Appendix A—Extracts from Agenda Paper 12D prepared for the December 2017 IASB meeting—Summary of feedback on the proposed amendments to IAS 16

[…]

Feedback summary

A1. Many respondents either disagreed with, or expressed concerns about, the proposed amendments. Many of the respondents who disagreed acknowledged the need to address the accounting for the cost of PPE, but were of the view that a more comprehensive solution was required than the approach proposed by the Board in the amendments.

A2. Some respondents agreed with the proposed amendments. These respondents agreed with the Board's conclusion that the proposed amendments to prohibit deducting sales proceeds from the cost of an item of PPE would provide information that is more relevant to users of financial statements. A number of these respondents nonetheless expressed concerns that the amendments would not provide specific requirements on cost allocation.

A3. The main matters arising are summarised in this paper as follows:

(a) cost allocation;

(b) exclusion of depreciation;

(c) available for use;

(d) assessment of 'ordinary' activities;

(e) interaction with existing requirements;

(f) overall approach;

(g) transition; and

(h) other comments.

Cost allocation

A4. Many respondents said the requirement to identify costs that relate to items produced and sold before an item of PPE is available for use, and thus to distinguish those costs from other costs incurred before that date, would present significant practical challenges.

A5. Some respondents also disagreed with the observation in paragraph BC8 of the ED that the proposed amendments would require 'little more judgement beyond that already required to apply IFRS Standards'. These respondents said the proposed amendments would increase the judgements required, and therefore in their view would not eliminate diversity in practice. For example, one respondent said:

> Even if the proposed amendments would provide consistency in how revenue is recognised before an asset is available for its intended use, they would not reduce diversity in practice because more estimation and judgements would be required in assessing how costs should be allocated... [KPMG]

A6. A few respondents provided some additional information on (i) the practical challenges an entity would face and (ii) the additional judgements that would be required in allocating costs between the cost of items produced before PPE is available for use and the cost of construction of the PPE itself. The main challenges identified were as follows:

(a) entities would need to apply considerable judgement to determine what is normal capacity in order to allocate costs to the items produced and sold. Because the asset is still being constructed, entities may not be able to readily determine the asset's normal capacity or a relevant production measure in order to cost the output produced;

(b) entities would be required to analyse direct and indirect costs incurred during the testing period. For example, an entity would need to determine how much materials and labour to allocate between items sold and the PPE under construction. This would be a new judgement not previously required; and

(c) entities may not have a reliable or comprehensive costing system available before an item of PPE is available for use.

A7. Some respondents said, if the Board proceeds in the direction proposed by the amendments, additional requirements are required. In this respect, a few respondents said paragraphs BC9-BC11 of the ED were helpful and suggested including those paragraphs in IAS 16.

A8. Some of these respondents said, in the absence of additional requirements, this could result in increased diversity in practice due to the additional judgements that an entity would need to make. A comment from one respondent that is representative of similar comments received illustrates this:

> We think that if the IASB decides to proceed with this proposal to recognize proceeds from selling items produced before an asset is available for use in profit or loss, specific guidance is required to assist entities in determining the related costs to recognize in profit or loss. Otherwise, there would be diversity in how costs of goods sold and the related profit margin are determined. [Accounting Standards Board of Canada].

A9. A few respondents anticipated, however, that entities should have no significant difficulty in making such judgements:

> Although entities will still have to make judgements about the amount of cost to allocate against the sales proceeds, we think that the entities concerned will usually have a great deal of experience of making such judgements and should therefore have no difficulty in doing so. [Business Europe].

A10. Although many respondents encouraged the Board to provide further requirements on cost allocation, one respondent said, at a minimum, the Board should provide enhanced disclosure requirements in order to provide users with transparency of revenue and the cost of PPE.

Exclusion of depreciation

A11. Paragraph BC7(b) of the ED states that the Board observed that 'before an item of property, plant and equipment is available for use, the cost of producing any inventory excludes depreciation of that asset'. Paragraph BC11 of the ED states 'any consumption of an item of property, plant and equipment before it is available for use is likely to be negligible'.

