Project **Agenda decision**

Topic **IAS 37 Provisions, Contingent Liabilities and Contingent Assets – analysis of comments**

Introduction

1. The IFRS Interpretations Committee received a request in October 2010, to clarify whether the discount rate used to calculate provisions should be adjusted for own credit.

2. The Committee discussed the issue at its meeting in November 2010 and issued a tentative agenda decision not to take the issue on to its agenda. The staff presented a paper at the Committee's January 2011[1] meeting, discussing the comments received on that tentative agenda decision. Following the discussion on that paper, a revised tentative agenda decision was published in the January 2011 IFRIC Update.

3. This paper discusses the comments received on the revised tentative agenda decision.

Comment letter analysis

4. Ten comment letters were received on the revised tentative agenda decision. Details of the respondents are in Appendix B.

[1] http://www.ifrs.org/NR/rdonlyres/4A97C5AB-DC80-482C-8FCD-865B9841533E/0/031101obs03IAS37InclusionofowncreditrisketcAttachments.pdf

5. One respondent[2] agreed with the wording of the tentative agenda decision published in January 2011 IFRIC Update. Broadly speaking, the remaining respondents did not agree with the wording of the tentative agenda decision published in the January 2011 IFRIC Update. Apart from one respondent[3], the commentators did not however suggest that the Committee should reconsider taking the issue onto its agenda.

6. Specifically, the respondents disagree with the statement that 'the predominant practice today is to exclude own credit risk which is generally viewed in practice as a risk of the entity rather than a risk specific to the liability', and the assertion that the Committee 'does not expect significant diversity in practice'.

7. A number of the letters[4] received noted arguments against the wording above. They state that there are currently a number of entities applying IFRS that 'do factor in credit risk to their ARO discount rate' and that 'several companies [utilizing IFRS] have explicitly stated that they are using a discount rate that includes the company's own credit risk'. One letter (CL #6) provides a list of international oil and gas companies applying IFRS, which they state 'indicated significant divergence in practice in the use of discount rates in measuring decommissioning obligations'. One letter also notes that diversity in practice is further supported by the 'comments that were received on the recent exposure draft of amendments to IAS 37'.

8. Given this stated diversity in practice, the respondents request that the Committee reconsider the wording of the tentative agenda decision. Specifically, the majority of the respondents asked that the agenda decision state that inclusion of credit risk in the discount rate used in the measurement of provisions is an acceptable interpretation of IAS 37.

9. Further, some of the respondents requested that the Committee make 'a strong recommendation' to the *Liabilities* team to clarify this point in the new standard.

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[2] CL #10
[3] CL #7
[4] CL #1, 2, 3, 4, 5, 6, 7 and 9

Staff analysis and recommendation

10. The staff think that the Committee should reword the tentative agenda decision to reflect similar wording as was published in the tentative agenda decision in the November 2010 IFRIC Update. The staff think that paragraph 47 of IAS 37 is not clear on this issue, and the comment letters received provide evidence of diversity in practice outside of the jurisdiction in which this issue was initially raised.

11. The staff do not think, however, that the Committee is in a position to state that own credit risk should or should not be included in the discount rate when measuring provisions. The staff still think the best place for this clarity to be provided is in the new *Liabilities* standard.

12. Following the discussion above, the staff recommends that the Committee word the tentative agenda decision as set out in Appendix A.

Questions for the Committee
1. Does Committee agree with the staff's recommendation?
2. Does the Committee have any further comments on the wording for the agenda decision in Appendix A?

Appendix A – Agenda decision

The Committee received a request for interpretation of the phrase ‘the risks specific to the liability’ and whether this means that an entity’s own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities. The request assumed that future cash flow estimates have not been adjusted for the entity’s own credit risk.

The Committee observed that paragraph 47 of IAS 37 states that ‘risks specific to the liability’ should be taken into account in measuring the liability. The Committee noted that IAS 37 does not explicitly state whether or not own credit risk should be included ~~The Committee also noted that the predominant practice today is to exclude own credit risk which is generally viewed in practice as a risk of the entity rather than a risk specific to the liability. Accordingly, the Committee does not expect significant diversity in practice, and therefore [decided] not to add this issue to its agenda~~.

The Committee noted that this request for guidance would be best addressed as part of the Board’s project to replace IAS 37 with a new liabilities standard, and that the Board is already considering the request for additional guidance to be incorporated into this new standard. Consequently the Committee ~~[~~decided~~]~~ not to add this issue to its agenda.

Appendix B – Summary of respondents

CL#	Respondent	Respondent type	Geography
1	Canadian Natural Resources Limited	Preparer	Canada
2	Talisman Energy Inc.	Preparer	Canada
3	Deloitte	Accounting firm	International
4	Jeremy G. Kalanuk	Individual	Canada
5	Pengrowth Energy Corporation	Preparer	Canada
6	Canadian Association of Petroleum Producers	Industry organisation	Canada
7	KPMG	Accounting firm	International
8	NAL Energy Corporation	Preparer	Canada
9	Accounting Standards Board of Canada	Professional membership organisation	Canada
10	E&Y	Accounting firm	International

CANADIAN ASSOCIATION OF PETROLEUM PRODUCERS

February 10, 2011

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH, United Kingdom

Dear IFRS Interpretations Committee:

Re: January 6, 2011 IFRS Interpretations Committee Tentative Agenda Decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of Own Credit Risk in the Discount Rate

The Canadian Association of Petroleum Producers (CAPP) is pleased to provide comments to the IFRS Interpretations Committee on the Tentative Agenda Decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate. CAPP represents companies, large and small, that explore for, develop and produce natural gas and crude oil throughout Canada. CAPP's member companies produce more than 90 per cent of Canada's natural gas and crude oil. CAPP's associate members provide a wide range of services that support the upstream crude oil and natural gas industry. Together CAPP's members and associate members are an important part of a national industry with revenues of about $100 billion-a-year.

