
Project	Annual Improvements – 2009–2011 cycle
Topic	IAS 16 <i>Property, Plant and Equipment</i> – Clarification of accounting for servicing equipment

Introduction

1. This paper discusses a perceived inconsistency in paragraph 8 of IAS 16 *Property, Plant and Equipment* (PP&E) with respect to servicing equipment and classification as PP&E or inventory.

Purpose of this paper

2. The purpose of this paper is to ask the Board to consider an amendment to paragraph 8 of IAS 16 that would clarify the accounting for certain items of PP&E.
3. This paper:
 - (a) provides background information and explains the issue;
 - (b) makes a staff recommendation for
 - (i) a proposed amendment to IAS 16 as presented in Appendix A,
 - (ii) an assessment of the proposed amendment against the criteria for inclusion in the *Annual Improvements* process;

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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- (c) asks the Board whether they agree with the IFRS Interpretations Committee's (the Committee) recommendation.

Background information and issue raised

- 4. Paragraph 8 of IAS 16 is reproduced below for ease of reference:
 - 8. Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.
- 5. Constituents point out that in some jurisdictions, this perceived inconsistency leads to classifying servicing equipment as inventory when it is:
 - (a) used during more than one period, and
 - (b) not used only in connection with an item of PP&E.
- 6. Constituent state that this is an issue as it unduly overstates inventory compared with PP&E.
- 7. The staff notes that in addition, the last sentence of paragraph 8 of IAS 16 requires servicing equipment to be classified as PP&E when it is used only in connection with an item of PP&E.
- 8. At the IFRS Interpretation Committee meeting in May 2010, the Committee agreed with the staff proposal to recommend the Board add this issue to the 2009–2011 *Annual Improvements* cycle¹.

¹ The Committee recommended the Board amend IAS 16. The proposed amendment will clarify that servicing equipment is property, plant and equipment when an entity expects to use it in more than one period and inventory when the entity expects to use it in less than one period. It will also propose to delete the requirement that spare parts and servicing equipment used during only one period in connection with an item of property, plant and equipment be classified as property, plant and equipment.

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Staff recommendation***Proposed amendment***

9. To address the perceived inconsistency, the staff recommends paragraph 8 of IAS 16 be amended to:
 - (a) clarify that servicing equipment is PP&E when used during more than one period, otherwise it should be classified as inventory; and
 - (b) delete the requirement that spare parts and servicing equipment used only in connection with an item of PP&E be classified as PP&E.
10. The proposed amendment wording is included in Appendix A.

Transition provisions

11. The staff believes that the transition provisions for this proposed amendment should be in line with the general principle on accounting for a change in accounting policy in accordance with paragraph 19 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The transition provisions for the proposed amendment therefore require retrospective application.

Consequential amendments

12. The staff has reviewed other IFRSs for potential consequential amendments triggered by this proposed amendment. As a result of this review, the staff does not propose any consequential amendment.

Annual Improvements criteria assessment

13. The staff notes that the current wording of paragraph 8 of IAS 16 contains unclear guidance as to the classification of servicing equipment and adds an unnecessary condition to the definition of PP&E. While improving consistency, the proposed amendment does not change an existing principle or introduce a new principle.

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Therefore, the staff believes that the proposed improvement meets the existing criteria for inclusion in the 2009-2011 *Annual Improvements*.

Questions to the Board

14. The Committee discussed this issue and agreed to recommend that the Board should include this issue in the *Annual Improvements 2009-2011* cycle.

Question 1 – Committee recommendation on the need for the amendment

Does the Board agree with the Committee recommendation to amend IAS 16 as proposed in paragraphs 9-10?

Question 2 – Staff assessment of the proposed amendment against the criteria for inclusion in the *Annual Improvements* process

Does the Board agree with the inclusion of the proposed amendment to IAS 16 in the *Annual Improvements* cycle for 2009-2011?

Question 3 – Wording for the proposed amendment

Does the Board agree with the wording for the proposed amendment as set out in Appendix A?

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Appendix A**

Appendix A - Drafting for proposed amendment

- A1. This appendix includes proposed drafting of the proposed amendment. It is based on the text included in the most recently issued standards (including the *Improvements to IFRSs* published in May 2010). New text is underlined and deleted text is struck through.

Proposed amendment to IAS 16 *Property, Plant and Equipment*

Paragraph 8 is amended and paragraph 81F is added.

Recognition

- 8 Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed. However, major spare parts, ~~and stand-by equipment~~ and servicing equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. ~~Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.~~

Effective date and transition

Effective date

- 81F *Improvements to IFRSs* issued in [date] amended paragraph 8. An entity shall apply this amendment for annual periods beginning on or after 1 January 2012. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

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Appendix A

**Basis for Conclusions on proposed amendment to IAS 16
*Property, Plant and Equipment***

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Classification of servicing equipment as inventory or PP&E

- BC1 In response to an inconsistency in the classification requirements for servicing equipment, the Board proposes to clarify that servicing requirements should be items of property, plant and equipment when they are used during more than one period and inventory otherwise. In doing so, the Board proposes to put the emphasis on the definition of property, plant and equipment. As a consequence, the Board also proposes to delete the “used only in connection with” condition on the grounds that this condition is too restrictive compared to the current definition of property, plant and equipment.