Accounting Standards Board Canada
277 Wellington Street West,
Toronto, ON Canada M5V 3H2
T. 416 977.3222 F. 416 204.3412
www.frascanada.ca

October 19, 2017

Submitted electronically via www.ifrs.org

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: Property, Plant and Equipment–Proceeds before Intended Use (ED/2017/4)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Property, Plant and Equipment–Proceeds before Intended Use (Proposed amendments to IAS 16)" issued in June 2017.

Our process

As part of the due process for this proposal, we consulted with our IFRS® Discussion Group and stakeholder groups in the mining and oil and gas industries. We took into account the results of this outreach when developing this letter.

Our views

We disagree with the proposal to prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced while bringing the asset to the location and condition for it to be capable of operating in the manner intended by management (i.e., available for use). We question whether the proposal would achieve the project's objective of providing relevant information to users of financial statements. While we understand the proposal is a simple way to remove diversity in practice on accounting for the proceeds, the proposal would not provide entities with sufficient guidance to determine the amount of cost of goods sold for the selling items produced. To achieve the intended effect of providing relevant information to users, we think the IASB should further develop this proposal to

address how entities should identify the appropriate costs related to selling items produced before an asset is available for use.

We strongly encourage the IASB to reconsider its observation that applying the proposal would require minimal additional judgment beyond what is already required in applying IFRS Standards. This proposal would result in entities having to make the distinction between costs associated with bringing the asset to available for use (which are capitalized according to IAS 16 *Property, Plant and Equipment*) and costs for producing the selling items while bringing the asset to available for use (which are proposed to be recognized in profit or loss). The same costs are often necessary for both producing the selling item and bringing the asset to available for use. Making this distinction would be a new area of judgment for entities that currently deduct from the cost of the asset any proceeds from selling items produced during the pre-production stage.

Without sufficient guidance to ensure that entities develop a consistent costing approach for the selling items produced, profit margins for entities undertaking similar activities may not be comparable. Depreciation expense, which is a significant cost for producing any selling item in capital-intensive industries, is also not recognized until after the asset is available for use. As a result, an entity's profit margin before the asset is available for use may not be a meaningful measure for users to predict future profitability and cash flows.

In Canada, there are significant capital-intensive industries such as mining and oil and gas that would be affected by the proposed amendments. We strongly encourage the IASB to consider further work on this project in order to provide relevant information to users of financial statements.

Our response to your question

The Appendix to this letter responds to the question posed in the Exposure Draft and expands on the points raised above.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Rebecca Villmann, Director, Accounting Standards (+1 416 204-3464 or email rvillmann@acsbcanada.ca) or Davina Tam, Principal, Accounting Standards (+1 416 204-3514 or dtam@acsbcanada.ca).

Yours truly,

Linda F. Mezon, FCPA, FCA
CPA (MI)
Chair, Canadian Accounting Standards Board
lmezon@acsbcanada.ca
+1 416 204-3490

About the Canadian Accounting Standards Board

We are an independent body with the legal authority to establish accounting standards for use by all Canadian publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans in the private sector. We are comprised of a full-time Chair and volunteer members from a variety of backgrounds, including financial statement users, preparers, auditors and academics; a full-time staff complement supports our work.

Our standards

We have adopted IFRS® Standards as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS Standards in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS Standards as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS Standards

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS Standards. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS Standard to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS Standard. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

APPENDIX

Question

The Board is proposing to amend IAS 16 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 would recognise the proceeds from selling such items, and the costs of producing those items, in profit or loss.

Do you agree with the Board's proposal? Why or why not? If not, what alternative would you propose, and why?

1. We understand the proposal is intended to be a simple way to remove the global diversity in practice as described in paragraph BC3 in the Basis for Conclusions. However, the proposal does not holistically consider the accounting implications for determining the costs related to the selling items produced before an asset is available for use.

2. Paragraph BC8 in the Basis for Conclusions indicates that the proposed amendments would require minimal additional judgment beyond what is already required in applying IFRS Standards to identify the costs that relate to selling items produced before the asset is available for use. We disagree with that assessment. If the asset is still being constructed (i.e., not yet available for use), an entity would need to exercise more judgment to determine what is normal capacity or a relevant production measure for purposes of allocating costs to the selling items produced. Costs of conversion of inventories in IAS 2 *Inventories* are determined based on applying a normal capacity concept to allocate fixed production overhead. Similarly, production stripping costs in IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* are allocated between inventory produced (if applicable) and the stripping asset based on a relevant production measure. To apply IFRS Standards like IAS 2 and IFRIC 20, the entity would have already made the key judgment that the construction of the asset is complete because the asset has reached the production stage. This key judgment enables the entity to know what is the asset's normal capacity or relevant production measure in order to cost the output produced.

