

ACCOUNTING STANDARDS BOARD

INTERPRETATION OF THE STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

CHANGES IN EXISTING DECOMMISSIONING, RESTORATION AND SIMILAR LIABILITIES

(IGRAP 2)

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Acknowledgement

This Interpretation of the Standards of Generally Recognised Accounting Practice (IGRAP) is drawn primarily from the equivalent IFRIC® Interpretation 1 on *Changes in Existing Decommissioning, Restoration and Similar Liabilities* issued by the IFRS® Interpretations Committee of the International Accounting Standards Board (IASB®). The IASB has issued a comprehensive body of IFRS® Standards and IFRIC® Interpretations. Extracts of the IFRIC Interpretation 1 on *Changes in Existing Decommissioning, Restoration and Similar Liabilities* are reproduced in this Interpretation of the Standards of GRAP with the permission of the IASB.

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Introduction

Interpretation of the Standards of Generally Recognised Accounting Practice

The Accounting Standards Board (Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

(a) departments (including national, provincial and government components);

(b) public entities;

(c) trading entities (as defined in the PFMA);

(d) constitutional institutions;

(e) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and

(f) Parliament and the provincial legislatures.

The above are collectively referred to as “entities” in Standards of GRAP.

The Board has approved the application of International Financial Reporting Standards (IFRS® Standards) issued by the International Accounting Standards Board® for:

(a) public entities that meet the criteria outlined in the Directive on *The Selection of an Appropriate Reporting Framework by Public Entities;* and

(b) entities under the ownership control of any of these entities.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard and any related Interpretations of the Standards of GRAP.

Any limitation of the applicability of specific Standards or Interpretations is made clear in those Standards or Interpretations.

This Interpretation is set out in paragraphs .01 to .11. All paragraphs in this Interpretation have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Interpretation should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of GRAP*, the *Preface to the Interpretations of the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*.

Standards of GRAP and Interpretations of Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards, published in the Government Gazette.

Reference may be made here to a Standard of GRAP that has not been issued at the time of issue of this Interpretation. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Interpretation of the Standards of GRAP on *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

References

- GRAP 1 *Presentation of Financial Statements*
- GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*
- GRAP 5 *Borrowing Costs*
- GRAP 17 *Property, Plant and Equipment*
- GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets*
- GRAP 21 *Impairment of Non-cash-generating Assets*
- GRAP 26 *Impairment of Cash-generating Assets*

Background

.01 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 the Standard of GRAP on *Property, Plant and Equipment* (GRAP 17), 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. The Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19) 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

.02 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 GRAP 17; and

(b) recognised as a liability in accordance with GRAP 19.

For example, a decommissioning, restoration or similar liability may exist for decommissioning a plant, rehabilitating environmental damage of a landfill site, or removing equipment.

Issue

.03 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) or service potential required to settle the obligation;

(b) a change in the current market-based discount rate as defined in paragraph .52 of GRAP 19 (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

.04 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 or service potential required to settle the obligation, or a change in the discount rate, shall be accounted for in accordance with paragraphs .05 to .07.

.05 If the related asset is measured using the cost model:

(a) Subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.

(b) The amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in surplus or deficit.

(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 or recoverable service amount, and shall account for any impairment loss, in accordance with the Standards of GRAP on *Impairment of Non-cash-generating Assets* or *Impairment of Cash-generating Assets*.

.06 If the related asset is measured using the revaluation model:

(a) Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:

(i) a decrease in the liability shall (subject to (b)) be credited directly to the revaluation surplus in net assets, except that it shall be recognised in surplus or deficit to the extent that it reverses a revaluation deficit on the asset that was

previously recognised in surplus or deficit;

(ii) an increase in the liability shall be recognised in surplus or deficit, except that it shall be debited directly to the revaluation surplus in net assets to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

(b) In the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess shall be recognised immediately in surplus or deficit.

(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 end of the reporting period. Any such revaluation shall be taken into account in determining the amounts to be recognised in surplus or deficit or net assets under (a). If a revaluation is necessary, all assets of that class shall be revalued.

(d) The Standard of GRAP on *Presentation of Financial Statements* (GRAP 1) requires disclosure on the face of the statement of changes in net assets of each item of revenue or expense that is recognised directly in net assets. In complying with this requirement, the change in the revaluation surplus arising from a change in the liability shall be separately identified and disclosed as such.

