Exposure Draft ED/2017/4: Property, Plant and Equipment – Proceeds before Intended Use

Dear Hans,

Mazars welcomes the opportunity to comment on the International Accounting Standards Board’s Exposure Draft, *Proceeds before Intended use*, issued on 20 June 2017.

We understand the Board seeks to resolve an issue that concerns few industries, mainly the extractive and petrochemical industries.

The proposed solution to that issue is to remove the question (by removing paragraph 17e of IAS 16 and requiring the sales of items produced during the testing period of the PPE with the corresponding costs in profit or loss) rather than providing guidance for these industries.

In doing so we believe the Board will generate new inconsistencies and difficulties of application for a broad range of industries such as Automotive, Aerospace and Defence, which have presently no difficulties of application.

Issues that would be raised by the ED are:

1. Identification of costs of producing items while preparing the PPE
   - some costs would be missing such as depreciation costs of the PPE used to produce the items;
   - How to distinguish between production costs and costs related to the preparation of the PPE?
2. The existing requirements in IAS 16 are conceptually correct and consistent with the ones provided in IAS 23 on investment income. We note that other industries such as the Automotive, Aerospace and Defence apply IAS 16 in a consistent manner such as intended by the standard. We are not aware of any debates in these industries as regards the testing phase definition.

These issues are discussed in a more detailed manner below.

As a consequence we would strongly recommend not to prohibit the recognition of selling proceeds against the cost of PPE. In other words rather than changing IAS 16, we would recommend that the Board introduces additional guidance.

In particular, such guidance could clarify that when the selling proceeds exceeds the cost of testing, this is a strong indicator that the PPE is no longer in the testing phase but rather ready for use. Such clarification would reinforce/strengthen the proper or intended way of applying IAS 16.17e) requirements.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

Michel Barbet-Massin
Head of Financial Reporting Technical Support
Point 1: Identification of costs of producing items while preparing the PPE

We believe applying the proposed amendment would generate other inconsistencies than those currently identified.

This amendment would lead to the recognition of sold items in profit or loss. If these sold items occur in the ordinary course of business, they would be accounted for according to IFRS 15. When selling an item to a customer according to IFRS 15, the entity will generate a margin. We do not believe the proper margin would be recognised as some costs to fulfill the performance obligation would be missing such as the depreciation costs of the PPE that produced the output.

If the sold items are not considered to be incurred in the ordinary course of business, then IFRS 15 would not apply. These output would not be recognised as revenue but rather as “other income”. It might be confusing to explain how these “other income” may arise before the ordinary course of business started.

In addition it would be particularly complicated for entities to distinguish between the production costs (i.e. costs to fulfill the performance obligation) that should be recorded as costs of sales, from testing costs, that are an element of cost of the PPE and that are to be capitalised. The ED provides no guidance on that issue.

Point 2: actual requirements are conceptually compliant with current IFRS

As explained above, the proposed amendment intends to prohibit an inappropriate application of current requirements of IAS 16.17e by removing this paragraph even though these requirements are conceptually correct.

We agree with the argument of Mr. Zhang who considers that present requirements of IAS 16 are consistent with other standards such as IAS 23. Indeed for funds specifically borrowed to obtain a qualified asset, an entity determines the borrowing costs eligible for capitalisation as the actual borrowing costs less any investment income generated by the part of the fund not yet consumed.

As current requirements are conceptually consistent with other standards and as many entities apply them in the way intended by the Board, we would rather consider as an alternative view providing additional guidance to improve the appropriate application of IAS 16.17e.

In practice it should be rare that proceeds from sold items produced while bringing the asset to its final location and condition (i.e. during testing phase) exceed the costs of testing.

Such a situation would be, from our point of view, a strong indicator that the PPE is already available for use (i.e. in the location and condition necessary for it to be capable of operating in the manner intended by management) and that depreciation should have already started. Such a clarification would be very helpful.
In addition, we would recommend to include the definition of “testing” as presented in BC10 of the proposed ED:

"The Board concluded that when testing whether an item of property, plant and equipment 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."

Indeed that definition is helpful to determine when the testing phase of the PPE ends. The testing phase should generally be the last step before property plant and equipment is brought to the location and condition necessary for it to be capable of operating in the manner intended by management.

Generally when the testing phase ends, the property plant and equipment is ready for use. When the use of the PPE begins, the depreciation of the PPE should start and any proceed produced from this point should be accounted for in profit or loss and no longer as a reduction of the cost of PPE.