IEAF International Energy Accounting Forum

IASB
30 Cannon Street
London EC4M 6XH
UK
Brussels, October 20, 2017

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EFRAG

*Exposure Draft ("ED") ED/2017/4 Property, Plant and Equipment – Proceeds before Intended Use*
*Proposed amendments to IAS 16*

Dear Mr Hoogervorst,

We are writing this letter concerning the ED as published in June concerning the accounting for proceeds during the testing phase of a property, plant and equipment ("PP&E").

The International Energy Accounting Forum (hereafter "IEAF") consists of the major European companies in the utility business (see the list of our members in appendix 1). The goal of the IEAF is to discuss and formulate best practices, to reduce areas of difference in accounting in the sector, to advocate the energy industry's point of view, and to make specialist energy industry knowledge available to the International Accounting Standards Board and other standard setters.

We have been following closely this topic as the energy business is often facing pretty long construction phases and the related proceeds generated (if any) may be significant. We have included in appendix 2 the comment letter we sent in 2014 to the IFRS Interpretations Committee ("IFIRC"). At that time, we draw the following points of attention:

- Most of the energy players have an accounting practice which includes all the proceeds relating to the testing phase in the carrying amount of the PP&E;
- Testing phase in the energy sector is crucial and the capability to operate the plant depends on this phase (no testing would result in the entity not obtaining the adequate authorization, hence not allowing it to operate the power plant);
- IAS 16 is built on a cost approach and the testing phase cannot be viewed as a separate component of the PP&E (as we would identify these components for depreciation purposes when the asset is ready to use) and the carrying amount of the PP&E should include all the cash flows related the testing phase. In other words, the PP&E as a whole is the unit of account to consider;

- Finally, we do not find any conceptual ground to explain any P&L effect from a performance point of view when no depreciation charge is accounted for yet.

Note that some of our constituents have also participated in bilateral discussions with the IFRIC and IASB staff at that time.

With respect to the current ED, the IEAF would like to provide the Board with the additional comments. Note that those comments reflect the view of a majority of the IEAF constituents. We have included in appendix 3 the dissenting opinion received by one of our members.

When referring to the current ED, **we disagree with the conclusions raised** that any proceeds generated during the testing phase should be accounted for as an income. We cannot believe when reading BC6 that users have difficulties to get a clear picture of the entity total revenue because it may be offset against the cost of PPE and that those costs can be distorted by deducting sales proceeds before the assets are available for use. The lifecycle of an entity's business would typically include a pre-development phase, a development and construction phase and finally an operating phase. While the first phase would generally lead to costs being expensed when incurred, the development and construction phase is important as this will give the entity the ability to generate cash flows during the operating phase through the use of the constructed asset. When the asset is in the location and condition necessary for it to be capable of operating in the manner intended by management, the entity will be able to generate cash flows through the sale of goods or services generated during its ordinary activities. This is only at this stage that an entity will be able to account for a revenue (which will also usually be in the scope of IFRS 15). We believe that this cut-off (construction vs operation) is important and in particular the cost of a PPE would be defined as the total consideration paid and accumulated that is necessary to bring the asset to the location and condition capable of meeting management's intended use.

In the utility industry, the testing phase could correspond to a power plant which is for the first time connected to the grid and tested for use. The proceed is the revenue generated from the power production and the cost of testing would mainly include the fuel and carbon emission rights costs (if any). For a merchant gas-fired or coal-fired power plant, the margin can either be positive or negative depending on the spread[1]. In that context, testing has generally two meanings. Firstly, it is to make sure that the external contractors achieved the features agreed (as the construction is often outsourced). Secondly, from the legal perspective, it is necessary for the owner of the power generating plant to test it in order to receive an authorisation to operate. In many countries, it is necessary to connect the power generating plant to the national grid (this date is usually mentioned on an official document transmitted to the general manager of the transportation grid) and this requires official authorisation, i.e. no testing would result in the entity not obtaining the necessary permit, hence not allowing it

[1] The spread is often referred to as either clean spark spread (margin of a gas-fired power plant, resulting from the sale of power and the purchase of the gas and CO2 emission rights that are needed to produce the power) or clean dark spread (margin of a coal-fired power plant, resulting from the sale of power and the purchase of the coal and CO2 emission rights that are needed to produce the power)

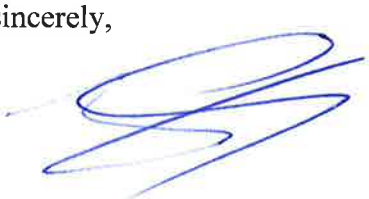
to run the power plant and generate cash flows during its operations. Furthermore, the testing phase is being performed irrespective of the margin generated, i.e. the decision to run the testing does not depend on the spread but is a necessary step to get the appropriate authorization to operate. In other words, the decision to operate for testing purposes which, eventually, can generate cash flows is not taken in the context of the entity's ordinary activities.

