

STAFF PAPER

November 2014

IFRS Interpretations Committee Meeting

IFRS IC April and May 2014

Project	Finalisation of agenda decision
Paper topic	IAS 16 <i>Property, Plant and Equipment</i> and IAS 2 <i>Inventories</i> Accounting for core inventories
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. In July 2014, the IFRS Interpretations Committee (the ‘Interpretations Committee’) published a tentative agenda decision not to add to its agenda a request to clarify the accounting for core inventories.
2. The submitter defined core inventories as a minimum amount of material that:
 - (a) is necessary to permit a production facility to start operating and to maintain subsequent production;
 - (b) cannot be physically separated from other inventories; and
 - (c) can be removed only when the production facility is finally decommissioned or at considerable financial charge.
3. The issue analysed was whether core inventories should be accounted for under IAS 2 *Inventories* or IAS 16 *Property, Plant and Equipment*.
4. At its meeting in March 2014 the Interpretations Committee tentatively decided to develop an Interpretation and directed the staff to define the scope of what is considered to be core inventories and to analyse the applicability of the concept to a range of industries.

5. At the July 2014 meeting the Interpretations Committee discussed the feedback received from informal consultations with IASB members, the proposed scope of core inventories and the staff analysis of the applicability of the issue to a range of industries. On the basis of this discussion the Interpretations Committee tentatively decided not to continue with the development of an Interpretation and decided to issue a tentative agenda decision that can be found in the [IFRIC Update of July 2014](#).

Purpose of the paper

6. The purpose of this paper is to:
- (a) provide an analysis of the comments received on the tentative agenda decision; and
 - (b) set out the wording for the final agenda decision (see **Appendix A**).

Comment letter analysis

7. The comment period for the tentative agenda decision ended on 29 September 2014. We received **four** responses as follows:
- (a) two respondents (Deloitte and the Brazilian Accounting Pronouncements Committee (CPC)) agree with the Interpretations Committee's tentative decision not to add to its agenda a request to clarify the accounting for core inventories;
 - (b) the European Securities and Markets Authority (ESMA), who is the original submitter of the issue on core inventories, disagrees with the Interpretations Committee's tentative agenda decision to remove the issue from its agenda; and
 - (c) the Australian Accounting Standards Board (AASB) agrees with the Interpretations Committee's tentative decision but disagrees with one of the Interpretations Committee's reasons for tentatively removing the issue from its agenda.

8. The comment letters from these respondents are attached to this paper (see **Appendix B**).
9. In the following paragraphs, we explain in more detail the comments expressed by ESMA and the AASB.
10. ESMA disagrees with the Interpretations Committee's tentative decision not to clarify whether 'core inventories' should be accounted for in accordance with IAS 2 or IAS 16. The respondent thinks that it is important to clarify which principles are to be applied (IAS 2 **or** IAS 16) and claims that an Interpretation of these Standards or an amendment to these Standards is needed because:
 - (a) the issue of the accounting for core inventories is applicable to a range of industries, is widespread and is sufficiently narrow;
 - (b) the IASB should ensure that the requirements in IAS 2 and IAS 16 are consistently applied and that their requirements are applied to all transactions with similar economic characteristics, in order to promote comparability of the financial statements; and
 - (c) IAS 2 and IAS 16 are Standards that are not expected to be revised in the foreseeable future.
11. ESMA and the AASB are concerned that the Interpretations Committee uses the argument of lack of diversity in practice *within* industries as the reason to justify its decision not to add the issue of core inventories to its agenda. These respondents observe that:
 - (a) diversity in practice does exist, notwithstanding the fact that diversity in practice was not observed *within* entities in the same industry; and
 - (b) the application of IFRSs should be industry-neutral.
12. Moreover, the AASB observes that:
 - (a) a lack of diversity in practice *within* industries is an insufficient basis for not addressing the issue if there is diversity *between* industries; and
 - (b) the justification provided by the Interpretations Committee might create a precedent for not addressing issues in the future.

13. Accordingly, the AASB recommends that the Interpretations Committee should:

- (a) remove from the final agenda decision the current basis for the Interpretations Committee's decision. In other words, the Interpretations Committee should delete the last sentence in the fourth paragraph of the tentative agenda decision that we reproduce below (emphasis added):

The Interpretations Committee further noted that, **although the diversity in practice was noted between industries, there was no, or only limited, diversity in practice within the industries for which the issue is significant.**

- (b) mention that the issue is too broad for the Interpretations Committee to deal with. In this respect the respondent recommends:

- (i) adding the following statement (emphasis added):

However, **further analysis and assessment of these fact patterns would require a broader project** than the Interpretations Committee could perform on behalf of the IASB.

