

STAFF PAPER

October 2016

IASB[®] Meeting

Project	IAS 16 <i>Property, Plant and Equipment</i>		
Paper topic	Proceeds and costs of testing PPE: should net proceeds reduce the cost of PPE?		
CONTACT(S)	Raghava Tirumala	rtirumala@ifrs.org	+44 (0)20 7246 6953

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (the Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS[®] Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB *Update*.

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify the requirements in paragraph 17(e) of IAS 16 *Property, Plant and Equipment*. The request relates to net proceeds from selling items produced while testing an item of property, plant and equipment (PPE) under construction. The submitter asked whether an entity recognises 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.
2. The Interpretations Committee discussed the issue and, after exploring different approaches to address the issue, recommend that the Board propose a narrow-scope amendment to IAS 16. That proposed amendment (described as Approach A in this paper) would prohibit the deduction of proceeds from the sale of items produced while making an item of PPE available for use from the cost of that PPE.¹
3. This paper is structured as follows:
 - (a) background (paragraphs 4–8);

¹ For ease of reading within this paper, the phrase ‘making an item of PPE available for use’ has been used to refer to ‘bringing an asset to the location and condition necessary for it to be capable of operating in the manner intended by management’, which are the words used in IAS 16.

- (b) the Interpretation Committee’s considerations and recommendations (paragraphs 9–47);
- (c) questions for the Board;
- (d) *Appendix I*— Overview of the meetings of the Interpretations Committee;
- (e) *Appendix II*—Assessment against the Interpretations Committee’s agenda criteria; and
- (f) *Appendix III*—Initial staff thoughts on the wording of the proposed amendments to IAS 16.

Background

The requirements in IAS 16

- 4. Paragraph 16(b) of IAS 16 explains that the cost of PPE includes ‘any 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’.
- 5. Paragraph 17 of IAS 16 specifies examples of directly attributable costs, which include the following:
 - 17 Examples of directly attributable costs are:
 - (a) ...
 - (e) 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); and
 - (f) ...

The submission

- 6. The submitter raised concerns specifically in relation to the petrochemical industry. The submitter observed that some entities in that sector receive proceeds

from selling items produced while making PPE available for use. Those entities deduct the proceeds from the cost of the PPE, even when the amount of the proceeds materially exceeds the costs of testing. The submitter suggested that an entity should deduct proceeds only from the cost of testing, and that the amount of proceeds deducted should not exceed the costs of testing.

Feedback received as part of the Interpretations Committee’s discussions

7. Feedback received from outreach activities and in comment letters on a previous tentative agenda decision on the issue indicates that there is diversity in practice in this respect, especially within particular industry sectors. The feedback also indicated that this issue touches on some wider application issues regarding the costs of PPE—for example:
 - (a) when is an item of PPE available for use?
 - (b) which costs qualify as costs of testing?
 - (c) how to account for other proceeds received (that do not relate to testing) before an item of PPE is made available for use?
 - (d) how to distinguish costs associated with inventory from costs associated with PPE?

8. We understand that, within some industry sectors, entities adopt different approaches when accounting for income earned before PPE is available for use. This can lead to materially different amounts being recognised as PPE.

The Interpretation Committee’s considerations and recommendations

Why propose amendments to IAS 16?

9. In July 2014, the Interpretations Committee issued a tentative agenda decision on this issue. That tentative agenda decision concluded that the amount of net proceeds deducted from the cost of PPE should not exceed the costs of testing. The Interpretations Committee did not finalise that agenda decision because of concerns raised in comment letters.

10. One of the main concerns raised was that the content of the agenda decision went beyond the principles and requirements in IAS 16—ie the conclusions reached by the Interpretations Committee were interpretative in nature and had the potential to significantly affect existing practice for some industry sectors.
11. In the light of the feedback received, the Interpretations Committee then explored whether any amendments to IAS 16 would clarify some aspects of the accounting for the costs of PPE. The Interpretations Committee considered three approaches, all involving amendments to IAS 16, to address the issue raised and the wider questions to the extent possible.
 - (a) **Approach A**—Prohibit the deduction of sale proceeds from the cost of PPE.
 - (b) **Approach B**—(i) Clarify which proceeds an entity deducts from the cost of PPE; and (ii) provide additional application guidance on ‘testing’.
 - (c) **Approach C**—Clarify when an item of PPE is available for use, ie capable of operating in the manner intended by management.
12. Approaches A and B would most directly answer the question submitted. Approach A changes the requirements in IAS 16, whereas Approach B clarifies those requirements. Approach C goes beyond the question submitted to address the wider concerns raised regarding the costs of PPE.
13. See *Appendix I* for an overview of the Interpretations Committee’s meetings on this issue.

