

**Changes in Existing Decommissioning,  
Restoration and Similar Liabilities**

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Interpretation of SB-FRS 101 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (INT SB-FRS 101) is set out in paragraphs 1-10 and the Appendix. INT SB-FRS 101 is accompanied by Illustrative Examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Interpretations of Statutory Board Financial Reporting Standards*.

# INTERPRETATION OF STATUTORY BOARD FINANCIAL REPORTING STANDARDS

## INT SB-FRS 101

### Changes in Existing Decommissioning, Restoration and Similar Liabilities

#### References

- SB-FRS 1 *Presentation of Financial Statements* (as revised in 2004)
- SB-FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- SB-FRS 16 *Property, Plant and Equipment* (as revised in 2004)
- SB-FRS 23 *Borrowing Costs*
- SB-FRS 36 *Impairment of Assets* (as revised in 2004)
- SB-FRS 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 SB-FRS 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. SB-FRS 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 SB-FRS 16; and
  - (b) recognised as a liability in accordance with SB-FRS 37.

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

#### 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 (e.g. cash flows) required to settle the obligation;

- (b) a change in the current market-based discount rate as defined in paragraph 47 of SB-FRS 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).

## **Consensus**

- 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 SB-FRS 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 revaluation surplus in 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 revaluation surplus in 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. Any such revaluation shall be taken into account in determining the amounts to be taken to profit or loss and equity under (a). If a revaluation is necessary, all assets of that class shall be revalued.
  - (d) SB-FRS 1 requires disclosure on the face of the statement of changes in equity of each item of 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 capitalisation under SB-FRS 23 is not permitted.

### **Effective date**

- 9 This Interpretation becomes effective on 1 January 2006. Changes in accounting policies shall be accounted for according to the requirements of SB-FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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\* 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 SB-FRS 8, which was entitled *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 SB-FRS 101 *First-time Adoption of 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.*

- A1 SB-FRS 101 *First-time Adoption of Statutory Board Financial Reporting Standards* and its accompanying documents are amended as described below.

In paragraph 12 of the SB-FRS, the reference to paragraphs 13-25D is changed to 13-25E.

Subparagraphs 13(h) and (i) of the SB-FRS are amended, and subparagraph (j) is inserted, to read as follows:

- (h) share-based payment transactions (paragraphs 25B and 25C);
- (i) insurance contracts (paragraph 25D); and
- (j) decommissioning liabilities included in the cost of property, plant and equipment (paragraph 25E).

In the SB-FRS, a new heading and paragraph 25E are inserted, as follows:

#### **Changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment**

- 25E INT SB-FRS 101 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to SB-FRSs. If a first-time adopter uses this exemption, it shall:

- (a) measure the liability as at the date of transition to SB-FRSs in accordance with SB-FRS 37;
- (b) to the extent that the liability is within the scope of INT SB-FRS 101, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and
- (c) calculate the accumulated depreciation on that amount, as at the date of transition to SB-FRSs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under SB-FRSs.

In the Guidance on Implementing SB-FRS 101, the amendments described below are made.

Paragraph IG13 is amended to read as follows:

- IG13 In some cases, the construction or commissioning of an asset results in an obligation for an entity to dismantle or remove the asset and restore the site on which the asset stands. An entity applies SB-FRS 37 *Provisions, Contingent Liabilities and*

*Contingent Assets* in recognising and measuring any resulting provision. The entity applies SB-FRS 16 in determining the resulting amount included in the cost of the asset, before depreciation and impairment losses. Items such as depreciation and, when applicable, impairment losses cause differences between the carrying amount of the liability and the amount included in the carrying amount of the asset. An entity accounts for changes in such liabilities in accordance with INT SB-FRS 101 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. However, paragraph 25E of SB-FRS 101 provides an exemption for changes that occurred before the date of transition to SB-FRSs, and prescribes an alternative treatment where the exemption is used. An example of the first-time adoption of INT SB-FRS 101, which illustrates the use of this exemption, is given at paragraphs IG201-IG203.

