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International Accounting Standards Board®

International Financial Reporting Interpretations Committee

IFRIC DRAFT INTERPRETATION D4

Decommissioning, Restoration and Environmental Rehabilitation Funds

Comments to be received by 19 March 2004

IFRIC Draft Interpretation D4 *Decommissioning, Restoration and Environmental Rehabilitation Funds* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the draft Interpretation should be submitted in writing so as to be received by **19 March 2004**.

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This draft Interpretation is available from www.iasb.org.

INVITATION TO COMMENT

The International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC) invites comments on any aspect of this draft Interpretation *Decommissioning, Restoration and Environmental Rehabilitation Funds* and the incorporated draft amendment to IAS 39 *Financial Instruments: Recognition and Measurement*. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **19 March 2004**.

International Accounting Standards Board®

IFRIC *International Financial Reporting Interpretations Committee*

IFRIC DRAFT INTERPRETATION D4, incorporating a proposed amendment to IAS 39 *Financial Instruments: Recognition and Measurement*

Decommissioning, Restoration and Environmental Rehabilitation Funds

IFRIC [draft] Interpretation X *Decommissioning, Restoration and Environmental Rehabilitation Funds* ([draft] IFRIC X) is set out in paragraphs 1-12. The scope and authority of Interpretations are set out in paragraphs 1 and 8-10 of the *IFRIC Mandate and Operating Procedures*. [Draft] IFRIC X incorporates an amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and is accompanied by a Basis for Conclusions.

References

- IAS 27 *Consolidated and Separate Financial Statements*[*]
- IAS 28 *Investments in Associates*
- IAS 31 *Interests in Joint Ventures*
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- SIC-12 *Consolidation—Special Purpose Entities*

Background

1 This [draft] Interpretation deals with how to account for decommissioning, restoration and environmental rehabilitation funds, hereafter referred to as ‘decommissioning funds’ or ‘funds’. The purpose of these funds is to segregate assets to fund some or all of the costs of decommissioning of plant (such as a nuclear plant) or certain equipment (such as cars), or in undertaking environmental rehabilitation (such as rectifying pollution of water or restoring mined land), together referred to as ‘decommissioning’. These funds may be voluntary or required by regulation or law.

2 Such funds generally have the following features.

(a) The fund is separately administered by independent trustees.

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[*] In December 2003, the IASB issued thirteen revised Standards as part of its Improvements project. In this [draft] Interpretation, the new titles have been used. Entities that do not adopt the revised Standards before 1 January 2005 shall make the following substitutions:

For	Read
IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*	IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*
IAS 27 *Consolidated and Separate Financial Statements*	IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*
IAS 28 *Investments in Associates*	IAS 28 *Accounting for Investments in Associates*
IAS 31 *Interests in Joint Ventures*	IAS 31 *Financial Reporting of Interests in Joint Ventures*

(b) Entities (contributors) make contributions to the fund, which are invested in a range of assets that may include both debt and equity investments, and are available to help pay the contributors' decommissioning costs. The trustees determine how contributions are invested, within the constraints set by the fund's governing documents and any applicable legislation or other regulations.

(c) The contributors retain the obligation to pay decommissioning costs. However, contributors are able to obtain reimbursement of decommissioning costs from the fund up to the lower of the decommissioning costs incurred and the entity's share of assets of the fund.

(d) The contributors may have restricted or no access to any surplus of assets of the fund over those used to meet eligible decommissioning costs.

3 Funds within the scope of this [draft] Interpretation may have one of the following common structures:

(a) the fund is established by a single contributor to fund its own decommissioning obligations, whether for a particular site, or for a number of geographically dispersed sites.

(b) the fund is established with multiple contributors to fund their individual or joint decommissioning obligations, and the contributors are entitled to reimbursement for decommissioning expenses to the extent of their fund contributions plus any actual earnings on those contributions less their share of the costs of administering the fund. In addition, contributors may have an obligation to make potential additional contributions, for example, in the event of the bankruptcy of another contributor.

(c) the fund is established with multiple contributors to fund their individual or joint decommissioning obligations, and the required level of contributions is based on the current activity of a contributor, but the benefit obtained by that contributor is based on its past activity. Thus, there is a potential mismatch in the amount of contributions made by a contributor (based on current activity) and the value realisable from the fund (based on past activity).