The Interpretations Committee’s decision

14. The Interpretations Committee decided to recommend Approach A, ie to prohibit the deduction of proceeds from the sale of items produced while making an item of PPE available for use from the cost of that PPE. As a consequence, an entity would recognise the proceeds from selling such items, and the costs of producing those items, in profit or loss applying applicable Standards. The Interpretations Committee viewed Approach A as the most straight-forward way of addressing the identified diversity in practice compared to the other approaches.

15. This is the approach that we understand is generally applied in practice by entities applying US GAAP. US GAAP does not explicitly allow or require an entity to deduct pre-commissioning revenue (including testing proceeds), except for some specific industry guidance that explicitly permits the netting of proceeds (for example, pre-commissioning revenue for property developed for rental or sale). We also understand that, in practice, entities deduct such pre-commissioning revenues from the cost of assets only if explicitly permitted to do so. So, for example, entities within the extractive industries recognise any pre-commissioning revenue in profit or loss.

16. The Interpretations Committee observed that this approach would not require an entity to identify and distinguish the proceeds of testing from any other income earned before PPE is capable of operating in the manner intended. This identification would be required in Approaches B and C. In addition, the outcome of applying Approach A may not be very different from applying Approach B (discussed in paragraphs 20–31 of this paper). This is because Approach B would limit the amount of proceeds that an entity deducts from the cost of PPE.

17. We also understand that significant concerns have not been raised with the FASB about current practice that would suggest that a change is needed to the existing guidance in US GAAP.

18. The Interpretations Committee observed that a number of concerns that have arisen during its discussions would remain, whichever approach is taken.
 - (a) The first is that an entity is required to identify and distinguish the costs that correspond to income earned from all other costs incurred while making the PPE available for use. For some industries, it might be difficult to identify the costs that correspond to the income earned. Consequently, some are concerned that an entity might recognise material amounts of income in particular reporting periods with little or no associated costs recognised in those periods.

 - (b) The second is that the cost of producing output while making an item of PPE available for use would not include depreciation of the PPE. This is because an entity depreciates the PPE only from the date on which it

is available for use. Consequently, the cost of inventory might be understated.

19. In relation to those concerns, the Interpretations Committee acknowledged that an entity may need to apply judgement in distinguishing the costs that correspond to the income earned from other costs incurred while making PPE available for use. However, Approach A would not add any significant amount of complication to the judgements already required in applying IFRS Standards when an entity's operations require the use of PPE that takes some time to make available for use.

For example:

- (a) Paragraph 21 of IAS 16 states that some operations occur in connection with the construction or development of PPE but are not necessary to make the PPE available for use. An entity recognises income and related expenses of such incidental operations in profit or loss. To apply that paragraph, an entity is required to identify the incidental operations and distinguish the income and related expenses of those operations.
- (b) Applying IFRS Standards, an entity is already required to identify and distinguish:
 - (i) costs directly attributable to bringing PPE to the location and condition necessary for it to be capable of operating as intended, which it includes as part of the cost of PPE;
 - (ii) costs of bringing inventory to its present location and condition included as part of the cost of inventory, which it then recognises in profit or loss at the time that the inventory is sold; and
 - (iii) costs that it recognises directly in profit or loss, for example, costs of incidental operations (as described in paragraph 21 of IAS 16), costs of using or redeploying PPE (as described in paragraph 20 of IAS 16) or administrative, marketing or staff training costs (as described in paragraph 19 of IAS 16).

