June 2017

IFRS® Standards
Exposure Draft ED/2017/4

Property, Plant and Equipment—Proceeds before Intended Use

Proposed amendments to IAS 16

Comments to be received by 19 October 2017

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Property, Plant and Equipment—Proceeds before Intended Use

(Proposed amendments to IAS 16)

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Exposure Draft ED/2017/4 *Property, Plant and Equipment—Proceeds before Intended Use* (Proposed amendments to IAS 16) is published by the International Accounting Standards Board (Board) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **19 October 2017** and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Open for comment' page at: http://ifrs.org/projects/open-for-comment/.

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by a good reason, for example, commercial confidence. Please see our website for details on this and how we use your Personal Data.

ISBN: 978-1-911040-63-7

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Introduction

In this Exposure Draft, the International Accounting Standards Board (Board) proposes to amend IAS 16 *Property, Plant and Equipment*. The amendments would prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced while bringing that asset 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.

Background

Paragraph 17 of IAS 16 specifies examples of costs directly attributable to 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. One such example is the costs of testing. Paragraph 17(e) of IAS 16 states that the cost of an item of property, plant and equipment includes the 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.

The IFRS Interpretations Committee (Committee) received a request asking two questions about paragraph 17(e) of IAS 16:

(a) whether the proceeds referred to in that paragraph relate only to items produced from testing; and

(b) whether an entity deducts from the cost of an item of property, plant and equipment any proceeds that exceed the costs of testing.

When discussing the issue, the Committee identified a number of related questions about the cost of property, plant and equipment. After exploring different approaches, the Committee recommended that the Board propose an amendment to IAS 16 to prohibit deducting sales proceeds from the cost of an item of property, plant and equipment. The Board agreed with the Committee's recommendations.

Invitation to comment

The Board invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the question as stated;

(b) indicate the specific paragraph(s) to which they relate;

(c) contain a clear rationale;

(d) identify any wording in the proposals that is difficult to translate; and

(e) include any alternative the Board should consider.

The Board is not requesting comments on matters that are not considered in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **19 October 2017**.

Question for respondents

The Board is proposing to amend IAS 16 to prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity would recognise the proceeds from selling such items, and the costs of producing those items, in profit or loss. Do you agree with the Board's proposal? Why or why not? If not, what alternative would you propose, and why?

How to comment

Comments should be submitted using one of the following methods.

Electronically (our preferred method)	Visit the 'Open for comment' page, which can be found at: http://ifrs.org/projects/open-for-comment/
Email	Email comments can be sent to: commentletters@ifrs.org
Postal	IFRS Foundation 30 Cannon Street London EC4M 6XH United Kingdom

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by a good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

[Draft] Amendments to IAS 16 *Property, Plant and Equipment*

Paragraph 17 is amended; paragraphs 20A, 80D and 81M are added. Deleted text is struck through and new text is underlined.

Elements of cost

...

17 Examples of directly attributable costs are:

(a) ...

(e) costs of testing whether the asset is functioning properly (ie 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)~~, 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)~~; and

(f) ...

...

20A Items may be produced while bringing an asset to the location and condition necessary for it to be capable of operating in the manner intended by management, such as inventories produced when testing an asset. An entity recognises the proceeds from selling any such items, and the costs of producing those items, in profit or loss in accordance with applicable Standards.

...

Transitional provisions

...

80D [Draft] *Property, Plant and Equipment—Proceeds before Intended Use*, issued in [date], amended paragraph 17 and added paragraph 20A. An entity shall apply those amendments retrospectively only to items of property, plant and equipment brought to the location and condition necessary for them to be capable of operating in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments. The entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of that earliest period presented.

Effective date

...

81N [Draft] *Property, Plant and Equipment—Proceeds before Intended Use*, issued in [date], amended paragraph 17, and added paragraphs 20A and 80D. An entity shall apply those amendments for annual periods beginning on or after [date to be decided after exposure]. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

[Draft] Amendments to other Standards

IFRIC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine*

Paragraph 2 is amended. Deleted text is struck through and new text is underlined.

Background

...

