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IAS Plus website

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Recent months have seen the finalisation of several of the agenda projects of the International Financial Reporting Interpretations Committee (IFRIC). Four new Interpretations were released in November and December, as well as an amendment to **SIC-12 Consolidation – Special Purposes Entities**. This Newsletter provides a summary of all of the Interpretations issued by the IFRIC to date.

The IFRIC agenda remains full. There are a number of Draft Interpretations in issue, with a new batch expected shortly dealing with the complex area of service concession arrangements. Summaries of the drafts in issue, together with information on the progress of other IFRIC projects, can be found on our IAS Plus website.

The following are the final IFRIC pronouncements issued in 2004:

Number	Title	Effective date (annual periods beginning on or after)
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities	1 September 2004
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments	1 January 2005
IFRIC 3	Emission Rights	1 March 2005
IFRIC 4	Determining whether an Arrangement contains a Lease	1 January 2006
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	1 January 2006
Amendment to SIC-12	Scope of SIC-12 Consolidation – Special Purpose Entities	1 January 2005

IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities

IFRIC 1 contains guidance on accounting for changes in decommissioning, restoration and similar liabilities that have previously been recognised both as part of the cost of an item of property, plant and equipment under IAS 16 **Property, Plant and Equipment**, and as a provision (liability) under IAS 37 **Provisions, Contingent Liabilities and Contingent Assets**. An example would be a liability that has been recognised by the operator of a nuclear power plant for costs that it expects to incur when the plant is shut down (decommissioned). When the estimate of the expenditure required to settle the liability changes, IAS 37 requires the amount of the provision to be adjusted. The issue dealt with in IFRIC 1 is whether such changes should be recognised in current period profit or loss, or adjusted against the carrying amount of the asset.

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The Interpretation addresses adjustments of the liability that arise from:

- a revision in the timing or amount of the estimated decommissioning or restoration costs;
- a change in the current market-based discount rate (which includes changes in the time value of money and the risks specific to the liability); and
- the passage of time (also referred to as the unwinding of the discount).

Increases or decreases in liabilities – assets accounted for using the cost model under IAS 16

As regards increases or decreases resulting from changes in the estimated timing or amount of decommissioning costs, or from changes in the discount rate, for assets measured using the cost model under IAS 16, the following treatment is required:

- such changes will generally be added to, or deducted from, the cost of the related asset in the current period;
- if a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in profit or loss; and
- if the adjustment results in an addition to the cost of the asset, the entity is required to consider whether this is an indication that the increased carrying amount is not recoverable and, if so, is required to test the asset for impairment in accordance with IAS 36 *Impairment of Assets*.

"…changes will generally be added to, or deducted from, the cost of the related asset..."

Increases or decreases in liabilities – assets accounted for using the revaluation model under IAS 16

For assets measured using the revaluation model under IAS 16, a change in the decommissioning liability does not, of itself, affect the valuation of the asset for financial reporting purposes. Rather, it affects the difference between what would have been reported for the asset under the cost model and its valuation. In other words, such increases or decreases change 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, for a revalued asset the revaluation surplus decreases (or the revaluation deficit increases) by CU20.

Increases or decreases in liabilities attached to revalued assets should therefore be accounted for as follows:

- a decrease in the liability should generally be credited directly to the revaluation surplus, except that it should be recognised in profit or loss to the extent that is reverses a revaluation deficit on the asset that was previously recognised in profit or loss;
- an increase in the liability should be recognised in profit or loss, except that it should be debited directly to the revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset;
- 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 should be recognised immediately in profit or loss; and
- 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 balance sheet date. Where a change in the liability leads to a revaluation of the asset, all assets of the class are required to be revalued.

The Interpretation emphasises that, when accounting for revalued assets to which decommissioning liabilities attach, it is important to understand the basis of the valuation obtained. For example, some valuers may value the asset on a net basis, i.e. after deducting an allowance for decommissioning costs to reflect the fact that an entity acquiring the asset would also generally assume the decommissioning liability. In such circumstances, it will be necessary to adjust the valuation obtained by adding back the allowance for the liability, so that the liability is not double counted.

