

STAFF PAPER

March 2016

IFRS Interpretations Committee Meeting

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| Project | IAS 16 <i>Property, Plant and Equipment</i> |
| Paper topic | Accounting for proceeds and costs of testing PPE: should net proceeds reduce the cost of PPE? |
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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS Standard do not purport to be acceptable or unacceptable application of that IFRS Standard—only the IFRS Interpretations Committee or the International Accounting Standards Board (the “Board”) 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. The IFRS Interpretations Committee (‘the Interpretations Committee’) received a request to clarify the accounting for net proceeds from selling items produced while testing an item of property, plant and equipment (PPE) under construction. The submitter asked whether an entity should recognise the amount by which the net proceeds received exceed the costs of testing in profit or loss or, instead, as a deduction from the cost of the PPE.
2. In September 2015, the Interpretations Committee asked the staff to work on various areas, most of which are discussed in this paper. We think that if we were to attempt to resolve all of the questions raised in previous discussions, any solution developed by the Interpretations Committee would become considerably more complex than the nature of the question raised. Consequently, this paper explores approaches that would answer the question submitted but do not attempt to answer all questions raised during previous discussions.
3. In this paper, our analysis builds on the previous work of the Interpretations Committee on the issue, in essence identifying the aspects of that previous work that we think can be addressed in an efficient manner from this point forward.
4. Appendix A to this paper explains the areas not discussed in the main body of the paper that the Interpretations Committee asked us to consider further. Appendix

B provides an overview of the previous discussions of the Interpretations Committee on this issue.

Background

The requirements in IAS 16

5. Paragraph 16(b) of IAS 16 *Property, Plant and Equipment* explains that the cost of PPE includes any costs directly attributable to bringing the PPE to the location and condition necessary for it to be capable of operating in the manner intended by management.
6. Paragraph 17 of IAS 16 sets out examples of directly attributable costs, which include the following:
 - 17 Examples of directly attributable costs are:
 - (a) ...
 - (e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); ...

The submission

7. The original submission raised concerns specifically in relation to the petrochemical industry. The submitter observed that some entities in that sector receive net proceeds from selling items produced while bringing PPE to the location and condition necessary for it to be capable of operating in the manner intended by management. Those entities deduct the net proceeds from the cost of the PPE, even when the amount of the net proceeds materially exceeds the costs of testing. The submitter suggested that an entity should deduct net proceeds only from the cost of testing, and that the amount of net proceeds deducted should not exceed the costs of testing.

Feedback already received

8. The feedback received from outreach activities, and in comment letters received in relation to a previous tentative agenda decision on the issue, indicates that there is diversity in practice in this respect, especially within particular industries. The feedback also indicates that this issue touches on some wider application issues regarding the costs associated with PPE—for example, (a) how to determine when PPE is in the location and condition necessary for it to be capable of operating in the manner intended by management, and (b) how to distinguish costs associated with inventory from costs associated with PPE. We understand that, within some industry sectors, entities adopt different approaches in practice when accounting for income earned before an asset is capable of operating in the manner intended. This can lead to materially different amounts being recognised as PPE.

Staff analysis

9. In the light of the feedback received, we think that it is worth exploring whether we could develop amendments to IAS 16 that would clarify some aspects of the accounting for the costs of PPE.
10. This staff analysis section of the paper includes a menu of clarifications from which the Interpretations Committee could select—the Interpretations Committee could decide to move forward with any combination of these clarifications. We have structured the section to start with the clarifications that we think would most directly answer the question submitted, before discussing wider clarifications that could be made.
11. This section is structured as follows:
- (a) **Clarification 1:** Which net proceeds should an entity deduct from the cost of PPE, and should there be any limit on the proceeds deducted?
 - (b) **Clarification 2:** How should an entity interpret ‘testing’?
 - (c) **Clarification 3:** When is PPE capable of operating in the manner intended by management?
 - (d) **Clarification 4:** Should there be any disclosure requirements?