The following headings and paragraphs are added at the end of the Guidance:

## **SB-FRS Interpretations**

### **INT SB-FRS 101 *Changes in Existing Decommissioning, Restoration and Similar Liabilities***

- IG201 SB-FRS 16 requires the cost of an item of property, plant and equipment to include the initial estimate of the costs of dismantling and removing the asset and restoring the site on which it is located. SB-FRS 37 requires the liability, both initially and subsequently, to be measured at the amount required to settle the present obligation at the balance sheet date, reflecting a current market-based discount rate.
- IG202 INT SB-FRS 101 requires that, subject to specified conditions, changes in an existing decommissioning, restoration or similar liability are added to or deducted from the cost of the related asset. The resulting depreciable amount of the asset is depreciated over its useful life, and the periodic unwinding of the discount on the liability is recognised in profit or loss as it occurs.
- IG203 Paragraph 25E of INT SB-FRS 101 provides a transitional exemption. Instead of retrospectively accounting for changes in this way, entities can include in the depreciated cost of the asset an amount calculated by discounting the liability at the date of transition to SB-FRSs back to, and depreciating it from, when the liability was first incurred. IG Example 201 illustrates the effect of applying this exemption, assuming that the entity accounts for its property, plant and equipment using the cost model.

## IG Example 201: Changes in Existing Decommissioning, Restoration and Similar Liabilities

### BACKGROUND

An entity's first SB-FRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. Its date of transition to SB-FRSs is therefore 1 January 2004.

The entity acquired an energy plant on 1 January 2001, with a life of 40 years.

As at the date of transition to SB-FRSs, the entity estimates the decommissioning cost in 37 years' time to be 470, and estimates that the appropriate risk-adjusted discount rate for the liability is 5 per cent. It judges that the appropriate discount rate has not changed since 1 January 2001.

### APPLICATION OF REQUIREMENTS

The decommissioning liability recognised at the transition date is 77 (470 discounted for 37 years at 5 per cent).

Discounting this liability back for a further three years to 1 January 2001 gives an estimated liability at acquisition, to be included in the cost of the asset, of 67. Accumulated depreciation on the asset is  $67 \times 3/40 = 5$ .

The amounts recognised in the opening SB-FRS balance sheet on the date of transition to SB-FRSs (1 January 2004) are, in summary:

Decommissioning cost included in cost of plant	67
Accumulated depreciation	(5)
Decommissioning liability	<u>(77)</u>
Net assets/retained earnings	<u>(15)</u>

## Illustrative examples

*These examples accompany, but are not part of, INT SB-FRS 101.*

### 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 SB-FRS 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. Accordingly, if the asset is valued on a net basis, it is

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

necessary to adjust the valuation obtained by adding back the allowance for the liability, so that the liability is not counted twice.<sup>†</sup>

- (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 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

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

<sup>†</sup> For examples of this principle, see SB-FRS 36 *Impairment of Assets* and SB-FRS 40 *Investment Property*.

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 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 SB-FRSs. Retrospective application is required by SB-FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, where practicable, and is the benchmark treatment in the previous version of SB-FRS 8. The example assumes that the entity:

- (a) adopted SB-FRS 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 SB-FRS 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 INT SB-FRS 101

*This Basis for Conclusions accompanies, but is not part of, INT SB-FRS 101.*

### Introduction

BC1 This Basis for Conclusions summarises the considerations in reaching the consensus.

### Background

BC2 SB-FRS 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 SB-FRS 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 and should reflect a current market-based discount rate. It requires provisions to be reviewed at each balance sheet date 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 issue on how to account for changes in decommissioning, restoration and similar liabilities was asked to be addressed. 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. SB-FRS 16 contains requirements for the initial capitalisation of decommissioning costs and SB-FRS 37 contains requirements for measuring the resulting liability; neither specifically addresses accounting for the effect of changes in the liability. It was informed that differing views exist, resulting in a risk of divergent practices developing.

BC5 Accordingly, it was decided that guidance on accounting for the changes be developed. In so doing, it was 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 (e.g. 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 SB-FRS 16 and are recognised as a provision under SB-FRS 37. The Interpretation does not apply to changes in estimated liabilities in respect of costs that fall within the scope of other SB-FRSs, for example, inventory or production costs that fall within the scope of SB-FRS 2 *Inventories*. It was 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 SB-FRS 16 and the Interpretation, or of the inventory produced, which should be accounted for under SB-FRS 2.

### Basis for Consensus

BC7 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 was reached.

