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European Commission
1049 Brussels

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Dear Mr Berrigan

Endorsement of Property, Plant and Equipment – Proceeds before Intended Use, Amendments to IAS 16 *Property, Plant and Equipment*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of International Accounting Standards, EFRAG is pleased to provide its opinion on Property, Plant and Equipment – Proceeds before Intended Use, Amendments to IAS 16 *Property, Plant and Equipment* (‘the Amendments,’), which were issued by the IASB on 14 May 2020. An Exposure Draft of the Amendments was issued on 20 June 2017. EFRAG provided its comment letter on that Exposure Draft on 10 November 2017.

The Amendments would prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in a manner intended by management. Instead, an entity would recognise those sales proceeds in profit or loss.

The Amendments shall be applied retrospectively for annual periods beginning on or after 1 January 2022, with earlier application permitted. If entities apply the Amendments earlier, they shall disclose that fact. A description is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words whether the Amendments would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, leads to prudent accounting and is not contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our conclusions below.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

Based on the above reasoning, EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship and raised no issues regarding prudent accounting.

EFRAG has also assessed that the Amendments do not create any distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that the Amendments are not contrary to the true and fair view principle. EFRAG’s reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendments is

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conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

In EFRAG's assessment of whether the Amendments would be conducive to the European public good, EFRAG has assessed whether the Amendments would improve financial reporting, would reach an acceptable cost-benefit trade-off, and whether the Amendments could affect economic growth.

Our advice to the European Commission

As explained above, we have concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, and raise no issues regarding prudent accounting and that they are not contrary to the true and fair view principle. We have also concluded that the Amendments are conducive to the European public good. Therefore, we recommend the Amendments for endorsement without further delay.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,



Jean-Paul Gauzès
President of the EFRAG Board

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

- 1 Before the Amendments, paragraph 17(e) of IAS 16 specified that directly attributable costs include the costs of testing whether an asset is functioning properly, after deducting the net proceeds from selling any 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 IASB received a request asking whether:
 - (a) the proceeds specified in paragraph 17(e) relate only to items produced from testing; and
 - (b) an entity deducts from the cost of an item of property, plant and equipment any proceeds that exceed the costs of testing.
- 2 It has been noted that entities account differently for the proceeds that they receive from selling items produced while testing an item of property, plant or equipment before it is used for its intended purpose. This makes it difficult for investors to compare the financial positions and performances of entities.

The issue and how it has been addressed

- 3 Before the 2020 amendments IAS 16, 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 IASB's work on the request indicated that entities had applied the requirements in paragraph 17(e) differently - some entities deducted only proceeds from selling items produced from testing; others deducted all sales proceeds until the asset is in the location and condition necessary for it to be capable of operating in the manner intended by management (i.e. 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 even exceed the costs of testing or being recognised after the testing period (but before the intended use).
- 4 Having considered these findings, the IASB decided to amend paragraph 17 of IAS 16 to prohibit deducting from the cost of an item of property, plant and equipment (PPE) any proceeds from selling items produced before that asset is available for use. Consequently, an entity recognises such sales proceeds and related cost in profit or loss.

What has changed?

- 5 The Amendments prohibit entities from deducting from the cost of an item of PPE the proceeds from selling items produced while making that item of PPE available for use. Consequently, an entity should recognise the proceeds from selling any such items, and the cost of producing those items, in profit or loss in accordance with applicable Standards (generally IFRS 15 *Revenue from Contracts with Customers* and IAS 2 *Inventories*).
- 6 The Amendments should be applied retrospectively only to items of PPE made available for use on or after the beginning of the earliest period presented when the entity first applies the Amendments.
- 7 No transition relief has been provided for first-time adopters.

When do the Amendments become effective?

- 8 An entity shall apply the Amendments for annual periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies the Amendments for an earlier period, it shall disclose that fact.

Appendix 2: EFRAG’s technical assessment on Property, Plant and Equipment – Proceeds before Intended Use, Amendments to IAS 16 *Property, Plant and Equipment* against the endorsement criteria

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

- 1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that the Amendments:
 - (a) are not contrary to the principle set out in Article 4 (3) of Council Directive 2013/34/EU (The Accounting Directive); and
 - (b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 2 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.
- 3 The IAS Regulation further clarifies that *‘to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive’* (Recital 9 of the IAS Regulation).
- 4 EFRAG’s assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.
- 5 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendment is appropriate both for making decisions and assessing the stewardship of management.
- 6 EFRAG’s assessment on whether the Amendments are not contrary to the true and fair view principle set out in Article 4(3) of Council Directive 2013/34/EU is based on the assessment of whether it meets all other technical criteria and whether they lead to prudent accounting. EFRAG’s assessment also includes assessing whether the Amendments do not interact negatively with other IFRS Standards and whether all necessary disclosures are required. Detailed assessments are included in this appendix in the following paragraphs:
 - (a) relevance: paragraphs 7 to 11;
 - (b) reliability: paragraphs 13 to 20;

- (c) comparability: paragraphs 21 to 23;
- (d) understandability: paragraphs 25 to 27;
- (e) whether overall, they lead to prudent accounting: paragraphs 28 to 29; and
- (f) whether they would not be contrary to the true and fair view principle as noted in paragraphs 30 to 33.