"… increases attributable to the unwinding of the discount should always be recognised in profit or loss as they occur."

Increases attributable to the unwinding of the discount

IFRIC 1 requires that increases attributable to the unwinding of the discount should always be recognised in profit or loss as they occur. The IFRIC concluded that the unwinding of the discount is not a borrowing cost as defined in IAS 23 *Borrowing Costs* and, consequently, that the allowed alternative treatment of capitalisation under IAS 23 is not permitted.

"…the adjusted depreciable amount is depreciated over the remaining useful life of the asset."

Subsequent measurement

When the carrying amount of an asset has been adjusted for a change in the liability, the adjusted depreciable amount is depreciated over the remaining useful life of the asset. There is no retrospective adjustment of depreciation.

Once the related asset has reached the end of its useful life, any subsequent changes in the liability are recognised in profit or loss as they occur.

Effective date and transition

IFRIC 1 is effective for annual periods beginning on or after 1 September 2004. Earlier application is encouraged. If an entity applies the Interpretation for a period beginning before 1 September 2004, that fact should be disclosed.

For entities already applying IFRSs, changes in accounting policies resulting from the implementation of IFRIC 1 should be accounted for in accordance with IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors**. Therefore, where practicable, such changes in accounting policies should be applied retrospectively.

First-time adoption

The IFRIC has made consequential amendments to IFRS 1 **First-time Adoption of International Financial Reporting Standards**, so as to introduce a specific exemption from full retrospective application of IFRIC 1 in the first period in which an entity adopts IFRSs. A first-time adopter is not required to comply with the requirements of IFRIC 1 for changes in liabilities that occurred before the date of transition to IFRSs. Instead, where the relief is availed of, the first-time adopter should:

- measure its decommissioning liability as at the date of transition to IFRSs in accordance with IAS 37;
- to the extent that the liability is within the scope of IFRIC 1, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for the liability over the intervening period; and
- calculate the accumulated depreciation on that amount, as at the date of transition to IFRSs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under IFRSs.

The exemption from full retrospective application means that first-time adopters are permitted to calculate what the decommissioning liability is at the date of transition, and assume that the same liability (adjusted only for the time value of money) existed when the asset was first acquired/constructed. When discounting the liability it will, however, be necessary to take account of changes in the relevant discount rate in the period since the asset was first recognised.

UK issues

IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities

In UK GAAP Financial Reporting Standard (FRS) 15, **Tangible Fixed Assets** and FRS 12 **Provisions, Contingent Liabilities and Assets** provide guidance on decommissioning and restoration costs which may form part of an asset and require a provision. In addition, the Oil Industry Accounting Committee's Statement of Recommended Practice (SORP), **Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities**, provides detailed guidance. The effect of the international standards, including IFRIC 1, is similar to the UK treatment which is outlined below.

FRS 15 allows an asset to be recognised for estimated costs of dismantling and removing an asset and restoring a site to the extent that it is recognised as a provision under FRS 12, and allows such expenditure to be capitalised even if it is some time after the original capitalisation of the asset (paragraph 10). In the event that such estimated costs fell in value and caused the cost of the asset to fall below its carrying value, the asset would require an impairment review. International standards contain more guidance on how to account for revalued assets where a decommissioning liability exists (page 2, above) than do the UK standards.

FRS 12 requires future liabilities to be discounted where the time value of money is material (paragraph 45), and for the unwinding of the discount to be recognised as an interest expense (paragraph 48). This is consistent with IAS 16 and IFRIC 1.

IFRIC 2 Members' Shares in Co-operative Entities and Similar Instruments

IFRIC 2 interprets IAS 32 Financial Instruments: Disclosure and Presentation (as revised in 2003). It deals with the classification under IAS 32 of members' interests in co-operatives and similar entities (members' shares) that give the holder the right to request redemption for cash or another financial asset.