- (e) **An alternative approach:** Prohibit the deduction of income from the cost of PPE.

12. In summary:

- (a) Clarification 1 addresses the question submitted;
- (b) Clarification 2 proposes to add requirements to help entities apply Clarification 1;
- (c) Clarification 3 goes beyond the question submitted to address wider concerns raised about the accounting for PPE; and
- (d) Clarification 4 proposes to add a disclosure requirement.

13. If the Interpretations Committee does not wish to proceed with Clarifications 1 and 2, the alternative approach is a straight-forward way to address the question submitted by changing the requirements in IAS 16.

Clarification 1: Which net proceeds should an entity deduct from the cost of PPE, and should there be any limit on the proceeds deducted?

14. The wording of paragraph 17(e) of IAS 16 (reproduced in paragraph 6 of this paper) implies that the net proceeds from selling items that an entity deducts from the cost of PPE are only those net proceeds that arise from *testing* whether the PPE is functioning properly—an entity should not deduct any other proceeds from selling items that might occur before the PPE is capable of operating in the manner intended. This is because:

- (a) the reference to deducting net proceeds within paragraph 17 of IAS 16 is directly linked to the costs of testing; and
- (b) the example provided of items produced (and sold) while bringing the asset to the location and condition necessary for it to be capable of operating as intended is ‘samples produced when testing equipment’.

15. The wording of paragraph 17(e) of IAS 16 also implies that the net proceeds deducted from the cost of PPE should be not more than the costs of testing. This is because paragraph 17(e) of IAS 16 states that an example of directly attributable costs is ‘costs of testing whether the asset is functioning properly, *after* deducting

the net proceeds....’ [emphasis added]. We interpret those words to say that an entity includes in the cost of PPE the net costs of testing (after deducting any proceeds from testing). However, those net costs of testing included as part of the cost of PPE would never be a negative amount.

16. In saying that, we understand that this might not be clear because the phrase within paragraph 17(e) ‘net proceeds from selling any items produced while bringing the asset to that location and condition’ does not specifically refer to net proceeds from testing. In addition, IAS 16 does not set any limit on the amount of net proceeds that an entity can deduct from the cost of PPE.

17. Accordingly, we recommend amending IAS 16 to clarify that:
 - (a) an entity would deduct from the cost of PPE net proceeds from selling items produced only from testing whether the PPE is functioning properly;
 - (b) the amount of net proceeds from testing that an entity deducts from the cost of PPE would not exceed the costs of testing; and
 - (c) an entity would recognise any other income earned before PPE is capable of operating in the manner intended applying other relevant requirements or Standards (for example, IFRS 15 *Revenue from Contracts with Customers* (IAS 18 *Revenue*)).

18. We think that restricting the amounts deducted from the cost of PPE to only those net proceeds from testing (and thus prohibiting the deduction of any other income earned before the PPE is capable of operating as intended) will result in a more faithful representation of the cost of PPE and the activities of the entity. It would therefore provide more useful information about those activities. We think that, in many cases, other income earned may represent revenue from selling items to customers in the ordinary course of business. In that case, an entity should apply the requirements of IFRS 15 (IAS 18) to such contracts with customers. If an entity were to deduct such revenue from the cost of PPE:
 - (a) The entity would fail to recognise revenue (and associated costs) arising from the transfer of goods to customers in the period in which it transfers those goods; and

- (b) the depreciation charge on PPE recognised in future periods when the PPE is used within the entity's operations would be affected. This might distort the operating margins reported in current and future periods.

