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Mr Hans Hoogervorst
International Accounting Standards Board
1st Floor
30 Cannon Street
London
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Our ref RD/288

19 October 2017

Dear Mr Hoogervorst

Comment letter on ED/2017/4 Property, Plant and Equipment – Proceeds before Intended Use – Proposed amendments to IAS 16

We appreciate the opportunity to comment on the International Accounting Standards Board's Exposure Draft (ED) mentioned above. We have consulted with, and this letter represents the views of, the KPMG network.

We support the IASB's efforts to clarify IAS 16 in respect of proceeds from selling any items produced while bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. However, we do not support the proposal that the proceeds from selling such items, and the costs of producing those items, be recognised in profit or loss. Even if the proposed amendments would provide consistency in how revenue is recognised before an asset is available for its intended use, they would not reduce diversity in practice because more estimation and judgements would be required in assessing how costs should be allocated. As a minimum, additional guidance should be provided on how to allocate the costs.

We believe that a more effective approach would be to address the problem comprehensively, including clarifying when an item of property, plant and equipment (PP&E) is available for use.

Our detailed response to the question in the Exposure Draft is included in the appendix to this letter.

Please contact Reinhard Dotzlaw +44 (0)20 3078 3416 or Wolfgang Laubach +49 30 2068 4663 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

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Appendix

This appendix contains our detailed response to the proposals.

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?

We do not support the amendments as currently proposed because they raise a number of related issues and would not necessarily reduce diversity in practice. We believe that additional guidance should be provided on how to distinguish the costs relating to items produced and sold before an item of property, plant and equipment (PP&E) is available for its intended use.

We believe that a more effective approach would be to address the problem comprehensively, including clarifying when an item of PP&E is available for use.

No guidance on identifying the costs relating to items produced and sold

The proposed amendments state that the costs that relate to items produced and sold before an item of PP&E is available for its intended use would be recognised in profit or loss in accordance with applicable standards. However, the proposals do not provide any guidance on how to distinguish those costs from other costs incurred before that date.

The Basis for Conclusions on the Exposure Draft indicates that the Board observed that an entity would have to apply judgement in identifying those costs. However, it concluded that the proposed amendments would require little more judgement beyond that already required to apply IFRS.

We believe that measuring those costs would involve much more estimation and judgement. Entities would face challenges in allocating the costs between items sold, costs that should be capitalised and costs that should be excluded from inventories,

such as abnormal costs of wasted material or labour. For example, consumption of production materials could be related to both items sold and construction activities, because some are necessarily consumed in the construction of production lines, whereas others are caused by wastage due to unfamiliar production procedures during testing. In addition, allocating direct personnel and production costs is also complicated and difficult for an entity and lots of judgement is involved. Adding to the complexity is the fact that, during the testing period, production data that is available during normal operation may not be available; significantly less information is available at the earlier stages of the development than in the extraction stage. Therefore, we believe that the allocation of costs would require more judgement during that period, which may result in inconsistency among entities and less accuracy in the allocation.

Therefore, we believe that the amendments should include guidance on identifying the costs that relate to items produced and sold before an item of PP&E is available for use, and on how to distinguish those costs from other costs incurred before that date.

In addition to the increased complexity in allocating costs, we believe that the proposed amendments would lead to an increase in management costs, because more data analysis of direct and indirect costs incurred during the testing period would be required. For example, an entity would need to assess how much time is spent on production and testing work in a month. It would have to systematically identify and distinguish each cost item relating to income from those relating to assets. It may also need to provide more financial data analysis so that the financial statement users can better understand the entity's financial performance and fluctuations between periods. This may significantly increase the management costs of the entity.

Therefore, we believe that it is important to consider such management costs in developing guidance on identifying the costs that relate to the proceeds during that period and try to minimise the efforts. We are concerned that the costs would exceed the benefits.

Impact on earnings

Furthermore, the profit margin during the testing period would not reflect the actual business operations of an entity, because the costs of producing inventories before the item of PP&E is available for use would exclude depreciation of that asset.

The Exposure Draft acknowledges this issue, but the Board concluded that any such consumption of PP&E before it is available for its intended use is likely to be negligible.

We believe that for entities such as those with heavy asset investments, the impact would not be negligible and the profitability during the period before the asset is available for its intended use would not truly reflect the normal profitability, which could mislead the users of the financial statements.

Therefore, we believe that disclosure explaining the above should be developed, in addition to the existing disclosure requirements in IFRS 15 and IAS 2.

Additional Comments

During the development of the proposed amendments, the Board was informed of diverse practices in some industries in determining when an item of PP&E is available for use, and considered including some indicators of when an item of PP&E is available for use. However, it concluded that such an approach would be a much broader project than the proposed amendments would be and decided not to proceed with the approach.

We are aware that there is diversity in practice in determining when an item of PP&E is available for use and we believe that addressing this issue is very important. We are concerned that the proposed amendments may even create opportunities for profit manipulation, because an entity may find various ways to extend the testing period in view of the higher profit margin during testing.

We believe that a more effective approach would be to address the problem comprehensively, including clarifying when an item of PP&E is available for use. However, if the Board decides to go ahead with the proposals, we believe that this issue should be addressed as a next phase and guidance developed in order to reduce diversity in practice.