.07 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 surplus or deficit as they occur. This applies under both the cost model and the revaluation model.

.08 The periodic unwinding of the discount shall be recognised in surplus or deficit as a finance cost as it occurs. Capitalisation under the Standard of GRAP on *Borrowing Costs* is not permitted.

Transitional provisions

.09 All changes resulting from the application of this Interpretation shall be accounted for in accordance with the requirements of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors (GRAP 3).

Effective date

Initial adoption of the Standards of GRAP

.10 This Interpretation becomes effective with reference to the effective date of the applicable Standards of GRAP as determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.

Entities already applying Standards of GRAP

.11 An entity shall apply this Interpretation for annual financial statements covering periods beginning on or after 1 April 2011.

Appendix - Illustrative examples

This appendix is illustrative only and does not form part of this Interpretation. The purpose of this appendix is to illustrate the application of this Interpretation and to assist in clarifying its meaning.

Common facts

IE1. An entity has an electrical generating plant and a related decommissioning liability. The electrical generating plant started operating on 1 April 20X0. The plant has a useful life of 40 years. Its initial cost was R120 000; this included an amount for decommissioning costs of R10 000, which represented R70 400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31 March.

Example 1 - Cost model

IE2. On 31 March 20X9, the plant is 10 years old. Accumulated depreciation is R30 000 (R120 000 × $^{10}/_{40}$ years). Because of the unwinding of discount (5 per cent) over the 10 years, the decommissioning liability has grown from R10 000 to R16 300.

IE3. On 31 March 20X9, 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 R8 000. Accordingly, the entity adjusts the decommissioning liability from R16 300 to R8 300. On this date, the entity makes the following journal entry to reflect the change:

		R	R
Dr	Decommissioning liability	8 000	
Cr	Cost of asset		8 000

IE4. Following this adjustment, the carrying amount of the asset is R82 000 (R120 000 – R8 000 – R30 000), which will be depreciated over the remaining 30 years of the asset's life giving a depreciation expense for the next year of R2 733 (R82 000 ÷ 30). The next year's finance cost for the unwinding of the discount will be R415 (R8 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 the change would have been the same but the next year's finance cost would have reflected the new discount rate.

Example 2 - Revaluation model

IE6. The entity adopts the revaluation model in GRAP 17 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.

(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 R115 000 is obtained at 31 March 20X2. It includes an allowance of R11 600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. The amounts included in the statement of financial position at 31 March 20X2 are therefore:

	R
Asset at valuation (1)	126 600
Accumulated depreciation	nil
Decommissioning liability	(11 600)
Net amount	115 000
Accumulated surplus (2)	(10 600)
Revaluation surplus (3)	15 600

Notes:

(1) Valuation obtained of R115 000 plus

decommissioning costs of R11 600, allowed for in the valuation but recognised as a separate liability = R126 600.

(2) Three years' depreciation on original cost R120 000 × $^{3}/_{40}$ = R9 000 plus cumulative discount on R10 000 at 5 per cent compound = R1 600; total R10 600.

(3) Revalued amount R126 600 less previous net book value of R111 000 (cost R120 000 less accumulated depreciation R9 000).

IE9. The depreciation expense for 20X3 is therefore R3 420 (R126 600 × $^{1}/_{37}$) and the discount expense for 20X3 is R600 (5 per cent of R11 600). On 31 March 20X3, the decommissioning liability (before any adjustment) is R12 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 R5 000. Accordingly, the entity adjusts the decommissioning liability from R12 200 to R7 200.

IE10. The whole of this adjustment is taken to revaluation surplus, because it does not exceed the carrying amount that would have been recognised had the asset been carried under the cost model. If it had done, the excess would have been taken to surplus or deficit in accordance with paragraph .06(b). The entity makes the following journal entry to reflect the change:

		R	R
Dr	Decommissioning liability	5 000	
Cr	Cost of asset		5 000

IE11. The entity decides that a full valuation of the asset is needed at 31 March 20X3, in order to ensure that the carrying amount does not differ materially from fair value. Suppose that the asset is now valued at R107 000, which is net of an allowance of R7 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 R114 200. The following additional journal entry is needed:

		R	R
Dr	Accumulated depreciation (1)	3 420	
Cr	Asset at valuation		3 420
Dr	Revaluation surplus (2)	8 980	
Cr	Asset at valuation (3)		8 980

Notes:

(1) Eliminating accumulated depreciation of R3 420 in accordance with the entity's accounting policy.

