IFRS

STAFF PAPER

November 2014

IFRS Interpretations Committee Meeting

Project	**IAS 16 *Property, Plant and Equipment***		
Paper topic	Accounting for net proceeds and costs of testing on PPE		
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Introduction

1. In July 2014, the IFRS Interpretations Committee (the 'Interpretations Committee') discussed 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 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.

2. Our analysis of this issue was included in Agenda Paper 14 of the July 2014 meeting.[1]

3. The Interpretations Committee tentatively decided that it would not add this topic to the agenda. The Interpretations Committee considered that in the light of its analysis of the existing IFRS requirements, IAS 16 *Property, Plant and*

[1] Agenda Paper 14 of the July 2014 meeting: http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/July/AP14%20-%20IAS16%20Accounting%20for%20proceeds%20and%20cost%20of%20testing%20on%20PPE.pdf

Equipment and IAS 1 *Presentation of Financial Statements* contain sufficient guidance and neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee tentatively decided not to add the issue to its agenda.

4. The Interpretations Committee's full tentative agenda decision can be found in *IFRIC Update* (July 2014).[2]

Comment letter summary

5. The comment period for the tentative agenda decision ended on 29 September 2014. We received nine responses. These comment letters are in Appendix A.

6. One respondent, Comitê de Pronunciamentos Contábeis (CPC), agreed with the tentative agenda decision for the reasons provided in the agenda decision.

7. Five respondents, Accounting Standards Board of Canada (AcSB), AngloAmerican, Grant Thornton (GT), Deloitte and EY, agreed with issuing the agenda decision, but they disagreed with the reasons provided in the tentative agenda decision.

8. Three respondents, Australian Accounting Standard Board (AASB), PwC and CPA Canada, disagreed with issuing the agenda decision and suggested that the issue should be added to the Interpretations Committee's agenda.

9. The following concerns were raised by the respondents:

   (a) implication of the agenda decision for the extractive industry;

   (b) a lack of clarity in existing paragraphs from which the conclusion is drawn;

   (c) relating the corresponding costs to the profit;

   (d) necessity of guidance to account for the proceeds; and

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[2] *IFRIC Update* (July 2014): http://media.ifrs.org/2014/IFRIC/July/IFRIC-Update-July-2014.html

(e) the nature of the agenda decision.

(a) Implication of the agenda decision for the extractive industry

10. The majority of the respondents were concerned about the implication of the agenda decision for the extractive industry.[3] Some respondents pointed out that the issue is also relevant for energy and metal processing industries. Those respondents noted that it is common in those industries to credit net proceeds in excess of the costs of testing to the asset under construction:

> In our experience, 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 guidance in IFRS has been interpreted and applied and, in some instances, this has also been influenced by approaches that originated in previous GAAPs. It is not clear how the Committee's tentative agenda decision will impact these treatments, if at all. Furthermore, given the different types of revenue that can be earned while an asset is being constructed/developed, it is not clear whether the tentative decision actually concludes that the only proceeds/revenue that can be credited to the cost of an asset are those associated with the narrowly defined concept of cost of testing. (EY)
>
> In the extractive industries it is common for major capital projects to go through a ramp-up period during which the asset under construction may be producing saleable output, but is not yet capable of operating in the manner intended by management. During this period it is a widespread and established industry accounting practice to capitalise the costs of operating the asset, and to offset proceeds from the sale of the output against its carrying amount, even where these proceeds exceed the costs incurred. Applying the interpretation of IAS 16:17 outlined in the tentative agenda decision would therefore have a significant impact for many entities within the extractive industries (AngloAmerican)

[3] Deloitte, EY, PwC, GT, AngloAmerican and CPA Canada.

> The treatment of sales proceeds during a testing phase is a significant issue in the energy and extractives sectors, where construction of an asset can be a lengthy and complex process with many costs (including those of testing) attributable to bringing the asset to the condition necessary for it to be capable of operating in the manner intended by management. In many cases, the same costs (for example, of labour) are necessary for both the current production of saleable output and the completion of the asset. Within those industries, we believe that the predominant practice is for sales proceeds in excess of directly identified incremental testing costs to be deducted from the cost of the asset. For example, the proceeds from power generated during the commissioning of a new power station, or precious metals produced prior to completion of a processing plant, are generally viewed as having been generated in the process of testing whether the asset is functioning properly (and, as such, are viewed as directly attributable costs) and appropriately deducted from the cost of the asset, even if the income received is higher than the direct cost of testing. In these complex situations, judgement is required to identify direct and indirect testing costs and the asset to which they relate (the unit of account). (Deloitte)