Issues

4 The issues addressed in this [draft] Interpretation are:

(a) How should a contributor account for its interest in a fund?

(b) When a contributor has an obligation to make additional contributions, for example, in the event of the bankruptcy of another contributor, how should that obligation be accounted for?

Consensus

Accounting for an interest in a fund

5 The contributor shall determine whether it has control, joint control or significant influence over the fund by reference to IAS 27 *Consolidated and Separate Financial Statements*, IAS 31 *Interests in Joint Ventures*, IAS 28 *Investments in Associates* and SIC-12 *Consolidation—Special Purpose Entities*. If the contributor determines that it has such control, joint control or significant influence, it shall account for its interest in the fund in accordance with the relevant Standards. Otherwise, the contributor shall account for its interest in the fund in accordance with paragraphs 6-8.

6 When the fund does not relieve the contributor of its obligation to pay decommissioning costs, an asset and a liability shall be recognised by the contributor.

7 The contributor shall recognise the right to receive reimbursement from the fund as a reimbursement in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This reimbursement shall be measured at the lower of:

(a) the amount of the decommissioning obligation recognised; and

(b) the entity's share of the fair value of the net assets of the fund adjusted for actual or expected factors that affect the entity's ability to access these assets.

8 Changes in the carrying value of the right to receive reimbursement other than contributions to and payments from the fund shall be recognised in profit or loss in the period in which these changes occur.

Obligations to make additional contributions

9 When a contributor has an obligation to make potential additional contributions, for example, in the event of the bankruptcy of another contributor, this obligation is a contingent liability that is within the scope of IAS 37. The contributor shall recognise a liability only if it is probable that additional contributions will be made.

Disclosure

10 When the contributor accounts for its interest in the fund in accordance with paragraphs 6-8, it shall make the disclosures required by IAS 37. When a contributor has an obligation to make potential additional contributions that is not recognised as a liability (see paragraph 9), it shall make the disclosures required by paragraph 86 of IAS 37. Regardless of the method of accounting for an entity's interest in a fund, the entity shall disclose the nature of the entity's interest and any restrictions on access to the assets in the fund.

Effective date

11 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [date to be set at 3 months after the Interpretation is finalised]. Earlier application is encouraged. If an entity applies this [draft] Interpretation for a period beginning before [above date], it shall disclose that fact.

Transition

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

Appendix

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement*

The amendment in this [draft] appendix shall be applied for annual periods beginning on or after [date consistent with paragraph 11]. If an entity applies this [draft] Interpretation for an earlier period, the amendment shall be applied for that earlier period.

A1 Paragraph 2 of IAS 39 *Financial Instruments: Recognition and Measurement*[*] shall be amended to read as follows:

"This Standard shall be applied by all entities to all types of financial instruments except:

…

(j) rights to payments to reimburse the entity for expenditure it is required to make to settle a liability that it recognises as a provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or for which, in an earlier period, it recognised a provision in accordance with IAS 37."

[*] In December 2003, the IASB revised IAS 39. In this [draft] amendment, the new paragraph references have been used. Entities that do not adopt the revised Standard before 1 January 2005 shall make the same amendment to paragraph 1(f) of IAS 39 (revised 2000).

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft Interpretation.

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.

BC2 The IFRIC was informed that an increasing number of entities with decommissioning obligations are contributing to a separate fund established to help finance those obligations. The IFRIC was also informed that questions have arisen in practice over the accounting treatment of such funds and that there is a risk that divergent practices may develop. The IFRIC therefore concluded that it should provide guidance to assist in answering the questions in paragraph 4 of this draft Interpretation.

Consensus

Accounting for an interest in a fund

BC3 The IFRIC noted that some interests in funds would be within the scope of IAS 27 *Consolidated and Separate Financial Statements*, IAS 31 *Interests in Joint Ventures*, IAS 28 *Investments in Associates* or SIC-12 *Consolidation—Special Purpose Entities*.

BC4 For those interests in funds that are not within the scope of these Standards, the IFRIC considered whether those interests give rise to:

(a) an asset (the right to receive assets from the fund) and a liability (the decommissioning obligation); or

(b) a net asset or liability (the net decommissioning obligation relative to attributable fund assets).

BC5 The IFRIC concluded that both an asset and a liability exist when a fund does not relieve the contributor of its obligation to pay decommissioning costs. In this situation, the contributor remains liable for the decommissioning costs. Additionally, IAS 37 provides that:

(a) when an entity remains liable for expenditure, a provision should be recognised even where reimbursement is available; and

(b) if the reimbursement is virtually certain to be received when the obligation is settled, then it should be treated as a separate asset.

