ACCURATE AND RELIABLE

INSIGHT PAPER · IAS 16 · PROPERTY, PLANT & EQUIPMENT

Proceeds Before Intended Use

The May 2020 amendment to IAS 16 Property, Plant and Equipment — what changed, and what it means for your financial statements.

IN THIS PAPER

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SUBJECT

IAS 16, IAS 2 and IFRS 15 interaction

PREPARED FOR

Finance teams with assets under construction

ENQUIRIES

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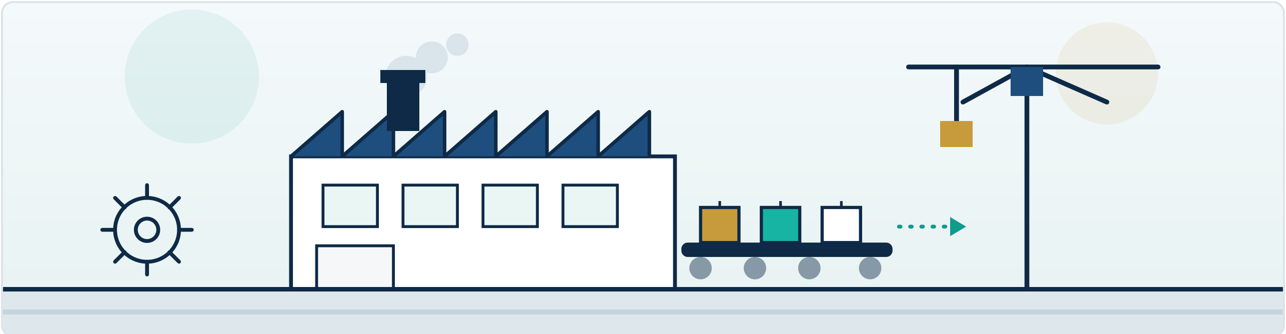
01 — BACKGROUND

A narrow-scope amendment with a wide effect

In May 2020, the International Accounting Standards Board issued an amendment to IAS 16 Property, Plant and Equipment (PPE).

The amendment seeks to clarify the way entities should account for the **proceeds from sale**, and the related production costs, of items produced by the relevant plant or equipment prior to it being available for its intended use.



Items produced while an asset is still being brought into use — and what happens to the proceeds when they are sold.

ISSUED	AMENDS	INTERACTS WITH
May 2020 By the International Accounting Standards Board	**IAS 16** Property, Plant and Equipment	**IAS 2 and IFRS 15** Inventories; Revenue from Contracts with Customers

The issue was initially raised with the **IFRS Interpretations Committee** that had originally intended to develop an interpretation of IAS 16 to deal with it. However, during the course of discussions the Committee concluded that a narrow-scope amendment to IAS 16 would be a better solution. The IASB developed an exposure draft published in 2017 and has now finalised the amendments.

02 — THE CHANGE

What the amendment changes

Property, Plant and Equipment — Proceeds before Intended Use (Amendments to IAS 16) amends the standard to **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 the manner intended by management. Instead, an entity recognises the proceeds from selling such items, and the cost of producing those items, in profit or loss.

BEFORE THE AMENDMENT

Deducted from asset cost

Incidental income from operating the asset whilst bringing it into use — such as from the sale of samples produced during testing — was deducted from the cost of the asset. In practice, entities applied this in different ways: some deducted only the proceeds from selling items produced while testing, others deducted the proceeds of all sales until an asset was available for use.

AFTER THE AMENDMENT

Recognised in profit or loss

Sales proceeds recognised before the related item of PPE is available for use are recognised in profit or loss together with the costs associated with the items sold, rather than by adjusting the cost of the item of PPE. The cost of the items sold is derived by applying the allocation and measurement requirements of IAS 2 *Inventories*.

The cost of an item of PPE recognised in the balance sheet includes the costs of testing the asset prior to it being available for its intended use. Questions had also arisen around the precise definition of ‘testing’.

Disclosure required

Disclosure of the amount of the proceeds and corresponding cost is required, along with details of the income statement line item in which they are included (if not already separately disclosed under IFRS 15).

03 — DEFINITIONS

Disclosure and the meaning of testing

> **Testing means assessing whether the technical and physical performance of the asset is such that it is capable of being used in the production or supply of goods or services, for rental to others, or for administrative purposes.**

The revisions to the standard also clarify the definition of testing set out above.

04 — IN PRACTICE

What does this mean for your company's financial statements?

Under the amendments, proceeds from selling items before the related item of PPE is available for use should be recognised in profit or loss together with the costs associated with that item of PPE in accordance with **IFRS 15 Revenue from Contracts with Customers** and **IAS 2 Inventories** respectively.

Two sets of costs to tell apart

In applying the amendments companies will need to distinguish between:

A

Costs of producing and selling

Costs associated with producing and selling items before the item of PPE is available for use. These are recognised in profit or loss alongside the related proceeds.

B

Costs of making the asset available

Costs associated with making the item of PPE available for its intended use. These continue to form part of the carrying amount of the asset.

Judgement will be required

Making this allocation of costs may require significant estimation and judgement. Companies will need to determine what is **normal capacity** in order to allocate costs to the items produced and sold. Because the asset is still being constructed, companies may not be able to readily determine the asset's normal capacity or a relevant production measure in order to cost the output produced.

The allocation sits between two standards — and the judgement is yours to document.

Applying the amendment?

For more information and or assistance with the IAS 16 amendment, cost allocation and the related disclosures, please contact us.

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