IFRS Alert

Updates on IAS 16 - Property, Plant and Equipment

8 November 2022

What is the issue?

IAS 16, ‘Property, Plant and Equipment’, requires the proceeds received from selling output produced before the asset is ready for its intended use to be recognised as income in profit or loss. The related cost of producing the output is measured using the guidance in IAS 2, ‘Inventories’, and it is recognised as an expense in profit or loss when sold.

If the items sold are the output of an entity’s ordinary activities, the income and cost are disclosed in accordance with the requirements of IFRS 15, ‘Revenue from Contracts with Customers’, and IAS 2. If the items sold are not part of an entity’s ordinary activities, the amendment to IAS 16 requires the disclosure of the amount and line item(s) in the statement of comprehensive income in which such proceeds and cost have been included.

The amendment to IAS 16 also clarifies that an entity is ‘testing whether the asset is functioning properly’ when it assesses the technical and physical performance of the asset. The financial performance of the asset is not relevant to this assessment. An asset might therefore be capable of operating as intended by management and subject to depreciation before it has achieved the level of operating performance expected by management.

What is the impact and for whom?

The amendment to IAS 16 could have a significant impact on entities that construct material items of PP&E and, as part of the construction, there is a ramp-up period to test whether the asset is operating as it should; similarly, where resources are extracted from the earth during the development of a mine which is above a body of resource (for example, where a shaft is sunk and resource is extracted in the development process). Industries that are expected to be significantly impacted are mining and industrial product manufacturers. Management might need to develop processes to track the cost of output generated during the development phase and to account for an asset as ready for its intended use earlier than before.

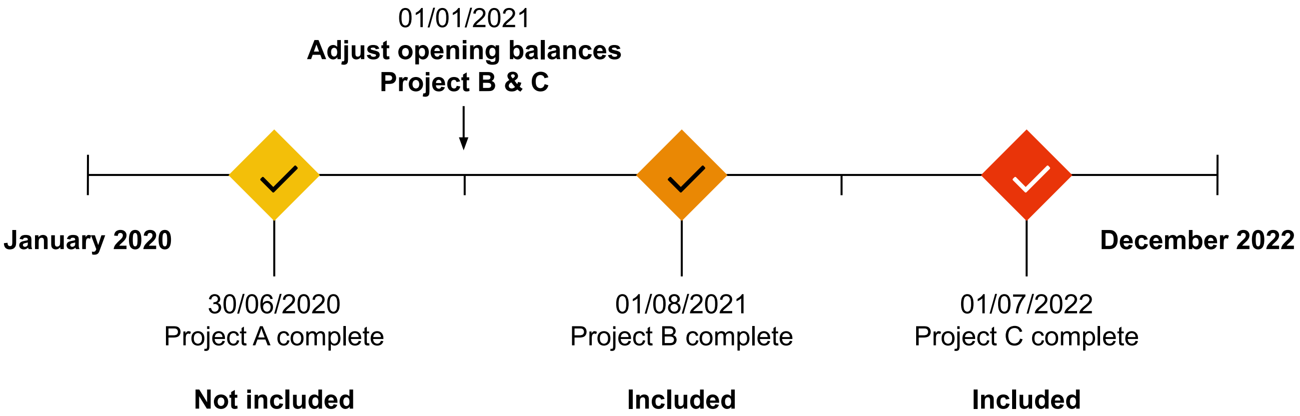
When does it apply?

The amendment is effective for annual reporting periods beginning on or after 1 January 2022. The reporting entity should apply the amendment retrospectively, but only to items of PP&E that are brought to the location and condition necessary for them to be capable of operating in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendment. Refer to the illustrative example below for the ease of adoption. The entity should recognise the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of that earliest period presented.

Earlier application is permitted. If an entity applies the amendment for an earlier period, it should disclose that fact.

Illustrative example

The entity is preparing its financial statements for the year ending 31 December 2022. It has three projects which status as illustrated below.



Project A the entity would not have to apply the revised standard to Project A, because it was ready for its intended use in 2020, which is before the earliest period presented in the 2022 annual financial statements.

Project B the entity would have to apply the revised standard to Project B, because it was ready for its intended use in the prior year which is the earliest period presented in the 2022 annual financial statements.

Project C the entity would have to apply the revised standard to Project C, because it was ready for its intended use in 2022 which is the period in which the amendment becomes effective.

In the 2022 annual financial statements, the 2021 comparatives would need to be adjusted retrospectively to apply the amendments. To the extent that Project B or C earned proceeds before intended use prior to 1 January 2021, an adjustment to the opening balances of retained earnings and PP&E at 1 January 2021 would be required if the entity's previous policy was not aligned with the IAS 16 amendment.

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