2 During the development phase of the mine (before production begins), stripping costs are ~~usually capitalised as part of the depreciable cost of building, developing and constructing the mine~~ <u>accounted for applying IAS 16 *Property, Plant and Equipment*</u>. ~~Those capitalised~~ <u>Capitalised</u> costs are depreciated or amortised on a systematic basis, usually by using the units of production method, once production begins.

Approval by the Board of Exposure Draft *Property, Plant and Equipment—Proceeds before Intended Use* published in June 2017

The Exposure Draft *Property, Plant and Equipment—Proceeds before Intended Use* (Proposed amendments to IAS 16) was approved for publication by twelve of the thirteen members of the International Accounting Standards Board. Mr Zhang voted against its publication. His alternative view is set out after the Basis for Conclusions on the Exposure Draft.

Hans Hoogervorst	Chairman
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Takatsugu Ochi	
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Basis for Conclusions on the Exposure Draft *Property, Plant and Equipment—Proceeds before Intended Use*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments. It summarises the considerations of the International Accounting Standards Board (Board) when developing the proposed amendments. Individual Board members gave greater weight to some factors than to others.

Background

BC1 Paragraph 16(b) of IAS 16 *Property, Plant and Equipment* explains that the cost of an item of property, plant and equipment includes costs directly attributable to bringing that 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 specifies examples of directly attributable costs. One example specified is the 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.

BC2 The IFRS Interpretations Committee (Committee) received a request asking whether:

(a) the proceeds specified in paragraph 17(e) of IAS 16 relate only to items produced from testing; and

(b) an entity deducts from the cost of an item of property, plant and equipment any proceeds that exceed the costs of testing.

BC3 The Committee noted that feedback from its outreach on the request indicated that:

(a) the issue mainly affects a few industries, such as the extractive and petrochemical industries.

(b) diverse reporting methods are applied. Some entities deduct only proceeds from selling items produced from testing; others deduct all sales proceeds until the asset is in the location and condition necessary for it to be capable of operating in the manner intended by management (ie available for use). For some entities, the proceeds deducted from the cost of an item of property, plant and equipment can be significant and can exceed the costs of testing.

BC4 In addition, feedback from outreach indicated that entities use different methods to assess when an item of property, plant and equipment is available for use.

Prohibit deducting sales proceeds from the cost of an item of property, plant and equipment

BC5 Having considered the Committee's recommendations, the Board proposes to amend paragraph 17 of IAS 16 to prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced before that asset is available for use. As a consequence, an entity would recognise such sales proceeds in profit or loss. The Board views its proposals as a simple and effective way of removing the identified diversity in practice in a manner that would improve financial reporting.

BC6 The Board concluded that the proposed amendments would provide relevant information to users of financial statements by requiring entities to recognise all sales as income (including revenue) when they occur. 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 property, plant and equipment. Those requirements also make it difficult to have a clear picture of the actual cost of some items of property, plant and equipment. The cost of those assets can be distorted by deducting sales proceeds before the assets are available for use.

BC7 During the development of the proposed amendments, the Board observed the following:

(a) an entity would be required to identify the costs that relate to items produced and sold before an item of property, plant and equipment is available for use, and to distinguish those costs from other costs incurred before that date. This is discussed further in paragraphs BC8–BC10.

(b) before an item of property, plant and equipment is available for use, the costs of producing any inventories excludes depreciation of that asset. This is because an entity depreciates an item of property, plant and equipment only from the date it is available for use. This is discussed further in paragraph BC11.

BC8 The Board observed that an entity would have to apply judgement in identifying the costs that relate to items produced and sold before an item of property, plant and equipment is available for use, and to distinguish those costs from other costs incurred before that date. However, the proposed amendments would require little more judgement beyond that already required to apply IFRS Standards. For example, an entity is already required to identify and distinguish the following:

(a) costs directly attributable to making an item of property, plant and equipment available for use, which the entity includes in the cost of the asset;

(b) costs of bringing inventories to their present location and condition included as part of the cost of inventories (paragraph 10 of IAS 2 *Inventories*), which it then recognises in profit or loss at the time that the inventories are sold;

(c) costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred, such as abnormal amounts of wasted materials, labour or other production costs (paragraph 16 of IAS 2);

(d) costs of stripping activity assets and cost of inventories produced during the production phase of a surface mine (IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*); and

(e) costs that it recognises directly in profit or loss, for example:

(i) administrative, marketing or staff training costs (paragraph 19 of IAS 16);

(ii) costs of using or redeploying property, plant and equipment (paragraph 20 of IAS 16); and

(iii) costs of incidental operations (paragraph 21 of IAS 16).

