

HK (IFRIC) Interpretation 1

Changes in Existing Decommissioning, Restoration and Similar Liabilities



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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HK(IFRIC) Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (HK(IFRIC)-Int 1) is set out in paragraphs 1-10 and the Appendix. HK(IFRIC)-Int 1 is accompanied by Illustrative Examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

HK(IFRIC) INTERPRETATION 1

Changes in Existing Decommissioning, Restoration and Similar Liabilities

References*

- HKAS 1 *Presentation of Financial Statements*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 23 *Borrowing Costs*
- HKAS 36 *Impairment of Assets*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Background

- 1 Many entities have obligations to dismantle, remove and restore items of property, plant and equipment. In this Interpretation such obligations are referred to as 'decommissioning, restoration and similar liabilities'. Under HKAS 16, the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. HKAS 37 contains requirements on how to measure decommissioning, restoration and similar liabilities. This Interpretation provides guidance on how to account for the effect of changes in the measurement of existing decommissioning, restoration and similar liabilities.

Scope

- 2 This Interpretation applies to changes in the measurement of any existing decommissioning, restoration or similar liability that is both:
- (a) recognised as part of the cost of an item of property, plant and equipment in accordance with HKAS 16; and
 - (b) recognised as a liability in accordance with HKAS 37.

For example, a decommissioning, restoration or similar liability may exist for decommissioning a plant, rehabilitating environmental damage in extractive industries, or removing equipment.

* With effect from 1 January 2005, all the existing Statements of Standard Accounting Practice (SSAP) and Interpretations for which there are equivalent International Accounting Standards (IAS) and SIC Interpretations will be renamed as Hong Kong Accounting Standards (HKAS) and Hong Kong (SIC) Interpretations (HK(SIC)-Int) with numbers corresponding to the equivalent IAS and SIC Interpretations, respectively. For full details of this change, please click on the following link: <http://www.hkicpa.org.hk/professionaltechnical/accounting/rm/memorandum.pdf>. If an entity applies this Interpretation for a period beginning before 1 January 2005, the entity shall follow the requirements of SSAPs effective for that period, unless the entity is applying the relevant HKASs for that earlier period. Accordingly, references to the HKASs in this Interpretation should be read as references to the related superseded SSAPs as recorded in the table of concordance set out in the HKICPA website: <http://www.hkicpa.org.hk/professionaltechnical/accounting/dueprocess/concordance.pdf>, where appropriate.

Issue

- 3 This Interpretation addresses how the effect of the following events that change the measurement of an existing decommissioning, restoration or similar liability should be accounted for:
- (a) a change in the estimated outflow of resources embodying economic benefits (eg cash flows) required to settle the obligation;
 - (b) a change in the current market-based discount rate as defined in paragraph 47 of HKAS 37 (this includes changes in the time value of money and the risks specific to the liability); and
 - (c) an increase that reflects the passage of time (also referred to as the unwinding of the discount).

Conclusions

- 4 Changes in the measurement of an existing decommissioning, restoration and similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, shall be accounted for in accordance with paragraphs 5-7 below.
- 5 If the related asset is measured using the cost model:
- (a) subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.
 - (b) the amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss.
 - (c) if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount, and shall account for any impairment loss, in accordance with HKAS 36.
- 6 If the related asset is measured using the revaluation model:
- (a) changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:
 - (i) a decrease in the liability shall (subject to (b)) be ~~credited directly to~~ recognised in other comprehensive income and increase the revaluation surplus within equity, except that it shall be recognised in profit or loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in profit or loss;
 - (ii) an increase in the liability shall be recognised in profit or loss, except that it shall be ~~debited directly to~~ recognised in other comprehensive income and reduce the revaluation surplus within equity to the extent of any credit balance existing in the revaluation surplus in respect of that asset.
 - (b) in the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess shall be recognised immediately in profit or loss.

- (c) a change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date/end of the reporting period. Any such revaluation shall be taken into account in determining the amounts to be taken to profit or loss and equity recognised in profit or loss or in other comprehensive income under (a). If a revaluation is necessary, all assets of that class shall be revalued.
- (d) HKAS 1 requires disclosure on the face of the statement of changes in equity—comprehensive income of each item—component of other comprehensive income or expense that is recognised directly in equity. In complying with this requirement, the change in the revaluation surplus arising from a change in the liability shall be separately identified and disclosed as such.
- 7 The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in profit or loss as they occur. This applies under both the cost model and the revaluation model.
- 8 The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. ~~The allowed alternative treatment of e~~Capitalisation under HKAS 23 is not permitted[§].