Other approaches considered by the Interpretations Committee*Approach B—Clarify which proceeds an entity deducts from the cost of PPE*

20. The wording of paragraph 17(e) of IAS 16 (reproduced in paragraph 5 of this paper) implies that the net proceeds from selling items that an entity deducts from the cost of PPE are only those net proceeds that arise from testing whether the PPE is functioning properly—an entity should not deduct any other proceeds from selling items that might occur before the PPE is available for use. This is because:
- (a) the reference to deducting net proceeds within paragraph 17 of IAS 16 is directly linked to the costs of testing; and
 - (b) the example provided in that paragraph of items produced (and sold) while making PPE available for use is ‘samples produced when testing equipment’.
21. The wording of paragraph 17(e) of IAS 16 also implies that the net proceeds deducted from the cost of PPE should be not more than the costs of testing. This is because paragraph 17(e) 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]. We interpreted those words to say that an entity includes in the cost of PPE the net costs of testing (after deducting any proceeds from testing). However, those net costs of testing included as part of the cost of PPE would never be a negative amount.
22. In saying that, we acknowledged that this might not be clear because the phrase within paragraph 17(e) ‘net proceeds from selling any items produced while bringing the asset to that location and condition’ does not specifically refer to net proceeds from testing. In addition, IAS 16 does not set any limit on the amount of net proceeds that an entity can deduct from the cost of PPE.
23. Accordingly, Approach B would amend IAS 16 to clarify that:
- (a) an entity should deduct from the cost of PPE proceeds from selling items produced only from testing whether the PPE is functioning properly;

- (b) the amount of proceeds from testing that an entity deducts from the cost of PPE should not exceed the costs of testing; and
- (c) an entity should recognise any other income earned before PPE is available for use applying other relevant requirements or Standards.

24. In restricting the amounts deducted from the cost of PPE to only those proceeds from testing (and thus prohibiting the deduction of any other income earned before the PPE is available for use), Approach B would ensure that the cost of PPE is not distorted by the deduction of income earned.

Concerns raised about the approach

25. In addition to those discussed in paragraph 18 of this paper, a few concerns have arisen during the Interpretations Committee’s discussions regarding this approach:

- (a) The first is that it would require an entity to identify and distinguish the net proceeds from testing from any other income earned while making the PPE available for use.
- (b) The second is that some find it difficult to understand why an entity would account for proceeds and costs of testing differently from other income earned (and the related costs incurred) while making PPE available for use.

26. We acknowledged that an entity may need to apply judgement in distinguishing the proceeds and costs of testing from other income and costs. However, similarly to Approach A, we would not anticipate that this would not add any significant amount of complication to the judgements already required in applying IFRS Standards when an entity’s operations require the use of PPE that takes some time to become available for use.

27. In addition, Approach B would have clarified the meaning of ‘testing’ (see paragraphs 29–31 of this paper). This would help an entity to distinguish the proceeds and costs of testing from any other income earned or costs incurred. Applying that meaning of testing, we generally would expect there to be relatively little production of items during the testing phase. In addition, if the proceeds from testing are greater than the costs of testing, then this might indicate that the

PPE is available for use—determining when PPE is available for use is discussed further in paragraphs 32–39 of this paper.

28. The following provides an overview of the income and costs that an entity might earn or incur during the period over which PPE is made available for use. This overview incorporates the clarifications in Approach B:

	← Time over which PPE is constructed / made ready for operating as intended →	
Capitalised as part of cost of PPE	Other costs of the PPE (eg purchase price, dismantling costs)	PPE capable of operating in manner intended Depreciation begins
	Costs directly attributable to bring PPE to the location and condition necessary to be capable of operating in manner intended (includes costs of testing whether PPE is functioning properly)	
	Net proceeds from selling items produced during testing (amount deducted from cost of PPE not more than costs incurred in testing)	
Capitalised as part of cost of inventory	Costs incurred in bringing inventories to present location and condition (inventories = assets to be sold in ordinary course of business)	
Recognised in profit or loss	Incidental operations not necessary for PPE to be capable of operating in manner intended Any proceeds from selling items (other than net proceeds from testing deducted from cost of PPE); any costs associated with items sold (these may have been capitalised as inventory) Other costs not capitalised as part of cost of PPE, eg costs incurred in using or redeploying PPE; costs of training, marketing, administration, conducting business.	