The principal conclusions of the IFRIC are as follows:

- all of the terms and conditions of members' shares should be considered in determining their classification as a financial liability or as equity;
- the contractual right of the holder to request redemption does not, in itself, require the members' shares to be classified as financial liabilities; and
- members' shares that would be classified as equity if the members did not have the right to request redemption are equity in either of the following circumstances:
  - if the entity has an unconditional right to refuse redemption of the members' shares; or
  - redemption is unconditionally prohibited by local law, regulation or the entity's governing charter.

"…the contractual right of the holder to request redemption does not, in itself, require the members' shares to be classified as financial liabilities."

Expectations as regards redemption do not impact on classification

IAS 32 establishes the general principle that the classification of a financial instrument is based on the terms of the instrument, and it is not impacted by the entity's history of, or intention to make, discretionary payments. Therefore, for example, where an entity has an unconditional right to refuse redemption, the members' shares are classified as equity, even where the entity has never, in practice, refused redemption.

Conditional prohibitions on redemption will not result in classification as equity

Provisions in local law, regulation or the entity's governing charter that prohibit redemption only in certain circumstances do not result in members' shares being equity. Any prohibition on redemption that is conditional only defers a financial liability already incurred and, therefore, does not result in classification of the instrument as equity. For example, the entity's ability to redeem may be subject to liquidity constraints. This is a conditional prohibition, and does not result in the members' shares being equity.

Partial prohibitions are evaluated by reference to the group of members' shares as a whole

"… the portion of shares subject to the redemption prohibition is not a financial liability."

Where there is an unconditional prohibition on redemptions beyond a specified amount, (eg. a specified amount of paid-in capital), this effectively prevents the entity from incurring any financial liability to redeem in excess of the specified amount of paid-in capital. Therefore, the portion of shares subject to the redemption prohibition is not a financial liability. While each share may be redeemable individually, a portion of the total shares outstanding at any time is not redeemable in any circumstance other than the liquidation of the entity.

Any change in the level of prohibition will lead to a transfer between financial liabilities and equity. This will arise, for example, where redemptions are limited by reference to the amount of new shares issued within the 3 years prior to the balance sheet date. In this case, a new issue of shares will increase the level of redemptions permitted, and a transfer will be made between equity and financial liabilities.

Measurement of the financial liability

When a financial liability for the redemption of members' shares is initially recognised, the financial liability is measured at fair value, in accordance with the general principles of IAS 39 Financial Instruments: Recognition and Measurement. Fair value, in the case of a financial liability for redemption of members' shares redeemable on demand, is the maximum amount payable under the redemption provisions of the entity's governing charter or applicable law.

Effective date and transition

The effective date and transition requirements of IFRIC 2 are the same as those for IAS 32 (as revised in 2003). The Interpretation, which should be applied retrospectively, is effective for annual periods beginning on or after 1 January 2005. If it is applied for an earlier period, that fact should be disclosed.

For entities already applying IFRSs, and for whom application of the Interpretation will result in a change in classification, then that reclassification will apply to earlier accounting periods.

First-time adoption

For first-time adopters of IFRSs in 2005, the impact can be restricted to the 2005 financial statements, as they are not required to apply IAS 32 to earlier periods.

UK issues

IFRIC 2 – Members' Shares in Co-operative Entities and Similar Instruments

In the UK, a draft Urgent Issues Task Force (UITF) Abstract 39, **Members' Shares in Co-operative Entities and Similar Instruments**, is currently under discussion and will have the effect of implementing IFRIC 2 for entities subject to UK accounting standards. Its content is identical to IFRIC 2 (with the exception that references to IASB literature are revised to UK literature) as it gives guidance on the classification of members' shares either as financial liabilities or as equity under FRS 25 (IAS 32) **Financial Instruments: Disclosure and Presentation**. However, entities applying the FRSSE will be exempt and the effective date and transitional provisions have been amended to be consistent with FRS 25. FRS 25 has been introduced into UK GAAP as part of a package of standards which includes FRS 26 (IAS 39) **Financial Instruments: Measurement**, and is effective from 1 January 2005 for entities which fall within the scope of FRS 26.