We also note that in some cases, the cost of testing could be insignificant (wind or solar farms having no fuel costs). When we exclude the depreciation from the cost of production (as it is explained in BC11), we would then see an income without ANY cost of production while for wind or solar assets, the only cost of production is the use of the constructed asset. We therefore question this exclusion and when reading BC11, we have the impression that this principle of exclusion has been based on the fact that it is supposed that "any consumption of an item of property, plant and equipment [...] is likely to be negligible".

We finally note that the IASB has been exploring other routes among which one was to **clarify when an item of PP&E is available for use**. The Board concluded that such an approach would be a much broader project that the proposed amendments would be (BC22). BC4 indicates that "the entities use different methods to assess when an item of property plant and equipment is available for use". **We believe that this is where the debate should be**. While the cut-off between construction and operation can sometimes be hardly identified, this would lead the entities using their own judgment to whether the asset is ready for use. Entities are not using different "methods": the same principle applies but current guidance may not be sufficiently available to achieve a common practice. We encourage the IASB to rather work with this mind-set rather than finalising the proposed fall-back solution as we do not view this amendment as an acceptable accounting solution.

If you require any clarification or information, please do not hesitate to contact us.

Yours sincerely,



On behalf of the International Energy Accounting Forum,

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## Appendix 1: Members of the International Energy Accounting Forum

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**Appendix 2: IEAF comment letter related to the IFRS Interpretations Committee Tentative Agenda – IAS 16 Property, Plant and Equipment: Accounting for proceeds and costs of testing on property, plant and equipment**


Wayne Upton
Chairman
**IFRS Interpretations Committee**
30 Cannon Street
London
United Kingdom
EC4M 6XH

October 22, 2014

**Re: Tentative agenda decision - IAS 16 Property, Plant and Equipment: Accounting for proceeds and costs of testing on property, plant and equipment**

Dear Mr Upton,

The International Energy Accounting Forum ("IEAF") comprises major European companies in the energy business (see the list of our members in appendix 1). The goal of the IEAF is to discuss and formulate best practices, to reduce areas of difference in accounting in the sector, to advocate the energy industry's point of view, and to make specialist energy industry knowledge available to the International Accounting Standards Board and other standard-setters.

The IEAF welcomes the opportunity to respond to the IFRS Interpretations Committee's publication in the July IFRIC Update of the tentative decision not to take onto the Committee's agenda a request for clarification on the accounting for the net proceeds from selling any items produced while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda, but not with the reasons set out in the tentative agenda decision as we believe that IAS 16 does not appear so self-evident. A majority of the members of the IEAF have an accounting practice which includes in the carrying amount of the PP&E all the proceeds relating to the testing phase.

In the utility industry, the testing phase could correspond to a power plant which is for the first time connected the grid and tested for use. Proceeds are received from this testing through revenue

generated from the power production. The cost of testing would mainly comprise fuel costs and carbon emission rights costs (if any). In some cases, the cost of testing could be insignificant (note that wind farms and photovoltaic panels have no fuel costs). For a merchant gas-fired or coal-fired power plant, the margin can either be positive or negative depending on the spread[1].

The testing phase is crucial and the capability to operate the plant (in the manner intended by management) depends on this phase (no testing would result in the entity not obtaining the necessary permit, hence not allowing it to operate the power plant). Furthermore, the testing phase is being performed irrespective of the margin generated, i.e. for a merchant power plant, the decision to perform the testing does not depend on the spread but is a necessary step to get the appropriate authorization to operate.

Even if IAS 16 is built on a cost approach (to us, the cost approach/model is in opposition to the revaluation approach/model, i.e. a cost does not always need to be a debit [cfr government grant]) the testing phase cannot be viewed as a separate component of the PP&E and the final carrying amount of the PP&E should include the testing phase as a whole. In other words, the PP&E as a whole is the unit of account to which the testing phase proceeds relate.

Lastly, considering the outcome of the conceptual framework project, we have difficulty understanding the profit or loss impact from a performance point of view as well as from a matching principle point of view: would it mean that depreciation commences, in order to match sales and costs of sales, while the asset is not yet available for use?

In case you would like to obtain further explanations, please do not hesitate to contact us.

Best regards

On behalf of the IEAF,

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[1] The spread is often referred to as either clean spark spread (margin of a gas-fired power plant, resulting from the sale of power and the purchase of the gas and CO2 emission rights that are needed to produce the power) or clean dark spread (margin of a coal-fired power plant, resulting from the sale of power and the purchase of the coal and CO2 emission rights that are needed to produce the power)


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## Appendix 3: EDF dissenting view

EDF does not fully agree with the position expressed by IEAF. As proposed by the amendment, the recognition of proceeds from selling items in profit or loss would be more appropriate for certain industries or under certain circumstances that lead to proceeds exceeding costs of testing. However in other cases, it would be more appropriate to deduce the sales proceeds from the costs of testing, in particular when the conditions under which the items are produced are very different from those incurred in the operating phase. Considering whether the production of items is directly attributable to the costs of testing and the assets, or is an incidental operation to be recognised in profit or loss mostly depends on industries and circumstances. Then it should be left to the judgment of the entity.