Effective date

- 9 An entity shall apply this Interpretation for annual periods beginning on or after 1 September 2004. Earlier application is encouraged. If an entity applies the Interpretation for a period beginning before 1 September 2004, it shall disclose that fact.
- 9A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 6. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

Transition

- 10 Changes in accounting policies shall be accounted for according to the requirements of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

[§] ~~If an entity applies this Interpretation for a period beginning before 1 January 2005, the allowed alternative treatment referred to in the last sentence of this paragraph should be read as the treatment of capitalisation under the previous version of HKAS 23, which was entitled SSAP 19 *Borrowing Costs*, unless the entity is applying HKAS 23 for that earlier period.~~

^{*} If an entity applies this Interpretation for a period beginning before 1 January 2005, the entity shall follow the requirements of the previous version of HKAS 8, which was entitled SSAP 2 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, unless the entity is applying the revised version of that Standard for that earlier period.

Appendix

Amendments to HKFRS 1 First-time Adoption of International Financial Reporting Standards

The amendments in this appendix shall be applied for annual periods beginning on or after 1 September 2004. If an entity applies this Interpretation for an earlier period, these amendments shall be applied for that earlier period.

* * *

The amendments contained in this appendix when this Interpretation was issued have been incorporated into the relevant Standards.

Illustrative examples

These examples accompany, but are not part of, IFRIC 1.

Common facts

- IE1 An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1 January 2000. The plant has a useful life of 40 years. Its initial cost was CU120,000; this included an amount for decommissioning costs of CU10,000, which represented CU70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31 December.

Example 1: Cost model

- IE2 On 31 December 2009, the plant is 10 years old. Accumulated depreciation is CU30,000 (CU120,000 x 10/40 years). Because of the unwinding of discount (5 per cent) over the 10 years, the decommissioning liability has grown from CU10,000 to CU16,300.
- IE3 On 31 December 2009, the discount rate has not changed. However, the entity estimates that, as a result of technological advances, the net present value of the decommissioning liability has decreased by CU8,000. Accordingly, the entity adjusts the decommissioning liability from CU16,300 to CU8,300. On this date, the entity makes the following journal entry to reflect the change:

	CU	CU
Dr decommissioning liability	8,000	
Cr cost of asset		8,000

- IE4 Following this adjustment, the carrying amount of the asset is CU82,000 (CU120,000 – CU8,000 – CU30,000), which will be depreciated over the remaining 30 years of the asset's life giving a depreciation expense for the next year of CU2,733 (CU82,000 ÷ 30). The next year's finance cost for the unwinding of the discount will be CU415 (CU8,300 x 5 per cent).
- IE5 If the change in the liability had resulted from a change in the discount rate, instead of a change in the estimated cash flows, the accounting for the change would have been the same but the next year's finance cost would have reflected the new discount rate.

Example 2: Revaluation model

- IE6 The entity adopts the revaluation model in IAS 16 whereby the plant is revalued with sufficient regularity that the carrying amount does not differ materially from fair value. The entity's policy is to eliminate accumulated depreciation at the revaluation date against the gross carrying amount of the asset.
- IE7 When accounting for revalued assets to which decommissioning liabilities attach, it is important to understand the basis of the valuation obtained. For example:
- (a) if an asset is valued on a discounted cash flow basis, some valuers may value the asset without deducting any allowance for decommissioning costs (a 'gross' valuation), whereas others may value the asset after deducting an allowance for decommissioning costs (a 'net' valuation), because an entity acquiring the asset will generally also assume the decommissioning obligation. For financial reporting purposes, the decommissioning obligation is recognised as a separate liability, and is not deducted from the asset.

* In these examples, monetary amounts are denominated in currency units (CU).

Accordingly, if the asset is valued on a net basis, it is necessary to adjust the valuation obtained by adding back the allowance for the liability, so that the liability is not counted twice.

- (b) if an asset is valued on a depreciated replacement cost basis, the valuation obtained may not include an amount for the decommissioning component of the asset. If it does not, an appropriate amount will need to be added to the valuation to reflect the depreciated replacement cost of that component.

