International Financial Reporting Standard

Property, Plant and Equipment: Proceeds before Intended Use

May 2020

BASIS FOR CONCLUSIONS – AMENDMENTS

[IAS 16]

[Related to AASB 2020-3]

Amendments to the Basis for Conclusions on IAS 16 *Property, Plant and Equipment*

This Basis for Conclusions accompanies, but is not part of, IAS 16.

After paragraph BC16, new headings and paragraphs BC16A–BC16R are added. After paragraph BC36A, a new heading and paragraphs BC36B–BC36D are added.

Property, Plant and Equipment—Proceeds before Intended Use (2020 amendments)

Background

BC16A Before the 2020 amendments, paragraph 17(e) specified that directly attributable costs included the costs of testing whether an asset was functioning properly, after deducting the net proceeds from selling items produced while bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The Board received a request asking whether:

(a) the proceeds specified in paragraph 17(e) related only to items produced while testing; and

(b) an entity was required to deduct from the cost of an item of property, plant and equipment any such proceeds that exceeded the costs of testing.

BC16B The Board's research indicated that different entities had applied the requirements in paragraph 17(e) differently. Some entities deducted only proceeds from selling items produced while testing; others deducted the proceeds of all sales until an asset was in the location and condition necessary for it to be capable of operating in the manner intended by management (ie available for use). For some entities, the proceeds deducted from the cost of an item of property, plant and equipment could be significant and could exceed the costs of testing.

Recognising proceeds and related cost in profit or loss

BC16C After considering the findings in paragraph BC16B, the Board decided to amend paragraph 17 to prohibit an entity from deducting from the cost of an item of property, plant and equipment the proceeds from selling items produced before that asset is available for use (proceeds before intended use).

BC16D In the Board's view, the amendments will improve financial reporting. Proceeds before intended use and related cost meet the definition of income and expenses in the *Conceptual Framework for Financial Reporting*. Those items of income and expenses reflect an entity's performance for the period and they should, therefore, be included in the statement of profit or loss.

BC16E The previous requirement to offset proceeds against the cost of an item of property, plant and equipment reduced the usefulness of financial statements to users of financial statements. This is because the previous requirement resulted in an entity including amounts that did not faithfully represent:

(a) its performance. Offsetting proceeds against the cost of an asset understates an entity's revenue (or income) in the period. Moreover, doing so could also have a pervasive and long-term effect on an entity's performance when the asset has a long useful life. Offsetting proceeds decreased the depreciable amount of such an asset and, consequently, reduced the depreciation charge recognised as an expense over the asset's useful life.

(b) the cost of an item of property, plant and equipment. Offsetting proceeds could result in the carrying amount of the asset understating its cost. This, in turn, could reduce the usefulness of financial metrics, such as return on assets, that use the asset's carrying amount.

BC16F The Board considered suggestions that recognising proceeds before intended use and related cost in profit or loss might not provide useful information to users of financial statements. Those holding this view suggested that such sales proceeds—and the related margin—may have little predictive value because:

(a) the sales proceeds are generally non-recurring and are not necessarily an output of an entity's ordinary activities; and

(b) the cost of items produced would not include depreciation of the item of property, plant and equipment—because depreciation of that asset begins when it is available for use.

BC16G In the Board's view, however, the fact that the proceeds may have little predictive value was not a compelling argument for excluding them from profit or loss—the statement of profit or loss includes other items of income or expenses that may have little predictive value but the inclusion of which nonetheless provides useful information to users of financial statements. Recognising proceeds before intended use and related cost in profit or loss will result in entities reporting amounts that more faithfully represent their performance and financial position. It will also have confirmatory value about an entity's performance. The disclosure requirements in paragraph 74A(b) will highlight such proceeds and cost for users of financial statements (see paragraphs BC16L–BC16M).

Measuring the cost of items produced

BC16H When it exposed draft amendments for comment, the Board proposed no requirements on measuring the cost of items produced before an item of property, plant and equipment is available for use. A number of respondents to the Board's draft amendments suggested that the Board develop such requirements. They said measuring the cost of items produced could require extensive judgement, which in turn could result in differences in how entities measure that cost. Respondents' views differed on how prescriptive any requirements should be—some suggested the Board develop only high-level principles while others suggested providing detailed application guidance.

