

# Defining Issues<sup>®</sup>

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## Alert

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## Proposal on Planned Major Maintenance

Companies would be prohibited from accruing as a liability the future costs of periodic major overhauls and maintenance of plant and equipment if a new proposed FASB Staff Position is adopted.<sup>1</sup> Other methods of accounting for major overhauls and maintenance of plant and equipment would continue to be acceptable. The proposed Staff Position would apply to entities in all industries for fiscal years beginning after December 15, 2006, and retrospective application would be required.

The term “planned major maintenance” is not defined in authoritative accounting literature. As used in the proposed Staff Position, it refers to a significant overhaul or maintenance of plant and equipment. Major maintenance is commonly performed on airplanes, ships, oil refineries, electric power plants, and heavy-manufacturing equipment and facilities.

### The Method Targeted for Prohibition

The proposed Staff Position would prohibit the accrue-in-advance method. Companies applying this method ratably recognize planned major maintenance costs by accruing a liability in periods before the maintenance is performed. When the maintenance is performed, the costs incurred are offset against the established liability. The FASB’s rationale for proposing to prohibit the accrue-in-advance method is that the costs for future planned major maintenance activities do not meet the definition of a liability, because no obligating event has occurred.

### Acceptable Methods

The guidance on accounting for planned major maintenance activities in the AICPA guide on audits of airlines is often applied by analogy by companies in other industries.<sup>2</sup> The guide describes four acceptable methods of accounting: the accrue-in-advance, direct expense, built-in

<sup>1</sup> Proposed FASB Staff Position, No. AUG AIR-a, Accounting for Planned Major Maintenance Activities, May 31, 2006, available at [www.fasb.org](http://www.fasb.org).

<sup>2</sup> AICPA Industry Audit Guide, Audits of Airlines, With Conforming Changes as of May 1, 2003.



overhaul, and deferral methods. The proposed Staff Position would remove the accrue-in-advance method from the set of acceptable methods. The other three methods would continue to be acceptable.

The FASB decided not to provide any additional guidance on the other accounting methods in use or otherwise address them.

The SEC staff has taken the position that a change from the accrue-in-advance method to one of the other methods would be considered a preferable change in accounting principle.<sup>3</sup> The staff also stated that companies should disclose their policy for accounting for planned major maintenance and, if using the accrue-in-advance method, should include a schedule of the liability in accordance with Rule 12-09 of Regulation S-X.<sup>4</sup>

AcSEC had proposed a change in the guidance on accounting for planned major maintenance activities as part of its project on property, plant, and equipment. The 2001 proposal would have required companies to apply the direct expense method and would have eliminated the other three methods.<sup>5</sup> However, the FASB did not approve the final SOP that incorporated the proposal, and the project was removed from AcSEC's agenda.

#### **Effective Date and Transition**

The final Staff Position would be effective for fiscal years beginning after December 15, 2006 (January 1, 2007 for calendar-year companies). Retrospective application in accordance with Statement 154 would be required unless it is impracticable.<sup>6</sup>



The deadline for submitting comments is July 31, 2006.

The descriptive and summary statements in this presentation are not intended to be a substitute for the texts of FASB pronouncements, AICPA literature, SEC regulations, or any other applicable or potential requirements. Companies applying GAAP or filing with the SEC should apply the texts of the relevant laws, regulations, and accounting requirements, consider their particular circumstances, and consult their accounting and legal advisors.

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<sup>3</sup> EITF Topic D-88, Planned Major Maintenance Activities, March 16, 2000, available at [www.fasb.org](http://www.fasb.org).

<sup>4</sup> Regulation S-X, Rule 12-09, Valuation and Qualifying Accounts, available at [www.sec.gov](http://www.sec.gov).

<sup>5</sup> AcSEC, Proposed Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment, June 29, 2001.

<sup>6</sup> FASB Statement No. 154, Accounting Changes and Error Corrections, May 2005, available at [www.fasb.org](http://www.fasb.org).