A12. Many respondents expressed concern about excluding depreciation from the cost of items produced before the asset is available for use. These respondents observed this might result in a unit cost and margin that are not reflective of normal business operations, thereby potentially leading to less relevant information and the need to use alternative performance measures to explain fluctuations in margins.

A13. The comment below from one respondent – who expressed support 'in principle' for the proposed amendments – is representative of other similar comments on the proposed treatment of depreciation:

> This exclusion, in isolation, would result in a higher margin while the asset is under construction compared to when it is operational […] This change may impact the comparability of financial information period to period and between companies…' [BHP Billiton Limited]

A14. A few respondents said they could find no conceptual reason not to allocate depreciation to the cost of items produced before an item of PPE is available for use. In addition, some respondents disagreed with the Board's observation that any consumption of an item of PPE before it is available for use is likely to be negligible. These respondents said:

(a) if an entity generates material proceeds from selling items before an item of PPE is available for use, this might indicate the consumption of that asset is more than negligible;

(b) the Board's observation is not appropriate for items of PPE that take a long time to make available for use. This is particularly relevant in the extractive industry; and

(c) consumption of an item of PPE during the testing phase could be a significant cost to the entity if the useful life of the asset is short and the cost of developing the asset is significant.

A15. Nonetheless, although acknowledging the amounts may be other than negligible, a few respondents suggested entities could overcome this challenge. For example, one respondent said:

> Where the impact is considered to be material, we believe that existing disclosure requirements are sufficient to ensure such matters will be brought to the attention of readers. [Grant Thornton]

Available for use

A16. Paragraph 20 of IAS 16 states that 'recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management'. Determining the point at which that occurs is important—it is at that point that an entity stops accumulating costs in the carrying amount of the asset, and starts depreciating the asset.

A17. Paragraphs BC18-BC23 of the ED explain why the Board did not propose to clarify when an item of PPE is available for use.

A18. Many respondents said clarifying or developing further requirements on when an asset is available for use is fundamental to resolving the matter the Board is trying to address. Those respondents, however, did not provide suggestions on the approach the Board should take in doing this. Some respondents highlighted existing diversity in how entities determine when an item of PPE is available for use. They also said the existence of material proceeds might indicate that an item of PPE is already available for use. For example, one respondent said:

> Respondents believe that the reason entities were generating sales proceeds that exceeded costs of 'testing' is because entities were not correctly identifying the point at which the item of PPE is in the location and condition necessary for it to be

> capable of operating in the manner intended by management, and are rather identifying a later date […]. If additional guidance is provided on determining when items of PPE are available for use, respondents would not expect proceeds generated from testing to be material. [SAICA]

A19. Some respondents also said the proposed amendments could increase the risk of earnings management if the Board does not concurrently address when an asset is available for use. For instance, one respondent said:

> ESMA shares the concerns that the amendments may open up possibilities for earnings management if no guidance is provided regarding the point in time at which an asset is available for use and capitalisation of any testing costs shall end. Therefore ESMA encourages the IASB to provide additional guidance in this area. [ESMA]

A20. A few respondents said, although identifying when an asset is available for use is an area that warrants attention, improvements in financial reporting may be better achieved through improved application of the existing requirements, instead of proposing amendments in this respect.

Assessment of 'ordinary' activities

A21. Paragraph BC24 of the ED states 'if the asset is to be used in the entity's ordinary activities, there is no basis on which to conclude that inventories produced by the asset before it is available for use would not be output from the entity's ordinary activities. Consequently, proceeds from selling inventories produced would represent revenue within the scope of IFRS 15 *Revenue from Contracts with Customers*.'

A22. Many respondents disagreed with BC24 because, in their view:

(a) making an item of PPE available for use (including testing whether the asset is functioning properly) does not occur regularly and, accordingly, is not part of the entity's ordinary activities;

(b) the output produced from testing is different in nature from that produced when the asset is available for use. In some cases, the output from testing is not sold but may be scrapped or used as a sample; and

(c) testing an asset is not part of operating activities – rather, it is a step that is required before an asset is placed into operations.