(b) A lack of clarity in existing paragraphs from which the conclusion is drawn

11. Some respondents raised a concern that paragraphs 17(c) and 21 of IAS 16 do not provide sufficient grounds to draw the conclusion on the issue:[4]

> The purpose of paragraph 17 of IAS 16 is to provide guidance on the types of cost that may be directly attributable, not to provide guidance on how to account for an excess of net proceeds over cost. Paragraph 17(e) does not seem to envisage an excess of net proceeds over the cost of testing. (GT)

> Paragraph 21 supports the recognition of income and expenses related to incidental operations that are not necessary to bring the item to the location and condition necessary for its intended use in profit or loss. (AcSB)

[4] Including GT, PwC and AcSB.

(c) Relating the corresponding costs to the profit

12. Some respondents raised the concern that, if proceeds are recognised in profit or loss, no corresponding depreciation expense for the assets would be booked because the commercial production has not commenced:[5]

> We are concerned that the treatment required by the tentative agenda decision would result in the recognition of income and a profit margin prior to the commencement of operations. In these circumstances, the activities resulting in saleable output that are also necessary for the completion of the asset (and, hence, are capitalised) could result in the recognition of revenue with no depreciation and little or no other associated cost; we do not believe that this would be an appropriate outcome. (Deloitte)
>
> Clarifying the definition of "costs" in relation to the "items produced". For example, while a mine is not capable of operating in the manner intended by management, should these costs be determined on a total cost basis, an incremental cost basis, or set at nil? Should depreciation be included in "costs" before the asset is capable of operating in the manner intended by management? (CPA Canada)

(d) Necessity of guidance to account for the proceeds

13. Some respondents raised the concern that it is not clear how to account for the net proceeds.[6] For example:

> Clarifying where in the income statement the "net proceeds" would be recorded and whether this would be on a gross basis or net basis. (CPA Canada)
>
> How should entities deal with revenue earned from testing in instances where it is not possible to separate the cost of testing from the broader costs of development. (EY)

[5] Including Deloitte and CPA Canada.
[6] Including CPA Canada, EY AngloAmerican and AASB.

Over what period of time entities should assess whether proceeds exceed the cost of testing (particularly where an asset is ramping up over a number of accounting periods). (AngloAmerican)

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. (AASB)

(e) The nature of the agenda decision

14. Some respondents raised the concern that this agenda decision provides an interpretation and so sufficient due process as ordinarily required for amendments to Standards or an Interpretation should be carried out.[7]

Further outreach to some of the respondents

15. In order to further understand the concerns raised, we contacted some of the respondents and received the following comments.

Diversity in practice whether pre-commissioning revenue is recognised in profit or loss or deducted from assets, in extractive industry

(a) One respondent commented that diversity in practice in the extractive industry exists, particularly on whether pre-commissioning revenue is recognised in profit or loss or deducted from assets. The respondent noted that some entities recognise pre-commissioning revenue in profit or loss, while others deduct pre-commissioning revenue from the assets.

(b) In contrast, another respondent commented that no diversity in practice exists in the extractive industry. The respondent noted that, during the development phase, most entities deduct all the pre-commissioning revenues from total assets, while, during the production phase, all entities recognise proceeds as revenue. The respondent commented that, during the production phase, if an issuer is operating a surface

[7] Including AASB, GT and PwC.

mine, the issuer allocates the costs to fixed assets and inventory produced in accordance with the principles in IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*. If an issuer is operating in other types of extractive industry, the issuer allocates the costs to the fixed assets and inventory on a similar approach to the principles in IFRIC 20.

Proceeds from testing/pre-commissioning revenue

(a) The Interpretations Committee discussion did not make it clear whether pre-commissioning revenue would be within the scope of IFRS 15 *Revenue from Contracts with Customers*. Clarification should be given on whether such amounts are considered 'revenue' as defined in IFRS 15.

(b) While the issue considered by the Interpretations Committee is focused on testing revenue, other pre-commissioning revenue may be generated as a result of the process of bringing the asset to the location and condition for its intended use. For example, when sinking a shaft in a mine, ores might be extracted and sold. It may be difficult to determine how the revenue generated and costs incurred with respect to that ore should be allocated between assets and income.

(c) Industry practice in accounting for such pre-commissioning revenue under IFRS varies. Some interpret paragraph 17(c) of IAS 16 quite narrowly, as applying only to income earned from actually testing the asset, while others interpret it to include other types of pre-commissioning revenue. The diversity is due to the limited guidance in IFRS. There seems to be some influence from local GAAPs. For example, UK GAAP recommended, and old Australian GAAP required, that any proceeds earned from the sale of product during the pre-commissioning phase should be recognised in profit or loss. US GAAP seems to be silent on the issue.