3. In addition, costs of conversion of inventories include direct costs such as labour. We note that the same labour costs may be used for both constructing the asset and producing the selling items during the pre-production phase. In order to apply the IASB's proposal, entities would need to determine what portion of the labour should be allocated to the selling items produced. This would be a significant area of judgment not previously required for entities that deduct from the cost of the asset any proceeds from selling items produced before the asset is available for use.

4. We have identified a publication[1] that describes various costing approaches being applied by entities that recognize revenue earned in profit or loss before the asset is available for use (often referred to as pre-commissioning revenue). Below is an excerpt from the publication describing the various costing approaches:

> - An amount equivalent to such revenues is charged to cost of sales and credited against the mine asset to record a zero net margin on such production
> - Using some standard or expected cost of mining to ascribe to the volumes produced, e.g., weighted average cost per tonne based on actual results over some historical period, e.g., the last two or three years; or for new mines, the expected cost per tonne as set out in the business/mine plan (producing a standard margin)
> - Recognising only the incremental cost of processing the product
> - Recognising nothing in cost of goods sold

5. We think that if the IASB decides to proceed with this proposal to recognize proceeds from selling items produced before an asset is available for use in profit or loss, specific guidance is required to assist entities in determining the related costs to recognize in profit or loss. Otherwise, there would be diversity in how cost of goods sold and the related profit margin are determined.

6. Paragraph BC11 in the Basis for Conclusions also acknowledges that depreciation expense would be excluded from the cost of the selling items produced before an asset is available for use. The IASB's observation is that consumption of the asset before it is available for use is likely to be negligible. However, we are unclear if this observation is true under all circumstances. For example, if an entity generates material proceeds from the quantity of selling items produced during the pre-production stage, this could suggest that consumption of the asset is more than negligible.

7. The IASB proposed this amendment to provide users with a clear picture of an entity's total revenue in the reporting period. However, if certain costs that are significant for capital-intensive industries such as depreciation expense, are not captured in the same reporting period, we are concerned that users would not have a clear picture of what the profit margin should be for such items produced and sold. For example, small mining entities may show profitability by recognizing proceeds before commercial production with negligible related costs given depreciation expense is excluded. As a result, users may find profit margins incomparable before and after an asset moves into production stage. Furthermore, if an entity never reaches commercial production, this proposal could potentially produce a misleading impression about the entity's true financial performance.

8. Based on the outreach performed, the prevalent accounting treatment in Canada is to deduct from the cost of the asset any proceeds from selling items produced before the asset is available for use. We commend the IASB's effort to improve financial reporting from the perspective of showing total

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[1] EY. *Delivering capital projects: Addressing the key accounting challenges*. May 2012.

revenues generated by an entity but strongly encourage this proposal be developed further to achieve its objective of providing relevant information to users.

Other comments:

9. For disclosure requirements, we are concerned with the IASB's view in paragraph BC24 in the Basis for Conclusions that items produced before an asset is available for use are considered output from an entity's ordinary activities. For example, in mining industries, the quality/grade of the items sold could vary significantly pre- and post-production stage. It is also possible that some mines may never reach commercial production such that items sold prior to production stage are viewed differently compared to output from an entity's ordinary activities. We think that it is important for users to be able to identify whether the proceeds and related costs pertain to items produced before an asset is available or to items produced after the asset is available for use because the nature and risks of the cash flows could be different.

10. With regards to the transition requirements, we agree with IASB's considerations as stated in paragraphs BC27 to BC28 in the Basis for Conclusions.

11. We note that paragraph 21 of IAS 16 provides the requirement for recognizing income and related expenses arising from incidental operations in profit or loss. The rationale provided for this accounting treatment is that incidental operations are not necessary to bring an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management. If the IASB decides to proceed with this proposal, we recommend the IASB revisit this rationale given that the proceeds and related costs arising from selling items while bringing the asset to available for use is also being recognized in profit or loss as per paragraph 20A in the Exposure Draft.

12. Our IFRS Discussion Group has been monitoring the IFRS Interpretations Committee's discussions on this issue. At its May 2016 and November 2016 meeting, and also in a private session with the IASB staff at its October 2017 meeting, the Group expressed concerns with the proposal. These concerns are included in this letter. The Group sees the issue of determining when an asset is available for use to be more fundamental than addressing where in financial statements to recognize the proceeds from selling items produced during the pre-production stage. We understand that the IASB thought it would be a much broader project to clarify when an asset is capable of operating as intended by management, as explained in paragraphs BC18 to BC23 in the Basis for Conclusions. However, we think that providing guidance to help entities accurately make this key judgment is a more effective way to reduce the occurrence of the submitter's fact pattern (i.e., net proceeds from selling items produced exceed the costs of testing the asset). Such guidance would improve financial reporting as users would understand better how an entity determines when the output produced is considered the entity's ordinary course of business.