BC9 In applying the proposed amendments, an entity might need to assess 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. The Board noted that the existing requirements in IAS 2 and IAS 16 on costs are helpful in this respect. For example, in assessing whether costs incurred while an item of property, plant and equipment is being tested are costs of inventories or costs of testing (included in the cost of the item of property, plant and equipment), an entity would consider whether the items produced during testing meet the definition of inventories in IAS 2. Similarly, an entity might consider whether particular costs represent (a) abnormal amounts of wasted material (recognised in profit or loss); or (b) costs necessary to make the item of property, plant and equipment available for use or to bring inventories to their present location and condition.

BC10 In addition, to help when assessing costs, the Board decided to clarify the meaning of 'testing', as specified in paragraph 17 of IAS 16. The Board concluded that when testing whether an item of property, plant and equipment is functioning properly, an entity assesses the technical and physical performance of the asset. The assessment of functioning properly is not an assessment of the financial performance of an asset, such as assessing whether the asset has achieved the level of operating margin initially anticipated by management.

BC11 With respect to the exclusion of depreciation from the cost of inventories produced and sold before an item of property, plant and equipment is available for use, the Board observed that any consumption of an item of property, plant and equipment before it is available for use is likely to be negligible. Paragraph 12 of IAS 2 states that the costs of conversion of inventories include a systematic allocation of fixed overheads incurred in converting materials into finished goods, such as depreciation of assets used in the production process. However, for inventories produced before an item of property, plant and equipment is available for use, the costs of conversion do not include depreciation of that asset because no such depreciation would exist.

Other approaches considered by the Board

BC12 The Board considered two other approaches to reduce the identified diversity in practice:

(a) clarifying which proceeds an entity deducts from the cost of property, plant and equipment; and

(b) clarifying when an item of property, plant and equipment is available for use.

Clarifying which proceeds an entity deducts from the cost of property, plant and equipment

BC13 Paragraph 17(e) of IAS 16 implies that the sales proceeds an entity deducts from the cost of an item of property, plant and equipment are proceeds from selling items produced only when testing whether the asset is functioning properly. This is because the reference within paragraph 17 of IAS 16 to deducting sales proceeds is directly linked to the costs of testing. This is also supported by the example in that paragraph of samples produced when testing equipment.

BC14 Paragraph 17(e) of IAS 16 also implies that the proceeds deducted from the cost of an item of property, plant and equipment should not exceed the costs of testing. Paragraph 17 of IAS 16 states that an example of directly attributable costs is 'costs of testing whether the asset is functioning properly, *after* deducting the net proceeds…' [emphasis added]. Arguably, this implies that an entity includes in the cost of an item of property, plant and equipment the net costs of testing (after deducting related sales proceeds), but that the net costs of testing could never be a negative amount.

BC15 Nonetheless, the Board acknowledged that the explanation in paragraphs BC13–BC14 might be unclear because of the wording in the Standard. The phrase within paragraph 17(e) of IAS 16 'proceeds from selling any items produced' does not refer specifically to proceeds from testing. In addition, IAS 16 does not specify any limit on the amount of proceeds an entity can deduct from the cost of an item of property, plant and equipment.

BC16 Consequently, the Board considered whether to amend IAS 16 to require an entity to:

(a) deduct from the cost of an item of property, plant and equipment proceeds from selling items produced only when testing whether the asset is functioning properly;

(b) limit the amount of proceeds deducted from the cost of an item of property, plant and equipment to the costs of testing; and

(c) recognise any other sales proceeds before property, plant and equipment is available for use in profit or loss in accordance with applicable IFRS Standards.

BC17 The Board decided not to proceed with the approach set out in paragraph BC16 because:

(a) this approach would have required an entity to distinguish proceeds from testing from any other sales proceeds before an item of property, plant and equipment is available for use. Consequently, this approach would be more complicated to apply than the proposed amendments would be.

