EFRAG

European Financial Reporting Advisory Group

November 14, 2003

Kevin Stevenson
Chairman IFRIC
30 Cannon Street
London EC4M 6XH
UK

Dear Kevin,

Re: IFRIC Draft Interpretation 2 *Changes in Decommissioning, Restoration and Similar Liabilities*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the draft of the IFRIC Interpretation 2 on *Changes in Decommissioning, Restoration and Similar Liabilities* ("D2"). This letter is submitted in EFRAG's capacity of contributing to IASB's and IFRIC's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRIC interpretation on the issue.

We acknowledge that both IAS 16 *Property, Plant and Equipment* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* contain requirements on how to account for decommissioning, restoration and similar liabilities at the initial recognition of a liability and a related asset but not on the treatment of subsequent changes in estimates. We therefore believe that IFRIC should provide guidance on how to account for the effects of subsequent changes in the measurement of these liabilities and related assets.

The basic principle underlying the D2 proposal is that a change in an estimated decommissioning, restoration or similar liability "should be viewed as revising the initial liability and the cost of the asset" (BC 6). The approach essentially assumes that an initial estimate of the cost of an asset is regularly revised as more information becomes available and as discount rates change. Using the new cost basis the accumulated depreciation to date is recalculated and an adjustment is made in income in the current year for any "catch-up" amount needed to reflect what would have been the case had the revised cost been known at the outset. Similarly, an adjustment is made to reflect the amount that has to be depreciated in the future. The approach is therefore primarily retrospective in nature.

Whilst the D2 approach has considerable merit, it is inconsistent with the way in which existing international standards (IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IAS 16 *Property, Plant and Equipment*) are universally interpreted, as requiring changes in estimates to be accounted for prospectively. Our understanding is that IFRIC rejected a prospective approach because it believes that, if all of the changes in the decommissioning or restoration liability were to be attributed to the future use of the asset, the usage would be likely to be miscosted. Moreover, if the liability were adjusted downwards, the adjustment could exceed the existing depreciable amount of the asset and a negative carrying amount of the asset would arise.

We have considered these arguments but believe, on balance, that it is more important that the interpretation should be consistent with existing standards and that the changes in estimates of future decommissioning, restoration and similar liabilities and the related asset should be accounted for fully prospectively, without "catch up" of the effect to past periods' accumulated depreciation in the period of the change in estimates. We, therefore, do not support the approach proposed in D2. Instead we prefer a fully prospective approach capitalising all of the effect of changes in estimated outflows of resources embodying economic benefits and in the discount rate, and depreciating them prospectively (as described in BC9 alternative (c)).

In reaching our conclusion we considered the example of a nuclear power installation. Initially, the useful economic life may be estimated to be 30 years and the decommissioning costs calculated, then discounted back to initial value at the date of installation. After some years of operation it is decided that the installation's life can be extended to 40 years. The postponement of decommissioning by ten years reduces the present value of the liability, and consequently the amortisation of this component of the asset's cost. At the same time, extension of the asset's life by ten years requires an adjustment to the rate of depreciation of the asset. If the reduction in value of the decommissioning cost component is to be dealt with retrospectively yet the adjustment to the asset's life in respect of decommissioning and all other cost components to be dealt with prospectively, the same event will have been recognised in two different ways. This will be very difficult to explain and is not likely to enhance transparency. Accordingly, we suggest that the interpretation be amended to make it consistent with existing standards (IAS 8 paragraph 26, IAS 16 paragraph 52).

If you would like further clarification of the points raised in this letter, Paul Rutteman or myself would be happy to discuss these further with you.

Yours sincerely

Johan van Helleman
EFRAG, Chairman