Relevance

- 7 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.
- 8 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.
- 9 EFRAG notes that the previous requirement to offset proceeds against the cost of an item of PPE made it difficult for users of financial statements to have a clear picture of:
- (a) an entity's performance over time. Offsetting proceeds against the cost of an asset could:
 - (i) affect an entity's revenue (or income) in the period; and
 - (ii) have a long-term effect on an entity's performance when the asset has a long useful life. Offsetting proceeds decreased the depreciable amount of the asset and, consequently, reduced the depreciation charge recognised as an expense over the useful life of the asset.
 - (b) the cost of an item of PPE. Offsetting proceeds could distort the carrying amount of the asset.
- 10 Therefore, EFRAG assesses that the Amendments could lead to more relevant information regarding the costs of an item of PPE.
- 11 EFRAG acknowledges the concerns that have been raised when recognising proceeds before intended use and related cost in profit or loss might not provide useful information to users of financial statements. EFRAG notes the argumentation that such sales proceeds may have little predictive value because they are generally non-recurring and not necessarily an output of an entity's ordinary activities. EFRAG considers that the view that proceeds may have little predictive value is not a compelling argument to exclude that from income recognition.
- 12 EFRAG also notes that separate disclosure is required for proceeds and costs that are not an output of an entity's ordinary activities.

Reliability

- 13 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 14 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.
- 15 Proceeds before intended use and the related cost meet the definition of income and expenses in the *Conceptual Framework for Financial Reporting*. Those income and expenses reflect an entity's performance for the period and, therefore, should be

- included in the statement of profit or loss. EFRAG therefore assesses that these Amendments improve financial reporting and could contribute to reliable information.
- 16 EFRAG acknowledges that concerns have been raised with regards to the amount of judgement required in identifying costs that relate to items sold before an item of PPE is available for use, and to distinguish those costs from other costs incurred before that date. However, EFRAG notes that entities are required to apply IAS 2 *Inventories* in identifying and measuring such costs for the following reasons:
- (a) the requirements in IAS 2 set out a framework for identifying and measuring costs without being overly prescriptive; and
 - (b) an entity would already be required to apply IAS 2 in identifying and measuring costs 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 the definition of inventories in IAS 2. It would be beneficial 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.
- 17 Furthermore, EFRAG notes that the judgement involved in identifying and measuring the cost of items sold is not substantially different from judgements already required when applying IAS 2 and other IFRS Standards to the identification and measurement of costs, in particular for assets that take some time to get ready for their intended use (for example, identifying abnormal amounts of wasted materials and labour, allocating costs to joint products, identifying costs of operations incidental to the construction or development of an item of PPE).
- 18 With regards to the disclosure of such judgements made, EFRAG notes that there are no disclosure requirements in this respect. However, EFRAG considers that other IFRS Standards such as IAS 1 *Presentation of Financial Statements* already require the disclosure of information about estimates and judgements.
- 19 EFRAG considers that by clarifying the meaning of 'testing' in paragraph 17, such clarification might help an entity in determining when an asset is available for use. Therefore, EFRAG assesses that such clarification could help reduce the confusion around the application of such definition and could increase the reliability of information presented by preparers.
- 20 EFRAG notes that the Amendments are narrow in scope and expected to mainly affect a few industries, such as the extractive and petrochemical industries. In this instance, EFRAG notes that the expected benefits of retrospectively applying the amendments in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* might be outweighed by the costs of doing so - in particular, entities affected might find it burdensome to apply the Amendments retrospectively to assets made available for use many years ago. Therefore, EFRAG considers the transitional provisions of applying the Amendments only to items of PPE that are brought to the location and condition necessary for them to be capable of operating in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the Amendments as reliable.

