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## **Proceeds before intended use - Proposed amendments to IAS 16 - Towards a draft comment letter**

### **Objective**

- 1 The objective of this paper is to discuss the EFRAG Secretariat's response to the question expected to be raised in the forthcoming Exposure Draft *Proceeds before Intended Use* (Proposed amendments to IAS 16 *Property, Plant and Equipment*) ('the Amendments').
- 2 The EFRAG Secretariat drafted its responses based on the information that is publicly available and based on the EFRAG Secretariat's understanding of the expected content of the forthcoming Exposure Draft.

### **Information for EFRAG TEG**

- 3 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 includes the following: '*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 (such as samples produced when testing equipment)*'.

### **Description of the issue**

- 4 The IASB noted that there is diversity in practice in applying the requirements of paragraph 17 in IAS 16 for the deduction of proceeds relating to the costs of testing whether the item of PPE is functioning properly. 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. Some entities limit the deduction of net proceeds only to the *costs of testing*, whilst others extend the deduction to other costs of PPE if the deduction is greater than the costs of testing.
- 5 At its meeting in October 2016, the IASB decided to propose amendments to IAS 16. The Amendments 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.
- 6 Additionally, the IASB decided:
  - (a) to require an entity to apply the proposed Amendments only to items of PPE made available for use from the beginning of the earliest comparative period presented when first applying the Amendments; and
  - (b) not to provide transition relief for first-time adopters.
- 7 The IASB is expecting to issue an Exposure Draft in June 2017.

## Summary of the discussion

- 8 The EFRAG Secretariat expects the following question to be included in the forthcoming Exposure Draft.

### Question

The IASB is expected to propose amending IAS 16 to prohibit deducting from the cost of property, plant and equipment any proceeds from selling items produced while making that item of property, plant and equipment ready for its intended use by management. Consequently, an entity would recognise such sales proceeds and related costs in profit or loss.

Further, the IASB is expected to propose that the Amendments are applied retrospectively.

Do you agree with the IASB's proposal? Why or why not?

### EFRAG Secretariat proposed answer to the question

**EFRAG supports the proposal of the IASB to prohibit the deduction of sales proceeds from the cost of PPE if those proceeds were generated in the process of making the item of PPE ready for its intended use by management.**

**Consequently, EFRAG agrees that those proceeds and related costs should be included in profit or loss as proceeds from selling those items produced represents revenue within the scope of IFRS 15 *Revenue from Contracts with Customers*, and the costs of producing that output represents costs of inventory within the scope of IAS 2 *Inventories*.**

**EFRAG does not support full retrospective application of the Amendments. EFRAG considers that the complexity of potentially restating items of property, plant and equipment as well as revenue and cost of goods sold would outweigh the benefits.**

- 9 EFRAG supports the IASB's initiative to address the issue in order to reduce the identified diversity in practice in a manner that would improve financial reporting.
- 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 introduced will not be excessive to those already required in applying IAS 16 when an entity uses PPE that takes some time to make available for use.
- 11 EFRAG considers that more relevant information would be provided to users of financial statements about an entity's total sales revenue in the period if all sales are recognised when they occur, . Further, by not offsetting sale proceeds against the cost of PPE, the cost of PPE will not be distorted by the deduction of revenue.
- 12 EFRAG also notes that the cost of producing output before an item of PPE is available for use would not include depreciation of the asset because an entity depreciates PPE only from the date on which it is available for use. EFRAG considers that separating costs of testing from any associated revenue will provide more relevant information as any notional "profit on testing" will no longer be apparent and potentially misleading
- 13 Regarding the transition provision, EFRAG generally supports retrospective application of new, or amendments to existing, Standards and Interpretations.

- 14 However, EFRAG does not support full retrospective application of the Amendments as required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* as it will compel an entity to go back to initial recognition for each relevant item of PPE in order to ascertain whether it deducted from the cost of the asset proceeds from selling items produced before the asset was available for use. EFRAG therefore considers that full retrospective application will be burdensome for entities to apply and that the benefits of restating are likely to be outweighed by the costs. As a result, EFRAG agrees with the IASB's proposal to apply the proposed retrospective application of the Amendments only to items of PPE made available for use from the beginning of the earliest comparative period presented when first applying the Amendments.

**Question for EFRAG TEG**

- 15 Does EFRAG TEG agree with the proposed response to the questions expected to be raised in the forthcoming Exposure Draft?