

## IFRIC Interpretation 5

# Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

*This version includes amendments resulting from IFRSs issued up to 31 December 2008.*

IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* was developed by the International Financial Reporting Interpretations Committee and issued by the International Accounting Standards Board in December 2004.

The Basis for Conclusions was amended to reflect the revision of IAS 1 *Presentation of Financial Statements* in September 2007.

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**BASIS FOR CONCLUSIONS**

IFRIC Interpretation 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (IFRIC 5) is set out in paragraphs 1–15 and the Appendix. IFRIC 5 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 2 and 7–17 of the *Preface to International Financial Reporting Standards*.

# IFRIC Interpretation 5

## *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

### References

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- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- 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* (as revised in 2003)
- SIC-12 *Consolidation—Special Purpose Entities* (as revised in 2004)

### Background

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- 1 The purpose of decommissioning, restoration and environmental rehabilitation funds, hereafter referred to as ‘decommissioning funds’ or ‘funds’, is to segregate assets to fund some or all of the costs of decommissioning 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’.
- 2 Contributions to these funds may be voluntary or required by regulation or law. The funds may have one of the following structures:
  - (a) funds that are 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) funds that are established with multiple contributors to fund their individual or joint decommissioning obligations, when contributors are entitled to reimbursement for decommissioning expenses to the extent of their contributions plus any actual earnings on those contributions less their share of the costs of administering the fund. Contributors may have an obligation to make additional contributions, for example, in the event of the bankruptcy of another contributor.
  - (c) funds that are established with multiple contributors to fund their individual or joint decommissioning obligations when the required level of contributions is based on the current activity of a contributor and the benefit obtained by that contributor is based on its past activity. In such cases 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).
- 3 Such funds generally have the following features:
  - (a) the fund is separately administered by independent trustees.
  - (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 contributor’s share of assets of the fund.
  - (d) the contributors may have restricted access or no access to any surplus of assets of the fund over those used to meet eligible decommissioning costs.

## Scope

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- 4 This Interpretation applies to accounting in the financial statements of a contributor for interests arising from decommissioning funds that have both of the following features:
- (a) the assets are administered separately (either by being held in a separate legal entity or as segregated assets within another entity); and
  - (b) a contributor's right to access the assets is restricted.
- 5 A residual interest in a fund that extends beyond a right to reimbursement, such as a contractual right to distributions once all the decommissioning has been completed or on winding up the fund, may be an equity instrument within the scope of IAS 39 and is not within the scope of this Interpretation.

## Issues

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- 6 The issues addressed in this 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

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### Accounting for an interest in a fund

- 7 The contributor shall recognise its obligation to pay decommissioning costs as a liability and recognise its interest in the fund separately unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay.
- 8 The contributor shall determine whether it has control, joint control or significant influence over the fund by reference to IAS 27, IAS 28, IAS 31 and SIC-12. If it does, the contributor shall account for its interest in the fund in accordance with those Standards.
- 9 If a contributor does not have control, joint control or significant influence over the fund, the contributor shall recognise the right to receive reimbursement from the fund as a reimbursement in accordance with IAS 37. This reimbursement shall be measured at the lower of:
- (a) the amount of the decommissioning obligation recognised; and
  - (b) the contributor's share of the fair value of the net assets of the fund attributable to contributors.

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.

### Accounting for obligations to make additional contributions

- 10 When a contributor has an obligation to make potential additional contributions, for example, in the event of the bankruptcy of another contributor or if the value of the investment assets held by the fund decreases to an extent that they are insufficient to fulfil the fund's reimbursement obligations, 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

- 11 A contributor shall disclose the nature of its interest in a fund and any restrictions on access to the assets in the fund.
- 12 When a contributor has an obligation to make potential additional contributions that is not recognised as a liability (see paragraph 10), it shall make the disclosures required by paragraph 86 of IAS 37.
- 13 When a contributor accounts for its interest in the fund in accordance with paragraph 9, it shall make the disclosures required by paragraph 85(c) of IAS 37.

## **Effective date**

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- 14 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies this Interpretation to a period beginning before 1 January 2006, it shall disclose that fact.