Concerns raised about the approach

19. A number of concerns have been raised at previous meetings and in comment letters regarding this approach:
 - (a) The first is that it would require an entity to identify and distinguish (i) the net proceeds from testing from any other income earned before the PPE is capable of operating in the manner intended, and (ii) the costs of testing from all other costs incurred to bring the PPE to the location and condition necessary for it to be capable of operating as intended.
 - (b) The second is that some have raised concerns about recognising income earned (other than net proceeds from testing) in profit or loss before the PPE is capable of operating as intended. This is because the PPE is depreciated only from the date on which it is capable of operating as intended, and thus before that date an entity would not recognise any depreciation charge on the PPE in profit or loss. In addition, we understand that, for some industries, it might be difficult to identify and distinguish the costs associated with the income earned from all other costs incurred. Consequently, some are concerned that an entity might recognise material amounts of income in particular reporting periods with little or no associated costs recognised in those periods.

20. We acknowledge those concerns and agree that an entity may need to apply judgement in distinguishing the proceeds and costs of testing from other income and costs. Nonetheless, we do not think that those concerns should prevent amendments being made to clarify the proceeds that an entity deducts from the cost of PPE for the following reasons:
 - (a) Applying IFRS Standards, an entity is already required to identify and distinguish revenue from contracts with customers from any other income earned. The entity applies IFRS 15 (IAS 18) to those revenue

contracts. Paragraph 21 of IAS 16 also requires an entity to distinguish income from incidental operations (that it recognises in profit or loss) from proceeds from selling items that are deducted from the cost of PPE.

(b) Applying IFRS Standards, an entity is already required to identify and distinguish:

- (i) costs directly attributable to bringing PPE to the location and condition necessary for it to be capable of operating as intended, which it includes as part of the cost of PPE;
- (ii) costs of bringing inventory to its present location and condition included as part of the cost of inventory, which it then recognises in profit or loss at the time that the inventory is sold; and
- (iii) costs that it recognises directly in profit or loss, for example, costs of incidental operations (as described in paragraph 21 of IAS 16), costs of using or redeploying PPE (as described in paragraph 20 of IAS 16) or administrative, marketing or staff training costs (as described in paragraph 19 of IAS 16).

21. We think that the clarifications proposed would not add any significant amount of complication to the judgements already required in applying IFRS Standards when an entity's operations require the use of PPE that takes some time to bring to the location and condition necessary for it to be capable of operating as intended.

22. In addition, in paragraphs 27-30 of this paper, we propose to clarify the meaning of 'testing', which would help an entity to distinguish the proceeds and costs of testing from any other income earned or costs incurred. Applying that meaning of testing, we would generally expect there to be relatively little production of items from the PPE during the testing phase. In addition, if the net proceeds from testing are greater than the costs of testing, then this might indicate that the PPE is now in the location and condition necessary to be capable of operating in the manner intended—determining when PPE is capable of operating in the manner intended is discussed further in paragraphs 31-38 of this paper.

23. The following provides an overview of the income and costs that an entity might earn or incur during the period over which PPE is brought to the location and condition necessary for it to be capable of operating as intended. This overview incorporates the staff recommendation regarding Clarification 1:

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

Objections to the previous tentative agenda decision

24. In July 2014, the Interpretations Committee issued a tentative agenda decision for this issue. In line with our staff recommendation, that tentative agenda decision also concluded that the amount of net proceeds deducted from the cost of PPE should not exceed the costs of testing. The Interpretations Committee did not finalise that agenda decision because of concerns raised in comment letters.
25. One of the main concerns raised was that the content of the agenda decision went beyond what many thought should be included within an agenda decision—ie the conclusions reached were interpretative in nature and had the potential to significantly affect existing practice for some industry sectors.
26. We think that our recommendation to propose amendments to IAS 16 addresses this aspect of the previous discussions of the Interpretations Committee. If the Interpretations Committee and the International Accounting Standards Board (‘the Board’) were to decide to propose and finalise such amendments, then the

amendments would be subject to all of the relevant due process steps. In addition, for example, the Interpretations Committee (and the Board) would consider transition for those entities that may have been applying a different approach before applying the amendments.

Clarification 2: How should an entity interpret ‘testing’?

