Project **Liabilities—amendments to IAS 37**

Topic **Consequential amendments to IFRIC 5**

Paper overview

1. This paper considers consequential amendments to IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* required by the proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Measurement of rights to reimbursement from the fund

2. The staff recommend that the Board delete from IFRIC 5 the requirement for contributors to measure rights to receive reimbursement from a decommissioning fund 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

   IFRIC 5 would instead state only that contributors should recognise and measure a right to receive reimbursement for recognised liabilities in accordance with IAS 37.

Recognition of obligations to make additional contributions

3. For obligations to make additional contributions to the fund, the staff recommend:

(a) allowing the possibility that some of these obligations will be financial liabilities within the scope of IAS 32 and IAS 39 rather than IAS 37.

(b) deleting the 'probability recognition' criterion, ie the criterion that requires obligations to be recognised only if it is probable that additional contributions will be made.

Background

4. Paragraph 46 of the IFRIC *Due Process Handbook* states that:

> An IFRIC Interpretation is withdrawn when an IFRS or other authoritative document issued by the IASB that overrides or confirms a previously issued IFRIC consensus becomes effective. The IFRIC Interpretations that would be affected by an authoritative IASB document are identified in the exposure draft of that document. The IASB informs the IFRIC when an exposure draft proposes the withdrawal of an IFRIC Interpretation.

5. Three IFRIC Interpretations address liabilities within the scope of IAS 37:

- IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
- IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
- IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment.*

6. It is necessary to consider for each of these Interpretations:

   (a) whether the consensus will still be consistent with the requirements of IAS 37 when the latter is revised; and

   (b) whether and how the Interpretation should be absorbed into the revised IAS 37.

7. This paper considers the first of these questions. The staff will consider the second question when we start drafting the revised standard.

Overall conclusions

8. The staff's overall conclusions are that:

   (a) the consensus in IFRICs 1 and 6 will still be consistent with the requirements of IAS 37 when the latter is revised. Only minor amendments will be required to reflect changes in terminology etc.

   (b) some aspects of IFRIC 5 will not be consistent with the revised IAS 37 and need to be amended.

9. The rest of this paper discusses consequential amendments to IFRIC 5. It:

   (a) summarises the existing requirements of IFRIC 5 (paragraphs 10-11);

   (b) proposes changes to the measurement requirements for reimbursement rights (paragraphs 12-26);

   (c) proposes changes to the recognition requirements for obligations to make additional contributions (paragraphs 27-33).

The existing requirements of IFRIC 5

10. IFRIC 5 applies to entities that contribute to ‘decommissioning funds’, ie funds that segregate assets to fund some or all of the costs of decommissioning plant or equipment or environmental restoration or rehabilitation. IFRIC 5 applies if the contributor’s right to access the assets of the fund is restricted. It specifies:

    (a) whether a contributor should recognise its interest in the fund and its decommissioning obligations gross or net.

    (b) the relevant accounting standards for recognising the asset. If the contributor has control, joint control or significant influence the relevant standards are IAS 27, IAS 28, IAS 31 and SIC-12. Otherwise, the contributor recognises a reimbursement right in accordance with IAS 37.

    (c) how the contributor should measure its reimbursement right if applying IAS 37; and

    (d) how the contributor should account for any obligations to make additional contributions to the fund.

11. Requirements (c) and (d) above—ie those addressing the measurement of reimbursement rights and obligations to make additional contributions—will be inconsistent with IAS 37 when the latter is revised. They are discussed separately below.

Measurement of reimbursement rights

Requirements of IFRIC 5

12. IFRIC 5 specifies how a contributor that does not have control, joint control or significant influence over a fund should measure a reimbursement right in accordance with IAS 37:

> 9 … 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.

13. Paragraph BC14 in IFRIC 5 explains why the asset is capped at the amount of the decommissioning obligation recognised:

> The IFRIC noted that paragraph 53 of IAS 37 specifies the accounting for rights to receive reimbursement. … The IFRIC also noted that this paragraph prohibits the recognition of an asset in excess of the recognised liability. … Accordingly, the IFRIC concluded that … [the right to reimbursement] should be measured at the lower of the amount of the decommissioning obligation and the reimbursement right.