Costs of testing/costs of other pre-commissioning activity

(a) The agenda decision will create difficulties for entities when determining the appropriate amount of costs that should also be recognised in profit or loss in relation to such revenue. This is because it is extremely difficult to distinguish those costs that are directly attributable to constructing/developing the mine or field from those that represent the cost of producing the saleable material.

(b) Some companies may not currently be tracking costs of testing as a separate group of costs. Those entities might have practical challenges in determining what comprises the 'cost of testing'.

(c) It seems that the agenda decision implies that the testing cost itself is the unit of account. However, IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* seems to deem the unit of account of fixed assets to be the entire asset. Accounting in accordance with IFRIC 1 and accounting for proceeds of testing should be consistent and, accordingly, testing proceeds should be deducted from the total cost of the asset.

Concerns about the results produced by the changing accounting approaches

(a) If income is recognised before the asset is available for use, income would be recognised without depreciation. It raises a concern that profit margin would be overstated and give a distorted view of the profitability of the entity.

(b) If the amount of pre-commissioning revenue deducted from an asset is significant relative to the cost of the asset, it raises a concern that the cost of the asset would be inappropriately understated and result in a higher margin because of lower depreciation expenses.

Staff analysis of the comments received

16. Although we heard mixed views whether diversity in practice exists, we consider that the responses indicate that there is diversity. Accordingly, we consider that the Interpretations Committee should add this item to its agenda.

17. We identified the following two key judgements involved in accounting for this issue:

(a) when is the asset available for use. This is relevant for determining when capitalisation of costs (and deduction of revenue) should cease and depreciation commence; and

(b) what costs qualify as costs of testing, while bringing the asset to that location and condition. This is relevant for determining what costs should be capitalised, and potentially, the limit of how much revenue could be deducted.

18. Having made those judgements, we considered the following queries:

(c) how to account for the excess of proceeds over the costs of testing;

(d) how to account for other proceeds received on other activities (that are not testing) that are also necessary to bring the asset to that location and condition; and

(e) other issues.

(a) When is the asset available for use

19. We noted that some respondents commented on a ramp-up period during which the asset under construction may be producing saleable output, but is not yet capable of operating in the manner intended by management. Accordingly, we considered whether the 'available for use' assessment should be clarified.

20. We think that the revenue earned and the costs incurred after the item becomes available for use (see paragraph 55 of IAS 16) should be recognised in profit or loss. In accordance with paragraph 20(a) of IAS 16, we think that the asset operating at less than full capacity does not necessarily mean that the asset is not in the location and condition necessary for it to be capable of operating in the manner intended by management. Consequently, the revenue and costs incurred should be recognised in profit or loss if the asset is available for use (emphasis added):

> 20 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. Therefore, costs incurred in using or redeploying an item is not included in the carrying amount of that item. For example, the following costs are *not* included in the carrying amount of an item of property, plant and equipment:
>
> (a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or *is operated at less than full capacity*;
>
> (b) …

21. The staff also considers that the agenda decision made in 2011 gives additional clarification on the available for use assessment in paragraphs 16(b) and 55 of IAS 16. If the PPE is comprised of a group of assets that become available for use at different times, an available for use assessment should be made by each separate item, as follows (emphasis added):

> The Interpretations Committee received a request to clarify the accounting for sales proceeds from testing an asset before it is ready for commercial production. The submitted fact pattern is that of an industrial group with several autonomous plants being *available for use at different times*. This group is subject to regulation that requires it to identify a 'commercial production date' for the whole industrial complex.
>
> …
>
> *It also observed that the 'commercial production date' referred to in the submission for the whole complex was a different concept from the 'available for use' assessment in paragraph 16(b) of IAS 16. The Committee thinks that the guidance in IAS 16 is sufficient to identify the date at which an item of property, plant and equipment is 'available for use' and, therefore, is sufficient to distinguish proceeds that reduce costs of testing an asset from revenue from commercial production.*

As a result, the Committee does not expect diversity to arise in practice and therefore decided not to add this issue to its agenda.

22. We consider that this is a critical judgement and should be carefully made; however, we consider that IAS 16 is sufficiently clear to determine when the asset is ‘available for use’. Consequently, we do not consider that the Interpretations Committee should clarify when an asset is ‘available for use’.

(b) What costs qualify as costs of testing, while bringing the asset to that location and condition

23. We consider it important to determine what costs qualify as costs of testing, while bringing the asset to that location and condition.

24. The challenge described in the feedback is whether costs are incremental costs only, full absorption costs (for example, including depreciation) or some other form.