IE8 Assume that a market-based discounted cash flow valuation of CU115,000 is obtained at 31 December 2002. It includes an allowance of CU11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. The amounts included in the balance sheet statement of financial position at 31 December 2002 are therefore:

	CU
Asset at valuation (1)	126,600
Accumulated depreciation	nil
Decommissioning liability	<u>(11,600)</u>
Net assets	<u>115,000</u>
Retained earnings (2)	(10,600)
Revaluation surplus (3)	15,600

Notes:

- (1) Valuation obtained of CU115,000 plus decommissioning costs of CU11,600, allowed for in the valuation but recognised as a separate liability = CU126,600.
- (2) Three years' depreciation on original cost CU120,000 \times 3/40 = CU9,000 plus cumulative discount on CU10,000 at 5 per cent compound = CU1,600; total CU10,600.
- (3) Revalued amount CU126,600 less previous net book value of CU111,000 (cost CU120,000 less accumulated depreciation CU9,000).

IE9 The depreciation expense for 2003 is therefore CU3,420 (CU126,600 \times 1/37) and the discount expense for 2003 is CU600 (5 per cent of CU11,600). On 31 December 2003, the decommissioning liability (before any adjustment) is CU12,200 and the discount rate has not changed. However, on that date, the entity estimates that, as a result of technological advances, the present value of the decommissioning liability has decreased by CU5,000. Accordingly, the entity adjusts the decommissioning liability from CU12,200 to CU7,200.

IE10 The whole of this adjustment is taken to revaluation surplus, because it does not exceed the carrying amount that would have been recognised had the asset been carried under the cost model. If it had done, the excess would have been taken to profit or loss in accordance with paragraph 6(b). The entity makes the following journal entry to reflect the change:

	CU	CU
Dr decommissioning liability	5,000	
Cr revaluation surplus		5,000

* For examples of this principle, see IAS 36 *Impairment of Assets* and IAS 40 *Investment Property*.

IE11 The entity decides that a full valuation of the asset is needed at 31 December 2003, in order to ensure that the carrying amount does not differ materially from fair value. Suppose that the asset is now valued at CU107,000, which is net of an allowance of CU7,200 for the reduced decommissioning obligation that should be recognised as a separate liability. The valuation of the asset for financial reporting purposes, before deducting this allowance, is therefore CU114,200. The following additional journal entry is needed:

	CU	CU
Dr accumulated depreciation (1)	3,420	
Cr asset at valuation		3,420
Dr revaluation surplus (2)	8,980	
Cr asset at valuation (3)		8,980

Notes:

- (1) Eliminating accumulated depreciation of CU3,420 in accordance with the entity's accounting policy.
- (2) The debit is to revaluation surplus because the deficit arising on the revaluation does not exceed the credit balance existing in the revaluation surplus in respect of the asset.
- (3) Previous valuation (before allowance for decommissioning costs) CU126,600, less cumulative depreciation CU3,420, less new valuation (before allowance for decommissioning costs) CU114,200.

IE12 Following this valuation, the amounts included in the balance sheet ~~statement of financial position~~ are:

	CU
Asset at valuation	114,200
Accumulated depreciation	nil
Decommissioning liability	<u>(7,200)</u>
Net assets	<u>107,000</u>
Retained earnings (1)	(14,620)
Revaluation surplus (2)	11,620

Notes:

- (1) CU10,600 at 31 December 2002 plus 2003's depreciation expense of CU3,420 and discount expense of CU600 = CU14,620.
- (2) CU15,600 at 31 December 2002, plus CU5,000 arising on the decrease in the liability, less CU8,980 deficit on revaluation = CU11,620.

Example 3: Transition

IE13 The following example illustrates retrospective application of the Interpretation for preparers that already apply IFRSs. Retrospective application is required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, where practicable, and is the treatment in IAS 8. The example assumes that the entity:

- (a) adopted IAS 37 on 1 July 1999;
- (b) adopts the Interpretation on 1 January 2005; and
- (c) before the adoption of the Interpretation, recognised changes in estimated cash flows to settle decommissioning liabilities as income or expense.

IE14 On 31 December 2000, because of the unwinding of the discount (5 per cent) for one year, the decommissioning liability has grown from CU10,000 to CU10,500. In addition, based on recent facts, the entity estimates that the present value of the decommissioning liability has increased by CU1,500 and accordingly adjusts it from CU10,500 to CU12,000. In accordance with its then policy, the increase in the liability is recognised in profit or loss.