- (ii) amending the last paragraph of the tentative agenda decision as follows (emphasis added):

In the light of the additional analysis of the different fact patterns that arise in practice, the Interpretations Committee [decided] ~~not to continue with the development of an interpretation,~~ **the issue is too broad for the Interpretations Committee to address,** and to remove this item from its agenda.

Staff analysis

Should the Interpretations Committee resume its discussions on core inventories?

14. We note that ESMA thinks that the Interpretations Committee should not remove this issue from the agenda. ESMA notes that the issue is one that the Interpretations Committee is capable of addressing and it thinks that it is important that the IASB ensures that IAS 2 and IAS 16 are consistently applied.
15. However, we understand that the members of the Interpretations Committee attributed the different accounting approaches to different facts and circumstances and not to diversity in practice for similar facts and circumstances.
16. Some Interpretations Committee members were also concerned about establishing the principles that would be applied (IAS 2 or IAS 16) to account for core inventories, because they observed that this could result in significant changes in practice within industries in which no diversity currently exists.
17. On the basis of our understanding of the discussion held at the July 2014 meeting by the members of the Interpretation Committee and the fact that other respondents support the Interpretations Committee's tentative decision to remove the issue from its agenda we think that the Interpretations Committee should not resume its discussions about the accounting for core inventories.

Proposed changes to the wording of the tentative agenda decision

18. We observe that ESMA and the AASB both raised some concerns about the observation given by the Interpretations Committee for not addressing the issue that: "although the diversity in practice was noted between industries, there was no, or only limited, diversity in practice within the industries for which the issue is significant".
19. As noted above, we understand that the Interpretations Committee attributed the different accounting to different facts and circumstances and not to diversity in practice for similar facts and circumstances. We agree with the AASB's suggestion to delete the Interpretations Committee's observation of the extent of

the diversity in practice *between* and *within* industries, because it could be misinterpreted:

- (a) as being the reason for removing the issue from the Interpretations Committee's agenda; and
- (b) as implying that the diversity in practice between industries is not as concerning as the diversity in practice within industries.

20. We also agree with the AASB's suggestion to indicate that the issue is too broad for the Interpretations Committee to address, because we think that this is consistent with the reasons provided by the Interpretations Committee in its tentative agenda decision for removing the issue. These are that:

- (a) fact patterns in different industries can vary significantly (*currently in the fourth paragraph of the tentative agenda decision*); and
- (b) additional analysis would be required of the different fact patterns that arise in practice (*currently in the last paragraph of the tentative agenda decision*).

Staff recommendation

21. After considering the comments received on the tentative agenda decision, we recommend that the Interpretations Committee should finalise its decision not to add this issue to its agenda and include some edits to the final agenda decision, as follows:

- (a) delete the last sentence in the fourth paragraph of the tentative agenda decision; and
- (b) state that the reason why the Interpretations Committee removed this issue from its agenda is that the scope of the issues raised in the submission is too broad for the Interpretations Committee to address in an efficient manner.

22. The proposed wording of the final agenda decision is shown in **Appendix A** to this paper.

Questions for the Interpretations Committee

Question for the Interpretations Committee

1. Does the Interpretations Committee agree with our recommendation to finalise the agenda decision and to make the wording changes as indicated in Appendix A?

Appendix A—Final agenda decision

A1. We propose the following wording for the final agenda decision.

IAS 16 *Property, Plant and Equipment* and IAS 2 *Inventories*—‘Core inventories’

The Interpretations Committee received a request to clarify the accounting for ‘core inventories’. The submitter defined core inventories as a minimum amount of material that:

- (a) is necessary to permit a production facility to start operating and to maintain subsequent production;
- (b) cannot be physically separated from other inventories; and
- (c) can be removed only when the production facility is finally decommissioned or at considerable financial charge.

The issue is whether core inventories should be accounted for under IAS 16 or IAS 2.

The Interpretations Committee discussed the issue at its March 2014 meeting and tentatively decided to develop an interpretation. The Interpretations Committee further directed the staff to define the scope of what is considered to be core inventories and to analyse the applicability of the concept to a range of industries.

At its July 2014 meeting, the Interpretations Committee discussed the feedback received from informal consultations with IASB members, the proposed scope of core inventories and the staff analysis of the applicability of the issue to a range of industries. In its redeliberations, the Interpretations Committee observed that the fact patterns in different industries can vary significantly. ~~The Interpretations Committee further noted that, although the diversity in practice was noted between industries, there was no, or only limited, diversity in practice within the industries for which the issue is significant.~~ However, further analysis and assessment of these different fact patterns that arise in practice would require a broader-scope project.