(c) How to treat the proceeds in excess of costs of testing

25. This is the main issue after determining the costs of testing. The issue is whether the excess of proceeds over costs of testing should be recognised in profit or loss or against the asset. If the proceeds are recognised in profit or loss, a related issue is whether the proceeds should be presented as revenue or other income. Another issue is whether the cost of goods sold should be recognised and measured in accordance with the requirements for ordinary operations (ie including depreciation) or some other basis, noting that this activity occurs before the asset is ready for intended use.

(d) How to account for other proceeds received on other activities (that are not testing) that are necessary to bring the asset to that location and condition

26. Another issue is whether the guidance on testing costs described in paragraph 17(e) of IAS 16 should be applied to other types of pre-commissioning incomes.

27. We understand that, before the asset is available for use, some other pre-commissioning processes are necessary to bring the item to the location and

condition necessary for it to be capable of operating in the manner intended by management. Some of these pre-commissioning process result in the generation of revenue. For example, we understand that the sinking of a shaft in the construction of a deep mine is a necessary part of the construction of the mine. Ore that is removed in the process of constructing the shaft would be sold. Paragraph 21 of IAS 16 will not apply to such operations because they are necessary for the construction of the mine.[8] However, the costs of constructing the shaft and removing the ore are not part of testing the mine. So the question arose whether paragraph 17(e) of IAS 16 should be applied to the costs and the associated income from the production and sale of the ore.

(e) Other issues

Disclosure on proceeds deducted from assets

28. The submitter expressed concern about the lack of disclosure requirements about how the net proceeds from selling items produced and the testing costs are accounted for. The submitter questioned whether any disclosure should be required for proceeds deducted from the assets.

Applicability of IFRS 15

29. During our outreach, some respondents questioned whether IFRS 15 is applicable to pre-commissioning revenue. The question arises about how IFRS 15 would require such income to be presented.

Interaction with IFRIC 20

30. Our outreach raised the question about whether there is any interaction with IFRIC 20. Paragraph 8 of IFRIC 20 requires:

[8] Paragraph 21 of IAS 16 states that income and expenses of operations that are not necessary to bring the PPE to the location and condition should be included in profit or loss.

To the extent that the benefit from the stripping activity is realised in the form of inventory produced, the entity shall account for the costs of that stripping activity in accordance with the principles of IAS 2 Inventories.

31. We noted that the scope of IFRIC 20 is specifically limited to the production phase of the mine. Because this issue specifically relates to the pre-production phase, we consider that there is no interaction between this issue and IFRIC 20.

Staff recommendation

32. We recommend that the Interpretations Committee should add this item to its agenda to analyse this issue further. The scope should not be limited to a certain industry. Specifically, we recommend the Interpretations Committee to consider the following issues:

- what costs qualify as costs of testing, while bringing the asset to that location and condition;
- how to treat the proceeds in excess of the costs of testing;
- how to account for other proceeds received on other activities (that are not testing) that are necessary to bring the asset to that location and condition;
- disclosure on proceeds deducted from assets; and
- applicability of IFRS 15.

Question for the Interpretations Committee

Question for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's recommendation that it should add this item to its agenda? 2. Does the Interpretations Committee agree with the scope of the issues identified in the staff recommendation?

Appendix A—Comment letters received

SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
www.cpc.org.br

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.

Standard / Topic	*Our Comments*
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)

Accounting Standards Board
AcSB
CNC
Conseil des normes comptables

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September 24, 2014

(By e-mail to ifric@ifrs.org)

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

Dear Sirs,

Re: Tentative agenda decision on IAS 16 *Property, Plant and Equipment* – accounting for proceeds and costs of testing on PPE

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on the accounting for proceeds and costs of testing on property, plant and equipment (PPE). This tentative agenda decision was published in the July 2014 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff and the AcSB's IFRS Discussion Group. The Group consists of members with a range of backgrounds and experience, including preparers, users and auditors of financial statements prepared in accordance with IFRSs. The views included in this letter do not necessarily represent a common view of the AcSB, its staff or the AcsB's IFRS Discussion Group. Views of the AcSB are developed only through due process.

While we agree with the Committee's decision not to add this item to its agenda, we disagree with the tentative agenda decision stating "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".

We do not agree with the analysis that paragraph 21 of IAS 16 supports the recognition of net proceeds in excess of the costs of testing in profit or loss when testing the asset is determined to be procedures required to bring the asset to the location and condition necessary for it to operate in the manner intended by management. Paragraph 21 supports the recognition of income and expenses related to incidental operations that are <u>not</u> necessary to bring the item to the location and condition necessary for its intended use in profit or loss.