Additional application guidance on ‘testing’

29. Paragraph 17(e) of IAS 16 refers to ‘costs of testing whether the asset is functioning properly’. Accordingly, in determining the net proceeds and costs of testing to be included as part of the cost of PPE, an entity would identify the activities undertaken to assess whether the PPE is functioning properly.
30. In May 2015, the Interpretations Committee reached a consensus on the meaning of ‘functioning properly’. The Interpretations Committee concluded that, in assessing whether PPE is functioning properly, an entity assesses the technical and physical performance of PPE.
31. Assessing the technical and physical performance of the PPE means assessing whether the PPE is capable of producing items that can be sold in the ordinary course of business. The assessment of functioning properly is *not* an assessment of the financial performance of PPE, such as assessing whether PPE can achieve the level of operating margin ultimately intended by management.

Approach C—Clarify when an item of PPE is available for use

32. 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 PPE is in that location and condition, ie available for use, is important—it is at that point that an entity stops accumulating costs capitalised as part of the cost of PPE and starts depreciating the PPE.
33. During previous discussions, some Interpretations Committee members noted that they have observed diversity in practice as to when entities determine when PPE is available for use, and asked the staff to explore this issue. Stakeholders also raised this issue during the development of the June 2014 amendments to IAS 16 and IAS 41 *Agriculture* regarding bearer plants.
34. The IFRS Discussion Group (‘IDG’) of the Canadian Accounting Standards Board (AcSB) also discussed this issue in December 2014². The IDG observed that this is an issue, in particular, in the extractive industries. Entities sometimes use a predetermined throughput/yield/capacity as a criterion to determine when PPE is available for use and that predetermined level can vary widely between different entities. The IDG was of the view that clarifying when an asset is available for use would help to achieve consistent application.
35. We agreed with that view. However, although related to the question submitted, we thought that amending IAS 16 to clarify this issue would be beyond the scope of that question. We also noted that the Board discussed whether to address this issue when amending IAS 16 and IAS 41 for bearer plants, but decided not to do so.
36. Nonetheless, if this issue were to be addressed, we suggested that Approach C would include in IAS 16 some indicators of when PPE is available for use. The suggested indicators set out below were developed on the basis of requirements already in IFRS Standards. Those indicators were intended to be just that—

² <http://www.frascanada.ca/international-financial-reporting-standards/ifrs-discussion-group/search-past-meeting-topics/item81466.pdf>

indicators that PPE is available for use—they would not be applied as criteria or requirements.

37. Each of the following might indicate that PPE is in the location and condition necessary for it to be capable of operating in the manner intended:
- (a) The physical construction of the PPE is complete (as discussed in paragraph 23 of IAS 23 *Borrowing Costs*).
 - (b) The testing of the technical and physical performance of the asset is complete.
 - (c) The PPE is capable of producing items that can be sold in the ordinary course of business (ie the PPE is capable of producing inventory as defined in IAS 2 *Inventories*). Similarly to the meaning of testing discussed earlier in this paper, this assessment would focus on the technical and physical performance of the PPE, and not the financial performance of that PPE.
38. As required by paragraphs 24–25 of IAS 23, we suggested that an entity should make this assessment for each part or component of the PPE that is capable of operating independently of other parts of the PPE.
39. Including these indicators would not remove the need to apply judgement—an entity ultimately would still need to determine when the PPE is capable of operating in the manner intended.

Other matters

40. At its September 2016 meeting, the Interpretations Committee also considered:
- (a) whether existing disclosure requirements in IFRS Standards are sufficient to provide useful information in the context of the proposed amendments; and
 - (b) the transition requirements relating to the proposed amendments.

Disclosure requirements

41. The Interpretations Committee observed that items produced by an item of PPE before it is available for use are likely to be output from an entity's ordinary activities. If the PPE is to be used in the entity's ordinary activities, there is no

basis to conclude that output produced by that PPE before it is available for use is not output from the entity's ordinary activities.

