STAFF PAPER

October 2019

IASB Meeting

Project	**Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)**
Paper topic	Transition, Effective Date and Due Process

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Introduction and purpose

1. In June 2019, the International Accounting Standards Board (Board) decided to proceed with finalising its proposed amendments to IAS 16 *Property, Plant and Equipment* published in the Exposure Draft *Property, Plant and Equipment—Proceeds before Intended Use* (Exposure Draft), with some modifications. The Exposure Draft proposed to prohibit deducting from the cost of an item of property, plant and equipment (PPE) any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, applying the proposed amendments to IAS 16, an entity would recognise sales proceeds in profit or loss.

2. The purpose of this paper is to:
   (a) ask the Board whether it agrees with our recommendation with respect to transition and the effective date for the amendments to IAS 16;
   (b) set out the steps in the IFRS Foundation Due Process Handbook (Due Process Handbook) that the Board has taken in developing the amendments to IAS 16;
   (c) ask the Board to confirm that it is satisfied that it has complied with the due process requirements;

(d) seek the Board's permission to begin the balloting process for the amendments to IAS 16; and

(e) ask whether any Board member intends to dissent from the publication of the amendments to IAS 16.

Structure of the paper

3. This paper is structured as follows:

   (a) Summary of the amendments (paragraphs 5–7);

   (b) Transition and effective date (paragraphs 8–27);

   (c) Due process steps and permission for balloting (paragraphs 28–36):

      (i) re-exposure;

      (ii) intention to dissent;

      (iii) confirmation of due process steps; and

      (iv) proposed timetable for balloting and publication.

4. This paper includes two appendices:

   (a) Appendix A—Extract from the Basis for Conclusions on the Exposure Draft; and

   (b) Appendix B—Actions taken to meet the due process requirements.

Summary of the amendments

5. Paragraph 16(b) of IAS 16 states that the cost of an item of PPE includes any costs directly attributable to bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management[1]. Paragraph 17 of IAS 16 specifies examples of directly attributable costs. Paragraph 17(e) identifies as one such example the cost of testing whether the asset is functioning properly, after

[1] For ease of reference, this paper uses the phrases 'available for use' or 'intended use' to describe the point in time at which an item of PPE is in the location and condition necessary for it to be capable of operating in the manner intended by management.

deducting the net proceeds from selling any items produced while making the asset available for use.

6. The proposed amendments to IAS 16 would:

   (a) prohibit deducting from the cost of an item of PPE any proceeds from selling items produced before the asset is available for use (sales proceeds). Consequently, an entity would recognise such sales proceeds, together with the costs of producing those items (production costs), in profit or loss applying IFRS Standards.

   (b) clarify the meaning of ‘testing’ in paragraph 17(e)—ie when testing whether an item of PPE is functioning properly, an entity assesses the technical and physical performance of the asset, and not its financial performance.

7. The Board tentatively decided to finalise those proposed amendments. Furthermore, in response to feedback, the Board also tentatively decided:

   (a) to require an entity to identify and measure production costs applying the measurement requirements in paragraphs 9–33 of IAS 2 *Inventories*;

   (b) to develop neither presentation nor disclosure requirements for the sale of items that are part of an entity’s ordinary activities; and

   (c) for the sale of items are not part of an entity’s ordinary activities (and to which an entity does not apply IFRS 15 *Revenue from Contracts with Customers* and IAS 2), to require an entity to:

      (i) disclose separately the sale proceeds and related production costs recognised in profit or loss; and

      (ii) specify the line item(s) in the statement of profit or loss and other comprehensive income that include(s) the sale proceeds and related production costs.

Transition and effective date

Transition

Entities already applying IFRS Standards

Proposal in the Exposure Draft

8. The Board proposed requiring entities to apply the amendments retrospectively only to items of PPE made available for use on or after the beginning of the earliest period presented in the financial statements in which an entity first applies the amendments. Applying this approach, an entity would recognise the cumulative effect of initially applying the proposed amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of that earliest period presented.

9. Appendix A to this paper reproduces paragraphs BC27–BC28 of the Exposure Draft, which outline the Board's considerations in this respect.

Respondents' comments

10. Only a few respondents commented on the proposed transition requirements. They said notwithstanding the proposed transition relief, applying the proposed amendments would be burdensome—it could result in significant costs in some instances because entities might be required to collect data for sales proceeds and production costs over several years. One respondent also said the amendments might lead to revisions to the profitability of some ongoing projects for which investment decisions had already been made.

11. Those respondents suggested applying the amendments prospectively. Not all respondents explained what they meant by prospective application; however, two respondents suggested that the Board require an entity to apply the proposed amendments only to items of PPE that an entity begins testing on or after the effective date of the amendments. Accordingly, an entity would not apply the amendments to items of PPE (a) made available for use before the effective date (including those made available for use during comparative periods), or (b) for which testing has begun before the effective date.