The tentative agenda decision also suggests that "costs of testing" could be a separate unit of account rather than considering the item of PPE as the unit of account. We disagree with this concept because paragraph 17(e) of IAS 16 provides examples of directly attributable costs that comprise the cost of an item of PPE.

We are concerned that the tentative agenda decision could have broader implications. For example, the proposed approach could require entities to separately track costs of testing incurred over multiple interim periods. Entities would need to consider potentially reversing amounts previously recognized in profit or loss if cumulative net proceeds are subsequently less than cumulative costs of testing in future reporting periods. This may produce unintended results, particularly for Canadian entities that have quarterly reporting requirements. The proposed approach may also communicate inconsistent information to users of financial statements because if excess net proceeds are recognized in profit or loss and commercial production has not commenced, there would be no corresponding depreciation expense for the assets.

Based on the outreach performed, we understand that this is not a common issue in Canada or other jurisdictions. The prevalent accounting approach in this situation appears to be netting sales proceeds against the cost of the asset, even if the proceeds exceed the costs of testing. We think that insufficient rationale was provided in the tentative decision to support changing the prevalent accounting approach. Accordingly, we recommend that the IFRS Interpretations Committee revise the rationale for not adding this item to its agenda.

We would be pleased to provide more details if you require. If so, please contact me at +1 416 204-3464 (e-mail rvillmann@cpacanada.ca), or Davina Tam, Principal, Accounting Standards at +1 416 204-3514 (e-mail dtam@cpacanada.ca).

Yours truly,

Rebecca Villmann

Rebecca Villmann, CPA, CA
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Director, Accounting Standards

AngloAmerican

CORPORATE OFFICE

GROUP FINANCE AND
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20 Carlton House Terrace
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Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

26 September 2014

Dear Mr Upton,

Re: Tentative agenda decision: IAS 16 *Property, Plant and Equipment – accounting for proceeds and costs of testing on PPE*

We welcome the opportunity to comment on the Committee's recent tentative agenda decision on the accounting for the proceeds and costs of testing on property, plant and equipment (PPE).

We agree with the decision not to bring the matter onto the Committee's agenda. However we wish to highlight our concerns about the reasons provided for the decision, as we do not believe that paragraph 17 of IAS 16 is sufficient to reach the conclusion that net proceeds in excess of the costs of testing must be recognised in profit or loss.

In the extractive industries it is common for major capital projects to go through a ramp-up period during which the asset under construction may be producing saleable output, but is not yet capable of operating in the manner intended by management. During this period it is a widespread and established industry accounting practice to capitalise the costs of operating the asset, and to offset proceeds from the sale of the output against its carrying amount, even where these proceeds exceed the costs incurred.

Applying the interpretation of IAS 16:17 outlined in the tentative agenda decision would therefore have a significant impact for many entities within the extractive industries. Moreover it would raise a number of difficult questions of application when applied to complex capital projects, including:

- Which costs should be included within the 'costs of testing';
- Over what period of time entities should assess whether proceeds exceed the cost of testing (particularly where an asset is ramping up over a number of accounting periods);
- Whether such proceeds should be presented as revenue in the income statement; and
- How to ensure that any profit margins recognised are appropriate, particularly when no depreciation is being charged and the majority of the associated production costs are capitalised.

As a result, we believe it would be appropriate for the Committee to review the reasons for its tentative agenda decision, taking account of the wide range of facts and circumstances that might determine the appropriate treatment of revenues generated by an item of PPE before it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

We would be very happy to discuss these points with you in more detail. Please contact me if you would find this helpful.

Yours sincerely,

Siobhán Grafton
Head of Financial Reporting
Anglo American plc

Grant Thornton

An instinct for growth™

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Wayne Upton
Chairman
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18 September 2014

Sent by e-mail to: ifric@ifrs.org

Dear Mr Upton,

Tentative agenda decision - IAS 16 Property, Plant and Equipment: accounting for proceeds and costs of testing on PPE

Grant Thornton International Ltd is pleased to comment on the IFRS Interpretation Committee's (IFRIC's) tentative agenda decision on 'IAS 16 Property, Plant and Equipment—accounting for proceeds and costs of testing on PPE', published in the July 2014 IFRIC Update.

We agree that this issue should not be added to the IFRIC's agenda. However we disagree with the rationale expressed in the tentative decision and the interpretive language it contains.

We believe the specific issue raised in the original submission is not widespread and should not be added to the IFRIC's agenda for that reason. In saying this we note that the submission describes a fact pattern in which revenue from production when testing an item of plant exceeds the costs of testing the plant (the "excess"). It is implicit in this fact pattern that there is a defined testing phase, the costs of which are distinguishable. In our experience, this is not a common fact pattern.