A23. Some respondents said entities should not recognise sale proceeds during the testing phase (and any related production costs) in profit or loss. However, other respondents said an entity should recognise those proceeds in profit or loss, but distinguish them from revenue as defined in IFRS 15. This could be done either through disclosure or by presenting testing proceeds separately from revenue (eg as other income) in the statement of profit or loss.

A24. The Board considered proposing, but did not propose, additional disclosure requirements in the context of the proposed amendments. This is because the Board concluded that the existing requirements are sufficient to enable an entity to disclose relevant information (paragraphs BC24-BC26 of the ED). Several respondents explicitly agreed with this conclusion. However, one respondent disagreed:

> …IFRS 15 requires the disclosure of revenue from contracts disaggregated into categories […].It is not clear whether disaggregated information for the associated costs with this type of revenue should also be disclosed when they are deemed material. We note that there is no similar disclosure requirement for disaggregated information under IAS 2 *Inventories*. [CPA Canada]

Interaction with existing requirements

Paragraphs 16(b) and 21 of IAS 16

A25. Paragraph 16(b) of IAS 16 requires an entity to include in the cost of an item of PPE 'any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management'. Consistent with this requirement, paragraph 21 of IAS 16 requires an entity to recognise income and related expenses of incidental operations in profit or loss because ‘incidental operations are not necessary’ to make an item of PPE available for use.

A26. A few respondents said the proposed amendments might conflict with this requirement. This is because, in their view, the cost of producing items during the testing phase are necessary to make the item of PPE available for use and are directly attributable to that asset. One respondent said entities may need to revisit judgements made in assessing which costs are ‘directly attributable’ in the light of the proposed amendments.

Paragraph 22 of IAS 16 and paragraph 16 of IAS 2 Inventories

A27. A few respondents asked for further clarity on how an entity would assess what is meant by abnormal costs (such as wastage of materials, labour or other production costs) in the context of testing activities. Paragraph 16 of IAS 2 requires an entity to exclude from the cost of inventories costs such as abnormal amounts of wasted materials, labour or other production costs. Paragraph 22 of IAS 16 also requires an entity to exclude such abnormal costs from the cost of a self-constructed asset. Some of these respondents suggested an entity capitalise such costs because these costs are necessary to make the item of PPE available for use.

IFRS 6 Exploration for and Evaluation of Mineral Resources

A28. A few respondents noted the proposed amendments would apply only to assets in the scope of IAS 16. These respondents suggested the Board clarify whether the requirements would also apply to proceeds received during the exploration and evaluation phase. Another respondent said this clarification was important. This is because the transitional relief provided in the proposed amendments would not otherwise be available to entities applying the requirements in IAS 16 by analogy to exploration and evaluation assets within the scope of IFRS 6.

IAS 23 Borrowing Costs

A29. For funds borrowed specifically to obtain a qualifying asset, IAS 23 requires an entity to determine the borrowing costs eligible for capitalisation as the actual borrowing costs less any investment income on the temporary investment of those borrowings. Similar to the alternative view expressed in paragraph AV6 of the ED, some respondents said the proposed amendments would conflict with the requirements in IAS 23.

Overall approach

A30. Many respondents questioned the overall direction of the project. They suggested the Board reconsider the effect of the proposed amendments and whether the proposed amendments would improve financial reporting.