- BC8 In developing its consensus, the following three alternative approaches for accounting for changes in the outflow of resources embodying economic benefits and changes in the discount rate were also considered:
- (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 Alternative (a) was rejected, because this approach does not treat changes in the outflow of resources embodying economic benefits and in the discount rate in the same way, whose importance was agreed, given that matters such as inflation can affect both the outflow of economic benefits and the discount rate.
- BC10 In considering alternative (b), it was 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, alternative (b) was decided against 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 SB-FRS 16.
- BC11 Alternative (c) was the approach proposed in draft Interpretation on *Changes in Decommissioning, Restoration and Similar Liabilities*, published on 3 October 2003. In making that proposal, the asset was regarded, 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. Therefore 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 was taken. Merit in this proposal was still seen, but it was concluded on balance that, under current standards, full prospective capitalisation should be required for the reasons set out in paragraphs BC12-BC18.

#### **SB-FRS 8 and a change in accounting estimate**

- BC12 SB-FRS 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 it was viewed that the partly retrospective treatment proposed in draft INT SB-FRS *Changes in Decommissioning, Restoration and Similar Liabilities* is consistent with these requirements of SB-FRS 8, most responses to the draft Interpretation suggested that SB-FRS 8 would usually be interpreted as requiring a fully prospective treatment. It was agreed that SB-FRS 8 would support a fully prospective treatment also, and this is what the Interpretation requires.

## **SB-FRS 16 and changes in accounting estimates for property, plant and equipment**

- BC14 Many responses to the draft Interpretation argued that the proposal in draft INT SB-FRS *Changes in Decommissioning, Restoration and Similar Liabilities* was inconsistent with SB-FRS 16, which requires other kinds of change in estimate for property, plant and equipment to be dealt with prospectively. For example, as SB-FRS 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 It was agreed that a sufficient case had not been made for treating changes in estimates of decommissioning and similar liabilities differently from other changes in estimates for property, plant and equipment. It was understood that there was no likelihood of the treatment of other changes in estimate for such assets being revisited in the near future.
- BC17 It was 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 There were concerns 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. It was noted that the first concern could be dealt with if the assets were reviewed for impairment in accordance with SB-FRS 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 US GAAP approach in Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (SFAS 143) was considered. 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 draft INT SB-FRS *Changes in Decommissioning, Restoration and Similar Liabilities* was not. However, it was agreed that because SB-FRS 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, whose importance was agreed.

### **The interaction of the Interpretation and initial recognition under SB-FRS 16**

- BC21 In developing the Interpretation, the improvements that have been made to SB-FRS 16 were considered and it was agreed that there would be explanation of the interaction of the two.

- BC22 SB-FRS 16 (as revised in 2004) 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 it was 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 SB-FRS 16, the issues on 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 were not addressed. The Interpretation addresses issues (a) and (b).

#### **The interaction of the Interpretation and the choice of measurement model under SB-FRS 16**

- BC24 SB-FRS 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 view taken is that the measurement model that an entity chooses under SB-FRS 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. It was noted that:
- (a) if the entity chooses the revaluation model, SB-FRS 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 SB-FRS 16, cumulative revaluation surpluses for an asset are accounted for in equity, and cumulative revaluation deficits are accounted for in profit or loss. It was 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 SB-FRS 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. It was 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, SB-FRS 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. It was 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.

### **The unwinding of the discount**

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

### **Disclosures**

- BC28 The issue on whether the Interpretation should include disclosure guidance and agreed that it was largely unnecessary because SB-FRS 16 and SB-FRS 37 contain relevant guidance was considered, for example:
- (a) SB-FRS 16 explains that SB-FRS 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) SB-FRS 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 (e.g. future interest rates, future changes in salaries, and future changes in prices).

- BC29 However, in respect of assets measured using the revaluation model, it was noted that changes in the liability would often be taken to the revaluation reserve. These changes reflect an event of significance to users, and it was agreed that they should be given prominence by being separately disclosed and described as such in the statement of changes in equity.

### **Transition**

- BC30 It was agreed that preparers that already apply SB-FRSs should apply the Interpretation in the manner required by SB-FRS 8, which is usually retrospectively. Another application method, especially when SB-FRS 37 requires retrospective application, could not be justified.

- BC31 It was 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, SB-FRS 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 It was noted that SB-FRS 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 SB-FRS 8 on practicability do not apply to SB-FRS 101 *First-time Adoption of Statutory Board Financial Reporting Standards*. Retrospective application of this Interpretation at the date of transition to SB-FRSs, which is the treatment required by SB-FRS 101 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. It was 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 SB-FRS 101 accordingly.