ACCOUNTING METHODOLOGICAL CENTRE (AMC)

FOUNDATION
«NATIONAL NON-GOVERNMENT STANDARD-SETTER
«ACCOUNTING METHODOLOGICAL CENTRE»

Moscow, 12 October 2017 № 4ОБ-IASB/2017
Phone: +74956500707
E-Mail: info@bmcenter.ru

Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

AMC comments on IASB ED/2017/4 Proceeds before Intended Use (Proposed Amendments to IAS 16)

Accounting Methodology Centre (AMC) is pleased to have the opportunity to comment on the proposed amendments to the IAS 16 Property, Plant and Equipment – Proceeds before Intended Use. AMC is responsible for the development of Russian Accounting Standards and for issuance of interpretations and guidance for Russian companies.

We agree with the decision to clarify the meaning of testing and support the way how it is proposed to be realised in the paragraph 17(e) by words in brackets.

Speaking about other aspects we agree with the general idea and objective of the amendments but do not agree with the way how it is realised in the ED and with its wording.

The paragraph 17(e) of the current version of IAS 16 is worded as if the selling of the produced items happens immediately after producing them, figuratively speaking, on the same day. But it is hardly so in practice. The Russian accountants have faced this very problem already and it was included in the agenda of our Interpretations Committee (a body of the AMC similar to IFRIC). The main reason of raising this question in Russia was not the deficiency of answering how to deal with the proceeds from selling, but the deficiency of answering how to deal with the items before selling. Production and sales are different events for the accounting purposes. And no matter how short or long the period between them is. Anyway a reporting date could well happen in this period and an accountant has to measure the produced items somehow, to record them somewhere in the balance sheet and to invent some decent name for them. They are definitely not a property, plant and equipment (further referred as PPE). But what are they then and how they should be measured? That is the question IAS 16 has to answer instead of references to the proceeds from selling.

The proposed amendments delete the confusing words from the paragraph 17(e) and we agree with that. But in the mentioned respect the new proposed paragraph 20A is not better than the current version. The second sentence tackles the proceeds from selling again saying meanwhile nothing about the accounting of produced items before selling. If an entity applies IFRS 15 it is highly unlikely that the revenue recognition takes place simultaneously with the producing the items. There are exceptions when it does (e.g. some services) but such cases are hardly relevant to the considering problem.

We are certain that the accounting of selling proceeds is not in the scope of IAS 16 at all. The only reason justifying a few words in IAS 16 about selling proceeds is a correction of previous estimates – If produced items are measured (e.g.) at net realisable value the information about the real selling price could give us the basis to adjust our previous judgement about that value. But even this is rather in the scope of IAS 8 than IAS 16.

The actual question of the IAS 16 is what to do with the produced items in the respect of the cost of tested property, plant and equipment. It would be fine if the standard determines the further accounting of the produced items, particularly their classification (sort of asset) and measurement (at least initial). But first of all, the standard has to establish the coherence of their initial measurement with the cost of tested PPE.

When an entity incurs expenditures for the (so-called in Russia) "hot commissioning" it obtains thank to them two sorts of benefits. The first one is testing of an asset. The second one is receiving some "products". The accounting question is how to allocate the commissioning cost between these two. The main difficulty is that the expenditures are related to both (always some of them and usually most of them). The expenditures are necessary to bring the item of PPE in the condition to be capable of operating in the manner intended by management. Therefore they are directly attributable to PPE. And in the same time the same expenditures are necessary to produce salable (or usable) items. Therefore they are directly attributable to that sort of asset too (inventories or whatever that items are).

We suggest the following way to solve this issue: to consider the measurement of the produced items as a primary step and to measure the cost of PPE (within commissioning) by default. It means that we assess the produced items first and consider their value as a part of commissioning (testing) cost allocated to them. Then the rest of the cost is considered as a part of cost allocated to PPE.

The next question is how to measure the produced items. We think the best assessment is the probable cost which would be if the production was not within testing but within regular using of the asset. We are aware that such estimate couldn't be always obvious but nevertheless the IAS 16 should direct how to do it depending of circumstances.