IE15 On 1 January 2005, the entity makes the following journal entry to reflect the adoption of the Interpretation:

	CU	CU
Dr cost of asset	1,500	
Cr accumulated depreciation		154
Cr opening retained earnings		1,346

IE16 The cost of the asset is adjusted to what it would have been if the increase in the estimated amount of decommissioning costs at 31 December 2000 had been capitalised on that date. This additional cost would have been depreciated over 39 years. Hence, accumulated depreciation on that amount at 31 December 2004 would be CU154 (CU1,500 x 4/39 years).

IE17 Because, before adopting the Interpretation on 1 January 2005, the entity recognised changes in the decommissioning liability in profit or loss, the net adjustment of CU1,346 is recognised as a credit to opening retained earnings. This credit is not required to be disclosed in the financial statements, because of the restatement described below.

IE18 IAS 8 requires the comparative financial statements to be restated and the adjustment to opening retained earnings at the start of the comparative period to be disclosed. The equivalent journal entries at 1 January 2004 are shown below. In addition, depreciation expense for the year ended 31 December 2004 is increased by CU39 from the amount previously reported:

	CU	CU
Dr cost of asset	1,500	
Cr accumulated depreciation		115
Cr opening retained earnings		1,385

Basis for Conclusions on HK(IFRIC)-Int 1

This Basis for Conclusions accompanies, but is not part of, IFRIC 1.

The original text has been marked up to reflect the revision of IAS 1 Presentation of Financial Statements in 2007: new text is underlined and deleted text is struck through.

HK(IFRIC) Interpretation 1 is based on IFRIC Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. In approving HK(IFRIC) Interpretation 1, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on HK(IFRIC) Interpretation 1. Accordingly, there are no significant differences between HKFRS Interpretation 1 and IFRIC Interpretation 1. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 1 referred to below generally correspond with those in HK(IFRIC) Interpretation 1.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

Background

BC2 IAS 16 *Property, Plant and Equipment* requires the cost of an item of property, plant and equipment to include the initial estimate of the costs of dismantling and removing an asset and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

BC3 IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires that the measurement of the liability, both initially and subsequently, should be the estimated expenditure required to settle the present obligation at the ~~balance sheet date~~end of the reporting period and should reflect a current market-based discount rate. It requires provisions to be reviewed at ~~each balance sheet date~~the end of each reporting period and adjusted to reflect the current best estimate. Hence, when the effect of a change in estimated outflows of resources embodying economic benefits and/or the discount rate is material, that change should be recognised.

BC4 The IFRIC was asked to address how to account for changes in decommissioning, restoration and similar liabilities. The issue is whether changes in the liability should be recognised in current period profit or loss, or added to (or deducted from) the cost of the related asset. IAS 16 contains requirements for the initial capitalisation of decommissioning costs and IAS 37 contains requirements for measuring the resulting liability; neither specifically addresses accounting for the effect of changes in the liability. The IFRIC was informed that differing views exist, resulting in a risk of divergent practices developing.

BC5 Accordingly, the IFRIC decided to develop guidance on accounting for the changes. In so doing, the IFRIC recognised that the estimation of the liability is inherently subjective, since its settlement may be very far in the future and estimating (a) the timing and amount of the outflow of resources embodying economic benefits (eg cash flows) required to settle the obligation and (b) the discount rate often involves the exercise of considerable judgement. Hence, it is likely that revisions to the initial estimate will be made.

Scope

- BC6 The scope of the Interpretation addresses the accounting for changes in estimates of existing liabilities to dismantle, remove and restore items of property, plant and equipment that fall within the scope of IAS 16 and are recognised as a provision under IAS 37. The Interpretation does not apply to changes in estimated liabilities in respect of costs that fall within the scope of other IFRSs, for example, inventory or production costs that fall within the scope of IAS 2 *Inventories*. The IFRIC noted that decommissioning obligations associated with the extraction of minerals are a cost either of the property, plant and equipment used to extract them, in which case they are within the scope of IAS 16 and the Interpretation, or of the inventory produced, which should be accounted for under IAS 2.

