

IAS 16: Depreciation of Spare Parts, Stand-by Equipment and Servicing Equipment

Extract, IFRS Discussion Group Report on Meeting – December 9, 2014

Annual Improvements 2009–2011 Cycle, issued by the IASB in May 2012, amended paragraph 8 of IAS 16 *Property, Plant and Equipment* to state that “items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this IFRS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.” The amendments were effective for annual periods beginning on or after January 1, 2013.

Based on the amendments, if spare parts, stand-by equipment and servicing equipment are expected to be used during more than one period, they would be classified as property, plant and equipment. If they are not expected to be used during more than one period, they should be treated as inventory. Materiality judgments are often considered when deciding how spare parts, stand-by equipment and servicing equipment are accounted for.

When spare parts are classified as property, plant and equipment, the question of when to commence depreciation becomes evident. Paragraph 55 of IAS 16 states that “depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.”

Issue: When should depreciation commence for a spare part?

View A – Depreciation should begin when the spare part is available to be used.

Consideration may be given to whether a spare part is only “on stand-by”, that is, the spare parts may be major items and parts critical to be kept on hand to ensure uninterrupted operation of production equipment. These are often referred to as “critical spares” or “insurance spares” in the mining industry. If the spare part is “available for use” when an identical item stops working, it could be argued that depreciation should commence. The depreciation period would start immediately over the lesser of its useful life, and the remaining expected useful life of the equipment to which it is associated.

View B – Depreciation should begin when the spare part is put into use.

If major spare parts are not considered critical, the timing of depreciation may differ. For example, if the spare part is expected to be used as a replacement part at a future point in time, the spare part will be installed and put into use at a later date. Depreciation commences when it is installed as a replacement part. These types of items are often referred to as “capital spares” in the mining industry.

The Group's Discussion

Group members noted that in determining when depreciation commences for a spare part, an entity needs to consider the underlying nature of the spare part (i.e., if it is considered a “critical spare” or “capital spare”). One important factor to consider is whether there is a reasonable expectation that the spare part will be used in order to determine when the service potential is being consumed. For critical spares, Group members noted that the service potential is being consumed over time because in the event of an emergency breakdown, the spare part will function immediately. For capital spares, there is a reasonable expectation that it will be put into use such that the service potential starts to be consumed when it is installed. Therefore, Group members concluded that when depreciation commences for a spare part depends on the underlying nature of the spare part.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.