(b) it would be difficult to understand why an entity would account for proceeds from testing differently from other sales proceeds earned before an item of property, plant and equipment is available for use. Similarly, if the proceeds from testing were to exceed the costs of testing, it would be difficult to understand why an entity would recognise some proceeds from testing in the cost of an asset and other proceeds from testing in profit or loss.

Clarifying when an item of property, plant and equipment is available for use

BC18 Paragraph 20 of IAS 16 states that 'recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management'. Determining the point at which that occurs is important—it is at that point that an entity stops accumulating costs in the carrying amount of the asset, and starts depreciating the asset.

BC19 During the development of the proposed amendments, the Board was informed of diverse practices in some industries in determining when an item of property, plant and equipment is available for use—the Board was informed that some entities include costs within, and deduct sales proceeds from, the cost of an asset for an extensive period of time. The Board observed that some think clarifying when an item of property, plant and equipment is available for use would reduce the sales proceeds that entities deduct from the cost of property, plant and equipment, and thus respond to a concern that may have led to the request to the Committee.

BC20 Consequently, the Board considered whether to amend IAS 16 to include the following as indicators of when an item of property, plant and equipment is available for use:

(a) the physical construction of the asset is complete (as described in paragraph 23 of IAS 23 *Borrowing Costs*).

(b) the testing of the technical and physical performance of the asset is complete (as described above in paragraph BC10).

(c) the asset is capable of producing items that can be sold in the ordinary course of business (ie capable of producing inventories as defined in IAS 2). Consistent with the meaning of testing, this assessment would focus on the technical and physical performance of the asset, and not its financial performance.

BC21 Such an approach would not have removed the need to apply judgement in determining when an item of property, plant and equipment is available for use—it would just have provided some additional information to help when making that judgement.

BC22 The Board concluded that such an approach would be a much broader project than the proposed amendments would be. This approach would have affected the accounting for many items of property, plant and equipment and additional research would have been required to assess any potential unintended consequences. The Board also observed that it was unclear whether the indicators considered would be helpful in determining when an item of property, plant and equipment is available for use, without raising additional questions. For these reasons, the Board decided not proceed with this approach.

BC23 When developing the June 2014 amendments to IAS 16 and IAS 41 *Agriculture* regarding bearer plants, the Board considered whether to clarify when an item of property, plant and equipment is available for use, but decided not to do so.

Other matters

Disclosure requirements

BC24 The Board considered whether disclosures already required by IFRS Standards are sufficient to provide useful information in the context of the proposed amendments. The Board observed that the most common items produced by an item of property, plant and equipment before it is available for use are inventories produced during testing of the asset. If the asset is to be used in the entity's ordinary activities, there is no basis on which to conclude that inventories produced by the asset before it is available for use would not be output from the entity's ordinary activities. Consequently, proceeds from selling inventories produced would represent revenue within the scope of IFRS 15 *Revenue from Contracts with Customers*.

BC25 If revenue and the cost of inventories produced before an item of property, plant and equipment is available for use has a material effect on an entity's financial statements, the entity would disclose:

(a) the information required by IFRS 15. In particular, the entity might consider revenue from sale of those inventories as a category of revenue when disclosing information required by paragraph 114 of IFRS 15.

(b) the information required by IAS 2 regarding the costs of producing inventories; for example, the accounting policy adopted, the carrying amount of inventories (if any), and the amount of inventories recognised as an expense.

BC26 In the light of the requirements in IFRS 15 and IAS 2, the Board proposes no additional disclosure requirements. The Board concluded that the existing requirements are sufficient to require an entity to disclose relevant information about the sale of output produced before an item of property, plant and equipment is available for use.

Transition requirements

Entities that already apply IFRS Standards

BC27 The Board considered the following in relation to transition:

(a) the proposed amendments to IAS 16 are narrow in scope and are expected to mainly affect a few industries, such as the extractive and petrochemical industries. For most entities, output produced before property, plant and equipment is available for use is not expected to be material. Consequently, there might be little need for transition requirements beyond those in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

(b) if an entity is required to apply the amendments retrospectively, it would recalculate the carrying amount of property, plant and equipment at the beginning of the earliest period presented when first applying the amendments. In recalculating that carrying amount, an entity would be required to go back to the initial recognition of each relevant item of property, plant and equipment to ascertain whether it deducted from the cost of the asset proceeds from selling items produced before the asset was available for use.