BC16I After considering this feedback, the Board decided to require an entity to apply IAS 2 *Inventories* in measuring the cost of items produced. The Board made this decision because:

(a) IAS 2 sets out a framework for measuring cost without being overly prescriptive; and

(b) an entity would already be required to apply IAS 2 in measuring cost if the entity were to determine that the sale of items produced is an output of its ordinary activities—in this case, the items produced would meet IAS 2's definition of inventories. It would be useful to apply the same requirements to the cost of items produced irrespective of whether the sale of those items is an output of an entity's ordinary activities.

BC16J In addition, the Board concluded that the judgement involved in measuring the cost of items produced is not substantially different from judgements already required when applying IAS 2 and other IFRS Standards in measuring cost, in particular for assets that take a substantial period of time to get ready for their intended use (for example, measuring the cost of abnormal amounts of wasted materials and labour, allocating costs to joint products or measuring the cost of operations incidental to the construction or development of an item of property, plant and equipment).

BC16K The Board acknowledged the amendments might result in implementation costs for some entities. However, the Board concluded that a requirement to measure the cost of items produced applying IAS 2 would not impose costs that outweigh the usefulness of the information provided.

Presentation and disclosure

BC16L The Board developed the requirements in paragraph 74A(b) to provide users of financial statements with information about the sale of items that are not an output of an entity's ordinary activities. Users of financial statements said information that enables them to identify proceeds before intended use, and to understand how those proceeds and related cost affect an entity's performance, would be useful.

BC16M The Board decided not to develop similar requirements for sales of items that are an output of an entity's ordinary activities because the requirements of IFRS 15 *Revenue from Contracts with Customers* and IAS 2 would apply to the proceeds from such sales and related cost.

BC16N Measuring the cost of items produced could necessitate the use of estimates and judgement. However, the Board decided not to add disclosure requirements in this respect because other IFRS Standards such as IAS 1 *Presentation of Financial Statements* already require the disclosure of information about estimates and judgements.

BC16O The Board also decided not to develop specific presentation requirements for proceeds before intended use and related cost because IAS 1 already includes relevant requirements, for example on:

(a) the offsetting of income and expenses; and

(b) the presentation of income and expenses as separate line items in the statement of profit or loss.

Available for use and the meaning of 'testing'

BC16P Paragraph 20 requires an entity to determine when an item of property, plant and equipment is available for use. The Board was informed of differences in how entities make that determination, and considered suggestions to clarify when an asset is available for use. Some of those making this suggestion said the existence of significant proceeds before intended use might indicate that an asset is already available for use before it is determined to be so. In their view, such a clarification would reduce the amount of proceeds being deducted from the cost of an asset than had previously been the case and, thus, would address the matter identified in paragraph BC16B without changing how those proceeds are recognised.

BC16Q The Board decided not to amend IAS 16 to clarify when an asset is available for use. Such an amendment would not be narrow in scope—it might affect the measurement of many items of property, plant and equipment, and additional research would be required to assess potential unintended consequences. Furthermore, the Board had obtained no evidence that differences in how entities determine when an asset is available for use could lead to material differences in the entities' financial statements.

BC16R Nonetheless, the Board decided to clarify the meaning of 'testing' in paragraph 17, noting that such a clarification might help an entity in determining when an asset is available for use. The Board concluded that when testing whether an asset is functioning properly, an entity assesses the technical and physical performance of the asset. The assessment of functioning properly is not an assessment of the financial performance of an asset, such as assessing whether the asset has achieved the level of operating margin initially anticipated by management.

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Property, Plant and Equipment—Proceeds before Intended Use (2020 amendments)

BC36B The 2020 amendments are expected mainly to affect only a few industries, such as mining and petrochemicals. The Board therefore considered the need, if any, for transition requirements beyond those in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC36C The Board concluded that the expected benefits of retrospectively applying the amendments in accordance with IAS 8 might be outweighed by the costs of doing so—in particular, an affected entity might find it difficult and costly to apply the amendments retrospectively to assets made available for use many years ago. In the Board's view, the transition requirements in paragraph 80D promote consistency in application of the amendments for all periods presented, but limit the number of assets an entity is required to reassess on first applying the amendments.

BC36D The Board decided not to provide transition requirements for first-time adopters of IFRS Standards because:

(a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides deemed cost exemptions for items of property, plant and equipment. These exemptions allow a first-time adopter to measure such assets without reference to IAS 16.

(b) if a first-time adopter does not apply those deemed cost exemptions, it would apply all the requirements in IAS 16 retrospectively. The Board concluded that there would be little benefit in providing first-time adopters with an exception or exemption relating to only one aspect of the requirements in IAS 16.

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