In the light of the above, the Interpretations Committee ~~[decided] not to continue with the development of an interpretation,~~ decided to remove this item from its agenda.

Appendix B—comment letters submitted

(included in the following page)

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

Email: ifric@ifrs.org

22 September 2014

Dear Mr Upton

Tentative agenda decision - IAS 16 *Property, Plant and Equipment* and IAS 2 *Inventories*: 'Core inventories'

Deloitte Touche Tohmatsu Limited is pleased 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 'core inventories' necessary to permit a production facility to start operating and to maintain subsequent production.

We agree with the IFRS Interpretations Committee's decision to remove this item from its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely



Veronica Poole
Global IFRS Leader



SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
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September 29, 2014

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Tentative agenda decisions open for comment in the IFRIC Update

Dear Board Members,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee), the standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies welcomes the opportunity to presents comments to the Tentative agenda decisions open for comment in the IFRIC Update.

<i>Standard / Topic</i>	<i>Our Comments</i>
IFRS 12 Disclosure of Interests in Other Entities – disclosure of summarized financial information about material joint ventures and associates	We agree that transparency is fundamental and shouldn't be mitigated, in special non-disclosure information of joint ventures or associate companies.
IAS 16 Property, Plant and Equipment and IAS 2 Inventories – 'Core inventories'	This practice can be important to the calculation of taxes, but despite all range of practices within the industries, this is not significant issue to be added to the agenda.
IAS 16 Property, Plant and Equipment – accounting for proceeds and cost of testing on PPE	We agree with the Interpretations Committee consideration that in the light of its analysis of existing IFRS requirements, IAS 16 and IAS 1 contain sufficient guidance.
IAS 21 The Effect of Changes in Foreign Exchange Rate – Foreign exchange restrictions and hyperinflation	For the first point of the issue, about multiple foreign exchange rates, the principle is explicit on paragraph 26 of IAS 21. For the second point of the issue, about lack of exchange rate for a long time especially in hyperinflation scenarios, we do agree that it is not the subject of IAS 21 and should be a scope of a new project.
IAS 39 Financial Instruments: Recognition and Measurement – holder's accounting for exchange of equity instruments	This is a specific case, which derives from a punctual change in the Law that will not happen in the same way.

We agree with the determination of Interpretations Committee not adding the mentioned issues to its agenda. We also suggest that the Committee revise its due process and does not include topics with a clear response in the literature itself in public hearing nor in the Committee agenda in order to prioritize the most relevant issues.

If you have any questions about our comments, please contact us at operacoes@cpc.org.br.

Yours sincerely,

Idésio da Silva Coelho Júnior
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)

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

Re: The IFRS Interpretations Committee's tentative agenda decision on IAS 2 *Inventories* and IAS 16 *Property, Plant and Equipment* – 'Core Inventories'

Dear Mr Upton,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to respond to the IFRS Interpretations Committee's (IFRS IC) publication in the July IFRIC Update of the tentative decision related to the application of IAS 2 *Inventories* and IAS 16 *Property, Plant and Equipment*. We are pleased to provide you with the following comments with the aim of improving the consistent application and enforceability of IFRSs.

ESMA has considered the IFRS IC's tentative decision not to continue with the development of an interpretation and to remove from its agenda the request for clarification¹ on accounting for 'core inventories'.

ESMA disagrees with the IFRS IC's tentative decision not to develop an interpretation or provide guidance that would clarify whether core inventories should be accounted for under IAS 2 or IAS 16. ESMA is concerned that despite the fact that the issue is applicable to a range of industries and that diversity in practice has been identified between industries, the IFRS IC decided not to address the issue. We are particularly surprised that the IFRS IC justifies its decision with the argument that only limited diversity in practice has been identified within the industries for which the issue is significant. ESMA strongly believes that the IASB should not develop industry specific standards but ensure that they are applicable to all transactions with similar economic characteristics in order to promote comparability. Indeed, to our knowledge, this is the first time that the IFRS IC uses the argument of limited diversity within industries to justify its decision not to add an issue to its agenda.