42. If revenue and the cost of output produced while making PPE available for use has a material effect on the profitability of the entity and/or trend information, the entity is expected to apply:
- (a) IFRS 15 (IAS 18) to account for revenue from sale of that output, and consequently disclose the information required by that Standard. In particular, the entity could consider revenue from sale of that output as a category for disclosure of disaggregated revenue, applying paragraph 114 of IFRS 15. This would enable users of financial statements to understand the nature, amount, timing and uncertainty of that revenue and those cash flows.
 - (b) IAS 2 to measure the cost of that output, and consequently disclose the accounting policy adopted in measuring the output, the carrying amount of the output in inventory (if any), and the cost of the output recognised as an expense.
43. Consequently, the Interpretations Committee decided not to recommend including additional disclosure requirements. Existing requirements in IFRS 15 and IAS 2 are sufficient to allow (or require) an entity to disclose relevant information about the sale of output produced before PPE is available for use, if material.

Transition requirements

For entities that already apply IFRS Standards

44. In considering the need for specific transition requirements, the Interpretations Committee considered the following factors:
- (a) the amendments to IAS 16, if finalised, would be narrow-scope amendments. Those amendments to IAS 16 are unlikely to affect many entities, because, for most entities, the output produced while making PPE available for use is not expected to be material. Consequently, some might suggest there is little need for any specific transition requirements—an entity should apply the amendments retrospectively

applying 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 PPE as at the beginning of the earliest comparative period when first applying the amendments. In recalculating the carrying amount of PPE, an entity would be required to go back to when each relevant item of PPE was initially recognised, to ascertain whether proceeds from selling items produced while making the PPE available for use were deducted from the cost of the PPE.
- (c) entities affected by the amendments, such as entities in the extractives industry, would be likely to find it burdensome to apply the amendments retrospectively, especially for items of PPE capitalised some considerable time ago. Consequently, a less burdensome approach would be to require application of the amendments for all items of PPE made available for use on or after the beginning of the earliest comparative period when first applying the amendments. This approach would ensure consistent application of the amendments for all of the periods presented in those financial statements. An entity would, therefore, be required to reassess the carrying amount of only those items of PPE made available for use during the comparative period, or to be made available for use in future periods.

45. Based on the above factors, the Interpretations Committee concluded that the benefits of retrospective application are outweighed by the costs. Consequently, the Interpretations Committee recommended prospective application of the proposed amendments to items of PPE made available for use from the beginning of the earliest comparative period when first applying the amendments.

For first-time adopters

46. In considering the need for transition requirements for first-time adopters, the Interpretations Committee considered the following:

- (a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides a deemed cost exemption for PPE (paragraphs D5–

D7 of IFRS 1). That exemption allows an entity to measure an item of PPE at the date of transition to IFRSs at its fair value, and use that fair value as its deemed cost at that date. Additionally, there are specific deemed cost exemptions for an entity with oil and gas properties in development or production phases (paragraph D8A of IFRS 1), and an entity holding items of PPE that are used, or were previously 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.
- (c) We cannot possibly know of the requirements applied by a first-time adopter in applying its previous GAAP. If a first-time adopter does not apply the deemed cost exemption in IFRS 1, it would apply all of the requirements in IAS 16 retrospectively. Accordingly, we suggest that there is little benefit in providing a first-time adopter with relief from applying this amendment, when it would have to apply all of the other requirements in IAS 16.

47. On the basis of these considerations, the Interpretations Committee decided to recommend not providing transition relief for first-time adopters, beyond the deemed cost exemption already in IFRS 1.

Questions for the Board

Questions

1. Does the Board agree with the proposed amendments to IAS 16, which would prohibit the deduction of proceeds from selling items produced while making an item of PPE available for use from the cost of that PPE?
2. Does the Board agree not to include additional disclosure requirements as part of the proposed amendments to IAS 16?
3. Does the Board agree to require prospective application of the proposed amendments to items of PPE made available for use from the beginning of the earliest comparative period when first applying the amendments?
4. Does the Board agree not to provide transition relief for first-time adopters?