BC6 In concluding that a net asset or liability did not arise, the IFRIC also noted the following.

(a) There is no legally enforceable right to set off the rights under the decommissioning fund and decommissioning liabilities and, given that the main objective is reimbursement, it is likely that settlement will not be net or simultaneous. Treating these rights and liabilities as analogous to financial assets and financial liabilities would not result in offset because the offset criteria in IAS 32 *Financial Instruments: Disclosure and Presentation* are not met.

(b) Treating the decommissioning obligation as analogous to a financial liability would not result in derecognition through extinguishment. If the fund does not assume the obligation for decommissioning, the criteria for derecognition of financial liabilities through extinguishments in IAS 39 *Financial Instruments: Recognition and Measurement* are not met. At best, the funds act like an in-substance defeasance that itself does not qualify for derecognition of the liability.

(c) It would not be appropriate to treat decommissioning funds as analogous to pension funds, which are presented net of the related liability because, in allowing a net presentation for pension plans in IAS 19 *Employee Benefits,* IASC specifically stated that it believed the situation is "unique to employee benefit plans" and that it did "not intend to permit this net presentation for other liabilities if the conditions in IAS 32 and IAS 39 are not met" (IAS 19, Basis for Conclusions paragraph 68I).

The right to receive reimbursement from a fund and amendment to scope of IAS 39

BC7 The IFRIC considered how the right to receive amounts from a decommissioning fund should be accounted for. The IFRIC noted that under IFRSs there are two forms of rights to reimbursement that would be accounted for differently:

(a) A contractual right to receive reimbursement in the form of cash. This meets the definition of a financial asset and is within the scope of IAS 39.

(b) A right to reimbursement other than a contractual right to receive cash. This does not meet the definition of a financial asset and is within the scope of IAS 37.

BC8 The IFRIC discussed whether a right to reimbursement that meets the definition of a financial asset in IAS 39 (ie those in paragraph BC7(a)) should be classified as:

(a) a loan or receivable, because the right is a non-derivative asset with fixed or determinable payments that is not quoted in an active market; or, if not,

(b) an available-for-sale asset, because the right would not meet the definitions of held-for-trading or held-to-maturity financial assets.

The IFRIC also noted that this financial asset, whether classified as (a) or (b) above, may contain an embedded derivative.

BC9 The IFRIC concluded that treatment as a loan or receivable with an embedded derivative under IAS 39 could be very complex because it would require separate recognition of the embedded derivative and its host debt contract. Interest would need to be accrued on the host debt contract. The IFRIC noted that there is no 'correct' rate at which to accrue interest because no rate is specified by the terms and conditions that create the right to reimbursement. In addition, changes in the fair value of the derivative would need to be recognised, calculated as the change in the entire asset, less changes in the value of the host debt contract. The IFRIC concluded that a similar treatment could be required if the asset were treated as an available-for-sale financial asset with an embedded derivative. The IFRIC agreed that recognising a single asset for the right to reimbursement would provide more relevant and reliable information to a user of the financial statements about such an asset, and would be more straightforward to apply.

BC10 Furthermore, the IFRIC agreed that both types of reimbursement described in paragraph BC7 should be accounted for in the same way. However, the IFRIC noted that this did not appear possible under existing IFRSs because some such rights are within the scope of IAS 39, and others are not. Therefore, it asked the IASB to amend the scope of IAS 39 to exclude rights to reimbursement for expenditure required to settle:

(a) a provision that has been recognised in accordance with IAS 37; and

(b) obligations that had been originally recognised as provisions in accordance with IAS 37, but were subsequently converted into liabilities. An example of such a liability is one that was originally recognised as a provision because of uncertainty about the timing of the cash outflow, but is subsequently converted to a liability because the timing is now certain.

BC11 The IASB agreed to propose an amendment to IAS 39 as set out in the Appendix to this draft Interpretation, so that all such rights to reimbursement would be within the scope of IAS 37.