In general there are two possible situations. First, the produced items are inventories. Second, they are not inventories. It depends whether they meet the definition of inventories in IAS 2, i.e. whether they are supposed to be involved (by selling or using) in the ordinary course of business.

When the produced items are inventories their assessment is quite easy. We can just take a carrying amount of similar inventories which were produced within regular activities (If the circumstances of their production are a bit different we can make some relevant adjustments). The further accounting of such inventories should be in accordance with IAS 2. There are no rationales for IAS 16 to intrude into these questions (including proceeds from selling).

If there are no similar inventories this very fact could indicate that the items produced within testing are not inventories. A common example is when an entity obtains some products which are substandard because of receiving them during testing of PPE instead of normal conditions. Therefore the entity could not sale them as a "finished product" or use them in further operating cycle. It could only sale them as a scrap and intend to do this. But the entity does not sale any scrap in the ordinary course of business. It means that the produced items are not inventories. Of course there could be some exceptions – for example the situations described in AV5 when newly established entities have not started ordinary production yet and therefore have no inventories at all. Nevertheless IAS 16 has to focus on common situations, not on exceptions.

If the produced items are not inventories they should be classified somehow in the statement of financial position anyway. There no relevant IFRS for this sort of assets. According to IAS 1 par.29 an entity shall present such an asset separately unless it is immaterial. And of course this asset should be measured somehow.

Contact:
Director: Sukhareva Oksana
Phone: +74956500707
E-Mail: info@bmcenter.ru

The general purpose of the measurement is to estimate the probable cost of producing the items as if it would be in normal conditions instead of commissioning (testing) of PPE. The particular way of measurement depends of circumstances. We think that the net realisable value could be applicable in many cases as a deemed cost.

Of course in all cases whether the produced items are inventories or not their value should not exceed the total sum of real commissioning (testing) cost that could rightly be referred as “attributable” to those items. If that is a case (which is possible but highly improbable) the produced items should be measured at this sum of commissioning (testing) cost. It means that no penny of this cost would be added to cost of PPE. We consider this fact not as a drawback of the accounting approach but as a reflection of the real economic situation. It means that the entity has managed to make the commissioning and testing procedures of PPE for free because of producing incidental valuable items.

The Interpretations Committee of the AMC had a series of meetings in 2014-2015 where was a heated debate about this problem. Anyway finally a consensus was found. As a result in February 2015 the Committee issued an Interpretation № P-57/2015 “Testing and Commissioning of Property, Plant and Equipment Resulting in Production”. It is published here: http://bmcenter.ru/Files/R-KpT_Testirovanie_puskonaladka_OS

The Interpretation has been issued in Russian (as well as other Interpretations). For the purposes of the ED 2017/4 we have translated it in English, which is attached below.

Contact:
Director: Sukhareva Oksana
Phone: +74956500707
E-Mail: info@bmcenter.ru

INTERPRETATION R-57/2015
TESTING AND COMMISSIONING OF PROPERTY, PLANT AND EQUIPMENT RESULTING IN PRODUCTION

Adopted on 20 February 2015

ISSUE

An entity has commissioned equipment. On the one hand, this process was aimed at bringing the asset to working condition for its intended use. On the other hand, items may be produced from commissioning such as finished products and recyclable materials that can be sold or used otherwise by the entity. Accounting rules for property, plant and equipment set out in Accounting Statement 6/01 do not regulate accounting for costs related to asset testing and commissioning activities that result in the production of items.

International Financial Reporting Standards contain only one phrase reading that costs included in the cost of a property, plant and equipment should be reduced by proceeds from selling any items produced from testing. The fact that such items can be sold much later after the commissioning and testing process to put the fixed asset into service is not taken into account. No details are also given for situations where such items can be mixed with finished products made in the course of normal operations.

Given the above, it is necessary to determine an approach to accounting for commissioning costs, and the evaluation of items produced from commissioning and their implications for the cost of property, plant and equipment.

CONSENSUS

1. Commissioning costs increase the cost of property, plant and equipment when they are required and incurred to bring the asset to the condition and location necessary for it to be capable of operating in the manner intended by management.