## **Transition**

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- 15 Changes in accounting policies shall be accounted for in accordance with the requirements of IAS 8.

## **Appendix**

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

*The amendment in this appendix shall be applied for annual periods beginning on or after 1 January 2006. If an entity applies this Interpretation for an earlier period, the amendment shall be applied for that earlier period.*

\* \* \* \* \*

*The amendment contained in this appendix when this Interpretation was issued in 2004 was incorporated into IAS 39 as issued on and after 16 December 2004.*

# Basis for Conclusions on IFRIC Interpretation 5

*This Basis for Conclusions accompanies, but is not part of, IFRIC 5.*

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

## Introduction

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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 (paragraphs 1–3)

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BC2 The IFRIC was informed that an increasing number of entities with decommissioning obligations are contributing to a separate fund established to help fund those obligations. The IFRIC was also informed that questions have arisen in practice over the accounting treatment of interests in 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 6, in particular on the accounting for the asset of the right to receive reimbursement from a fund. On the issue of whether the fund should be consolidated or equity accounted, the IFRIC concluded that the normal requirements of IAS 27 *Consolidated and Separate Financial Statements*, SIC-12 *Consolidation—Special Purpose Entities*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures* apply and that there is no need for interpretative guidance. The IFRIC published its proposed Interpretation on 15 January 2004 as D4 *Decommissioning, Restoration and Environmental Rehabilitation Funds*.

BC3 Paragraphs 1–3 describe ways in which entities might arrange to fund their decommissioning obligations. Those that are within the scope of the Interpretation are specified in paragraphs 4–6.

## Scope (paragraphs 4 and 5)

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BC4 D4 did not precisely define the scope because the IFRIC believed that the large variety of schemes in operation would make any definition inappropriate. However, some respondents to D4 disagreed and commented that the absence of any definition made it unclear when the Interpretation should be applied. As a result, the IFRIC has specified the scope by identifying the features that make an arrangement a decommissioning fund. It has also described the different types of fund and the features that may (or may not) be present.

BC5 The IFRIC considered whether it should issue a wider Interpretation that addresses similar forms of reimbursement, or whether it should prohibit the application of the Interpretation to other situations by analogy. The IFRIC rejected any widening of the scope, deciding instead to concentrate on the matter referred to it. The IFRIC also decided that there was no reason to prohibit the application of the Interpretation to other situations by analogy and thus the hierarchy of criteria in paragraphs 7–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* would apply, resulting in similar accounting for reimbursements under arrangements that are not decommissioning funds, but have similar features.

BC6 The IFRIC considered comments from respondents that a contributor may have an interest in the fund that extends beyond its right to reimbursement. In response, the IFRIC added clarification that a residual interest in a fund, such as a contractual right to distributions once all the decommissioning has been completed or on winding up the fund, may be an equity instrument within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*.

## Basis for consensus

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### Accounting for an interest in a fund (paragraphs 7–9)

- BC7 The IFRIC concluded that the contributor should recognise a liability unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay. This is because the contributor remains liable for the decommissioning costs. Additionally, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* 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.
- BC8 In concluding that the contributor should recognise separately its liability to pay decommissioning costs and its interest in the fund, the IFRIC also noted the following:
- (a) There is no legally enforceable right to set off the rights under the decommissioning fund against the decommissioning liabilities. Also, given that the main objective is reimbursement, it is likely that settlement will not be net or simultaneous. Accordingly, 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*<sup>\*</sup> 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 in IAS 39 for derecognition of financial liabilities through extinguishment are not met. At best, the fund acts like an in-substance defeasance that 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. This is because, in allowing a net presentation for pension plans in IAS 19 *Employee Benefits*, the International Accounting Standards Board's predecessor organisation, IASC, stated that it believed the situation is 'unique to employee benefit plans and [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 BC68I).
- BC9 As to the accounting for the contributor's interest in the fund, the IFRIC noted that some interests in funds would be within the scope of IAS 27, IAS 28, IAS 31 or SIC-12. As noted in paragraph BC2, the IFRIC concluded that, in such cases, the normal requirements of those Standards would apply and there is no need for interpretative guidance.
- BC10 Otherwise, the IFRIC concluded that the contributor has an asset for its right to receive amounts from the fund.