Basis for Consensus

- BC7 The IFRIC reached a consensus that changes in an existing decommissioning, restoration or similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, should be added to or deducted from the cost of the related asset and depreciated prospectively over its useful life.
- BC8 In developing its consensus, the IFRIC also considered the following three alternative approaches for accounting for changes in the outflow of resources embodying economic benefits and changes in the discount rate:
- (a) capitalising only the effect of a change in the outflow of resources embodying economic benefits that relate to future periods, and recognising in current period profit or loss all of the effect of a change in the discount rate.
 - (b) recognising in current period profit or loss the effect of all changes in both the outflow of resources embodying economic benefits and the discount rate.
 - (c) treating changes in an estimated decommissioning, restoration and similar liability as revisions to the initial liability and the cost of the asset. Under this approach, amounts relating to the depreciation of the asset that would have been recognised to date would be reflected in current period profit or loss and amounts relating to future depreciation would be capitalised.
- BC9 The IFRIC rejected alternative (a), because this approach does not treat changes in the outflow of resources embodying economic benefits and in the discount rate in the same way, which the IFRIC agreed is important, given that matters such as inflation can affect both the outflow of economic benefits and the discount rate.
- BC10 In considering alternative (b), the IFRIC observed that recognising all of the change in the discount rate in current period profit or loss correctly treats a change in the discount rate as an event of the present period. However, the IFRIC decided against alternative (b) because recognising changes in the estimated outflow of resources embodying economic benefits in current period profit or loss would be inconsistent with the initial capitalisation of decommissioning costs under IAS 16.
- BC11 Alternative (c) was the approach proposed in draft Interpretation D2 *Changes in Decommissioning, Restoration and Similar Liabilities*, published on 4 September 2003. In making that proposal, the IFRIC regarded the asset, from the time the liability for decommissioning is first incurred until the end of the asset's useful life, as the unit of account to which decommissioning costs relate. It therefore took the view that revisions to the estimates of those costs, whether through revisions to estimated outflows of resources embodying economic benefits or revisions to the discount rate, ought to be accounted for in the same manner as the initial estimated cost. The IFRIC still sees merit in this proposal, but concluded on balance that, under current

standards, full prospective capitalisation should be required for the reasons set out in paragraphs BC12-BC18.

IAS 8 and a change in accounting estimate

- BC12 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to recognise a change in an accounting estimate prospectively by including it in profit or loss in the period of the change, if the change affects that period only, or the period of the change and future periods, if the change affects both. To the extent that a change in an accounting estimate gives rise to changes in assets or liabilities, or relates to an item of equity, it is required to be recognised by adjusting the asset, liability or equity item in the period of change.
- BC13 Although the IFRIC took the view that the partly retrospective treatment proposed in D2 is consistent with these requirements of IAS 8, most responses to the draft Interpretation suggested that IAS 8 would usually be interpreted as requiring a fully prospective treatment. The IFRIC agreed that IAS 8 would support a fully prospective treatment also, and this is what the Interpretation requires.

IAS 16 and changes in accounting estimates for property, plant and equipment

- BC14 Many responses to the draft Interpretation argued that the proposal in D2 was inconsistent with IAS 16, which requires other kinds of change in estimate for property, plant and equipment to be dealt with prospectively. For example, as IAS 8 also acknowledges, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised in profit or loss in the current period. The effect, if any, on future periods is recognised in profit or loss in those future periods.
- BC15 Some responses to the draft Interpretation noted that a change in the estimate of a residual value is accounted for prospectively and does not require a catch-up adjustment. They observed that liabilities relating to decommissioning costs can be regarded as negative residual values, and suggested that the Interpretation should not introduce inconsistent treatment for similar events. Anomalies could result if two aspects of the same change are dealt with differently—for example, if the useful life of an asset was extended and the present value of the decommissioning liability reduced as a result.
- BC16 The IFRIC agreed that it had not made a sufficient case for treating changes in estimates of decommissioning and similar liabilities differently from other changes in estimates for property, plant and equipment. The IFRIC understood that there was no likelihood of the treatment of other changes in estimate for such assets being revisited in the near future.
- BC17 The IFRIC also noted that the anomalies that could result from its original proposal, if other changes in estimate were dealt with prospectively, were more serious than it had understood previously, and that a fully prospective treatment would be easier to apply consistently.

