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

### **Objective**

- 1 The objectives of this session is to discuss and approve a final comment letter on ED/2017/4 *Property, Plant and Equipment - Proceeds before Intended Use (Proposed amendments to IAS 16)* (the 'ED').

### **Background**

- 2 The IASB issued the ED on 20 June 2017, with comments due by 19 October 2017. The ED proposes a narrow-scope amendment to IAS 16 *Property, Plant, and Equipment* on costs capitalised as part of the cost of an item of property, plant and equipment (PPE) to reduce the diversity in application of the Standard. The proposed amendments prohibit deducting sales proceeds from the cost of an item of PPE while that asset is being made available for use. Instead, entities would recognise those sales proceeds and related costs in profit or loss.
- 3 On 5 July 2017, EFRAG issued its draft comment letter on the ED. Comments were requested by 13 October 2017.
- 4 In its draft comment letter EFRAG supported most of the proposed amendments in the ED, as it assessed that they will reduce diversity in practice and address an inconsistency in IFRS Standards.

### **EFRAG TEG discussion and advice to the EFRAG Board**

#### *EFRAG TEG discussion*

- 5 At its meeting on 25 October 2017, EFRAG TEG considered the feedback received in response to EFRAG's draft comment letter on the ED. The respondents' views for assessing the amendments in were split. In summary:
  - (a) The six respondents that agreed, indicated that the proposed amendments will improve consistency. They 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.
  - (b) The six respondents that did not agree argued 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. They also questioned the appropriateness of applying IFRS 15 *Revenue from Contracts with Customers* to proceeds from testing, questioning whether such sales are always 'in the ordinary course of

business', and raised concerns as to other inconsistencies. Finally, they commented on difficulties of distinguishing costs of goods sold from other costs of PPE.

- 6 Some EFRAG TEG members shared these concerns and also considered that the proposed amendments:
- (a) Were too broad and could have unintended consequences. Some EFRAG TEG members therefore argued that any changes to IAS 16 should be more limited in scope and address only the issue that was submitted to the IFRS Interpretations Committee, i.e. proceeds received during testing that in excess of the cost of testing.
  - (b) Do not address what they view as the main issue. These EFRAG TEG members suggest that clarifying when an asset is available for use is more important than changing the treatment of 'proceeds' generated before this point is reached.
- 7 Other EFRAG TEG members supported the ED and therefore suggested to keep the draft comment letter as it will improve consistency in financial reporting.

*EFRAG TEG advice to the EFRAG Board*

- 8 EFRAG TEG recommended to support the ED, with some additional suggestions, by virtue of the casting vote from the EFRAG TEG Chairman.

**Updating the final comment letter**

- 9 Given the diversity of views, the written procedure was cancelled and replaced with a discussion at a public meeting.
- 10 As noted above, EFRAG TEG recommends to support the proposals in the ED. However, this paper also outlines some alternative approaches for the EFRAG Board to consider in reaching a final decision.

*Alternative A: Retain the updated draft comment letter*

- 11 Under alternative A, which is the recommendation of EFRAG TEG, the response to the question is as per Paper 06.02.

*Alternative B: Disagree with the IASB and retain the status quo*

- 12 Under alternative B, EFRAG would disagree with the proposed amendments in the ED and call for retention of the current guidance in IAS 16. The argument for this alternative is that there is no consensus for change so the status quo should prevail. However, this would not address diversity or the perceived inconsistency between IAS 16 and IFRS 15 *Revenue from Contracts with Customers*.
- 13 Under alternative B the response to the question could be amended along the following lines (new text is underlined and deleted text is struck through):

**EFRAG does not 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 is of the view that the proposed amendments may raise new practical and conceptual issues and will result in many entities recognising significant amounts of income while making an item of PPE ready for its intended use by management. This may not provide the most representationally faithful depiction of their financial performance, especially as there may be no costs that can fairly be allocated to offset that income.**

**Therefore, EFRAG considers that the current guidance should be retained.**

**~~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.~~**

*Alternative C: Disagree and address the issue raised to IFRS IC more narrowly*

- 14 In the initial request to the IFRS IC, the submitter asked whether an entity recognises the amount by which the net proceeds exceed the costs of testing in profit or loss or as a deduction from the cost of the PPE. However, the proposed amendments address all proceeds received before the PPE is available for use.
- 15 Alternative C involves recommending that the IASB address only this narrower issue to avoid or reduce the possible unintended consequences of a wider amendment. The main problem with this approach is that it would not address proceeds generated outside the testing phase, for which there is currently no explicit guidance and some inconsistency in practice. The narrow focus on ‘testing’ also puts more pressure on the meaning of that term.
- 16 Under alternative C the response to the question would be along the following lines:

**EFRAG does not 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 is of the view that the scope of the proposed amendments goes beyond the original issue and suggests that it should be limited to proceeds generated during the testing phase. Consequently, EFRAG agrees that the meaning of ‘testing’ should be defined.**

**Therefore, EFRAG recommends that the IASB should provide guidance on whether entities should recognise the amount by which the net proceeds received exceed the costs of testing in profit or loss or, instead, as a deduction from the cost of the PPE, i.e. the IASB should address the issue raised to the IFRS IC.**

*Alternative D: Disagree and suggest a need to consider the underlying concepts more broadly*

- 17 Some commentators argue that the proposals in the ED are not principle-based and raise conceptual questions. Alternative D involves recommending that the IASB

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steps back from the 'quick fix' in the ED and address the underlying issues more comprehensively.

- 18 The main drawback of this approach is that a new project would be subject to the IASB's agenda capacity and would leave the identified issues unaddressed for a considerable period of time.
- 19 Under alternative D the response to the question would be along the following lines:

**EFRAG does not support 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 considers that the issue is too broad to be addressed in a narrow scope amendment of this nature. The proposals in the ED raise questions as to whether the 'cost' of an asset is a gross or a net amount and the meaning of 'ordinary course of business' for the purpose of IFRS 15, among others.**

**EFRAG suggests that the IASB should instead consider the case for taking on a broader project that would address the underlying principles and issues more comprehensively.**

**To the extent that the IASB determines that additional guidance is required on a shorter term basis, EFRAG considers that the focus should be on clarifying when an item of PPE is ready for its intended use by management.**

**Questions for EFRAG Board**

- 20 Which of the four alternatives, or combination of alternatives, do EFRAG Board members prefer?
- 21 Subject to the decisions on the questions above, do you approve the final comment letter for publication?

**Agenda Papers**

- 22 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 06-02 – *Proposed Final Comment Letter on IASB Amendments to IAS 16*;
  - (b) Agenda paper 06-03 – *Comment Letter Analysis on IASB Amendments to IAS 16* - for background only; and
  - (c) Agenda paper 06-04 – *ESMA CL - EFRAG DCL on ED 2017-4* - for background only.