We are concerned about the statement in the second paragraph of the tentative decision about accounting for the excess ("consequently, 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"). This is an interpretive statement that, in our view, is not supported by IAS 16. We are concerned that implementing this interpretation could disrupt well-established practices and create practical issues.

Regarding consistency with IAS 16, we note:

- the purpose of paragraph 17 of IAS 16 is to provide guidance on the types of cost that may be directly attributable, not to provide guidance on how to account for an excess of net proceeds over cost. Paragraph 17(e) does not seem to envisage an excess of net proceeds over the cost of testing;
- IAS 16 paragraph 9 explicitly states that this Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of PP&E. However, paragraph

15 is clear that once an entity determines what constitutes an item of PP&E, the unit of account in IAS 16 for determining cost is that item. For example, if an entity determines that the item is an entire machine, cost would be determined for this entire asset, not for smaller physical components or individual activities carried out in bringing it to the location and condition necessary for it to be capable of operating in the manner intended by management. By contrast, recognising a credit in profit or loss for the excess in the testing phase amounts to treating that phase as a separate unit of account;

- testing whether the asset is functioning properly is not an incidental operation and recognition in profit or loss is therefore not supported by paragraph 21 of IAS 16.

Regarding the practical implications:

- established practice in some sectors, including but not limited to mining, is to deduct the net proceeds from sales of output produced in the development phase while bringing the asset to the condition necessary for it to be capable of operating in the manner intended by management from total asset cost. This practice could be viewed as inconsistent with the tentative agenda decision (partly depending on whether the IFRIC's comment relates narrowly to proceeds and costs during the testing phase or more broadly to income generated while undertaking activities necessary to bring an asset to the intended location and condition);
- in many cases there is no testing phase as such, or testing activities take place concurrently with other development activities and the related costs are not readily distinguishable from other necessary activities. Implementing the approach suggested would require entities to determine the start and end of the testing phase and to distinguish the costs of testing from other directly attributable costs;
- recognising the excess in profit or loss raises questions of presentation and could distort margins and other metrics.

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Please contact our Global Head of IFRS, Andrew Watchman (andrew.watchman@gti.gt.com or telephone + 44 207 391 9510), if you would like to discuss these comments.

Yours sincerely,

Kenneth C. Sharp

Kenneth C Sharp
Global Leader - Assurance Services
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Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
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Email: ifric@ifrs.org

22 September 2014

Dear Mr Upton

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

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 the net proceeds from selling any items produced while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda, but not with the reasons set out in the tentative agenda decision. We do not believe that paragraph 17 of IAS 16 is sufficient to reach the conclusion that net proceeds in excess of testing costs must be recognised in profit or loss. In addition, application of the treatment required by the tentative agenda decision is not practicable for complex construction projects where the costs of 'testing' may be indistinguishable from costs to complete construction of the asset and/or sales proceeds are incidental to the construction efforts.

The treatment of sales proceeds during a testing phase is a significant issue in the energy and extractives sectors, where construction of an asset can be a lengthy and complex process with many costs (including those of testing) attributable to bringing the asset to the condition necessary for it to be capable of operating in the manner intended by management. In many cases, the same costs (for example, of labour) are necessary for both the current production of saleable output and the completion of the asset. Within those industries, we believe that the predominant practice is for sales proceeds in excess of directly identified incremental testing costs to be deducted from the cost of the asset. For example, the proceeds from power generated during the commissioning of a new power station or precious metals produced prior to completion of a processing plant are generally viewed as having been generated in the process of testing whether the asset is functioning properly (and, as such, are viewed as directly attributable costs) and appropriately deducted from the cost of the asset, even if the income received is higher than the direct cost of testing. In these complex situations, judgement is required to identify direct and indirect testing costs and the asset to which they relate (the unit of account).

We are concerned that the treatment required by the tentative agenda decision would result in the recognition of income and a profit margin prior to the commencement of operations. In these circumstances, the activities resulting in saleable output that are also necessary for the completion of the asset (and, hence, are capitalised) could result in the recognition of revenue with no depreciation and little or no other associated cost; we do not believe that this would be an appropriate outcome.

The full facts and circumstances will always need to be considered and, as such, we do not believe that the generalised statement in the second paragraph of the tentative agenda decision is appropriate. In our view, it would be more appropriate to state that fact patterns giving rise to revenue prior to an asset being available for its intended use can vary significantly and that judgement needs to be applied in the complex scenarios arising in the industries for which the issue is significant. To fully analyse every variant would be a significant undertaking which we do not believe is merited.