Proposed amendments to IAS 37

14. As noted in IFRIC 5, paragraph 53 of IAS 37 at present caps the amount recognised as a reimbursement right to the amount recognised for the related liability. The Exposure Draft of Proposed Amendments to IAS 37 proposed to keep this cap:

> When an entity has a right to be reimbursed by a third party for some or all of the economic benefits that will be required to settle a liability, it recognises the reimbursement right as an asset if the reimbursement right can be measured reliably. *The amount recognised for the reimbursement right shall not exceed the amount of the liability*.[1]

15. However, in June 2009, the Board decided tentatively to delete the cap from IAS 37.

Consequences for IFRIC 5

16. Thus it seems that there is a need for a consequential amendment to IFRIC 5—if the asset cap is deleted from IAS 37, it should also be deleted from IFRIC 5.

17. However, the staff think that simply deleting the asset cap would have wider consequences for IFRIC 5 than for IAS 37. As a result, the new requirements of IFRIC 5 would not be consistent with the new requirements of IAS 37.

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1 Exposure Draft of Proposed Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*, June 2005, paragraph 46, emphasis added.

18. To understand the differences, it is first necessary to consider the effect of deleting the asset cap from IAS 37. The staff think that the only effect would be to remove an artificial constraint on the measurement of reimbursement rights. Deleting the asset cap would *not* expand the range of rights that are recognised applying IAS 37. In other words, the reimbursement rights recognised applying IAS 37 would still only be those rights that relate to *recognised* liabilities. They would not include rights to receive reimbursement for costs for which the entity had not yet recognised a liability.

19. In contrast, it appears that deleting the asset cap from IFRIC 5 would lead to additional rights being recognised. This is because contributors would recognise a reimbursement right measured at their share of the fair value of the net assets of the fund. These net assets might include more than just reimbursement rights for recognised obligations. They could include rights to:

    (a) receive a share of any surplus when the fund is wound up.

    (b) benefit from reduced contributions to the fund or increased benefits from the fund (for example by adding new sites for no additional contributions) in the future.

    (c) benefit from past contributions in the future, based on current and planned level of activity. Such benefits could arise if contributions have been made before the decommissioning obligation is recognised.

20. These additional rights are discussed in paragraphs BC19 and BC20 of the Basis for Conclusions accompanying IFRIC 5. Paragraph BC19 explains that some respondents to the exposure draft that preceded IFRIC 5 opposed the asset cap because its effect was to exclude recognition of assets other than the reimbursement right. Paragraph BC20 explains how the IFRIC responded. The IFRIC concluded that:

(a) a right to receive a share of any surplus when a fund is wound up may be an equity instrument to which IAS 39 would apply.

(b) recognition of the other assets described in paragraph 19 above would be inconsistent with the asset cap in IAS 37. The IFRIC also noted that the circumstances in which these assets exist are likely to be limited and that most of the assets would not meet the recognition criteria in the *Framework* because they cannot be measured reliably.

21. This discussion confirms that the asset cap in IFRIC 5 does not just constrain the amount at which reimbursement rights are recognised, but also serves to prohibit the recognition of rights beyond rights to reimbursement *for obligations already incurred*. Without the cap, the amount at which the reimbursement right would be recognised applying paragraph 9 of IFRIC 5—ie the contributor's share of the fair value of the net assets attributable to contributors—could include other assets, such as those described in paragraph 19 above.

Options for the Board

22. Thus, the staff think that the consequential amendments required to IFRIC 5 are not as straightforward as they might appear. Three possibilities are considered below.

23. Option 1: One option would be to remove the asset cap but specify that the amount recognised should be limited to the amount the contributor can access as reimbursement for *recognised* decommissioning obligations. In this way, the measurement basis specified by IFRIC 5 would remain consistent with the requirements of IAS 37:

> 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,~~ <u>that the contributor could access as reimbursement for recognised decommissioning obligations</u>.