- BC18 The IFRIC had been concerned that a fully prospective treatment could result in either unrealistically large assets or negative assets, particularly if there are large changes in estimates toward the end of an asset's life. The IFRIC noted that the first concern could be dealt with if the assets were reviewed for impairment in accordance with IAS 36 *Impairment of Assets*, and that a zero asset floor could be applied to ensure that an asset did not become negative if cost estimates reduced significantly towards the end of its life. The credit would first be applied to write the carrying amount of the asset down to nil and then any residual credit adjustment would be recognised in profit or loss. These safeguards are included in the final consensus.

Comparison with US GAAP

- BC19 In reaching its consensus, the IFRIC considered the US GAAP approach in Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (SFAS 143). Under that standard, changes in estimated cash flows are capitalised as part of the cost of the asset and depreciated prospectively, but the decommissioning obligation is not required to be revised to reflect the effect of a change in the current market assessed discount rate.
- BC20 The treatment of changes in estimated cash flows required by this Interpretation is consistent with US GAAP, which the proposal in D2 was not. However, the IFRIC agreed that because IAS 37 requires a decommissioning obligation to reflect the effect of a change in the current market-based discount rate (see paragraph BC3), it was not possible to disregard changes in the discount rate. Furthermore, SFAS 143 did not treat changes in cash flows and discount rates in the same way, which the IFRIC had agreed was important.

The interaction of the Interpretation and initial recognition under IAS 16

- BC21 In developing the Interpretation, the IFRIC considered the improvements that have been made to IAS 16 by the Board and agreed that it would explain the interaction of the two.
- BC22 IAS 16 (as revised in 2003) clarifies that the initial measurement of the cost of an item of property, plant and equipment should include the cost of dismantling and removing the item and restoring the site on which it is located, if this obligation is incurred either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. This is because the Board concluded that whether the obligation is incurred upon acquisition of the item or as a consequence of using it, the underlying nature of the cost and its association with the asset are the same.
- BC23 However, in considering the improvements to IAS 16, the Board did not address how an entity would account for (a) changes in the amount of the initial estimate of a recognised obligation, (b) the effects of accretion of, or changes in interest rates on, a recognised obligation or (c) the cost of obligations that did not exist when the entity acquired the item, such as an obligation triggered by a change in a law enacted after the asset is acquired. The Interpretation addresses issues (a) and (b).

The interaction of the Interpretation and the choice of measurement model under IAS 16

- BC24 IAS 16 allows an entity to choose either the cost model or the revaluation model for measuring its property, plant and equipment, on a class-by-class basis. The IFRIC's view is that the measurement model that an entity chooses under IAS 16 would not be affected by the Interpretation.

BC25 Several responses to the draft Interpretation sought clarification of how it should be applied to revalued assets. The IFRIC noted that:

- (a) if the entity chooses the revaluation model, IAS 16 requires the valuation to be kept sufficiently up to date that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.^{*} This Interpretation requires a change in a recognised decommissioning, restoration or similar liability generally to be added to or deducted from the cost of the asset. However, a change in the liability does not, of itself, affect the *valuation* of the asset for financial reporting purposes, because (to ensure that it is not counted twice) the separately recognised liability is excluded from its valuation.
- (b) rather than changing the valuation of the asset, a change in the liability affects the difference between what would have been reported for the asset under the cost model, under this Interpretation, and its valuation. In other words, it changes the revaluation surplus or deficit that has previously been recognised for the asset. For example, if the liability increases by CU20, which under the cost model would have been added to the cost of the asset, the revaluation surplus reduces (or the revaluation deficit increases) by CU20. Under the revaluation model set out in IAS 16, cumulative revaluation surpluses for an asset are accounted for in equity,[†] and cumulative revaluation deficits are accounted for in profit or loss. The IFRIC decided that changes in the liability relating to a revalued asset should be accounted for in the same way as other changes in revaluation surpluses and deficits under IAS 16.
- (c) although a change in the liability does not directly affect the value of the asset for financial reporting purposes, many events that change the value of the liability may also affect the value of the asset, by either a greater or lesser amount. The IFRIC therefore decided that, for revalued assets, a change in a decommissioning liability indicates that a revaluation may be required. Any such revaluation should be taken into account in determining the amount taken to profit or loss under (b) above. If a revaluation is done, IAS 16 requires all assets of the same class to be revalued.
- (d) the depreciated cost of an asset (less any impairment) should not be negative, regardless of the valuation model, and the revaluation surplus on an asset should not exceed its value. The IFRIC therefore decided that, if the reduction in a liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess reduction should always be taken to profit or loss. For example, if the depreciated cost of an unimpaired asset is CU25, and its revalued amount is CU100, there is a revaluation surplus of CU75. If the decommissioning liability associated with the asset is reduced by CU30, the depreciated cost of the asset should be reduced to nil, the revaluation surplus should be increased to CU100 (which equals the value of the asset), and the remaining CU5 of the reduction in the liability should be taken to profit or loss.