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

- BC11 The IFRIC noted that under existing 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. Such a financial asset would be classified as an available-for-sale financial asset (unless accounted for using the fair value option) because it does not meet the definitions of a financial asset held for trading, a held-to-maturity investment or a loan or receivable.<sup>†</sup>
  - (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.
- BC12 The IFRIC concluded that both these forms of reimbursement have economically identical effects. Therefore accounting for both forms in the same way would provide relevant and reliable information to a user of the

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<sup>\*</sup> In August 2005, IAS 32 was amended as IAS 32 *Financial Instruments: Presentation*.

<sup>†</sup> An interest in a decommissioning fund would not meet the definition of held for trading because it is not acquired or incurred principally for the purpose of selling or repurchasing it in the near term, nor of a held-to-maturity investment because it does not have fixed or determinable maturity. In addition, an interest in a fund is excluded from the definition of loans and receivables in IAS 39 since it is 'an interest acquired in a pool of assets that are not loans and receivables'.

financial statements. 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 Board 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 are no longer provisions because their timing or amount is no longer uncertain. 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 subsequently becomes another type of liability because the timing is now certain.

BC13 This amendment was approved by the Board and is set out in the Appendix of IFRIC 5.\* As a result, all such rights to reimbursement are within the scope of IAS 37.

BC14 The IFRIC noted that paragraph 53 of IAS 37 specifies the accounting for rights to receive reimbursement. It requires this right to reimbursement to be separately recognised when it is virtually certain that reimbursement will be received if the contributor settles the obligation. The IFRIC also noted that this paragraph 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 when the right to reimbursement is virtually certain to be received if the contributor settles its decommissioning obligation, it should be measured at the lower of the amount of the decommissioning obligation recognised and the reimbursement right.

BC15 The IFRIC discussed whether the reimbursement right should be measured at:

- (a) the contributor's share of the fair value of the net assets of the fund attributable to contributors, 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).

BC16 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. Paragraph 36 of IAS 37 requires such provisions to be measured at 'the best estimate of the expenditure required to settle the present obligation at the ~~balance sheet date~~ end of the reporting period'. The IFRIC noted that the amount in paragraph BC15(a)—ie the contributor's share of the fair value of the net assets of the fund attributable to contributors, 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 contributor 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 the liability recognised.

BC17 In contrast, the IFRIC noted that the amount in paragraph BC15(b)—ie the fair value of the reimbursement right—would take into account the factors such as liquidity that the IFRIC believed to be difficult to measure reliably. Furthermore, this amount would be lower than that in paragraph BC15(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 BC22–BC25) would result in double-counting of the risk of the additional contribution being required if the measure in paragraph BC15(b) were to be used.

BC18 Consequently, the IFRIC concluded that the approach in paragraph BC15(a) would provide the most useful information to users.

### The asset cap

BC19 Many respondents to D4 expressed concern about the 'asset cap' that is imposed by the requirement in paragraph 9. This asset cap limits the amount recognised as a reimbursement asset to the amount of the decommissioning obligation recognised. These respondents argued that rights to benefit in excess of this amount give rise to an additional asset, separate from the reimbursement asset. Such an additional asset may arise in a number of ways, for example:

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\* The amendment has been incorporated into the text of IAS 39 as published in this volume.

- (a) the contributor has the right to benefit from a repayment of any surplus in the fund that exists once all the decommissioning has been completed or on winding up the fund.
- (b) the contributor has the right to benefit from reduced contributions to the fund or increased benefits from the fund (eg by adding new sites to the fund for no additional contributions) in the future.
- (c) the contributor expects to obtain benefit from past contributions in the future, based on the current and planned level of activity. However, because contributions are made before the decommissioning obligation is incurred, IAS 37 prevents recognition of an asset in excess of the obligation.