The Interpretation does not resolve the conceptual distinction between debt and equity, for example it does not address the issue of how a prohibition based on liquidity criteria can be distinguished from an unconditional prohibition on redemption. Shares in co-operative entities may, subject to the specific rights attached to them, need to be reclassified as financial liabilities unless their governing charter is amended. Recently, some commentators have suggested that problems may arise when Limited Liability Partnerships reporting either under IFRS or UK GAAP use these standards, as they might have to reclassify partners' capital from equity to liability, but further discussion in this area is likely to clarify this.

IFRIC 3 Emission Rights

In the light of the Kyoto agreement, several governments have developed, or are in the process of developing, schemes to encourage reductions in greenhouse gas emissions. IFRIC 3 focuses on the accounting to be adopted by participants in a 'cap and trade' scheme, although some of its requirements might be relevant to other schemes that are also designed to encourage reduced levels of emissions and share some of the features of a cap and trade scheme.

Typically, in cap and trade schemes, a government (or government agency) issues rights (allowances) to participating entities to emit a specified level of emissions. The government may issue the allowances free of charge or the participant may be required to pay for them. Participants in the scheme are able to buy and sell allowances and, therefore, in many schemes there is an active market for the allowances. At the end of a specified period, participants are required to deliver allowances equal to their actual emissions.

Allowances as intangible assets

IFRIC 3 concludes that emission rights (allowances), whether granted by government or purchased, are intangible assets that should be recognised in the financial statements in accordance with IAS 38 **Intangible Assets**. Where allowances are issued for less than fair value, they should be measured initially at their fair value.

Subsequent to initial recognition, where the entity accounts for the allowances using IAS 38's cost model, the allowances will be carried at cost less any accumulated amortisation and any accumulated impairment losses. Where the revaluation model is selected, the allowances will be carried at a revalued amount, being fair value at the date of revaluation (determined by reference to an active market) less any subsequent amortisation and any subsequent impairment losses.

"Where allowances are issued for less than fair value, they should be measured initially at their fair value."

In practice, it is unlikely that amortisation will be charged in respect of allowances. For those allowances traded in an active market, their residual value will be greater than or equal to their carrying amount, and hence the depreciable amount will be zero. The allowance will therefore generally be recognised in profit or loss when it is surrendered to settle the obligation that arises from producing emissions, or when it is sold to another entity.

Government grants

When allowances are issued to a participant by government (or a government agency) for less than their fair value, the difference between the amount paid (if any) and their fair value is a government grant that is accounted for in accordance IAS 20 Accounting for Government Grants and Disclosure of Government Assistance. Initially, the grant is recognised as deferred income in the balance sheet, and subsequently it is recognised as income on a systematic basis over the compliance period for which the allowances were issued.

Recognition as income over the compliance period is required, regardless of whether the allowances are held or sold. The IFRIC concluded that the deferred credit should not be derecognised when the allowances are sold, and should continue to be amortised.

Obligation to deliver allowances as a liability

As a participant produces emissions, it recognises a provision for its obligation to deliver allowances in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets. This provision is measured at the best estimate of the expenditure required to settle the present obligation at the balance sheet date – which will normally be the market value of the number of allowances required to cover emissions up to the balance sheet date.

Impairment of other assets

The existence or requirements of an emission rights scheme may cause a reduction in the cash flows expected to be generated by certain assets. Such a reduction is an indication that those assets may be impaired, and hence requires those assets to be tested for impairment in accordance with IAS 36 Impairment of Assets.

Effective date and transition

IFRIC 3 is effective for annual periods beginning on or after 1 March 2005. Earlier adoption is encouraged. If an entity applies IFRIC 3 for a period beginning before 1 March 2005, that fact should be disclosed.

Changes in accounting policies arising from the implementation of IFRIC 3 should be accounted for in accordance with the requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Therefore, where practicable, such changes in accounting policies should be applied retrospectively.

First-time adoption

The IFRIC did not perceive a need to create special transitional arrangements for first-time adopters applying IFRS 1 First-time Adoption of International Financial Reporting Standards. Accordingly a first-time adopter should adopt the accounting policies required by IFRIC 3 with retrospective effect at its date of transition.

