

Accounting Standards Interpretation (ASI) 2¹

Accounting for Machinery Spares

Accounting Standard (AS) 2, Valuation of Inventories and AS 10, Accounting for Fixed Assets

ISSUE

1. Which machinery spares are covered under AS 2 and AS 10 and what should be the accounting for machinery spares under the respective standards.

CONSENSUS

2. Machinery spares which are not specific to a particular item of fixed asset but can be used generally for various items of fixed assets should be treated as inventories for the purpose of AS 2. Such machinery spares should be charged to the statement of profit and loss as and when issued for consumption in the ordinary course of operations.
3. Whether to capitalise a machinery spare under AS 10 or not will depend on the facts and circumstances of each case. However, the machinery spares of the following types should be capitalised being of the nature of capital spares/insurance spares –
 - (i) Machinery spares which are specific to a particular item of fixed asset, i.e., they can be used only in connection with a particular item of the fixed asset, and
 - (ii) their use is expected to be irregular.
4. Machinery spares of the nature of capital spares/insurance spares should be capitalised separately at the time of their purchase whether procured at the time of purchase of the fixed asset concerned or subsequently. The

¹ Published in 'The Chartered Accountant', December 2002, pp. 603-604. The authority of this ASI is the same as that of the Accounting Standards to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standards to which it relates. ASI is intended to apply only to material items.

total cost of such capital spares/insurance spares should be allocated on a systematic basis over a period not exceeding the useful life of the principal item, i.e., the fixed asset to which they relate.

5. When the related fixed asset is either discarded or sold, the written down value less disposal value, if any, of the capital spares/insurance spares should be written off.

6. The stand-by equipment is a separate fixed asset in its own right and should be depreciated like any other fixed asset.

BASIS FOR CONCLUSIONS

7. Paragraphs 8.2 and 25 of AS 10, 'Accounting for Fixed Assets', state as below:

"8.2 Stand-by equipment and servicing equipment are normally capitalised. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item."

"25. Fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal."

8. Paragraph 4 of AS 2, 'Valuation of Inventories', states as below:

"4. Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process. Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets."

9. Machinery spares of the nature of capital spares/insurance spares are capitalised. Capital spares/insurance spares are meant for occasional use. Since they can be used only in relation to a specific item of fixed asset, they are to be discarded in case that specific fixed asset is disposed of. In other words, such spares are integral parts of the fixed asset.

10. A stand-by equipment is not of the nature of a spare but is of the nature of another piece of equipment which is being used in the manufacturing process. For example, a generator set kept in store as a stand-by to the generator set which is being used in the manufacturing process. Therefore, the stand-by equipment is a separate fixed asset in its own right and is depreciated like any other fixed asset.