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

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International Financial Reporting Standards Interpretations Committee
30 Cannon Street
London,
EC4M 6XH

29 September 2014

Dear IFRS Interpretations Committee members

Invitation to comment – *Tentative agenda decision – IAS 16 Property, Plant and Equipment – Accounting for net proceeds and costs of testing on PP&E*

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative decision of the IFRS Interpretations Committee ('Committee') published in the July 2014 IFRIC Update.
The Committee received "a request to clarify accounting for net proceeds received during the course of testing an item of property, plant and equipment ('PPE'), in the case that the net proceeds exceed the costs of testing".

We support the Committee's decision not to take the issue onto its agenda. However, we note that this agenda decision raises questions about the treatment of net proceeds from testing in certain sectors, particularly the extractive industries. We wish to clarify whether the implications for specific sectors were considered in reaching the tentative agenda decision. We also seek to understand whether the tentative agenda decision is considered to apply by analogy to similar situations, for example, the generation of revenue earned other than from testing (but before an asset is ready for its intended use), or whether the tentative agenda decision concludes that the only proceeds/revenue that can be credited to the cost of an asset are those associated with the narrowly defined concept of cost of testing. It is not clear whether it was the Committee's intention for this decision to be interpreted in either way.

In our experience, the extractives 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 guidance in IFRS has been interpreted and applied and, in some instances, this has also been influenced by approaches that originated in previous GAAPs. It is not clear how the Committee's tentative agenda decision will impact these treatments, if at all. Furthermore, given the different types of revenue that can be earned while an asset is being constructed/developed, it is not clear whether the tentative decision actually concludes that the only proceeds/revenue that can be credited to the cost of an asset are those associated with the narrowly defined concept of cost of testing.

There are other matters where we believe further guidance is required to ensure consistent application of the tentative agenda decision. For example, how should the excess of revenue earned over the cost of testing be presented in profit or loss, how should entities deal with revenue earned from testing in instances where it is not possible to separate the cost of testing from the broader costs of development; or, in the event that entities are required to change their approach, would entities be required to treat this change as the correction of an error.

Given the potential implications for certain sectors, particularly the extractive industries, EY seeks to understand whether the Committee will provide further guidance when finalising its agenda decision.

We would be pleased to discuss these matters further, and to provide specific examples of the areas that we believe would benefit from further clarification. Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

Ernst & Young Global Limited

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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@aasb.gov.au).

Yours sincerely

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.

Mr Michael Stewart
Director of Implementation Activities
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

11 September 2014

Dear Mr Stewart

Tentative agenda decision – *IAS 16 Property, Plant and Equipment* – Accounting for proceeds and costs of testing on PPE

We are responding to the IFRS Interpretation Committee's publication in the July IFRIC Update of the tentative decision not to take onto the Committee's agenda a request to clarify the 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 tentative decision states that net proceeds in excess of the costs of testing should be recognised in profit or loss, and references paragraph 21 of IAS 16 as the basis for that conclusion.

We note that the paragraph referenced is focussed on incidental operations related to an item of PPE which are not necessary to bring the item to the location and condition necessary for operation. Therefore, we do not believe that the paragraph referenced addresses the question raised by the agenda request.

The proposed decision appears to provide an interpretation of IAS 16.21 and its application to a different transaction type. We are concerned that an agenda decision rather than an interpretation or narrow scope amendment means that the issue raised has not been subject to sufficient due process. It appears to require a particular approach without guidance on how to apply the suggested approach.

The original agenda request notes that some companies currently credit net proceeds in excess of the costs of testing to the asset under construction. We understand that this approach is common in certain industries including the extractive industries, metal processing and power generation. This approach is seen by many as a reasonable and simple application of the standard which avoids the need to undertake complex calculations of the net cost or proceeds of each test unit sold.

The tentative agenda decision suggests that this approach is an error. Further, in the absence of any guidance, questions will remain on how to apply the agenda decision. For example, should the cost of testing include or exclude depreciation?

Our view is that this issue should be subject to further discussion and any proposed interpretation of the standard should be issued in the form of amendments which are subject to normal due process and are accompanied by appropriate application guidance.

If you have any questions in relation to this letter please do not hesitate to contact Mary Dolson (020 7804 2930).