UK issues

IFRIC 3 – Emission Rights

The UK's Emissions Trading Scheme, launched in 2002, is an example of a 'cap and trade' scheme to which IFRIC 3 will apply. The European Financial Reporting Advisory Group (EFRAG) has indicated some concerns with the draft IFRIC, and has yet to endorse the final version. This means that European Union countries using IFRS , including the UK, do not yet have to apply IFRIC 3. Similarly, in UK GAAP the principles of IFRIC 3 have not yet been introduced. The Accounting Standards Board issued a proposed UITF Abstract (Information Sheet 61) on emission rights, which is based on the interpretation, but has not issued a final Abstract.

The Interpretation is based on the principles of IAS 38 and 37 (discussed above), which are similar to their UK equivalents, FRS 10 Goodwill and Intangible Assets and FRS 12, Provisions, Contingent Liabilities and Assets.

A problem with IFRIC 3 is that it measures the obligation to deliver allowances at the end of the compliance period at market value through the profit or loss account. In contrast, the intangible asset is measured either at cost or revalued amount with changes in the value of allowances being reported in reserves. IFRIC's view is that this mismatch can only be rectified by an amendment to IAS 38. This issue is on the agenda for IFRIC's February meeting, and will also require intervention by the IASB.

IFRIC 4 Determining whether an Arrangement contains a Lease

In recent years, arrangements have developed that do not take the legal form of a lease but which convey rights to use assets in return for a payment or series of payments. Examples of such arrangements include outsourcing arrangements, telecommunication contracts that provide rights to capacity, and take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services.

These arrangements share many features of a lease. The IFRIC concluded that all arrangements meeting the definition of a lease in IAS 17 **Leases** should be accounted for in accordance with IAS 17 (subject to the scope of that Standard), regardless of whether they take the legal form of a lease. The objective of IFRIC 4, therefore, is to provide guidance to assist in determining whether an arrangement is, or contains, a lease.

"The asset need not be explicitly identified by the contractual provisions of the arrangement."

Determining whether an arrangement is, or contains, a lease

The Interpretation specifies that an arrangement that meets **both** of the following criteria is, or contains, a lease that should be accounted for in accordance with IAS 17:

- fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset). The asset need not be explicitly identified by the contractual provisions of the arrangement. Rather, it may be implicitly specified because it is not economically feasible or practical for the supplier to fulfil the arrangement by providing use of alternative assets; and
- the arrangement conveys a right to use the asset (i.e. it conveys to the purchaser (lessee) the right to control the use of the underlying asset). This will be the case if **any** of the following conditions is met:
  - the purchaser has the ability or right to operate the asset or direct others to operate the asset (while obtaining or controlling more than an insignificant amount of the output of the asset); or
  - the purchaser has the ability or right to control physical access to the asset (while obtaining more than an insignificant amount of the output of the asset); or
  - there is only a remote possibility that parties other than the purchaser will take more than an insignificant amount of the output of the asset, and the price that the purchaser will pay is neither fixed per unit of output nor equal to the current market price at the time of delivery.

Assessing or reassessing whether an arrangement is, or contains, a lease

The assessment of whether an arrangement contains a lease is made at the inception of the arrangement. A reassessment of the arrangement is permitted (and indeed required) only in the event of limited changes in circumstances specified by the Interpretation. If an arrangement is reassessed and is determined to contain a lease (or not contain a lease), lease accounting should be applied (or should cease to apply) from the date of change in circumstances.

Separating payments for the lease from other payments

For the purpose of applying IAS 17, payments and other consideration under the arrangement are separated into those for the lease and those for other elements in the arrangement on the basis of their fair values. The minimum lease payments for the purposes of IAS 17 include only payments for the lease (i.e. for the right to use the asset) and exclude payments for other elements in the arrangement (e.g. for services and the cost of inputs). Specific rules are set out where a purchaser determines that it is impracticable to separate the payments reliably.

