Compiled Interpretation **Interpretation 1**

June 2007

Changes in Existing Decommissioning, Restoration and Similar Liabilities

This compiled UIG Interpretation applies to annual reporting periods beginning on or after 1 January 2009. Early application is permitted. It incorporates relevant amendments made up to and including 14 June 2007.

Prepared on 1 November 2007 by the staff of the Australian Accounting Standards Board.

Australian Government

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UIG Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (as amended) is set out in paragraphs 1 – Aus8.4. Interpretations are listed in Australian Accounting Standard AASB 1048 *Interpretation and Application of Standards*. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

COMPILATION DETAILS

UIG Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* as amended

This compiled Interpretation applies to annual reporting periods beginning on or after 1 January 2009. It takes into account amendments up to and including 14 June 2007 and was prepared on 1 November 2007 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Interpretation issued by the AASB. Instead, it is a representation of Interpretation 1 (July 2004) as amended by other documents, which are listed in the Table below.

Table of Documents

Document	**Month issued**	**Application date** ***(annual reporting periods ... on or after ...)***	**Application, saving or transitional provisions**
Interpretation 1	Jul 2004	*(beginning)* 1 Jan 2005	
AASB 2007-6	Jun 2007	*(beginning)* 1 Jan 2009	see (a) below
AASB 2007-8	Sep 2007	*(beginning)* 1 Jan 2009	not compiled*

* The amendments made by this Standard are not included in this compilation, which presents the Interpretation as applicable to annual reporting periods beginning on or after 1 January 2009 – as it stood at 14 June 2007.

(a) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009, provided that AASB 123 *Borrowing Costs* is also applied to such periods.

Table of Amendments

Paragraph affected	**How affected**	**By … [paragraph]**
8	amended	AASB 2007-6 [16]

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

UIG Interpretation 1 as amended is equivalent to International Financial Reporting Interpretations Committee Interpretation IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* as issued and amended by the International Accounting Standards Board. Paragraphs that have been added to this Interpretation (and do not appear in the text of the equivalent IFRIC Interpretation) are identified with the prefix "Aus", followed by the number of the relevant IFRIC paragraph and decimal numbering.

For-profit entities that comply with Interpretation 1 as amended will simultaneously be in compliance with IFRIC 1 as amended. Not-for-profit entities using the added "Aus" paragraphs that specifically apply to not-for-profit entities will be complying with requirements consistent with AASB 116 *Property, Plant and Equipment*, but will not be simultaneously complying with IFRIC 1.

International Public Sector Accounting Standards (IPSASs) are issued by the International Public Sector Accounting Standards Board of the International Federation of Accountants. There is no specific IPSAS dealing with changes in decommissioning and similar liabilities.

INTERPRETATION 1

UIG Interpretation 1 was issued in July 2004.

This compiled version of Interpretation 1 applies to annual reporting periods beginning on or after 1 January 2009. It incorporates relevant amendments contained in other AASB documents up to and including 14 June 2007 (see Compilation Details).

URGENT ISSUES GROUP

INTERPRETATION 1

CHANGES IN EXISTING DECOMMISSIONING, RESTORATION AND SIMILAR LIABILITIES

REFERENCES

Accounting Standard AASB 101 *Presentation of Financial Statements*

Accounting Standard AASB 116 *Property, Plant and Equipment*

Accounting Standard AASB 123 *Borrowing Costs*

Accounting Standard AASB 136 *Impairment of Assets*

Accounting Standard AASB 137 *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 Accounting Standard AASB 116 *Property, Plant and Equipment*, 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. AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* 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 AASB 116; and

(b) recognised as a liability in accordance with AASB 137.

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 AASB 137 (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 paragraph 5(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; and

(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 AASB 136 *Impairment of Assets*.