Comparability

- 21 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 22 EFRAG has considered whether the Amendments result in transactions that are:
- (a) economically similar being accounted for differently; or

- (b) transactions that are economically different being accounted for as if they are similar.
- 23 EFRAG notes that if an item of PPE has been used to produce inventory the cost of inventory should include a depreciation charge. EFRAG acknowledges that when measuring the cost of items produced under the Amendments it would reasonably not include depreciation of the item of PPE, because depreciation of that asset only begins when it is available for use. Therefore, it may be argued that the Amendments may be inconsistent in how the cost of inventory is otherwise measured. However, EFRAG observes that this potential inconsistency is limited to the items sold before the item of PPE is in use. If such sales proceeds are frequent it could be an indication that the item of PPE is available for use.
- 24 EFRAG notes that absent the Amendments preparers of financial statements applied the requirement in paragraph 17(e) differently as some entities deducted only proceeds from selling items produced from testing while others deducted all sales proceeds until the asset is in the location and condition necessary for it to be capable of operating in the manner intended by management (i.e. available for use). Therefore, EFRAG assesses that the Amendments will encourage comparability.

Understandability

- 25 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.
- 26 Although there are a number of aspects related to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.
- 27 EFRAG assesses that the requirements in paragraph 74A(b) to disclose separately the proceeds and costs related to goods or services that are not an output of the entity's ordinary activities could lead to greater understandability to users of financial statements.

Prudence

- 28 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated, and liabilities or expenses are not understated.
- 29 EFRAG did not identify any aspects of the Amendments that would affect prudence.

True and Fair View Principle

- 30 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:
- (a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and
 - (b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.
- 31 EFRAG has assessed that the Amendments do not create any negative interactions with other IFRS Standards and are designed to complement IAS 16. Accordingly, EFRAG has assessed that the Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view.

- 32 EFRAG has concluded that the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss are required.
- 33 As a result, EFRAG concludes that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

- 34 Accordingly, for the reasons set out above, EFRAG's assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

- 1 EFRAG considered whether it would be conducive to the European public good to endorse the Amendments. In addition to its assessment included in Appendix 2, EFRAG has considered a number of issues in order to identify any potential negative effects for the European economy on the application of the Amendments. In doing this, EFRAG considered:
 - (a) Whether the Amendments improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how they fit into IFRS Standards as a whole;
 - (b) The costs and benefits associated with the Amendments; and
 - (c) Whether the Amendments could have an adverse effect to the European economy, including financial stability and economic growth.
- 2 These assessments allow EFRAG to draw a conclusion as to whether the Amendments are likely to be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether the Amendments are likely to improve the quality of financial reporting

- 3 EFRAG notes that the Amendments are designed to remove the inconsistencies of how entities account for the proceeds that they receive from selling items produced while testing an item of property, plant or equipment before it is used for its intended purpose.
- 4 EFRAG has therefore concluded that the Amendments are likely to improve the quality of financial reporting.

EFRAG's analysis of the costs and benefits of the Amendments

- 5 EFRAG first considered the extent of the work. For some Standards or Interpretations, it might be necessary to carry out some extensive work, in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work.

Cost for preparers

- 6 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.
- 7 Entities are required to identify the costs that relate to items sold before an item of PPE is available for use, and to distinguish those costs from other costs incurred before that date. The monitoring of these costs not previously required by IAS 16, could impose additional costs to preparers. However, EFRAG considers that the following expected benefits of the amendments to financial reporting outweigh those costs:
 - (a) Proceeds before intended use and the related cost meet the definition of income and expenses in the Conceptual Framework for Financial Reporting. Those income and expenses reflect an entity's performance for the period and, therefore, should be included in the statement of profit or loss.

- (b) The previous requirement to offset proceeds against the cost of an item of property, plant and equipment made it difficult for users of financial statements to have a clear picture of an entity's performance over time and the cost of an item of property, plant and equipment.

Costs for users

- 8 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.
- 9 The Amendments aim to promote consistency in applying the requirements by helping entities to account for proceeds and related costs for items of PPE sold before their intended use which could assist users of financial statements with their analysis, thereby reducing costs.
- 10 Overall, EFRAG's assessment is that the Amendments are likely to result in cost savings that will outweigh any incremental costs incurred by users to incorporate the new requirements in their analysis.

Benefits for preparers and users

- 11 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.
- 12 Overall, EFRAG's assessment is that users are likely to benefit from the Amendments, as the information resulting from it will remove inconsistency and increase comparability between entities and therefore will enhance their analysis. It will also enable users of financial statements to identify proceeds before intended use, and to understand how those proceeds and related cost affect an entity's performance.

Conclusion on the costs and benefits of the Amendments

- 13 EFRAG's overall assessment is that the overall benefits of enhanced consistency of application and increased comparability are likely to outweigh costs associated with complying with the Amendments.

Conclusion

- 14 EFRAG believes that the Amendments will generally bring improved financial reporting when compared to current guidance. As such, their endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.
- 15 EFRAG has not identified the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.
- 16 Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.
- 17 Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, EFRAG assesses that endorsing the Amendments is conducive to the European public good.