The wording of the proposed amendments to IAS 16

48. *Appendix III* to this paper sets out our initial thoughts on the wording of the proposed amendments to IAS 16 to reflect the Interpretation Committee's recommendation.
49. In drafting the proposed amendments, we considered the following:
- (a) the amendments should make clear that an entity can no longer deduct from the cost of PPE proceeds from selling items produced while making the asset available for use.
 - (b) the amendments should specify how to account for such proceeds (ie in profit or loss), and also specify how to account for the costs of producing the items sold.
 - (c) using the existing words in paragraph 17(e) of IAS 16 to draft the proposed amendments would help to avoid any unintended consequences of narrowing or widening the 'items' to which the existing requirements are applied. We have also drafted the proposed amendments to mirror the style of drafting in paragraph 21 of IAS 16.
50. The submitter's question related to paragraph 17(e) of IAS 16, and thus the question asked would be addressed by these proposed amendments.

Appendix I

Overview of the meetings of the Interpretations Committee

- A1. In April 2014, the Interpretations Committee received a request to clarify the requirements in paragraph 17(e) of IAS 16 *Property, Plant and Equipment* to account for net proceeds from selling items produced while testing an item of property, plant and equipment (PPE) under construction. The submitter asked whether an entity recognises 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.
- A2. The submission raised concerns specifically in relation to the petrochemical industry. The submitter observed that some entities in that sector receive net proceeds from selling items produced while making PPE available for use. Those entities deduct the net proceeds from the cost of the PPE, even when the amount of the net proceeds materially exceeds the costs of testing. The submitter suggested that an entity should deduct net proceeds only from the cost of testing, and that the amount of net proceeds deducted should not exceed the costs of testing.

July 2014 meeting—*initial tentative agenda decision*

- A3. The Interpretations Committee issued a tentative agenda decision in July 2014. That agenda decision indicated that an entity must recognise the amount by which net proceeds received exceed the costs of testing in profit or loss, rather than against the cost of the PPE.
- A4. The Interpretations Committee received 10 responses to the tentative agenda decision. The majority of respondents were concerned about the implications of the agenda decision for the extractives industry. One respondent stated that ‘the extractive industry approach to accounting for revenue earned before an asset is ready for its intended use (often referred to as pre-commissioning revenue) varies. The various treatments have evolved as a result of the way in which the relatively limited requirements in the Standards have been interpreted and applied. In some instances, the varied treatments have been influenced by alternatives that originated in previous GAAPs. It is not clear how the Committee's tentative agenda decision will impact these treatments, if at all.’

November 2014 meeting—added to the agenda for further consideration

- A5. The Interpretations Committee decided to add this item to its agenda to analyse the issue further. The Interpretations Committee said the scope should not be limited to specific industries, and suggested that the staff consider the following issues:
- (a) when an item of PPE is available for use;
 - (b) which costs qualify as costs of testing;
 - (c) how to treat proceeds in excess of the costs of testing;
 - (d) how to account for other proceeds received (that do not relate to testing) during the period that an item of PPE is made available for use;
 - (e) whether to require the disclosure of proceeds deducted from the cost of PPE; and
 - (f) whether IFRS 15 is applicable to the proceeds received.

January 2015 meeting—further consideration of broader issues

- A6. The Interpretations Committee observed that the analysis should focus on the meaning of ‘testing’ PPE; the reference to proceeds in IAS 16 is made only in relation to testing. On this basis, an entity would assess whether the activity that led to those proceeds was related to testing.

May 2015 meeting—decision to develop a draft Interpretation

- A7. The Interpretations Committee tentatively decided to develop a draft Interpretation on the meaning of testing, focusing on the meaning of ‘functioning properly’ in paragraph 17(e) of IAS 16. The Interpretations Committee considered that functioning properly reflects the technical and physical performance of PPE, and not the financial performance of PPE.

September 2015 meeting—discussion of draft Interpretation

- A8. In September 2015, the staff presented the draft Interpretation to the Interpretations Committee. The discussion focused on issues relating to the extractives industry. The Interpretations Committee did not reach consensus and directed the staff to:

- (a) develop requirements that clarify the narrowness of the scope of paragraph 17(e) of IAS 16, and the treatment of proceeds from testing in excess of the costs of testing;
- (b) develop requirements on the timing of when PPE becomes capable of operating in the manner intended;
- (c) consider the relevance of the requirements in paragraph 21 of IAS 16, which refers to income generated by incidental operations;
- (d) consider a cost-allocation model for circumstances in which PPE and inventory are produced concurrently before the PPE becomes capable of operating in the manner intended; and
- (e) develop a quantitative disclosure requirement for the amount of proceeds that has been deducted from the cost of PPE.

