

Case 16-10
Spare the Rod

Stellar Bright Solar (SBS or the “Company”) is a business that contracts to develop, construct, and operate solar power plants.

SBS entered into a contract to support the Big Desert solar power plant. According to the contract terms, SBS is responsible for the day-to-day operations of Big Desert as well as for general maintenance and repairs. Big Desert expects SBS to provide routine maintenance for continued operation of the plant and respond to equipment breakdowns and failures by providing immediate repairs. In addition, the terms of the contract require SBS to procure necessary materials to operate, maintain, and repair the plant. To comply with this requirement, the Company must maintain a certain level of materials and supplies (the “spare parts”) at all times.

On a regular basis, SBS reviews a listing provided by Big Desert of recommended spare parts for various components of the solar power plant and procures the necessary parts. Vendors deliver the parts to SBS along with a complete listing that describes the quantity and cost of the parts provided. SBS maintains this listing and uses it to (1) track expected usage of the spare parts and (2) determine their expected useful lives.

The spare parts consist of customized and generic parts that vary in cost, procurement time, expected usage (i.e., emergency replacement, standard replacement), and expected useful life. Big Desert uses the composite depreciation method for substantially all of the plant, and it expenses all major plant maintenance.

Required:

1. How should SBS classify the spare parts that it expects to use within one year — as inventory or as a prepaid/other current asset?
2. Should Big Desert depreciate the spare parts over their estimated useful lives or expense them as consumed?