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The problem

IAS 16.17(e) requires an entity to capitalise costs of testing whether an item of PPE is functioning properly, after deducting the net proceeds from selling any items produced while bringing that item of PPE to the location and condition necessary for it to be capable of operating in the manner intended by management (i.e. before the PPE is 'available for use').

The IFRS Interpretation Committee (IC) was asked to consider whether:

1. the deduction of the net sale proceeds referred to in IAS 16.17(e) relates only to items produced from testing, and
2. the proceeds deducted from the cost of an item of PPE could exceed the costs of testing.

The IC's outreach suggests that this issue affects mainly the petrochemical and extractives industries, where different reporting methods are applied. Some entities deduct from the cost of the asset only the proceeds from selling items produced from testing.

Other entities deduct all sale proceeds from the cost of the asset until the PPE is available for use, even if they do not relate to testing. They do so on the basis that the asset is not yet operating in the manner intended by management. In some cases, the amount of proceeds deducted from the cost of the PPE exceeds the costs of testing.

In determining whether the tax authority will accept the entity's tax treatment, and if not, the effect of the uncertainty on the entity's accounting tax position, the entity should assume that the tax authority will examine amounts that it has a right to examine and have full knowledge of all relevant information when making those examinations. There is no exception for circumstances in which there is no time limit on the tax authority's right to examine income tax filings.

The proposed amendments

The IASB proposes to require entities to recognise proceeds from selling items produced before the PPE is available for use in profit or loss, together with the costs of producing those items. Entities would no longer be permitted to deduct those proceeds from the cost of the PPE.

There is a related amendment to IFRIC Interpretation 20 Stripping Costs in the Production Phase of a Surface Mine.

Observation

The IC and IASB have been considering this issue since 2014. The proposal will likely have a significant impact to the petrochemical and extractives. In most other industries, the sale proceeds from output produced before PPE is available for use is not expected to be material.

The IASB observed that the most common items produced by an item of PPE before it is available for use are inventories. It believes that if the PPE is to be used in the entity's ordinary activities, inventories produced by the asset before it is available for use are no different from those produced after it is available for use, because they both represent outputs from an entity's ordinary activities. Accordingly, proceeds from selling those items would represent revenue within the scope of IFRS 15 Revenue from Contracts with Customers and requiring the sale proceeds to be recognised in profit or loss at the time of sale would be consistent with the principles of that standard.

The costs of producing the items sold before the asset is operating in the manner intended by management will not include depreciation, because depreciation commences only from the date the PPE reaches that state.

The IASB considered making amendments to limit the deductions from the cost of PPE to proceeds from testing, and that the deduction could not exceed the costs of testing. Any excess, as well as proceeds from non-testing activities, would be recognised in profit or loss. They also considered changing the requirements around when an item of PPE is considered to be available for use.

The IASB is not proposing any new disclosure requirements as they believe that the existing requirements in IFRS 15 and IAS 2 are sufficient to deal with the information needs of users that will arise from the proposals.

Effective date, transition requirements and comment period

The ED does not specify an effective date for the proposed amendments. The IASB will determine the effective date after considering the comments they receive on the ED.

The ED proposes retrospective application of the proposed amendments to items of PPE that become available for use on or after the beginning of the earliest period presented when first applying the amendments. The ED proposes that the cumulative effect of initially applying the amendments be adjusted to the opening retained earnings (or other components of equity, as appropriate) at the beginning of the earliest period presented.

Comments on the ED are due by 19 October 2017.



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