(c) entities affected by the amendments are likely to find it burdensome to apply the amendments retrospectively, especially for items of property, plant and equipment constructed many years ago. A less burdensome approach would require application of the amendments only for items of property, plant and equipment made available for use from the beginning of the earliest period presented when first applying the amendments. This approach would achieve consistent application of the amendments for all periods presented, but limit the number of assets an entity is required to reassess.

BC28 On the basis of the above factors, the Board concluded that the benefits of retrospective application applying IAS 8 might be outweighed by the costs. Consequently, the Board proposes retrospective application of the proposed amendments only to items of property, plant and equipment made available for use from the beginning of the earliest period presented when first applying the amendments. An entity would not apply the proposed amendments to items of property, plant and equipment made available for use before that date.

First-time adopters

BC29 In relation to transition for first-time adopters, the Board noted the following:

(a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides a deemed cost exemption for property, plant and equipment (paragraphs D5–D7 of IFRS 1). That exemption allows an entity to measure an item of property, plant and equipment at the date of transition to IFRSs at its fair value, and to use that fair value as its deemed cost. Additionally, there are specific deemed cost exemptions for entities with particular oil and gas properties (paragraph D8A of IFRS 1), and for entities holding items of property, plant and equipment used in operations subject to rate regulation (paragraph D8B of IFRS 1).

(b) apart from the exemptions described above, IFRS 1 does not exempt a first time adopter from the requirements in IAS 16. Accordingly, if a first-time adopter does not apply the deemed cost exemptions in IFRS 1, it would apply all of the requirements in IAS 16 retrospectively. The Board concluded that there would be little benefit in providing a first-time adopter with relief from applying these amendments when it would have to apply all the other requirements in IAS 16.

BC30 On the basis of these considerations, the Board proposes no further transition relief for first-time adopters beyond the deemed cost exemptions already in IFRS 1.

Alternative view

Alternative view on the Exposure Draft *Property, Plant and Equipment—Proceeds before Intended Use* published in June 2017

AV1 Mr Zhang voted against publication of the Exposure Draft. He disagrees with the proposal to prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced during testing before the asset is available for use. He thinks that the circumstances that led to the submission do not highlight the need to amend the requirements in IAS 16, but instead highlight inappropriate application and enforcement of those requirements.

AV2 Mr Zhang supports the Board's decision to clarify the meaning of testing as explained in paragraph BC10. Applying that meaning of testing, he is of the view that it would be rare for proceeds from selling items produced during testing to exceed the costs of testing. Consequently, he thinks that clarifying the meaning of testing, in isolation, would be helpful to ensure greater discipline in the application of paragraph 17 of IAS 16.

AV3 Mr Zhang believes that the issues the Board is attempting to solve in this Exposure Draft affect all, rather than a few, industries in which property, plant and equipment takes a long time to become available for use. He believes that the testing period, as explained in paragraph BC10, might be quite long, and the related expenditure might be significant. As a result, he is deeply concerned about unintended consequences of the proposed amendments.

The cost and revenue recognition principles

AV4 One of the basic accounting principles that has prevailed for a century is the cost principle. Applying this principle, the cost of acquiring or constructing an asset is defined as the consideration paid and accumulated that is necessary to bring the asset to the location and condition capable of meeting management's intended use. Therefore, if equipment is acquired or self-constructed and it requires a test to prove that the equipment has reached the point at which it is able to meet management's intended use, then the test is a necessary process of the acquisition or construction of the asset. The cost of the test, net of the proceeds from selling items produced during testing, is added to the cost of the equipment. Mr Zhang believes that the above principle has been generally accepted worldwide for a long time, and the proposed amendments depart sharply from the above time-honoured principle and related requirements in IFRS Standards.

