and Equipment – Proceeds before Intended Use (Proposed amendments to IAS 16)*.

<i>Name of respondent</i>	<i>Country</i>	<i>Category</i>
ASCG	Germany	National Standard Setter
SEAG (The Swedish Enterprise Accounting Group)	Sweden	Preparer organisation
FRC (Financial Reporting Council)	UK	National Standard Setter
ESMA	Europe	European Regulator
DASB (Dutch Accounting Standards Board)	The Netherlands	National Standard Setter
ICAEW	UK	National Standard Setter
OIC	Italy	National Standard Setter
FAR	Sweden	National Standard Setter
ICAC	Spain	National Standard Setter
ANC	France	National Standard Setter
BusinessEurope	Europe	Preparer organisation
IEAF (International Energy Accounting Forum)	Europe	Preparer organisation