"… entities need only apply the Interpretation to arrangements existing at the start of the earliest period for which comparative information under IFRSs is presented."

Effective date and transition

IFRIC 4 is effective for annual periods beginning on or after 1 January 2006. Earlier adoption is encouraged. If an entity applies IFRIC 4 for a period beginning before 1 January 2006, that fact should be disclosed.

IFRIC 4 is not required to be applied retrospectively. Where the exemption from retrospective application is availed of, entities need only apply the Interpretation to arrangements existing at the start of the earliest period for which comparative information under IFRSs is presented. The assessment of such arrangements is based on the facts and circumstances existing at the start of that period.

First-time adoption

The IFRIC has made consequential amendment to IFRS 1 **First-time Adoption of International Financial Reporting Standards**, so as to introduce a specific exemption from full retrospective application of IFRIC 4 in the first period in which an entity adopts IFRSs. The first-time adopter is permitted to apply the transitional provisions in IFRIC 4, as discussed in the previous paragraph. Therefore, a first-time adopter may choose to determine whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of the facts and circumstances existing at that date, rather than retrospectively assessing each agreement at the date of its inception.

UK issues

IFRIC 4 – Determining whether an Arrangement contains a Lease

The impact of the Interpretation is to widen the range of contracts which fall to be defined as leases, as arrangements which convey a right to use an asset may contain a lease. In the UK, outsourcing, 'take or pay' contracts and service concessions, which were thought to be outside the scope of IAS 17, may now fall within it. Entities which switch to IFRS may find that income needs to be accounted for as an operating lease, on a straight line basis. For some, this is likely to mean that revenue is recognised later than under UK GAAP, although FRS 5's **Application Note G** may already have resulted in the income from such contracts being recognised over the life of the contract. Accounting for service concessions is currently under discussion by IFRIC, and further guidance is expected to be issued in due course.

IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

IFRIC 5 deals with the accounting, in the financial statements of the contributor, for interests in decommissioning, restoration and environmental rehabilitation funds established to fund some or all of the costs of decommissioning assets or to undertake environmental rehabilitation.

The issues dealt with in IFRIC 5 are:

- how should a contributor account for its interest in a fund; and
- 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?

Note that the scope of IFRIC 5 is restricted to funds with separately-administered assets, where the contributor's right to access the assets is restricted. 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 **Financial Instruments: Recognition and Measurement**, and is not within the scope of IFRIC 5.

Assessing the relationship between the contributor and the fund

The contributor is required to assess whether it has control, joint control or significant influence over the fund, in accordance with relevant Standards, and to account for its interest by consolidation, proportionate consolidation, or equity accounting, as appropriate under those Standards.

"The contributor's obligation to pay decommissioning costs should be recognised as a liability…"

Accounting for the obligation to pay decommissioning costs

The contributor's obligation to pay decommissioning costs should be recognised as a liability, separate from its interest in the fund, unless its contributions to the fund have extinguished its obligation to pay decommissioning costs (even in the event that the fund fails to pay). Therefore, where an entity remains liable for expenditure, a provision should be recognised, even where reimbursement is available.

When a contributor has a potential obligation to make additional contributions, for example, in the event of the bankruptcy of another contributor, or if the value of the investments 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 accounted for under IAS 37. The contributor will recognise a liability only if it is probable that additional contributions will be made.

"… recognition of an asset in excess of the recognised liability is prohibited.

Accounting for the contributor's interest in the fund

In the absence of control, joint control, or significant influence, the contributor's right to reimbursement from the fund is accounted for in accordance with the rules set out in IAS 37 **Provisions, Contingent Liabilities and Contingent Assets** in respect of reimbursements. Therefore, if the reimbursement is virtually certain to be received when the obligation is settled, then it should be treated as a separate asset.

The reimbursement should be measured at the lower of the amount of the decommissioning obligation recognised, and the contributor's share of the fair value of the net assets of the fund attributable to contributors. Therefore, recognition of an asset in excess of the recognised liability is prohibited. For example, rights to receive reimbursement for decommissioning liabilities that have yet to be recognised as a provision are not recognised as an asset.

