Notice for Recipients of This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) addresses the accounting for planned major maintenance activities. This FSP would amend certain provisions in the AICPA Industry Audit Guide, *Audits of Airlines*.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues or specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

PROPOSED FASB STAFF POSITION

No. AUG AIR-a

Title: Accounting for Planned Major Maintenance Activities

Comment Deadline: July 31, 2006

Introduction

1. This FASB Staff Position (FSP) addresses the accounting for planned major maintenance activities. This FSP amends certain provisions in the AICPA Industry Audit Guide, *Audits of Airlines* (Airline Guide).

Background and Scope

2. The principal source of guidance on the accounting for planned major maintenance activities is the Airline Guide. The Airline Guide permits four alternative methods of accounting for planned major maintenance activities: direct expense, built-in overhaul, deferral, and accrual (accrue-in-advance). Those methods are widely used by other industries.

3. The Board believes that the accrue-in-advance method of accounting for planned major maintenance activities results in the recognition of liabilities that do not meet the definition of a liability in FASB Concepts Statement No. 6, *Elements of Financial Statements*. The guidance in this FSP is applicable to entities in all industries.

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4. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities.

Amendments to Airline Guide

5. This FSP amends the Airline Guide as follows: [Added text is <u>underlined</u> and deleted text is ~~struck out~~.]

a. Paragraph 3.69:

> Air carriers should adopt an accounting method that recognizes overhaul expenses in the appropriate period. This may result in different methods for different aircraft, as well as different methods for airframe overhauls and engine overhauls. The method chosen should recognize, among other things, the carrier's operating practices with respect to airframe and engine overhauls. The following accounting methods are ~~most often employed~~<u>permitted</u>:

- Direct expensing method
- Built-in overhaul method
- Deferral method
- ~~Accrual method~~

b. Paragraph 3.73:

~~*Accrual Method*. The accrual method provides for estimating the cost of the initial overhaul and accruing the cost, based on an hourly rate, to the overhaul. At that time, the actual cost of overhaul is charged to the accrual, with any deficiency or excess charged or credited to expense. The cost of the next overhaul is then estimated, based on the new rate, and accrued to that overhaul, at which time the process is repeated.~~

c. Paragraph 3.74:

In the case of the built-in overhaul ~~and accrual~~ method~~s~~, the estimated cost of initial overhauls should be tested by reference to manufacturers' specifications, historical experience, and the like. Actual capitalized costs of succeeding overhauls should be examined for propriety. Time between overhauls (TBO) should be tested by reference to FAA overhaul requirements, manufacturers' specifications, or the carrier's experience. Resulting rates and their application should be tested for reasonableness.

d. Paragraph 4.11.2:

Maintenance and engineering accounting—In the airline industry ~~four~~ three alternative methods exist for performing scheduled maintenance accounting (direct expensing method, built-in overhaul method, and deferral method~~, and accrual method~~). An airline using the~~ accrual,~~ deferral~~,~~ or built-in overhaul methods must make certain assumptions as to the cost and timing of the scheduled maintenance events, which can affect the recorded results. In addition an airline must apply the method selected consistently and should not switch back and forth between methods.

Effective Date and Transition

6. The guidance in this FSP shall be applied to the first fiscal year beginning after December 15, 2006. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The guidance in this FSP shall be applied retrospectively for all financial statements presented, unless it is impracticable to do so. This should include the recognition of:

a. The cumulative effect of the change to the new accounting principle on periods prior to those presented in the carrying amounts of assets and liabilities as of the beginning of the first period presented

b. An offsetting adjustment, if any, made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the new accounting principle.

7. If retrospective application to all years presented is impracticable, the financial statements presented shall be retrospectively adjusted for as many consecutive years as practicable and the cumulative effect of applying the guidance in this FSP shall be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the FSP can be applied. An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period. If it is impracticable to retrospectively apply the provisions of this FSP to any prior year, the cumulative effect shall be included in beginning retained earnings in the year in which the guidance in the FSP is first applied.

Disclosures

8. As of the date this FSP is adopted, an entity shall disclose the following:

a. The method of accounting for planned major maintenance activities selected
b. A description of the prior-period information that has been retrospectively adjusted, if any
c. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for any periods retrospectively adjusted
d. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented
e. If retrospective application to all prior periods is impracticable, the reasons why it is impracticable and a description of the alternative method used to report the change (paragraph 6).