6 If the related asset is measured using the revaluation model:

(a) changes in the liability alter the revaluation increase or decrease previously recognised on that asset, so that:

(i) a decrease in the liability shall (subject to paragraph 6(b)) be credited directly to the revaluation reserve in equity, except that it shall be recognised in profit or loss to the extent that it reverses a revaluation decrease on the asset that was previously recognised in profit or loss; or

(ii) an increase in the liability shall be recognised in profit or loss, except that it shall be debited directly to the revaluation reserve in equity to the extent of any credit balance existing in the revaluation reserve 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 reporting date. Any such revaluation shall be taken into account in determining the amounts to be taken to profit or loss and equity under paragraph 6(a). If a revaluation is necessary, all assets of that class shall be revalued; and

(d) AASB 101 *Presentation of Financial Statements* 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 reserve arising from a change in the liability shall be separately identified and disclosed as such.

Aus6.1 Notwithstanding paragraph 6, in respect of a not-for-profit entity, the requirements of paragraph 6 shall be applied in relation to a class of assets, consistent with the revaluation model requirements of AASB 116 for not-for-profit entities.

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. Capitalisation under AASB 123 *Borrowing Costs* is not permitted.

Application

Aus8.1 This Interpretation applies when AASB 116 applies.

Aus8.2 This Interpretation applies to annual reporting periods beginning on or after 1 January 2005.

[Note: For application dates of paragraphs changed or added by an amending document, see Compilation Details.]

Aus8.3 This Interpretation shall not be applied to annual reporting periods beginning before 1 January 2005.

Aus8.4 The requirements specified in this Interpretation apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.

Effective date of IFRIC 1

9 [Deleted by the UIG]

Transition to IFRIC 1

10 [Deleted by the UIG]

ILLUSTRATIVE EXAMPLES

These examples accompany, but are not part of, Interpretation 1. The UIG considers that the examples are an essential feature of the Interpretation.

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[1]; 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 annual reporting period 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 × 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 × 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

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

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 An entity has one item of property, plant and equipment.[2] The entity adopts the revaluation model in AASB 116 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 necessary to adjust the valuation obtained by adding back the allowance for the liability, so that the liability is not counted twice[3]; or

(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:

2 [Aus] This example therefore applies to both for-profit entities and not-for-profit entities.
3 For examples of this principle, see AASB 136 and AASB 140 *Investment Property*.

	CU
Asset at valuation (1)	126,600
Accumulated depreciation	nil
Decommissioning liability	(11,600)
Net assets	115,000
Retained earnings (2)	(10,600)
Revaluation reserve (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 × 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 × 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 reserve. (For a for-profit entity, this is because the adjustment 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 reserve		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 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 reserve (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 reserve because the decrease arising on the revaluation does not exceed the credit balance existing in the revaluation reserve 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	(7,200)
Net assets	107,000
Retained earnings (1)	(14,620)
Revaluation reserve (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 decrease on revaluation = CU11,620.

Example 3: Transition

IE13 – IE18 [Deleted by the UIG]

BASIS FOR CONCLUSIONS ON IFRIC 1

This IFRIC Basis for Conclusions accompanies, but is not part of, UIG Interpretation 1. It is considered that this Basis for Conclusions is an essential feature of the Interpretation. Australian footnotes have been added to the text and are identified with the prefix "Aus". An IFRIC Basis for Conclusions may be amended to reflect the requirements of the UIG Interpretation and AASB Accounting Standards where they differ from the corresponding International pronouncements.

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 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 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 (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 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.[1]

(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.[2]

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

1 [Aus] Under Accounting Standard AASB 116 *Property, Plant and Equipment*, not-for-profit entities account for revaluation increases and decreases in relation to classes of assets.

2 [Aus] Not-for-profit entities account for revaluations in relation to classes of assets.

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.[3] 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 (i.e. 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

3 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.

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, the IFRIC noted that changes in the liability would often be taken to the revaluation reserve. 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.

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.[4]

4 [Aus] This alternative approach is included in AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*.