БМЦ
FOUNDATION «NATIONAL NON-GOVERNMENT STANDARD-SETTER
«ACCOUNTING METHODOLOGICAL CENTRE»
(FOUNDATION "NSS"AMC")

First of all we should note that the importance of the time point at which an item of PPE is ready for its intended use is exaggerated. We have examined the IAS 16 carefully and realized that the only outcome of the occurring of this event is the depreciation starting. There is nothing except depreciation. In this respect we'd like to attract you attention to one of the shortcomings of IAS 16 (in recent years we have been collecting IFRS shortcomings and IAS 16 is widely represented in the collection).

The paragraph 20 of the standard directly contradicts to both paragraphs 7 and 10. It claims that recognition of costs in the carrying amount of an item of PPE allegedly ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. But there is no such condition in the recognition rule stated in paragraph 7. On the contrary paragraph 10 says that an entity evaluates under this recognition principle (stated in p.7) all its PPE costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of PPE and costs incurred subsequently to add to, replace part of, or service it. Moreover this idea was one of the main reasons for revising IAS 16 in 2003 and it is intentionally emphasized in the Introduction in paragraph IN6 as one of the main changes from the previous version of the standard.

Hence there are no reasons to link the decisions about cost recognition with the readiness of PPE. Those decisions could depend only on the nature of expenditures but not on the time when expenditures are incurred. There is only one exception – borrowing costs – but for them there is a special regulation in IAS 23.

When we did our comments on the ED we believed that this issue is outside the scope of the amendments. However, since the feedback summary (27) refers to paragraph 20 we decided that we should propose to correct this paragraph too. It must be aligned with paragraphs 7 and 10. Particularly, the first sentence of the paragraph 20 should be deleted and other sentences with clauses (a), (b), (c) amended to eliminate all references to the time when expenditures are incurred.

So we have to consider the COST OF BRINGING the item of PPE in the location and condition necessary for its intended use rather than the COST INCURRED BE-

FORE the item of PPE is in the location and condition necessary for its intended use.

Meanwhile the main question is how to allocate cost. It is very challenging because an entity obtains simultaneously two sorts of benefits. The first one is bringing PPE in the location and condition necessary for its intended use. The second one is receiving some side items. We hardly could find any particular expenditure directly attributable to only either one of this two. Most of expenditures bring both benefits. It is the main difficulty. When we consider some certain expenditure we could ascertain that it is necessary to bring the item of PPE in the condition to be capable of operating in the manner intended by management. Therefore it is directly attributable to PPE. And in the same time the same expenditure is necessary to produce salable (or usable) items. Therefore it is directly attributable to that sort of benefit too.

So there are no ways to allocate cost by facts (very few exceptions are possible). Every allocating way would be conditional in varying degrees. Taking this into account as we noticed in our comments on the ED we think that the best general approach to the allocating is to estimate the cost attributable to side items as a primary assessment and then to consider the cost attributable to PPE as a residual.

When we discussed the ways of assessment we found ourselves often talking simultaneously about different situation. So we decided to arrange our discussion sorting all situations by types. We identified six relevant different types which depend of the nature of side benefits an entity receives preparing PPE for intended use. This nature manifests in three factors:

(a) immediately consumed or made for further consumption
(b) for self-using or for sale
(c) sale to customer or to other party (i.e. in ordinary activities or not)

	for sale		self-using
	ordinary	other	
for further consumption	**1**	**3**	**5**
Immediately consumed	**2**	**4**	**6**

The current version of IAS 16 covers actually the situations 2 and 4 only. The paragraph 17 (e) addresses to proceeds from selling in such a way as if it happens immediately after producing the items. So we hardly could understand by the term “items” mentioned in the current paragraph version anything but services or similar satisfied over time (speaking in terms of IFRS 15).

In this context the ED is different. The new proposed paragraph 20A definitely puts another meaning in the term "items" because of mentioning inventories directly. This wording involves at least the situation 1 but means in the same time abandoning the situations 2, 4, 6.