27. Paragraph 17(e) of IAS 16 refers to ‘costs of testing whether the asset is functioning properly’. Accordingly, in determining the net proceeds and costs of testing to be included as part of the cost of PPE, an entity would identify the activities undertaken to assess whether the PPE is functioning properly.
28. In May 2015, the Interpretations Committee reached a consensus on the meaning of ‘functioning properly’. The Interpretations Committee concluded that, in assessing whether PPE is functioning properly, an entity assesses the technical and physical performance of the PPE. The assessment of functioning properly is *not* an assessment of the financial performance of the PPE, such as assessing whether the PPE can achieve the level of operating margin ultimately intended by management.
29. We think that assessing the technical and physical performance of the PPE means assessing whether the PPE is capable of producing items that can be sold in the ordinary course of business.
30. We agree with the previous conclusions of the Interpretations Committee in this respect—we think that including this clarification as to the meaning of testing in IAS 16 would provide helpful requirements for entities in identifying the net proceeds and costs of testing, as would be required by our staff recommendation on Clarification 1 in this paper.

Clarification 3: When is PPE capable of operating in the manner intended by management?

31. Paragraph 20 of IAS 16 states that ‘recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management’. Determining the point at which PPE is in that location and

condition is important—it is at that point that an entity stops accumulating costs capitalised as part of the cost of PPE and starts depreciating the PPE.

32. During previous discussions, some Interpretations Committee members noted that they have observed diversity in practice as to when entities determine when PPE is capable of operating in the manner intended, and asked that we explore this issue. Stakeholders also raised this issue during the development of the June 2014 amendments to IAS 16 and IAS 41 *Agriculture* regarding bearer plants.
33. The IFRS Discussion Group (‘the Group’) of the Canadian Accounting Standards Board (AcSB) also discussed this issue in December 2014¹. The Group observed that this is an issue, in particular, in the extractive industries. Entities sometimes uses a predetermined throughput/yield/capacity as a criterion to determine when PPE is capable of operating in the manner intended and that predetermined level can vary widely between different entities. The Group was of the view that clarifying when an asset is capable of operating in the manner intended would help to achieve consistent application.
34. We agree with that view. However, although related to the question submitted, we think that amending IAS 16 to clarify this issue is beyond the scope of that question. We also note that the Board discussed whether to address this issue when amending IAS 16 and IAS 41 for bearer plants, but decided not to do so.
35. Nonetheless, if the Interpretations Committee wishes to address this issue, we would suggest an approach that would include in IAS 16 some indicators of when PPE is capable of operating in the manner intended. The suggested indicators set out below have been developed on the basis of requirements already in IFRS Standards or would link to the staff recommendations in this paper. We would also intend those indicators to be just that—indicators that PPE is capable of operating in the manner intended—but they should not be applied as criteria or requirements. We would also clarify that these indicators are not an exhaustive list of indicators.

¹ <http://www.frascanada.ca/international-financial-reporting-standards/ifrs-discussion-group/search-past-meeting-topics/item81466.pdf>

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

Clarification 4: Should there be any disclosure requirements?

39. Independently of any of the above clarifications, the Interpretations Committee could decide to recommend adding a requirement to disclose the amount of net proceeds from selling items that an entity has deducted from the cost of PPE. The submitter also mentioned the lack of disclosure in this respect.
40. The benefits of adding such a disclosure requirement is that it would provide transparency about the existence of any material amounts deducted from the cost of PPE, and thus might highlight any diversity in applying IAS 16 in this respect.
41. Nonetheless, if the Interpretations Committee proceeds with Clarifications 1 and 2 in this paper, adding such a disclosure requirement might be viewed as unnecessary. This is because those clarifications might result in the amount of net proceeds deducted from the cost of PPE being immaterial for the vast majority of

entities. In this case, adding a disclosure requirement could be viewed as adding potential cost for little benefit because, even if immaterial, an entity may incur costs in justifying why it has not provided such a disclosure.