AV5 The proposed amendments would require an entity to recognise in profit or loss the proceeds from selling items produced when testing equipment applying IFRS 15 *Revenue from Contracts with Customers*. IFRS 15 is established to account for revenue from selling goods or providing services that are an output of the entity's ordinary activities. Since testing is an integral part of the acquisition or construction process to make equipment available for use, Mr Zhang is of the view that testing by nature is not part of an entity's ordinary activities, and the products from the process are not an output of an entity's ordinary activities.

Hence, he questions the appropriateness of applying IFRS 15 to proceeds from testing. He would like to point out that, in many cases, newly established entities have not started ordinary production because all of their property, plant and equipment is still under construction. If those newly established entities are required to recognise revenue and profit in the manner required by the proposed amendments, he is of the view that users of financial statements would be confused to see that entities have revenue and profit even before they commence their ordinary operations. To prevent possible misunderstanding, Mr Zhang emphasises that this discussion of ordinary activities reflects his views on the accounting principles underlying the IFRS Standards on revenue, inventories, property, plant and equipment etc. This discussion does not reflect his views on the conceptual debate on whether an income or expense is from ordinary or extraordinary transactions.

AV6 Mr Zhang believes that the requirements in related IFRS Standards are conceptually consistent, and that the proposed amendments would create inconsistencies between different IFRS Standards. For example, Mr Zhang thinks that the proposed amendments would create an inconsistency between IAS 16 and IAS 23 *Borrowing Costs*. For funds borrowed specifically to obtain a qualifying asset, IAS 23 requires an entity to determine the borrowing costs eligible for capitalisation as the actual borrowing costs less any investment income on the temporary investment of those borrowings. Mr Zhang views the existing requirements in IAS 16 as consistent with those requirements in IAS 23.

AV7 Similarly, Mr Zhang believes that the proposed amendments would create questions in relation to other IFRS Standards. For example, should an entity charge to profit or loss the costs of knocking down an old building in preparing a site instead of adding them to the costs of the land, and recognise the proceeds from selling the scrap of the old building in profit or loss instead of offsetting them against the costs of the land? If yes, how should the entity identify the costs related to that revenue? Moreover, he believes that similar questions would arise for extractive industries in relation to stripping costs incurred and proceeds from selling lower grade ores and other materials during the development stage.

Allocation of costs

AV8 Mr Zhang believes that depreciation forms an important part of cost of goods sold for most extractive and manufacturing industries applying IAS 2 *Inventories*. In relation to this, paragraph BC11 says that any consumption of the asset during testing is likely to be negligible. Mr Zhang does not find the reasons for saying so in this Exposure Draft. Paragraph BC11 also says that the Board noted that for inventories produced during testing of an item of property, plant and equipment, the costs of conversion do not include depreciation of that asset because no such depreciation would exist. Mr Zhang believes it is contradictory to require the recognition of income from selling items produced during testing and, at the same time, not to recognise depreciation on the basis that the asset is not available for use. He also believes that the resulting cost of goods sold and gross margin information will be misleading.

AV9 In determining the cost of items produced during testing, Mr Zhang understands the Board's considerations explained in paragraphs BC7–BC10. He does not agree, however, with the Board's observation that the proposed amendments would require little more judgement beyond that already required applying IFRS Standards.

AV10 He agrees that the examples listed in paragraph BC8 involve the use of judgement, but in all those examples he thinks that there is a reasonable basis to distinguish between the costs. However, the sales proceeds discussed in this Exposure Draft arise from the testing process that is an integral part of making an item of property, plant and equipment available for use. As a consequence, Mr Zhang thinks there is no reasonable basis to distinguish the costs of producing the items sold from the costs of testing.

Earnings manipulation

AV11 Mr Zhang agrees that it is judgmental to determine the point at which the process of making an asset available for use ends and the use of that asset to produce goods begins. Mr Zhang is deeply concerned about whether the proposed amendments would result in more severe earnings manipulation among entities through allocating more or less cost to the proceeds, and through changing the time to stop capitalising the related costs into property, plant and equipment. The possibility that more severe earnings manipulation could take place applying the proposed amendments arises from the earlier recognition of revenue and profit from selling items produced during testing, which is not currently permitted by IFRS Standards.

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ISBN 978-1-911040-63-7