The staff might need to conduct further research and consultation to determine whether contributors can readily measure this amount.

24. Option 2: If it would be difficult to measure the amount required applying Option 1, an alternative would be to keep the asset cap on grounds that it is a pragmatic means of limiting the asset to the amount that the contributor could access as reimbursement for recognised obligations.

25. Option 3: A third option would be to delete from IFRIC 5 all of the guidance on *how* to measure a reimbursement right. Paragraph 9 could simply state that if the contributor does not have control, joint control or significant influence over the fund, it should recognise and measure a right to receive reimbursement for recognised liabilities in accordance with IAS 37. Arguments for this option could be that:

(a) *guidance on* how *to apply IAS 37 is not a critical component of the consensus in IFRIC 5.* The main objective of IFRIC 5 was to resolve uncertainty about the applicable accounting standard. It had been unclear whether reimbursement rights should be accounted for as financial assets in the scope of IAS 39 or reimbursement rights in the scope of IAS 37. IFRIC 5 resolved this matter by making (with the Board's agreement) a consequential amendment to IAS 39. The amendment served to exclude from the scope of IAS 39 any reimbursement right for obligations recognised in accordance with IAS 37.

(b) *contributors should judge themselves how to measure the reimbursement right using the additional guidance to be added to IAS 37.* The Board has decided tentatively to specify in IAS 37 that reimbursement rights should be measured using assumptions that are consistent with those used to measure the related liabilities.

Staff conclusions and recommendation

26. For the reasons in paragraph 25, the staff recommend Option 3.

Recommendation 1: Reimbursement rights
The staff recommend that the Board delete from paragraph 9 of IFRIC 5 the requirement for contributors to measure reimbursement rights 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. Paragraph 9 would instead state that, if a contributor does not have control, joint control or significant influence over a decommissioning fund, it should recognise and measure a right to receive reimbursement for recognised liabilities in accordance with IAS 37. Do you agree with the staff recommendation?

Obligations to make additional contributions

27. Also inconsistent with the requirements of the revised IAS 37 will be the requirements in IFRIC 5 for any obligations to make additional contributions to the decommissioning fund.

Requirements of IFRIC 5

28. Paragraph 10 of IFRIC 5 states that:

> 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 make.

29. The staff think that two amendments will be required to this paragraph.

Probability recognition criterion

30. The Board proposes to delete from IAS 37 the requirement for entities to recognise a liability only if it is probable that an outflow of resources will be required to settle the obligation (the 'probability recognition' criterion). To be consistent, the last sentence of paragraph 10 in IFRIC 5 should similarly be deleted.

Applicable accounting standard

31. The second amendment relates to the statement that the obligation is within the scope of IAS 37. This statement is explained in paragraph BC24 of IFRIC 5:

> BC24 The IFRIC considered an 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 contractors 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.

32. The observation that financial guarantee contracts are excluded from the scope of IAS 39 was accurate when IFRIC 5 was issued in December 2004. However, this position changed when the Board issued amendments to IAS 39 in August 2005.[2] Now it is possible that some obligations to make potential additional contributions will be within the scope of IAS 39, not IAS 37.

[2] Amendments to IAS 39 and IFRS 4 *Financial Guarantee Contracts*, August 2005.

Staff recommendations

33. The staff therefore recommend the following changes:

> A ~~When a~~ contributor might have ~~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 make~~. If the obligation is a financial liability within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*, the contributor shall apply IAS 39 and IAS 32 *Financial Instruments: Presentation* to that obligation. Otherwise, it shall apply IAS 37.

Recommendation 2: Obligations to make additional contributions

The staff recommend that the Board amend the requirements for obligations to make additional contributions to:

(a) allow the possibility that some of these obligations will be financial liabilities within the scope of IAS 32 and IAS 39 rather than IAS 37.

(b) delete the 'probability recognition' criterion, ie the criterion that requires obligations to be recognised only if it is probable that additional contributions will be made.

Do you agree with the staff recommendation?