An alternative approach: prohibit the deduction of income from the cost of PPE

42. If the Interpretations Committee is unable to reach a consensus on Clarifications 1 and 2 in this paper, an alternative approach would be to amend IAS 16 to prohibit the deduction of income from the cost of PPE. This approach would address the diversity that has been observed in practice by changing the existing approach in IAS 16.
43. This is the approach that we understand is generally applied in practice by entities applying US GAAP. US GAAP does not explicitly allow or require an entity to deduct pre-commissioning revenue (including testing proceeds), except for some specific industry guidance that expressly permits the netting of proceeds (for example, pre-commissioning revenue for property developed for rental or sale). We understand that, in practice, entities deduct such pre-commissioning revenues from the cost of assets only if explicitly permitted to do so. So, for example, entities within the extractive industries recognise any pre-commissioning revenue in profit or loss.
44. The benefit of this approach is that it is more straight-forward than the approach suggested by Clarifications 1 and 2. This is because it would not require an entity to identify and distinguish the proceeds and costs of testing from any other income earned or costs incurred before PPE is capable of operating in the manner intended. In addition, the outcome of applying this approach may not be very different from applying Clarifications 1 and 2, because Clarifications 1 and 2 are intended to limit the amount of net proceeds that an entity deducts from the cost of PPE. We also understand that significant concerns have not been raised with the FASB about current practice that would suggest that a change is needed to the existing guidance in US GAAP.
45. Nonetheless, this approach would change the requirements of IAS 16, rather than clarify those requirements. Some of the wider concerns raised about Clarification

1 in paragraph 19(b) of this paper would be magnified applying this approach because an entity would recognise in profit or loss all income earned before PPE is capable of operating in the manner intended.

Staff recommendation and next steps

46. We recommend that the Interpretations Committee recommend to the Board that it should propose amendments to IAS 16 as follows:
- (a) Restrict the amount of net proceeds from selling items produced that an entity deducts from the cost of PPE to only those arising from testing, and clarify that the amount deducted should not exceed the costs of testing included as part of the cost of the PPE (**Clarification 1**).
 - (b) Clarify the meaning of testing—ie in assessing whether PPE is functioning properly, an entity assesses the technical and physical performance of the PPE, and not the financial performance of the PPE (**Clarification 2**).
47. We have mixed views about proposing amendments to IAS 16 to clarify when PPE is in the location and condition necessary for it to be capable of operating in the manner intended (**Clarification 3**). Although we can see benefits of doing so, we are not sure whether the indicators proposed would provide sufficient benefit in clarifying the requirements to outweigh the possible questions that might arise in understanding how to apply those indicators. On balance, we do not recommend Clarification 3, also considering that doing so goes beyond responding to the question submitted.
48. If the Interpretations Committee does not agree with the staff recommendation in paragraph 46 of this paper, then we recommend that the Interpretations Committee recommend to the Board that it should propose amendments to IAS 16 to prohibit the deduction of income from the cost of PPE (the alternative approach set out in paragraphs 42-45 of this paper).
49. We recommend the following regarding disclosure (**Clarification 4**):
- (a) If the Interpretations Committee decides to proceed with Clarifications 1 and 2 in this paper, we recommend not adding a disclosure requirement

regarding the net proceeds deducted from the cost of PPE. In this case, we think the benefit may not outweigh the potential costs.

- (b) If the Interpretations Committee decides not to proceed with those clarifications, then we recommend adding such a disclosure requirement to IAS 16 for the reason noted in paragraph 40 of this paper.

This disclosure requirement is not relevant if the Interpretations Committee decides to proceed with the alternative approach in this paper.

Next steps

- 50. If the Interpretations Committee agrees to propose amendments to IAS 16 by adopting either Clarifications 1 and 2 in this paper or the alternative approach, then we think that we should do the following:
 - (a) At the next Interpretations Committee meeting in May 2016, discuss transition relating to those amendments, including transition for first-time adopters of IFRS Standards.
 - (b) Having reached a consensus on transition, bring the Interpretations Committee's recommendations on the issue to a future Board meeting so that the Board can decide whether to proceed to propose amendments to IAS 16.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree with the staff recommendation to recommend to the Board that it propose amendments to IAS 16 as described in paragraph 46 of this paper?
2. If not, does the Interpretation Committee agree to recommend to the Board that it should propose amendments to IAS 16 to prohibit the deduction of income from the cost of PPE (the alternative approach in this paper)?
3. Does the Interpretation Committee wish to recommend to the Board to add a requirement to IAS 16 to disclose the net proceeds from selling items that an entity deducts from the cost of PPE?

