



Project	<i>Annual Improvements Project – 2009 - 2011 cycle – Identification of issues</i>
Topic	<i>IAS 16 Property, Plant and Equipment – Clarification on classification of servicing equipment as inventory or PP&E</i>

Introduction

1. The Committee received a request in April 2010 asking for improvement in IAS 16 *Property, Plant and Equipment* (PP&E) with respect to servicing equipment and classification as PP&E or inventory.

Objective of the paper

2. The objective of this paper is to:
 - (a) provide an analysis on the issue,
 - (b) recommend the issue be included in the next *Improvements to IFRSs* exposure draft, and
 - (c) propose wording in Appendix A for the proposed improvement.

The issue

3. A constituent pointed out that paragraph 8 of IAS 16 is unclear with respect to the classification of servicing equipment as PP&E or inventory. The confusion arises from a perceived contradiction in the way servicing equipment is addressed in the paragraph.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRS Interpretation Committee.

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 Committee or 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 Committee or the IASB can make such a determination.

Decisions made by the Committee are reported in IFRIC *Update*.

Interpretations are published only after the Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

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4. In some jurisdictions, this contradiction 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.
5. This constituent states that this is an issue as it unduly overstates inventory compared with PP&E.
6. This constituent therefore asks that paragraph 8 of IAS 16 is clarified that servicing equipment used during more than one period is an item of PP&E whatever the item or items of PP&E it is used in connection with.

Staff analysis

7. 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.
8. The first sentence of paragraph 8 provides guidance to classify spare parts and servicing equipment as inventory. Meanwhile, the second sentence provides for major spare parts and stand-by equipment to be classified as PP&E when expected to be used during more than one period.
9. The staff notes that servicing equipment, while addressed in the first sentence, is not referred to in the second sentence. This could be understood as meaning that servicing equipment should not be classified as PP&E even if it is used during more than one period.
10. In addition, the last sentence requires servicing equipment to be classified as PP&E when it is used only in connection with an item of PP&E. This last sentence suggests that servicing equipment used during more than one period

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shall be classified as inventory if it does not meet the “used only in connection with” condition.

11. Another consequence of the current wording is that servicing equipment, even if used within one period, is classified as a PP&E if it is used only in connection with an item of PP&E.
12. The staff thinks that the intent is that major items used during more than one period are to be classified as items of PP&E, as stated in the definition in paragraph 6 of IAS 16. Therefore the staff does not see any reason to introduce an additional condition for items to be “used only in connection with” in paragraph 8 of IAS 16.
13. The staff notes that paragraph 8 of IAS 16 contains:
 - (a) unclear guidance for service equipment; and
 - (b) a condition conflicting with the definition of PP&E to classify spare parts and servicing equipment as PP&E.
14. Therefore, 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; 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.
15. 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 22 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The transition provisions for the proposed amendment therefore require retrospective application.

Question 1 – Staff recommendation

Does the Committee agree with the staff recommendation to clarify that servicing equipment shall be items of PP&E when used during more than one period?

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Does the Committee agree with the deletion of the requirement that spare parts and servicing equipment used only in connection with an item of PP&E should be classified as PP&E?

Does the Committee agree with the staff recommendation on the transition provisions for this proposed amendment?

16. The wording for the proposed amendment is set out in Appendix A to this paper.

Question 2 – Proposed wording

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

If not, what wording would the Committee suggest?

Assessment against *Annual Improvements* criteria

Assessment against currently used criteria

17. The existing criteria for inclusion in the 2009-2011 *Annual Improvements* cycle are that the change is non-urgent and necessary.
18. 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. Therefore, the staff believes that the proposed improvement meets the existing criteria for inclusion in the 2009-2011 *Annual Improvements*.

Proposed new criteria

19. The Trustees have asked the Board to present enhanced criteria in determining the scope for the *Annual Improvements* process. This request is in response to comments received from constituents regarding appropriateness of criteria for judging whether an issue is an *Annual Improvement*.
20. At this stage, given the proposed new criteria are still to be finalised, the staff assesses inclusion in 2009-2011 *Annual Improvements* cycle with regards to the

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current criteria only. The staff will update the assessment accordingly prior to the publication of the exposure draft.

21. The staff recommends the change proposed in paragraph 14 be included in the 2009-2011 *Annual Improvements* cycle.

Question 3 – Assessment of improvements against criteria for inclusion in *Annual Improvements*

Does the Committee agree that the proposed improvement in paragraph 14 meets the current criteria for inclusion in *Annual Improvements*?

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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 Bound Volume as of 1 January 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. 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.