* IAS 1 *Presentation of Financial Statements* (revised 2007) replaced the term 'balance sheet date' with 'end of the reporting period'.

† As a consequence of the revision of IAS 1 in 2007 the increase is recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

The unwinding of the discount

- BC26 The IFRIC considered whether the unwinding of the discount is a borrowing cost for the purposes of IAS 23 *Borrowing Costs*. This question arises because if the unwinding of the discount rate were deemed a borrowing cost for the purposes of IAS 23, in certain circumstances this amount might be capitalised under the allowed alternative treatment of capitalisation.* The IFRIC noted that IAS 23 addresses funds borrowed specifically for the purpose of obtaining a particular asset. It agreed that a decommissioning liability does not fall within this description since it does not reflect funds (ie cash) borrowed. Hence, the IFRIC concluded that the unwinding of the discount is not a borrowing cost as defined in IAS 23.
- BC27 The IFRIC agreed that the unwinding of the discount as referred to in paragraph 60 of IAS 37 should be reported in profit or loss in the period it occurs.

Disclosures

- BC28 The IFRIC considered whether the Interpretation should include disclosure guidance and agreed that it was largely unnecessary because IAS 16 and IAS 37 contain relevant guidance, for example:
- (a) IAS 16 explains that IAS 8 requires the disclosure of the nature and effect of changes in accounting estimates that have an effect in the current period or are expected to have a material effect in subsequent periods, and that such disclosure may arise from changes in the estimated costs of dismantling, removing or restoring items of property, plant and equipment.
 - (b) IAS 37 requires the disclosure of:
 - (i) a reconciliation of the movements in the carrying amount of the provision for the period.
 - (ii) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.
 - (iii) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.
 - (iv) an indication of the uncertainties about the amount or timing of those outflows, and where necessary the disclosure of the major assumptions made concerning future events (eg future interest rates, future changes in salaries, and future changes in prices).
- BC29 However, in respect of assets measured using the revaluation model, the IFRIC noted that changes in the liability would often be taken to the revaluation surplus. These changes reflect an event of significance to users, and the IFRIC agreed that they should be given prominence by being separately disclosed and described as such in the statement of changes in equity.[†]

* In March 2007, IAS 23 was revised to require the previously allowed alternative treatment of capitalisation. Capitalisation of borrowing costs for a qualifying asset becomes the only accounting treatment. That revision does not affect the reasoning set out in this Basis for Conclusions.

† As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such changes are presented in the statement of comprehensive income.

Transition

- BC30 The IFRIC agreed that preparers that already apply IFRSs should apply the Interpretation in the manner required by IAS 8, which is usually retrospectively. The IFRIC could not justify another application method, especially when IAS 37 requires retrospective application.
- BC31 The IFRIC noted that, in order to apply the Interpretation retrospectively, it is necessary to determine both the timing and amount of any changes that would have been required by the Interpretation. However, IAS 8 specifies that:
- (a) if retrospective application is not practicable for all periods presented, the new accounting policy shall be applied retrospectively from the earliest practicable date; and
 - (b) if it is impracticable to determine the cumulative effect of applying the new accounting policy at the start of the current period, the policy shall be applied prospectively from the earliest date practicable.
- BC32 The IFRIC noted that IAS 8 defines a requirement as impracticable when an entity cannot apply it after making every reasonable effort to do so, and gives guidance on when this is so.
- BC33 However, the provisions of IAS 8 on practicability do not apply to IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Retrospective application of this Interpretation at the date of transition to IFRSs, which is the treatment required by IFRS 1 in the absence of any exemptions, would require first-time adopters to construct a historical record of all such adjustments that would have been made in the past. In many cases this will not be practicable. The IFRIC agreed that, as an alternative to retrospective application, an entity should be permitted to include in the depreciated cost of the asset at the date of transition an amount calculated by discounting the liability at that date back to, and depreciating it from, when it was first incurred. This Interpretation amends IFRS 1 accordingly.