MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Project Team, Cowan (ext. 233)
Subject:	Minutes of the March 8, 2006, Board Meeting—Planned Major Maintenance Activities Agenda Request
Date:	March 14, 2006
cc:	L. Smith, Bielstein, Golden, MacDonald, Project Team (Jolla, Beswick, Cowan), Gabriele, Swift, Polley, Leisenring, Vernuccio, FASB Intranet

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

<u>Topic</u>: Planned Major Maintenance Activities Agenda Request

<u>Basis for Discussion</u>: Memorandum—Agenda Request: Planned Major Maintenance Activities, dated February 22, 2006

<u>Length of Discussion</u>: 9:00 a.m. to 9:50 a.m.

<u>Attendance</u>:

Board members present:	Herz, Crooch, Batavick, Trott, Seidman, Schipper, Young, Leisenring (IASB)
Board members absent:	None
Staff in charge of topic:	Jolla
Other staff at Board table:	L. Smith, Golden, Beswick, Cowan
Outside participants:	None

Summary of Decisions Reached:

The Board decided:

1. To issue guidance in the form of an FSP to eliminate the accrue-in-advance method of accounting for planned major maintenance activities.
2. To address transition guidance at a future Board meeting and directed the staff to research the practicability of retrospective application.

Objective of Meeting:

The objective for today's meeting was to have the Board decide whether or not to add a project to its agenda to address accounting for planned major maintenance activities. The objective was met.

Matters Discussed and Decisions Reached:

1. Ms. Jolla opened the Board's discussion of planned major maintenance activities (PMMA) by summarizing the background of the issue. Ms. Jolla stated that the Board had objected to AcSEC's issuing of the final SOP, *Accounting for Certain Cost and Activities Related to Property, Plant, and Equipment*, in April 2004. In July 2004, AcSEC requested that the Board address four issues via an FSP or other short-term project. AcSEC also suggested that the Board undertake a broader project to address the accounting for property, plant, and equipment (PP&E). Ms. Jolla continued by stating that the Board considered AcSEC's recommendations and directed the FASB staff to further research the accounting for PMMA to refine the scope of a potential project.
2. Ms. Jolla explained that the staff held discussions with various constituents including auditors, preparers, and the staffs of the SEC and IASB. The staff also reviewed the financial statements of companies across a variety of industries that had significant investments in PP&E and reviewed the comment letters on the proposed SOP to understand the views of respondents regarding the accounting for PMMA.

3. Ms. Jolla stated that the primary guidance on accounting for PMMA is the AICPA Industry Audit Guide, *Audits of Airlines*, which permits four alternative methods of accounting for PMMA. Those alternative methods are (a) direct expense, (b) built-in overhaul, (c) deferral, (d) and accrual. The staff also reviewed international accounting literature. International Accounting Standard No. 16, *Property, Plant, and Equipment*, provides guidance on the accounting for maintenance or servicing costs. Ms. Jolla stated that IAS 16 requires that maintenance or service costs be "recognised in profit or loss as incurred". IAS 16 also requires an entity to capitalize the replacement of an individual part of PP&E if the recognition criteria for PP&E are met.
4. Ms. Jolla stated that the staff's research revealed diversity in the methods used to account for PMMA. She stated that in most companies in the airline and chemical industries the direct expense method is used in accounting for PMMA. Entities in the shipping industry typically account for PMMA using the deferral method. The staff also noted that diversity existed within industries. For example, in the oil and gas industry, diversity in methods is widely dispersed among the alternatives other than the built-in overhaul method. The staff also noted that in regulated industries accounting for PMMA was generally dictated by regulatory requirements. Ms. Jolla conveyed the staff's belief that there is also significant diversity in the way companies define PMMA. Ms. Jolla explained that the staff's research had also revealed that the accrue-in-advance method was used less than the direct expense and deferral methods and that some companies had recently switched from the accrue-in-advance method to another method.
5. Following the background and summary of the staff's research, Ms. Jolla asked the Board to decide if it would issue guidance on the accounting for PMMA. Ms. Jolla outlined the following four alternatives:
    a. Do not issue any additional guidance on the accounting for PMMA.
    b. Issue guidance in the form of an FSP to eliminate the accrue-in-advance method.
    c. Issue guidance in the form of an FSP to require direct expense of all maintenance activities (that is, eliminate the accrue-in-advance,

deferral, and built-in overhaul methods). If the maintenance activities result in the acquisition or replacement of PP&E, then the entity would capitalize assets according to its current policy for initial acquisition of PP&E and derecognize those parts that are replaced.

d. Issue guidance in the form of an FSP to require direct expense of all maintenance activities (that is, eliminate accrue-in-advance, deferral, and built-in overhaul methods).

6. Ms. Jolla stated that the staff recommended alternative C because of the opportunity to converge with IAS 16 and to eliminate the diversity in practice, by having a single method of accounting for PMMA without addressing the elements of a comprehensive project on PP&E. Further, alternative C removes the accrual of a liability that is inconsistent with the definition in FASB Concepts Statement No. 6, *Elements of Financial Statements,* (accrue-in-advance method) and eliminates double counting of assets (deferral method).