¹ Letter: Agenda item request: Core Inventories, ESMA/2013/1774, 2 December 2013



Even though we acknowledge that fact patterns in different industries can vary, ESMA believes that it is important to identify criteria clarifying which principles are to be applied (IAS 2 or IAS 16) in order to ensure that transactions with similar economic characteristics are accounted for in a similar manner. As an example we believe that, in the absence of a principle clarifying when IAS 2 or IAS 16 is to be applied, the examples described in Agenda paper 4B of the July 2014 IFRS IC meeting can be used to justify any of the alternative accounting treatments (i.e. an issuer can argue that its fact pattern differs from the one applied in a different industry). ESMA believes that allowing such diversity across industries could have a negative impact on the consistent application of IFRSs and on the comparability of financial statements among issuers. Furthermore, as neither IAS 2 nor IAS 16 is expected to be revised in the foreseeable future ESMA is concerned that the diversity in practice will persist for a long time.

Finally, ESMA believes that the issue of core inventories is sufficiently narrow and that the diversity is sufficiently widespread for the affected entities that it should be addressed by the IFRS IC within its mandate. In this context, ESMA believes that the agenda item request fulfils the criteria in paragraph 5.16² of the IASB and IFRS IC Due Process Handbook, for the IFRS IC to address the issue.

ESMA believes that addressing the issue of core inventories is critical for the consistent application and enforceability of IAS 2 and IAS 16 requirements.

We would be happy to discuss these issues further with you.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'S/M' with a flourish.

Steven Maijor
Chair
European Securities and Markets Authority

Cc: Hans Hoogervorst, Chair, International Accounting Standards Board

² widespread effect and material effect on those affected; improvement of financial reporting through the elimination, or reduction, of diverse reporting methods; and possibility to resolve the issue efficiently within existing IFRSs and the Conceptual Framework



Australian Government
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18 September 2014

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

Dear Wayne

Re: Tentative Agenda Decisions on IAS 16 *Property, Plant and Equipment*

The AASB is pleased to respond to the IFRS Interpretations Committee's (the Committee) tentative decisions (published in the July 2014 *IFRIC Update*) not to add to its agenda requests to clarify:

- (a) the accounting for 'core inventories'; and
- (b) accounting for the net proceeds from selling any items produced while bringing an item of property, plant and equipment (PPE) to the location and condition necessary for it to be capable of operating in the manner intended by management.

The AASB appreciates the Committee's deliberations on both issues. However, as outlined below, the AASB has broader concerns in regard to the Committee's process and basis for tentatively removing these issues from its agenda.

Item (a): 'Core inventories'

While the AASB agrees that the accounting for core inventories (or minimum fill) is a broad issue, the AASB is concerned with the Committee's basis for tentatively removing the issue from its agenda. The AASB is particularly concerned with the following wording in the *IFRIC Update*:

“At the July 2014 meeting, the Interpretations Committee discussed the feedback received from the informal consultations with IASB members, the proposed scope of core inventories and the staff analysis of the applicability of the issue to a range of industries. In its redeliberations, the Interpretations Committee observed that the fact patterns in different industries can vary significantly. The Interpretations Committee further noted that, although the diversity in practice was noted between industries, there was no, or only limited, diversity in practice within the industries for which the issue is significant.

In the light of the additional analysis of the different fact patterns that arise in practice, the Interpretations Committee [decided] not to continue with the development of an interpretation, and to remove this item from its agenda.”

Although the AASB notes that the main emphasis in the above reasoning is on ‘different fact patterns’, the AASB thinks that a lack of diversity in practice *within industries* is an insufficient basis for not addressing the issue if there is diversity *between industries*. The AASB is of the view that the making, and application, of IFRSs should be, to the extent possible, industry-neutral. Accordingly, diversity in practice *between industries* should be considered to be at least as significant an issue as diversity in practice *within industries*. Moreover, the AASB is concerned that the basis for removing the issue from the Committee’s agenda might create a precedent for not addressing issues in the future.

As noted above, the AASB appreciates the Committee staff’s work on this issue and agrees that the issue is too broad for the Committee to deal with. Accordingly, the AASB recommends the final agenda decision removes the current basis for the Committee’s decision and instead notes the issue is too broad for the Committee to deal with. Suggested wording for the final agenda decision is provided in Appendix A to this letter.

Item (b): ‘Proceeds from testing in excess of the costs of testing an item of PPE’

The AASB disagrees that it is clear, from paragraph 17 of IAS 16, that the excess of net proceeds from sales over the costs of testing an item of PPE should be recognised in profit or loss.

This concern is further supported by:

- (a) the results of the Committee staff’s outreach which indicated that practice is generally to credit any excess over the costs of testing to the asset; and
- (b) the discussion at the July Committee meeting which indicated that the majority of members considered the requirements of IAS 16 could:
 - (i) only be read as requiring a credit to the asset; or
 - (ii) could be read both ways (that is, a credit to the asset or through profit or loss).