Meanwhile if we understand correctly the main deficiency of financial reporting caused by current version of the paragraph 17 (e) relates only to situations 1 and 2. It is distortion of revenue and cost of sales presented in the statement of financial performance. This problem obviously doesn't touch the situations 5 and 6 because there are no any proceeds at all. But it hardly relates to situations 3 and 4 as well because proceeds from not-ordinary selling must not be classified as revenue.

Summarizing our discussion we offer the following approaches which we consider as most appropriate for each situation mentioned above.

Situation 1.

It is the most important and interesting situation. It was the main purpose for issuing Interpretation R-57/2015. The situation is typical for Russian petroleum-gas and metallurgical industries. Examples are oil produced from well drilling or metal produced from furnace heating. In these cases the produced items are inventories because they are held for sale in the ordinary course of business (IAS 2, §.6 (a).

The best way to assess produced items in this situation is to take a carrying amount of similar inventories which were produced within regular activities. This assessment reflects the probable cost which would be if the production was not within testing but within regular using of PPE. And here is the answer your question about depreciation. This assessment reflects the depreciation too because the cost of similar inventories includes the depreciation of assets used for producing the inventories. Since we allocate the testing cost to the testing PPE according to the residual principle there is no need to depreciate this PPE.

The further accounting of inventories produced during PPE testing should be in accordance with IAS 2 including proceeds from selling. There are no rationales for any specific accounting provisions for them. The scope of IAS 16 should not be spread beyond the moment when they are produced.

Situation 2.

This situation is less common than the first one. The example is trial pumping of petroleum products through pipeline during its commissioning.

The accounting approach is like in the situation 1. We consider the cost of similar services rendered in ordinary circumstances as a measure of that part of commissioning cost attributable to side services rendered during commissioning.

Situation 3.

This situation happens when an entity obtains some products which are sub-standard because of receiving them during commissioning of PPE instead of normal conditions. The entity could not sale them as a "finished product" but only as a scrap. Meanwhile if the entity does not sale any scrap in the ordinary course of business it has no similar inventories.

In such circumstances we could take the net realizable value of side items as a basis to determine the part of commissioning cost attributable to them. We consider this approach as most appropriate because of its practical expediency. The produced items should be classified somehow for the purposes of the statement of financial position. These items are not inventories and there are no relevant IFRSs for them. According to IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" par.11 (a) management shall refer to, and consider the applicability of, the requirements in IFRSs dealing with similar and related issues. For measuring the produced items there are two standards dealing with similar and related issues – IAS 2 and IFRS 5. Applying any of these two we have to measure the items at the lower of cost and net realizable value. But as we mentioned above the cost itself would be conditional no matter how we measure it. With this in mind it is irrational to search the best way to measure cost only for comparing it with the NRV. Better we would deem the NRV equal to cost.

Situation 4.

Truth be told we failed to find real recent examples for this situation from practice of our participants. So we could speak about it purely theoretically.

We don't see any deficiencies of the approach enshrined in the current version of IAS 16 par.17(e) provided that it applies for this situation. Since selling doesn't relate to ordinary activities there is no need to obscure revenue with these proceeds. A potential user of financial statements in these circumstances would be probably satisfied with the information about net cost of PPE and doesn't want to see the separate financial result from such proceeds. Their economic meaning is that the entity has managed to make PPE preparation cheaper because of producing side proceeds.

Situation 5.

This situation is similar to situation 1 and has high practical importance too.

The accounting approach is the same as in the situation 1. We consider the cost of similar inventories produced in common circumstances as a measure of that part of commissioning cost attributable to side items. The further accounting of them should be in accordance with IAS 2.

Situation 6.

This situation is relatively rare. Using of unfinished PPE for internal purposes is often implicit because nobody formalizes it and commits it to paper. So an accountant has no idea about such latent benefits. However if he has the information the accounting approach is like in the situation 2. We take the cost of similar benefits happened in ordinary circumstances as a measure of deemed cost of these side benefits.

Summarizing all situations we have to remember that we do not measure the value of side assets or benefits themselves. We just allocate the part of cost of preparing PPE for its intended use attributable to side assets or benefits. Therefor their value should not exceed the actual sum of commissioning (testing) cost that could rightly be referred as “attributable” to them.