A31. Some respondents said the potential costs of amending IAS 16 as proposed could outweigh the expected benefits and, accordingly, suggested the Board should not finalise the amendments as proposed. This is because:

(a) the proposed amendments would affect more than a few industries. These respondents said the proposed amendments could affect all industries for which it takes a long time to make an item of PPE available for use. This could have unintended consequences for any entity receiving proceeds during the testing phase of an item of PPE, but for which the proceeds are insignificant. Some other respondents, however, said the proposed amendments are relevant only to a few industries and, accordingly, they did not see sufficient benefit to justify the costs of standard-setting. Some of these respondents also said the existing requirements are well understood in the industries that would be most affected by the amendments;

(b) the proposed amendments could increase diversity in practice (as described in paragraphs A4-A8 of this paper) and also potentially increase the risk of earnings management (as described in paragraph A19 of this paper); and

(c) the proposed amendments would be burdensome to implement and could result in significant implementation costs (as described in paragraph A6 of this paper).

A32. One respondent suggested the Board undertake an effects analysis to confirm the expected benefits of the proposed amendments would outweigh the costs.

A33. Many respondents suggested the Board undertake further work to address the problem more comprehensively, instead of the more discrete approach taken. These respondents suggested there were a number of overlapping questions that the Board should address. In this respect, several respondents asked the Board to clarify the 'unit of account' –ie what is the asset or component of the asset—that an entity assesses in the context of being available for use.

A34. Conversely, some respondents suggested the Board limit the scope of any project to more narrowly focus on the request submitted to the Committee. Some of these respondents suggested confirming explicitly that the requirements in paragraph 17(e) of IAS 16 apply only to proceeds from testing activities, and some others suggested clarifying more precisely the nature of testing activities. One respondent also suggested amending IAS 16 so that an entity would be required to recognise against the cost of an item of PPE all proceeds received before it is available for use.

A35. A few respondents said the Board should not amend IAS 16—instead it should require an entity to provide specific disclosures when it receives material amounts of sale proceeds before an asset is available for use.

A36. One respondent said the proposed amendments could have a significant and undesirable effect on entities operating in the mining industry—in its view, this highlights the need for the Board to undertake a comprehensive project on extractive industries.

Transition

A37. A few respondents commented on the proposed transition requirements. These respondents said notwithstanding the transition relief provided, applying the proposed amendments would still be burdensome. Accordingly, they suggested prospective application of the proposed amendments. Two respondents suggested the Board provide transition relief for first-time adopters.

A38. The proposed amendments did not suggest an effective date. One respondent said the mandatory effective date should be no earlier than 1 January 2020. This is because of the large-scale nature of projects to which the proposed amendments would apply and the significant implementation effort that could be required to implement the proposed amendments.

Other comments

A39. A few respondents said the proposed clarification of 'testing' is helpful, whilst two respondents suggested the need for further clarification.

A40. Some asked for clarity as to the scope of the proposed amendments, for example whether the proposed amendments would apply to items that do not meet the definition of inventory in IAS 2.

A41. Two respondents asked for clarity about the consequential amendment proposed to IFRIC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine*.

A42. A few respondents also said the proposed amendments might affect some business decisions, such as deciding whether and when to invest in new equipment or technology.

[…]

Appendix B—Summary of feedback from ASAF members in July 2017

B1. ASAF members were asked for their preliminary views on the proposed amendments to IAS 16 *Property, Plant and Equipment* in the [ED]…

B2. Some ASAF members had not encountered the issue of how to account for the proceeds before intended use in their jurisdictions, whilst others indicated the issue is prevalent for some industry sectors such as extractives. The ANC representative suggested an effects analysis to assess whether there is a need for standard-setting to address the issue.

B3. A number of ASAF members indicated support for the proposed amendments. The FASB representative highlighted that the proposed amendments would result in requirements similar to those in US GAAP.

B4. The OIC representative agreed that an entity should recognise as revenue proceeds from selling items produced before an item of PPE is available for use.

B5. The AOSSG representative, however, said that the cost of items produced and sold before an item of PPE is available for use is a directly attributable cost as described in paragraph 16(b) of IAS 16. Therefore, the proposed amendment might create a conflict within IAS 16.