Appendix A—suggestions made at the Interpretations Committee meeting in September 2015 that are not discussed in the main body of this paper

- A1. In September 2015, the Interpretations Committee directed staff to consider a cost allocation model for circumstances in which PPE and inventory are produced concurrently before the PPE is capable of operating in the manner intended.
- A2. In considering this, we note that IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* includes requirements for the allocation of costs when PPE and inventory are produced at the same time. That Interpretation has a narrow scope—it provides requirements only for stripping costs in the production phase of a surface mine. The requirements in IFRIC 20 are based on the principles for cost allocation for joint products in IAS 2.
- A3. We have not developed this suggestion further at this stage because:
- (a) we think that doing so would require some considerable time to develop. It would require, for example, consultation with the industry sectors most affected—those that use PPE that takes some time to bring to the location and condition necessary for it to be capable of operating in the manner intended.
 - (b) providing requirements in this respect goes significantly beyond the question submitted, and has the potential to delay the possible clarifications that we think could be made to respond to the question submitted.

Appendix B— overview of the previous discussions of the Interpretations Committee on this issue

- B1. In April 2014, the Interpretations Committee received a request to clarify the accounting for the net proceeds from selling items produced while testing an item of property, plant and equipment (PPE) under construction in the petrochemical industry. 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.
- B2. In July 2014, the Interpretations Committee issued a tentative agenda decision. That agenda decision indicated that an entity must recognise the amount by which net proceeds received exceed the costs of testing in profit or loss, and not deduct it against the cost of the PPE.
- B3. The Interpretations Committee received 10 responses to the tentative agenda decision. The majority of the respondents were concerned about the implications of the agenda decision for the extractives industry. One respondent stated that ‘the extractive industry approach to accounting for revenue earned before an asset is ready for its intended use (often referred to as pre-commissioning revenue) varies. The various treatments have evolved as a result of the way in which the relatively limited requirements in IFRS has been interpreted and applied and, in some instances, this has also been influenced by alternatives that originated in previous GAAPs. It is not clear how the Committee's tentative agenda decision will impact these treatments, if at all.’
- B4. In November 2014, the Interpretations Committee decided to add this item to its agenda to analyse the issue further. The Interpretations Committee thought that the scope should not be limited to specific industries, and suggested considering the following issues:
- (a) when the PPE is available for use;
 - (b) what costs qualify as costs of testing;
 - (c) how to treat proceeds in excess of the costs of testing;

- (d) how to account for other proceeds received (that are not testing) that are necessary to bring the PPE to that location and condition;
- (e) whether to require the disclosure of proceeds deducted from the cost of PPE; and
- (f) the applicability of IFRS 15 to the proceeds received.

B5. In January 2015, the Interpretations Committee observed that the analysis should focus on the meaning of ‘testing’ the PPE; the reference to proceeds in IAS 16 is made only in relation to testing. On this basis, the appropriate question is whether the activity that led to those proceeds was testing.

B6. In May 2015, the Interpretations Committee tentatively decided to develop an Interpretation on the meaning of testing, focussing on the meaning of ‘functioning properly’ in paragraph 17(e) of IAS 16. The Interpretations Committee considered that functioning properly reflects the technical and physical performance of the PPE, and not the financial performance of the PPE.

B7. In September 2015, the staff presented the draft Interpretation to the Interpretations Committee. The discussion at the meeting focussed on issues relating to the extractives industry. The Interpretations Committee did not reach any consensus and directed the staff to work on the following areas:

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