BC12 The IFRIC then considered how IAS 37 should be applied to a right to receive reimbursement from a fund. IAS 37 requires the asset to be separately recognised when it is "virtually certain that reimbursement will be received if the enterprise settles the obligation." The IFRIC concluded that the terms of the funds addressed in this [draft] Interpretation are such that this "virtually certain" test will be met for decommissioning funds because the purpose of the funds is to segregate assets to fund decommissioning costs. Accordingly, the IFRIC concluded that paragraph 53 of IAS 37 should be applied to the recognition and measurement of the right to receive amounts from a decommissioning fund.

BC13 The IFRIC noted that paragraph 53 of IAS 37 prohibits the recognition of an asset in excess of the recognised liability. For example, rights to receive reimbursement to meet decommissioning liabilities that have yet to be recognised as a provision are not recognised. Accordingly, the IFRIC concluded that the asset should be measured at the lower of the amount of the decommissioning obligation recognised and the reimbursement right.

BC14 The IFRIC discussed whether the reimbursement right should be measured at:

(a) the entity's share of the fair value of the net assets of the fund taking into account any inability to access any surplus of the assets of the fund over eligible decommissioning costs (with any obligation to make good potential defaults of other contributors being treated separately as a contingent liability); or

(b) the fair value of the reimbursement right (which would normally be lower than (a) because of the risks involved, such as the possibility that the contributor may be required to make good defaults of other contributors).

BC15 The IFRIC noted that the right to reimbursement relates to a decommissioning obligation for which a provision would be recognised and measured in accordance with IAS 37. Such provisions are measured at "the best estimate of the expenditure required to settle the present obligation at the balance sheet date." The IFRIC noted that the amount in paragraph BC14(a)—ie the entity's share of the fair value of the net assets of the fund taking into account any inability to access any surplus of the assets of the fund over eligible decommissioning costs—is the best estimate of the amount available to the entity to reimburse it for expenditure it had incurred to pay for decommissioning. Thus, the amount of the asset recognised would be consistent with the amount of liability recognised.

BC16 In contrast, the IFRIC noted that the amount in paragraph BC14(b)—ie the fair value of the reimbursement right—would take into account the factors such as liquidity or block discounts that the IFRIC believed to be difficult to measure reliably. Furthermore, this amount would be lower than that in paragraph BC14(a) because it reflects the possibility that the contributor may be required to make potential additional contributions in the event of default by other contributors. The IFRIC noted that its decision that the obligation to make potential additional contributions should be treated as a contingent liability in accordance with IAS 37 (see paragraphs BC18-BC21) would result in double-counting of the risk of the additional obligation being made if the measure in paragraph BC14(b) were to be used.

BC17 Consequently, the IFRIC concluded that the approach in paragraph BC14(a) would provide the most useful information to users.

Obligations to make additional contributions

BC18 In some cases, a contributor has an obligation to make potential additional contributions, for example, in the event of the bankruptcy of another contributor.

BC19 The IFRIC noted that by 'joining' the fund, a contributor may assume the position of guarantor of the contributions of the other contributors, and hence become jointly and severally liable for the obligations of other contributors. The IFRIC noted a parallel with the example in paragraph 29 of IAS 37, which states: "where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability."

BC20 The IFRIC considered the argument that an obligation to make good potential shortfalls of other contributors has the attributes of a financial instrument (ie a financial guarantee) as defined in IAS 32 *Financial Instruments: Disclosure and Presentation* and should be accounted for in accordance with IAS 39 because the contributor has an obligation to deliver cash to the fund, and the fund has a right to receive cash from the contributor if a shortfall in contributions arises. However, the IFRIC noted that:

(a) a contractual obligation to make good shortfalls of other contributors is a financial guarantee. Financial guarantee contracts that provide for payments to be made if the debtor fails to make payment when due are excluded from the scope of IAS 39.

(b) when the obligation is not contractual, but rather arises as a result of regulation, it is not a financial liability as defined in IAS 32 or within the scope of IAS 39.

BC21 Therefore, the IFRIC concluded that an obligation to make additional contributions in the event of specified circumstances in the future should be treated as a contingent liability in accordance with IAS 37.

Disclosure

BC22 The IFRIC noted that the contributor may not be able to access the assets of the fund (including cash or cash equivalents) for many years, ie until it undertakes the decommissioning. Therefore, the IFRIC concluded that the nature of the contributor's interest and the restriction on access should be disclosed.

Effective date and transition

BC23 The IFRIC observed that the implementation of the proposed Interpretation is not expected to be problematic. Therefore, the IFRIC concluded that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should apply.