B6. ASAF members also suggested the Board consider the following:

(a) the AASB/NZASB, ANC, OIC, AOSSG and SAFRC representatives mentioned there might be practical difficulties in allocating costs between (i) those that relate to items produced and sold before an item of PPE is available for use, and (ii) those that an entity includes as part of the cost of the asset. Some members suggested highlighting that an entity should consider the requirements in IAS 2 *Inventories* when allocating costs. The SAFRC representative also suggested considering (i) the appropriate unit of account and (ii) when an item of PPE is available for use (an approach that the Board has already considered and is explained in the Basis for Conclusions on the ED);

(b) the AcSB representative noted that disclosure would be particularly important. Investors might be misled if they were to use the proceeds and margin generated from testing activities as a prediction of what an entity's future revenue and margin will be when the item of PPE is available for use; and

(c) the EFRAG representative questioned the need to provide a definition of testing activities as part of this amendment.

B7. The EFRAG representatives mentioned that, in its draft comment letter, EFRAG has asked its stakeholders whether a similar question arises regarding intangible assets.

Appendix C—Summary of feedback from GPF members in October 2017

C1. The staff sought feedback from GPF members on the proposed narrow-scope amendments to IAS 16 *Property, Plant and Equipment* published in June 2017. […]

General feedback on the [ED]

C2. GPF members expressed mixed views on the proposed amendments to IAS 16. One member explicitly agreed with the proposed amendments. Nonetheless, he said a better solution would be to clarify when an asset is available for use. Another member explicitly disagreed with the proposed amendments and said that the existing requirements of IAS 16 should remain unchanged. One member questioned whether the benefits from the change would outweigh the costs, especially because, in the member's experience, proceeds are generally not material. That member stated that dealing with such changes would be unwelcome when entities are implementing several new IFRS Standards.

Materiality of proceeds and industries affected

C3. Most of the GPF members reported that proceeds from testing and other activities before an item of PPE is available for use are generally not material. Some members said that if proceeds are material, entities may need to revisit the assumptions about whether the asset is available for use or whether the testing period has been completed. One member said that although the proceeds may be insignificant, the related testing costs could be material (for instance, because of significant 'set-up' costs).

C4. Two GPF members said the amendments would affect companies operating in the petrochemical and technological industries. The amendments could also affect industries that require government approval before using an asset.

Allocation of costs between the cost of inventory for the items sold and the cost of the asset

C5. Several members said the allocation of costs would be complex and entities would be required to apply significant judgement. This is mainly because entities may not have developed standard costs for items produced when the asset is being developed. One member said that additional complexities could arise from the interaction of these requirements with those set out in IFRS 15 *Revenue from Contract with Customers* for costs to fulfil a contract.

C6. One member acknowledged that the proposed amendments do not create any new judgements; however he said that the Board should clarify the interaction between the cost allocation requirements in IAS 16 and those in IAS 2 *Inventories*.

C7. Some members were concerned that the cost would not include depreciation of the asset. They said the cost of items sold before the asset is available for use might not be consistent with the cost of items sold afterwards, distorting reported margins.

C8. Some members said the proposed amendments might affect an entity's decision to sell items produced before an asset is available for use. For example, an entity could decide not to sell an item produced during the testing phase if doing so would result in the recognition of a loss or would affect the entity's key performance indicators for a particular period. One member said the amendments would clarify that an entity applies the requirements of IAS 2, regardless of whether it sells the item. However, another member said that the item produced may not meet the definition of inventory—particularly if an entity decides to keep or scrap the item.

C9. Two members said the cost allocation requirements focussed on inventory produced and suggested expanding the wording to cover other types of output that may be generated by an item of PPE (such as service revenue).

Definition of testing activities

C10. One member said the lack of a definition for testing activities had created practical issues and had led to diversity in practice.

C11. Two members said the proposed wording was unclear about whether the assessment refers to the asset:

(a) being capable of producing the intended output (regardless of whether the asset is generating the intended level of output); or

(b) operating as intended by management (which could include a consideration of whether the asset is generating the intended level of output).

C12. Another member said the proposed definition fails to cover all the activities that it should cover (for example, research and development).