(2) The debit is to revaluation surplus because the deficit arising on the revaluation does not exceed the credit balance existing in the revaluation surplus in respect of the asset.

(3) Previous valuation (before allowance for decommissioning costs) R126 600, less cumulative depreciation R3 420, less new valuation (before allowance for decommissioning costs) R114 200.

IE12. Following this valuation, the amounts included in the statement of financial position are:

	R
Asset at valuation	114 200
Accumulated depreciation	nil
Decommissioning liability	(7 200)
Net amount	107 000
Accumulated surplus (1)	(14 620)
Revaluation surplus (2)	11 620

Notes:

(1) R10 600 at 31 March 20X2 plus 20X3's depreciation expense of R3 420 and discount expense of R600 = R14 620.

(2) R15 600 at 31 March 20X2, plus R5 000 arising on the decrease in the liability, less R8 980 deficit on revaluation = R11 620.

Example 3 - Transition

IE13. The following example illustrates retrospective application of this Interpretation for preparers that already apply Standards of GRAP. Retrospective application is required by GRAP 3, where practicable. The example assumes that the entity:

(a) adopted GRAP 19 on 1 April 19X9;

(b) adopts this Interpretation on 1 March 20x5; and

(c) before the adoption of this Interpretation, recognised changes in estimated cash

flows to settle decommissioning liabilities as revenue or expense.

IE14. On 31 March 20X0, because of the unwinding of the discount (5 per cent) for one year, the decommissioning liability has grown from R10 000 to R10 500. In addition, based on recent facts, the entity estimates that the present value of the decommissioning liability has increased by R1 500 and accordingly adjusts it from R10 500 to R12 000. In accordance with its then policy, the increase in the liability is recognised in surplus or deficit.

IE15. On 1 April 20X5, the entity makes the following journal entry to reflect the adoption of this Interpretation:

		R	R
Dr	Cost of asset	1 500	
Cr	Accumulated depreciation		154
Cr	Opening accumulated surplus		1 346

IE16. The cost of the asset is adjusted to what it would have been if the increase in the estimated amount of decommissioning costs at 31 March 20X0 had been capitalised on that date. This additional cost would have been depreciated over 39 years. Hence, accumulated depreciation on that amount at 31 March 20X4 would be R154 (R1 500 × $^{4}/_{39}$ years).

IE17. Because, before adopting this Interpretation on 1 April 20X5, the entity recognised changes in the decommissioning liability in surplus or deficit, the net adjustment of R1 346 is recognised as a credit to opening accumulated surplus. This credit is not required to be disclosed in the financial statements, because of the restatement described below.

IE18. GRAP 3 requires the comparative financial statements to be restated and the adjustment to opening accumulated surplus at the start of the comparative period to be disclosed. The equivalent journal entries at 1 April 20X4 are shown below. In addition, depreciation expense for the year ended 31 March 20X4 is increased by R39 from the amount previously reported:

		R	R
Dr	Cost of asset	1 500	
Cr	Accumulated depreciation		115
Cr	Opening accumulated surplus		1 385

Comparison with the IFRIC® Interpretation on *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (May 2004)

This Interpretation is drawn primarily from the IFRIC Interpretation on *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (IFRIC 1). The main differences between this Interpretation and IFRIC 1 are as follows:

- This Interpretation uses different terminology, in certain instances, from IFRIC 1. The most significant examples are the use of the terms “net assets” and “surplus or deficit”. The equivalent terms in IFRIC 1 are “equity” and “profit or loss” respectively.
- The term “service potential” and “recoverable service amount” have been incorporated in this interpretation as equivalent terms for “future economic benefits” and “recoverable amount” respectively, to be public sector specific.
- As GRAP 1 does not incorporate the IASB® improvements on the statement of comprehensive income, this Interpretation has been aligned with the principles in GRAP 1.