Staff analysis and recommendation

12. In developing the proposed transition requirements, the Board specifically considered the costs of implementing the proposed amendments. As explained in paragraph BC27(c) of the Exposure Draft (see Appendix A to this paper), the proposed transition relief aims to reduce the burden on entities by limiting the number of items of PPE that an entity would be required to reassess, and yet achieving consistent application of the amendments for all periods presented.

13. We note that the amendments are expected to provide users of financial statements with a faithful representation of both the cost of an item of PPE and of an entity's total revenue (or income). Crediting sales proceeds against the cost of an item of PPE might have a pervasive and long-term effect on an entity's financial statements by reducing the cost of that item of PPE to an amount lower than it would otherwise be.

14. We think the transition requirements proposed in the Exposure Draft appropriately balance the need for improved financial reporting and the implementation costs of the amendments. Providing further relief by requiring or permitting entities to apply the amendments prospectively only to items of PPE for which an entity begins testing on or after the effective date could significantly reduce the expected benefits of the amendments. In particular, it could (a) hinder comparability for some time after the effective date, and (b) potentially be confusing for users of financial statements. This is because an entity might account for sales proceeds in periods after the effective date differently depending on the date on which the entity had begun the testing of an item of PPE. We also note that respondents did not provide information in respect of transition beyond that previously considered by the Board in developing the proposals.

15. Accordingly, we recommend confirming the proposed transition requirements—ie that an entity applies the amendments retrospectively only to items of PPE made available for use on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments.

First-time adopters

Proposal in the Exposure Draft

16. The Board proposed no specific transition relief for first-time adopters. Paragraph BC29 of the Exposure Draft outlines the Board's considerations in this respect and states:

> BC29 In relation to transition for first-time adopters, the Board noted the following:
>
> (a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides a deemed cost exemption for property, plant and equipment (paragraphs D5–D7 of IFRS 1). That exemption allows an entity to measure an item of property, plant and equipment at the date of transition to IFRSs at its fair value, and to use that fair value as its deemed cost. Additionally, there are specific deemed cost exemptions for entities with particular oil and gas properties (paragraph D8A of IFRS 1), and for entities holding items of property, plant and equipment used in operations subject to rate regulation (paragraph D8B of IFRS 1).
>
> (b) apart from the exemptions described above, IFRS 1 does not exempt a first time adopter from the requirements in IAS 16. Accordingly, if a first-time adopter does not apply the deemed cost exemptions in IFRS 1, it would apply all of the requirements in IAS 16 retrospectively. The Board concluded that there would be little benefit in providing a first-time adopter with relief from applying these amendments when it would have to apply all the other requirements in IAS 16.

Respondents' comments

17. Two respondents suggested providing first-time adopters with the same transition relief as that provided to entities already applying IFRS Standards—ie that first-time adopters be required to apply the amendments retrospectively only to items of PPE made available for use on or after the beginning of the earliest period presented. The respondents said applying the amendments retrospectively could be burdensome—one of these respondents said this could particularly be the case in situations in which

entities might not need to use the deemed cost exemption because of no significant differences between IFRS Standards and previous GAAP other than these amendments.

Staff analysis and recommendation

18. We continue to think there would be little benefit in providing a first-time adopter with the same relief as provided to entities already applying IFRS Standards. As explained in paragraph BC29(b) of the Exposure Draft, if an entity does not apply the deemed cost exemptions, it would have to apply all the requirements in IAS 16 retrospectively—including the measurement requirements of that Standard. We have not received information that, in our view, would justify a specific exemption only in respect of these amendments.

19. Accordingly, we recommend providing no specific transition relief for first-time adopters in respect of these amendments.

Questions 1 and 2 for the Board
1. **Transition requirements for entities already applying IFRS Standards**—Does the Board agree with our recommendation to require entities to apply the amendments retrospectively only to items of PPE made available for use on or after the beginning of the earliest period presented? 2. **Transition requirements for first-time adopters**—Does the Board agree with our recommendation to provide no specific transition relief for first-time adopters in respect of the amendments?

Effective date

20. The Board did not propose an effective date, but proposed that earlier application be permitted.

21. One respondent said the Board should allow a long transition period because the proposed amendments could affect large-scale projects.

Staff analysis and recommendation

22. Paragraph 6.35 of the Due Process Handbook explains that the mandatory effective date of any amendment date is set so that (a) jurisdictions have sufficient time to

incorporate the new requirements into their legal systems and (b) those applying IFRS Standards have sufficient time to prepare for the new requirements.

23. The Board generally allows at least 12 to 18 months between the publication of a new Standard or amendment and its mandatory effective date.

24. If the Board agrees with our recommendations set out in this paper, we expect the Board to issue the amendments during the first quarter of 2020.