Yours faithfully

PricewaterhouseCoopers

PricewaterhouseCoopers

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September 29, 2014

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom
(Delivered via e-mail to ifric@ifrs.org)

Re: IAS 16 *Property, Plant and Equipment*—accounting for proceeds and costs of testing on PPE

To the IFRS Interpretations Committee:

The Research, Guidance and Support group of Chartered Professional Accountants of Canada (CPA Canada) appreciates the opportunity to respond to the IFRS Interpretations Committee ("Interpretations Committee") July 2014 agenda decision regarding IAS 16 *Property, Plant and Equipment*—accounting for proceeds and costs of testing on PPE. This response was developed based on comments received from members of the *Mining Industry Task Force on IFRSs.*

CPA Canada
CPA Canada is the national organization established to support unification of the Canadian accounting profession under the Chartered Professional Accountant (CPA) designation. It was created by the Canadian Institute of Chartered Accountants (CICA) and The Society of Management Accountants of Canada (CMA Canada) to provide services to all CPA, CA, CGA and CMA accounting bodies that have unified or are committed to unification. As part of the unification effort, CPA Canada and the Certified General Accountants Association of Canada (CGA-Canada) are working toward integrating their operations this year. Unification will enhance the influence, relevance and contribution of the Canadian accounting profession both at home and internationally. The responsibility to set accounting, auditing and assurance standards rests with the Accounting Standards Board, the Auditing and Assurance Standards Board and the Public Sector Accounting Board.

Mining Industry Task Force on IFRSs
Canada is home to one of the largest mining sectors in the world. The Toronto Stock Exchange is the dominant financial market for the global mining industry, listing 57 percent of the world's public mining companies, and is a leader in global mining equity financings in comparison to other stock exchanges around the world. [1] Due to the large number of mining entities reporting under IFRS in Canada, CPA Canada and the Prospectors & Developers Association of Canada created the *Mining Industry Task Force on IFRSs* ("Task Force") to share non-authoritative views on IFRS application issues of relevance to mining companies. Task Force members include prominent Canadian auditors and preparers. To learn more about the Task Force please visit www.cpacanada.ca/ifrsmining.

General Comments

We appreciate the Interpretations Committee's consideration of the request to clarify accounting for the net proceeds from selling any items produced while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management. However, in light of the current feedback provided to us, we request that the Interpretations Committee reconsider the issue at the November 2014 meeting.

Specific Comments

The decision of the Interpretations Committee 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" appears inconsistent with paragraph 17 and 21 of IAS 16 and generally accepted practice in the mining industry, based on those paragraphs.

When accounting for the net proceeds from selling any items produced while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management, the unit of account is generally viewed to be the entire asset. Accordingly, we believe you should consider that any net proceeds be deducted from the cost of the asset and not included in profit and loss.

Some issues that relate to mining companies and some areas of further consideration that need to be addressed include:

- Clarifying the definition of "costs of testing whether an asset is functioning properly." In some industries these costs can be defined very narrowly. In mining, these costs are a much greater issue resulting from the extended business processes surrounding the development of a mine. [2]
- Clarifying the definition of "costs" in relation to the "items produced." For example, while a mine is not capable of operating in the manner intended by management, should these costs be determined on a fully loaded cost basis, an incremental cost basis, or set at nil? Should depreciation be included in "costs" before the asset is capable of operating in the manner intended by management?
- Clarifying where in the income statement the "net proceeds" would be recorded and whether this would be on a gross basis (revenue and cost of sales for example) or net basis (perhaps as other income).
- Understanding the life cycle of a mine.[3] The mining industry, by its nature, takes a long time to get an asset into its intended use by management and therefore a long testing period is common.
- Understanding the impact on the mining industry, as the majority of entities in this industry record the net proceeds during the pre-commercial production period against the asset under development.

Several members of the Task Force are affiliated with large accounting firms and have informed us that these firms are intending to respond to the Interpretations Committee on this issue. We understand that many of the points noted in this letter may be considered and further addressed in their responses.

If you have any questions or require additional information, please feel free to contact Alex Fisher, Principal at 1-416-204-3497 or afisher@cpacanada.ca.

Regards,

Gordon Beal, CPA, CA, M. Ed
Vice-President, Research, Guidance and Support
Chartered Professional Accountants of Canada

cc: Linda Mezon, FCPA, FCA, CPA (MI)
Chair, Canadian Accounting Standards Board

[1] KPMG Global Mining Institute, Canada Country Mining Guide, Page 3
[2] Refer to two documents prepared by the *Mining Industry Task Force on IFRSs* - "Background on Different Phases of Activities of a Mining Entity" and "Commencement of Commercial Production" for further details. Available at www.cpacanada.ca/ifrsmining
[3] Refer to two documents prepared by the *Mining Industry Task Force on IFRSs* - "Background on Different Phases of Activities of a Mining Entity" and "Commencement of Commercial Production" for further details. Available at www.cpacanada.ca/ifrsmining