7. Mr. Trott disagreed with the staff's assertion that alternative C would provide convergence with IAS 16. He specifically mentioned inspection costs, which are capitalized under IAS 16, but expensed in the staff's recommended alternative. Mr. Trott also noted that some companies effectively apply the built-in overhaul method under IAS 16, however, built-in overhaul is specifically prohibited in alternative C.

8. Ms. Jolla clarified that the level of convergence achieved through alternative C would depend on the PP&E policies of companies. A company could have a PP&E policy that would lead to accounting under alternative C that is very similar to accounting under IAS 16. Mr. Smith commented that the staff was not opposed to making alternative C more robust. He stated that the staff took a pragmatic approach in alternative C to avoid the need to define what should or should not be capitalized.

9. Mr. Leisenring stated that a fundamental problem with this area is the term *planned*. The maintenance is really required, either by regulation or economic reasons. He further stated that alternative C moves closer to

convergence, but any solution without a componentized approach cannot fully converge to IAS 16.

10. Mr. Crooch stated that the complexity of a potential project and the priority of items on the Board's agenda already are the reasons that he supports alternative B (alleviating the accrue-in-advance method). Mr. Crooch also stated that if alternative B was not chosen, the only other alternative he would not object to was alternative A, not issuing any guidance.
11. Mr. Trott stated that the accrue-in-advance, the direct expense, and the deferral methods are incorrect. He stated that the built-in overhaul method is the most correct, but would require significant resources. Mr. Trott explained that he did not support only eliminating the accrue-in-advance method because doing so would not accomplish convergence or significantly reduce the diversity in practice. He further stated that alternative C did not accomplish significant convergence or comparability among entities and that alternative D, while simple, is incorrect because items that meet the definition of assets are not recognized. Mr. Trott expressed his preference for a fifth alternative requiring the built-in overhaul method. In the absence of this alternative, Mr. Trott stated that he would prefer not to issue any guidance.
12. Mr. Batavick stated that he preferred not to issue guidance, however, he understands that the SEC will require elimination of the accrue-in-advance method if the Board does not. Due to the SEC's view, Mr. Batavick stated that he would rather have the Board eliminate the accrue-in-advance method and avoid the restatements that will occur if the Board does not act.
13. Ms. Schipper stated that the accrue-in-advance method is incorrect because it creates liabilities for items that do not meet the definition of a liability in Concepts Statement 6. She also explained that the deferral method and the direct expense method create measurement issues in that they overstate and understate assets, respectively. Ms. Schipper stated that the built-in overhaul method is conceptually defensible, but the Board it is not able to address PMMA using the built-in overhaul method given its resources and priorities. Because of these reasons, Ms. Schipper stated that she preferred a modification of alternative C that would expense all maintenance activities

unless a company makes a policy election to capitalize items that meet the criteria of IAS 16. This alternative, she explained, would provide convergence without taking extensive time and resources. Ms. Schipper stated that if the modified alternative C as she proposed is not an option, she would not object to only eliminating the accrue-in-advance method.

14. Ms. Seidman stated that she preferred alternative B, to eliminate the accrue-in-advance method, because of the complexity involved in addressing PMMA and because the Board's current agenda has resource constraints.
15. Mr. Young stated that he did not believe eliminating the accrue-in-advance method should be an urgent concern of the Board since the method is likely to go away due to the SEC's informal comments regarding it. He stated that eliminating the deferral method was more of a concern to him because it is hard for users of the financial statements to understand and use in projections. Mr. Young stated that he supported any alternative that eliminates the deferral method.
16. Mr. Herz stated that he does not believe the accrue-in-advance or the deferral methods are appropriate. He also stated that addressing PMMA using the built-in overhaul approach is likely to become too large of a project for the Board to accept given its current agenda. Mr. Herz stated that an alternative that expensed all maintenance, but allowed for a policy election to capitalize items that meet the criteria in IAS 16, as proposed by Ms. Schipper, may provide a workable solution.
17. Mr. Herz asked which Board members would object to alternative B, which eliminates the accrue-in-advance method. Mr. Young restated that he would object to any alternative that does not eliminate the deferral method. Mr. Herz then asked which Board members would object to alternative C. Three Board members said that they would object to alternative C (GMC, LFS, and GJB). Mr. Herz asked which Board members would support alternative B to eliminate the accrue-in-advance method of accounting for PMMA. Four Board members voted in favor of alternative B (GMC, LFS, GJB, and RHH).
18. Ms. Jolla asked the Board if they would like to consider transition alternatives. Mr. Trott asked why the staff had not recommended retrospective application

in accordance with FASB Statement No. 154, *Accounting Changes and Error Corrections*. Ms. Jolla explained that the transition guidance that the staff recommended was developed in connection with alternative C. The Board asked the staff to research the practicability of retrospective application for alternative B, eliminating the accrue-in-advance method.

Follow-up Items:

Research the practicability of accounting for the adoption of the provisions in the FSP as a change in accounting principle with retrospective application as described in Statement 154.

General Announcements:

None