Changes in the carrying amount of the right to receive reimbursement other than contributions to and payments from the fund should be recognised in profit or loss in the period in which those changes occur.

Disclosure

Contributors are required to disclose the nature of interests in funds, and any restrictions on access to the assets in the funds. In addition, where the arrangements give rise to contingent liabilities or reimbursement rights that are accounted for under IAS 37, then the relevant disclosure requirements of IAS 37 apply.

Effective date and transition

IFRIC 5 is effective for annual periods beginning on or after 1 January 2006. Earlier adoption is encouraged. If an entity applies IFRIC 5 for a period beginning before 1 January 2006, that fact should be disclosed.

Changes in accounting policies arising from the implementation of IFRIC 5 should be accounted for in accordance with the requirements of IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors**. Therefore, where practicable, such changes in accounting policies should be applied retrospectively.

First-time adoption

The IFRIC did not perceive a need to create special transitional arrangements for first-time adopters applying IFRS 1 **First-time Adoption of International Financial Reporting Standards**. Accordingly, a first-time adopter should adopt the accounting policies required by IFRIC 5 with retrospective effect at its date of transition.

UK issues

IFRIC 5 – Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

This Interpretation generally develops principles in IFRS which are similar to UK GAAP, particularly the Oil Industry Accounting Committee's SORP. However, a key concern the IFRIC raises for some UK companies is that the hurdle for asset recognition is high. Where a fund for future decommissioning exists in a joint venture or associate, the contributer to the fund cannot recognise all of its share of the fair value of the fund where this is higher than the recognised liability. This means that where a fund is in surplus, the surplus element is not recognised as an asset in the contributer's balance sheet, even when it has a bona fide and contractually established right to the surplus.

IFRIC amendment to the scope of SIC-12 Consolidation – Special Purpose Entities

The IFRIC amendment to SIC-12 amends the scope paragraph of SIC-12 **Consolidation – Special Purpose Entities** so that:

- the scope exclusion for equity compensation plans has been removed; and
- a scope exclusion for other long-term employee benefit plans has been added.

Prior to the implementation of IFRS 2 **Share-based Payment** IFRSs did not specify any recognition or measurement requirements for equity compensation benefits. Following the implementation of IFRS 2, a comprehensive model for the recognition and measurement of such benefits has been introduced. For consistency, the scope of SIC-12 has been amended so that the Interpretation will now apply to such plans. Therefore, for example, where the equity compensation benefits are administered via an employee benefit trust (or similar entity), removing the scope exclusion from SIC-12 will require an entity that controls such a trust to consolidate the trust.

The addition of the scope exclusion regarding other long-term employee benefit plans has also been introduced to ensure consistency – between post-employment benefit plans and other long-term employee benefit plans. SIC-12 excludes post-employment benefit plans from its scope. In the past, however, it has not specifically excluded other long-term employee benefit plans from its scope – even though IAS 19 specifies that such plans should be accounted for in a manner similar to the accounting for post-employment benefit plans. Therefore, the scope amendment has been made in order to correct this inconsistency.

Effective date and transition

The IFRIC amendment to SIC-12 is effective for annual periods beginning on or after 1 January 2005. If an entity applies IFRS 2 for an earlier period, then the amendment should also be applied for that earlier period. No specific transitional requirements for first-time adopters were considered necessary.

UK issues

Amendment to the Scope of SIC-12 Consolidation – Special Purpose Entities

The IFRIC's amendment to SIC-12 means that the treatment of Employee Share Options Plans (ESOPs) under IFRS will differ to that under UK GAAP. UITF 38, **Accounting for ESOP Trusts**, requires an entity to include individual assets and liabilities of the ESOP in its individual financial statements. On consolidation, these assets and liabilities also appear in the group's financial statements. Under IFRS, an entity which controls an employee benefit trust set up for the purposes of a share-based payment arrangement will be required to consolidate that trust, so that the ESOP will be included in the sponsoring entity's consolidated financial statements. There is no requirement in IFRS for the trust to be included in the entity's individual accounts.

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