March 2016 meeting—*decision to propose narrow-scope amendments*³

- A9. The Interpretations Committee considered whether amendments to IAS 16 could be developed that would clarify some aspects of the accounting for the costs of PPE. The Interpretations Committee considered whether to clarify:
- (a) which net proceeds an entity deducts from the costs of PPE;
 - (b) how an entity interprets ‘testing’; and
 - (c) when an item of PPE is capable of operating in the manner intended by management.
- A10. The Interpretations Committee concluded that developing a solution to resolve these broader questions would be considerably more complex than developing a solution for the question raised in the submission. Consequently, the Interpretations Committee discussed:
- (a) restricting the amount of proceeds that an entity deducts from the cost of PPE to only those proceeds arising from testing activities, and clarify that the net proceeds deducted should not exceed the costs of testing included as part of the cost of PPE; and

³ See [Agenda Paper 2](#) of March 2016 meeting.

(b) prohibiting the deduction of proceeds from the cost of PPE.

A11. The Interpretations Committee tentatively decided to propose a narrow-scope amendment to IAS 16 to prohibit the deduction of proceeds from the sale of items produced while making an item of PPE available for use from the cost of that PPE (paragraph A10(b) above).

A12. The Interpretations Committee also decided not to develop a cost-allocation model for circumstances in which PPE and inventory are produced concurrently before the PPE is capable of operating in the manner intended. The staff noted that IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* includes requirements for the allocation of costs when PPE and inventory are produced at the same time. That Interpretation has a narrow scope—it provides requirements only for stripping costs in the production phase of a surface mine. The requirements in IFRIC 20 are based on the cost allocation principles for joint products in IAS 2.

September 2016 meeting—disclosure and transition requirements⁴

A13. At this meeting, the Interpretations Committee recommended that the Board require prospective application of the proposed amendments to items of PPE made available for use from the beginning of the earliest comparative period when first applying the proposed amendments.

A14. The Interpretations Committee also decided that:

- (a) transition relief is not required for first-time adopters; and
- (b) disclosure requirements should not be added as part of any proposed amendments to IAS 16.

⁴ See [Agenda Paper 5](#) of September 2016 meeting

Appendix II Assessment against the Interpretations Committee’s agenda criteria

We have assessed this issue against the agenda criteria of the current *Due Process Handbook* as follows:

Agenda criteria

<p>We should address issues (5.16):</p> <p>that have widespread effect and have, or are expected to have, a material effect on those affected.</p> <p>...where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.</p> <p>...that can be resolved efficiently within the confines of existing Standards and the <i>Conceptual Framework for Financial Reporting</i>.</p> <p>Is the issue sufficiently narrow in scope that the Interpretations Committee can address it in an efficient manner, but not so narrow that it is not cost-effective for it to undertake the due process that would be required when making changes to IFRS (5.17)?</p> <p>Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).</p>	<p>Yes. We understand that, within some industry sectors, entities adopt different approaches in practice when accounting for income earned before PPE is available for use. This can lead to materially different amounts being recognised as PPE.</p> <p>Yes. We think that a clarification with respect to this issue would address the diversity identified in practice in applying the requirements in paragraph 17(e) of IAS 16.</p> <p>Yes. We think that an amendment can resolve the issue efficiently within the confines of existing Standards</p> <p>Yes. The issue is not being addressed in any current or planned Board project.</p>
---	---

Appendix III
Initial staff thoughts on the wording of the proposed amendments to IAS 16

Elements of cost

...

17 Examples of directly attributable costs are:

- (a) ...
- (e) 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);~~ 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 samples produced when testing equipment). An entity recognises the proceeds from selling such items and the cost of producing those items in profit or loss in accordance with applicable Standards.

21 Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

...