In light of the apparent diversity in views on the issue, the AASB is concerned that this issue would not be adequately addressed through a rejection notice, and considers that the issue would be more appropriately addressed as an amendment to IAS 16. In particular, the AASB considers that, because no transition guidance can be provided in a rejection notice, it is potentially unclear whether entities that had previously capitalised an excess over the costs of testing would be required to account for the excess in profit or loss retrospectively in accordance with the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

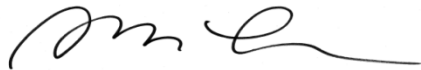
Accordingly, the AASB disagrees with the Committee’s decision to remove the issue from its agenda. The AASB considers the Committee should discuss the issue further by adding the issue to its agenda.

The AASB is also concerned that the wording of the tentative agenda decision goes beyond a rejection notice, and that constituents will view the Committee’s conclusions as a de facto interpretation of the accounting required by paragraph 17 of IAS 16. If the Committee proceeds with the agenda decision, the AASB recommends that, at a minimum, the

Committee does not mention its view on how to account for the excess of net proceeds over the costs of testing an item of PPE. Suggested wording for the final agenda is provided in Appendix B to this letter.

If you require further information on the matters raised above, please do not hesitate to contact me or Mitchell Bryce (mbryce@asb.gov.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'AT', with a long horizontal flourish extending to the right.

Angus Thomson
Acting Chair

Appendix A: AASB preferred wording for final agenda decision in relation to the accounting for ‘core inventories’

The Interpretations Committee received a request to clarify the accounting for ‘core inventories’. The submitter defined core inventories as a minimum amount of material that:

- (a) is necessary to permit a production facility to start operating and to maintain subsequent production;
- (b) cannot be physically separated from other inventories; and
- (c) can be removed only when the production facility is finally decommissioned or at considerable financial charge.

The issue is whether core inventories should be accounted for under IAS 2 or IAS 16.

The Interpretations Committee discussed the issue at the March 2014 meeting and tentatively decided to develop an interpretation. The Interpretations Committee further directed the staff to define the scope of what is considered to be core inventories and to analyse the applicability of the concept to a range of industries.

At the July 2014 meeting, the Interpretations Committee discussed the feedback received from the informal consultations with IASB members, the proposed scope of core inventories and the staff analysis of the applicability of the issue to a range of industries. In its redeliberations, the Interpretations Committee observed that the fact patterns in different industries can vary significantly. ~~The Interpretations Committee further noted that, although the diversity in practice was noted between industries, there was no, or only limited, diversity in practice within the industries for which the issue is significant.~~ However, further analysis and assessment of these fact patterns would require a broader project than the Interpretations Committee could perform on behalf of the IASB.

In the light of the additional analysis of the different fact patterns that arise in practice, the Interpretations Committee [decided] ~~not to continue with the development of an interpretation, the issue is too broad for the Interpretations Committee to address, and to remove this item from its agenda.~~

Appendix B: AASB preferred wording for final agenda decision in relation to the accounting for ‘net proceeds over the costs of testing an item of PPE’ [if the Committee confirms its decision to remove the issue from its agenda]

The Interpretations Committee received a request to clarify accounting for the net proceeds from selling any items produced while bringing an item of property, plant and equipment (PPE) to the location and condition necessary for it to be capable of operating in the manner intended by management. The submitter has asked whether the amount by which the net proceeds received exceed the costs of testing should be recognised in profit or loss or as a deduction from the cost of the PPE. The submitter also expressed concern about the lack of disclosure requirements about the accounting for the net proceeds from selling items produced and the costs of testing.

The Interpretations Committee noted that paragraph 17 of IAS 16 states that directly attributable costs include 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 (necessary for it to be capable of operating in the manner intended by management). ~~The Interpretations Committee considered that the amount by which net proceeds received exceed the costs of testing would be recognised in profit and loss and not against the cost of the asset.~~

The Interpretations Committee considered that an additional disclosure requirement is not necessary for the net proceeds and the costs of testing. If the net proceeds and the costs of testing are material, paragraph 17(c) of IAS 1 *Presentation of Financial Statements* would require additional disclosure if that information is necessary to enable users to understand the impact on the financial statements.

The Interpretations Committee considered that in the light of its analysis of the existing IFRS requirements, IAS 16 and IAS 1 contain sufficient guidance and neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee [decided] not to add the issue to its agenda.