BC20 The IFRIC concluded that a right to benefit from a repayment of any surplus in the fund that exists once all the decommissioning has been completed or on winding up the fund may be an equity instrument within the scope of IAS 39, in which case IAS 39 would apply. However, the IFRIC agreed that an asset should not be recognised for other rights to receive reimbursement from the fund. Although the IFRIC had sympathy with the concerns expressed by constituents that there may be circumstances in which it would seem appropriate to recognise an asset in excess of the reimbursement right, it concluded that it would be inconsistent with paragraph 53 of IAS 37 (which requires that ‘the amount recognised for the reimbursement should not exceed the amount of the provision’) to recognise this asset. The IFRIC also noted that the circumstances in which this additional asset exists are likely to be limited, and apply only when a contributor has restricted access to a surplus of fund assets that does not give it control, joint control or significant influence over a fund. The IFRIC expects that most such assets would not meet the recognition criteria in the *Framework* because they are highly uncertain and cannot be measured reliably.

BC21 The IFRIC also considered arguments that there should not be a difference between the treatment of a surplus when a fund is accounted for as a subsidiary, joint venture or associate, and when it is not. However, the IFRIC noted that, under IFRSs, restrictions on assets in subsidiaries, joint ventures or associates do not affect recognition of those assets. Hence it concluded that the difference in treatment between funds accounted for as subsidiaries, joint ventures or associates and those accounted for as a reimbursement right is inherent in IFRSs. The IFRIC also concluded that this is appropriate because, in the former case, the contributor exercises a degree of control not present in the latter case.

## Obligations to make additional contributions (paragraph 10)

BC22 In some cases, a contributor has an obligation to make potential additional contributions, for example, in the event of the bankruptcy of another contributor.

BC23 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. Such an obligation is a present obligation of the contributor, but the outflow of resources associated with it may not be probable. The IFRIC noted a parallel with the example in paragraph 29 of IAS 37, which states that ‘where an entity 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.’ Accordingly, the IFRIC concluded that a liability would be recognised by the contributor only if it is probable that it will make additional contributions. The IFRIC noted that such a contingent liability may arise both when the contributor’s interest in the fund is accounted for as a reimbursement right and when it is accounted for in accordance with IAS 27, IAS 28, IAS 31 or SIC-12.

BC24 The IFRIC considered the argument that an obligation to make good potential shortfalls of other contributors is a financial instrument (ie a financial guarantee) as defined in IAS 32 and hence should be accounted for in accordance with IAS 39. The grounds for this point of view are that 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 nor is it within the scope of IAS 39.

BC25 Therefore, the IFRIC concluded that an obligation to make additional contributions in the event of specified circumstances should be treated as a contingent liability in accordance with IAS 37.

### **Disclosure (paragraphs 11–13)**

- BC26 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 (eg until it undertakes the decommissioning), if ever. Therefore, the IFRIC concluded that the nature of the contributor's interest and the restriction on access should be disclosed. The IFRIC also concluded that this disclosure is equally relevant when a contributor's interest in a fund is accounted for by consolidation, proportional consolidation or using the equity method because the contributor's ability to access the underlying assets may be similarly restricted.

### **Effective date and transition (paragraphs 14 and 15)**

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- BC27 D4 proposed that the Interpretation should be effective for annual periods beginning on a date set at three months after the Interpretation was finalised. The IFRIC considered the view of some respondents that the Interpretation should apply from 1 January 2005 (an earlier date) on the grounds that this is the date from which many entities will adopt IFRSs, and hence adopting the Interpretation at that time would promote comparability between periods. However, the IFRIC noted its general practice is to allow at least three months between finalising an Interpretation and its application, to enable entities to obtain the Interpretation and implement any necessary systems changes. In addition, the IFRIC considered the Board's concern that the amendment to IAS 39 issued as part of the Interpretation would change the 'stable platform' of Standards that are in force for entities that will apply IFRSs for the first time in 2005. Therefore, the IFRIC decided to require that the Interpretation should be applied for annual periods beginning on or after 1 January 2006, with earlier application encouraged.
- BC28 The IFRIC observed that the implementation of the Interpretation is not expected to be problematic. Therefore, the IFRIC concluded that IAS 8 should apply. Respondents to D4 did not disagree with this conclusion.