2. The items produced from commissioning such as finished products and recyclable materials that the company can and intends to sell or otherwise use for receiving economic benefits are entered at their estimated value determined by the company based on their market value, net realizable value, the value of similar items and other relevant information. This estimated value cannot be higher than actual commissioning costs. This estimated value is deducted from commissioning costs included in the cost of the item of property, plant and equipment.

3. If the items produced from commissioning have been actually sold before the item of property, plant and equipment becomes ready for use, the cost of the item of property, plant and equipment is adjusted for a gain (loss) from their sale up to the amount of total commissioning costs. Income and expenses related to the sale of such items are not recognized. This paragraph does not apply to commissioning if related costs are not included in the cost of the item of property, plant and equipment and it also may not apply to items that are classified as finished products made and sold by the company during normal operations.

Contact:
Director: Sukhareva Oksana
Phone: +74956500707
E-Mail: info@bmcenter.ru

4. If revenue from the actual sale of items less costs related to their sale or preparation for sale exceeds commissioning costs, this excess amount is recognized as other income.

BASIS FOR CONCLUSIONS

Since asset testing and commissioning is aimed at bringing the asset to working condition for its intended use, unless circumstances dictate otherwise, related costs should be included in the cost of property, plant and equipment. Such work is not intended to produce any items. This means that the economic substance of proceeds from selling such items is about cost reduction, rather than income generation.

This approach is in line with paragraph 17 of IAS 16 reading that examples of directly attributable costs are:

....

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);

In cases that the proceeds exceed the costs, it appears to be inappropriate to reduce other costs related to the fixed asset by this excess amount. Such proceeds should be recognized as income in profit or loss for the period. Similar conclusions can be found in Discussion Paper 14 that was on the agenda of the IFRIC's meeting on 15 and 16 July 2014. The paper reads that IAS 16 contains sufficient guidance that revenue from production should be deducted only from the cost of testing, and that no interpretation is necessary. If the revenue exceeds testing costs, the excess amount should be recognized as income.

However, the company cannot know for sure at what price items produced from testing will be sold until it actually sells them. As such items should be accounted for before their sale, it is necessary to estimate their value. An approach to determining their estimated value depends on a specific business situation: there is no one-size-fits-all solution for all circumstances.

Upon the actual sale of items produced from testing, the amount of costs related to the item of property, plant and equipment can be adjusted, if the sale occurs before the asset is put into service and its depreciation commences.

However, it is not always possible to adjust their amount. In particular, when such items are identical to products made by the company in the normal course of business, they can be physically mixed with such products. In such instances, commissioning costs are reduced by the estimated value of the items only upon their production. It can be difficult to make further adjustments to the cost of property, plant and equipment, if it is impossible to separate items produced from commissioning from products made during normal operations. In such instances, it seems to be appropriate to account for such items in the usual way that it is done for inventories, which requires, inter alia, the recognition of any revenue from their sale.

Contact:
Director: Sukhareva Oksana
Phone: +74956500707
E-Mail: info@bmcenter.ru

ILLUSTRATIVE EXAMPLES

Examples of bookkeeping for items in the scope of this Interpretation

(The examples below exclude the treatment of VAT
because of its irrelevance for the purpose of this discussion)

Example 1

When commissioning an asset, an entity has received items **other than products** that it makes during normal operations:

Economic event	Debit	Credit	Amount (RUB)
Items received (measured at possible net realizable value at RUB 1000)	10	08	1000
Costs in the amount of RUB 300 were incurred to make the items fit for sale	10	60,70,…	300
An agreement was concluded to sell the items for RUB 1,350	10	08	50
The sold items were shipped to the buyer	62	10	1,350

Example 2

When commissioning an asset, an entity has received items that are **identical to products** that it makes during normal operations:

Economic event	Debit	Credit	Amount (RUB)
Items received (measured at the production cost of identical products at RUB 1000)	21	08	1000
Costs in the amount of RUB 300 were incurred to make the items fit for sale	21 43	60,70,… 21	300 1,300
An agreement was concluded to sell the items for RUB 1,350	-	-	-
The sold items were shipped to the buyer	62 90	90 43	1,350 1,300

Contact:
Director: Sukhareva Oksana
Phone: +74956500707
E-Mail: info@bmcenter.ru