25. The amendments are narrow in scope and would:

    (a) affect the measurement of only items of PPE that take time to make available for use and for which items are produced and sold during that time, ie a limited population of items in an entity's financial statements. If the Board were to agree with our recommendation relating to transition (see paragraph 15 of this paper), an entity would apply the amendments retrospectively only to some items of PPE—those that have been made available for use, or are in the process of being made available for use, from the beginning of the earliest period presented when first applying the amendments.

    (b) change only some aspects of the measurement of any such items. This is because an entity would need to restate the measurement of such items of PPE only for sales proceeds and production costs. We expect the amount and frequency of such sales proceeds and production costs to be limited because the asset is not yet available for use.

26. We think that entities would have sufficient time to apply the amendments if the Board were to set an effective date of 1 January 2022—ie approximately 21 months after the end of the first quarter of 2020. Accordingly, we recommend that the Board require entities to apply the amendments to annual periods beginning on or after 1 January 2022.

27. We see no reason to prevent entities from applying the amendments to an earlier period if they wish to do so. Accordingly, we recommend that the Board also permit earlier application of the amendments.

Question 3 for the Board
3. Effective date for the amendments to IAS 16—Does the Board agree with our recommendation to require entities to apply the amendments to annual periods beginning on or after 1 January 2022, with earlier application permitted?

Due process steps and permission for balloting

Re-exposure

28. Paragraphs 5–7 of this paper summarise the amendments to IAS 16 including any modifications the Board tentatively decided to make to the amendments proposed in the Exposure Draft. In the light of these modifications, we considered the requirements in paragraphs 6.25–6.29 of the Due Process Handbook to assess whether the Board should re-expose the amendments to IAS 16.

29. The Board considered feedback in the 72 comment letters received on the Exposure Draft. We also contacted, and obtained input from, a number of stakeholders to better understand their comments and assess the possible ways forward on this project[2]. The modifications discussed in paragraph 7 of this paper respond to concerns raised on the Exposure Draft—Agenda Papers 12B and 12C of the Board's November 2018 meeting include a detailed description and analysis of those concerns. We think the modifications do not constitute fundamental changes on which respondents have not had the opportunity to comment. In particular, the modifications:

    (a) respond to comments from respondents regarding production costs by requiring an entity to identify and measure production costs in the same way that it does inventory (by applying the requirements in IAS 2); and

    (b) help users of financial statements identify sales proceeds and production costs in the period before an item of PPE is available for use by requiring an entity to disclose those amounts in particular situations.

30. We also think re-exposure would not reveal any concerns not already considered by the Board. We note that the Board had identified most of these concerns before

[2] See paragraph 17 of Agenda Paper 12B for the November 2018 Board meeting.

publishing the Exposure Draft and had discussed them in the Basis for Conclusions to the Exposure Draft. For example:

(a) paragraphs BC8–BC10 of the Exposure Draft discussed the Board's considerations regarding production costs; and

(b) paragraphs BC18–BC23 of the Exposure Draft explained why the Board decided not to clarify when an item of PPE is available for use.

31. Accordingly, we recommend finalising the amendments to IAS 16 without re-exposure.

Intention to dissent

32. In accordance with paragraph 6.23 of Due Process Handbook, we are asking whether any Board member intends to dissent from the amendments to IAS 16.

33. One Board member dissented from the Exposure Draft[3]. Any Board members who intend to dissent from the amendments are asked to make their intention known at this meeting.

Confirmation of due process steps

34. We think the Board has undertaken all the due process activities identified as being required in the Due Process Handbook and hence is able to finalise the amendments. Appendix B to this paper summarises the due process steps taken in developing the amendments to IAS 16. The applicable due process steps to date for issuing the amendments have been completed.

35. We request permission to start the balloting process if the Board is satisfied that (a) it has been provided with sufficient analysis, and (b) has undertaken appropriate consultation and due process to support issuing the amendments.

[3] Paragraphs AV1–AV11 of the Exposure Draft include the Board member's alternative view.

Proposed timetable for balloting and publication

36. The balloting process for the amendments to IAS 16 will commence in the near term, with the amendments planned for issuance in the first quarter of 2020.

Questions 4–6 for the Board
4. **Re-exposure**—Does the Board agree with our recommendation in paragraph 31 of this paper not to re-expose the amendments to IAS 16?
5. **Dissent**—Does any Board member intend to dissent from the issuance of the amendments to IAS 16?
6. **Permission to ballot**—Is the Board satisfied that it has complied with the applicable due process requirements and that it has undertaken sufficient consultation and analysis to begin the balloting process for the amendments to IAS 16?

Appendix A—Extracts from the Basis for Conclusions on the Exposure Draft

Transition requirements

Entities that already apply IFRS Standards

BC27 The Board considered the following in relation to transition:

(a) the proposed amendments to IAS 16 are narrow in scope and are expected to mainly affect a few industries, such as the extractive and petrochemical industries. For most entities, output produced before property, plant and equipment is available for use is not expected to be material. Consequently, there might be little need for transition requirements beyond those in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

(b) if an entity is required to apply the amendments retrospectively, it would recalculate the carrying amount of property, plant and equipment at the beginning of the earliest period presented when first applying the amendments. In recalculating that carrying amount, an entity would be required to go back to the initial recognition of each relevant item of property, plant and equipment to ascertain whether it deducted from the cost of the asset proceeds from selling items produced before the asset was available for use.

(c) entities affected by the amendments are likely to find it burdensome to apply the amendments retrospectively, especially for items of property, plant and equipment constructed many years ago. A less burdensome approach would require application of the amendments only for items of property, plant and equipment made available for use from the beginning of the earliest period presented when first applying the amendments. This approach would achieve consistent application of the amendments for all periods presented, but limit the number of assets an entity is required to reassess.

BC28 On the basis of the above factors, the Board concluded that the benefits of retrospective application applying IAS 8 might be outweighed by the costs. Consequently, the Board proposes retrospective application of the proposed amendments only to items of property, plant and equipment made available for use from the beginning of the earliest period presented when first applying the amendments. An entity would not apply the proposed amendments to items of property, plant and equipment made available for use before that date.

Appendix B—Actions taken to meet the due process requirements

Step	Required / Optional	Actions
Consideration of information gathered during consultation		
The Board posts all of the comment letters that are received in relation to the Exposure Draft on the project pages.	Required	All comment letters received by the Board (72 comment letters) have been posted on the project website here: https://www.ifrs.org/projects/work-plan/property-plant-and-equipment-proceeds-before-intended-use/comment-letters-projects/ed-property-plant-and-equipment/#comment-letters
Board and IFRS Interpretations Committee (Committee) meetings are held in public, with papers being available for observers. All decisions are made in public sessions.	Required	The Board discussed the summary of feedback from comment letters at its 2017 December meeting (see Agenda Paper 12D *Summary of feedback*). The Board considered our analysis and recommendations at its November 2018 (see Agenda Papers 12B *Feedback analysis* and 12C *Project direction*) and June 2019 meetings (see Agenda Papers 12 *Finalisation of the proposed amendments*). The staff papers are publicly available. The Committee also discussed the analysis of feedback at its June 2018 meeting (see Agenda Paper 7 *Analysis of feedback on the proposed amendments to IAS 16*). Committee members provided their advice to the Board on the possible ways to move forward on the project. The project webpage has up-to-date information about all technical papers related to the project: https://www.ifrs.org/projects/work-plan/property-plant-and-equipment-proceeds-before-intended-use/#project-history
Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or ongoing associated costs.	Required	The Board considered the likely effects of the amendments when it discussed the possible ways forward for this project at its meeting in November 2018. See Agenda Paper 12C of that meeting for further details.
Round-table and outreach meetings to promote debate and hear views on proposals that are published for public comment	Optional	These amendments were discussed with (i) GPF members at the October 2017 GPF meeting and (ii) ASAF at its July 2017 and July 2018 meetings. In addition, we performed informal one-to-one meetings with some users of financial statements, standard-setters, regulators, audit firms and preparers to obtain (i) their views on various aspects of the Exposure Draft and on the possible ways forward for the project, and (ii) clarifications about comments made in comment letters.

Finalisation		
Due process steps are reviewed by the Board.	Required	This step will be met by this Agenda Paper.
Need for re-exposure of a Standard is considered.	Required	Paragraphs 28-31 of this paper discuss re-exposure. We recommend the Board not re-expose the amendments.
The Board sets an effective date for the Standard, considering the need for effective implementation, generally providing at least one year.	Required	Paragraphs 20-27 of this paper discuss the effective date. We recommend an effective date of 1 January 2022.
Drafting		
Drafting quality assurance steps are adequate.	Required	To be completed in due course. The Translations, Taxonomy and Editorial teams will review the pre-ballot draft. We intend to send a draft of the amendments to external parties for review before finalisation. This process allows external parties to review and report back to the staff on the clarity and understandability of the draft.
Publication		
Press release to announce the final Standard.	Required	To be completed in due course. A press release will be published with the amendments.
A Feedback Statement is provided which provides high level executive summaries of the Standard and explains how the Board has responded to the comments received.	Required	Not considered necessary because these amendments are narrow in scope. According to paragraph 6.38 of the Due Process Handbook, a Feedback Statement is required for all new IFRS Standards and major amendments. The Basis for Conclusions on the amendments would explain how the Board has responded to comments received.
Standard is published.	Required	The amendments will be made available on our website when published.