Canadian publicly-accountable entities are adopting International Financial Reporting Standards (IFRS) in 2011, with the first quarterly interim financial statements being made public by June 15, 2011. In addition, many of these entities will be including IFRS transitional information in their fourth quarter or annual 2010 management discussion and analysis. The inclusion or exclusion of a company's own credit risk in the discount rate for long-term decommissioning provisions is potentially the most material adjustment to the statement of financial position for the vast majority of CAPP's members. As such, CAPP's IFRS Committee members have been intently observing the IFRS Interpretations Committee's discussions on this issue as well as the IASB's progress on the IAS 37 replacement project.

In the Canadian oil and gas industry, oil and gas producers are legally obliged to abandon and remediate every well and facility after production has ceased. In many cases this abandonment and remediation occurs decades after the wells are originally drilled. The use of dedicated remediation funds is rare.

CAPP believes the IFRS Interpretations Committee should be aware of a number of facts in deliberating this issue. The purpose of this letter is to demonstrate the following:

1. *Risks specific to a liability* mentioned in paragraph 47 of IAS 37 can be interpreted to include credit risk;
2. Market participants view credit risk as specific to liabilities;

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3. Not including credit risk in the valuation of provisions creates problems in accounting for business combinations;
4. Current and future IFRS adopters using full cost accounting are at a competitive disadvantage to prior adopters and companies in other industries because of the use of risk free discount rates and the IFRS 1 full cost accounting exemption; and
5. Discounting provisions contain significant diversity in practice in North America, Europe and Asia.

Divergence within IFRS

Other IASB projects support the principle that credit risk is a risk specific to a liability. Paragraph 30 of the IASB's fair value measurement exposure draft indicates (emphasis added):

> "…non-performance risk includes, but may not be limited to, an entity's own credit risk. When measuring the fair value of a liability, an entity shall consider the effect of its credit risk (credit standing) and any other risk factors that might influence the likelihood that the obligation will not be fulfilled. <u>That effect may differ depending on the liability, e.g. whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability), and the terms of credit enhancements related to the liability, if any."</u>

Furthermore, IFRS 9 B5.7.13 indicates under the heading *"The Meaning of Credit Risk"* that (emphasis added):

> IFRS 7 defines credit risk as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'. The requirement in paragraph 5.7.7(a) relates to the risk that the issuer will fail to perform on that particular liability. It does not necessarily relate to the creditworthiness of the issuer. For example, if an entity issues a collateralized liability and a non-collateralized liability that are otherwise identical, <u>the credit risk of those two liabilities will be different, even though they are issued by the same entity</u>. The credit risk on the collateralized liability will be less than the credit risk of the non-collateralized liability. The credit risk for a collateralized liability may be close to zero.

By analogizing to financial instruments we recognize that the current IAS 37 is not in itself a "fair value" standard. We do, however, believe that the current IAS 37 standard is unclear in this respect and note that other areas of IFRS that *"risks specific to a liability"* can include credit risk.

We acknowledge that some IFRS reporters have chosen to interpret paragraph 47 of IAS to exclude credit risk (perhaps because their former GAAP required the use of a risk free rate) but we do not believe that the standard is clear in this respect either by a plain reading or in comparison to other IFRS. Therefore, we do not believe that using a risk free rate is the only possible interpretation.

Market Participants

As IFRIC observed, paragraph 47 of IAS 37 indicates that the discount rate for a provision will reflect *"the time value of money and the risks specific to the liability"*. The Committee noted that IAS 37 does not explicitly state whether or not own credit risk should be included. Some have argued that credit risk is specific to an entity rather than a liability. However, this is factually incorrect. If credit risk were specific to an entity rather than a liability, we would not see differences in credit spreads between junior and senior indebtedness. Clearly, market participants do price liabilities based on the security and seniority of the individual indebtedness. Subordinate debt invariably carries a higher interest rate than senior debt due to the increased risk of default specific to that subordinate liability.

Since debts at different levels of subordination issued by the same entity are priced differently owing to different security associated with the debt, clearly from a market participant's point of view credit risk is specific to a liability rather than to an entity.

Business Combination

When an acquired business has provisions associated with it, IFRS 3R does not provide an exception from measuring acquired provisions at fair value.

Assuming an entity acquired a probable contingent liability that was payable in the future, IFRS 3R would require the contingent liability to be recorded at fair value. However, immediately subsequent to this (per IFRS 3.56) it would be recorded at the higher of *"the amount that would be recognized in accordance with IAS 37 and the amount initially recognized less the amount recorded in accordance with IAS 18"*. Since the fair value of the contingency would be recorded at a credit risk adjusted rate, the measurement at a risk free rate under IAS 37 would always be greater than the amount recorded in the business combination. This immediate difference would lead to a day one loss on the acquisition of the business.

It cannot be the IASB's intention to require a day one loss after a business combination without providing any guidance on this occurrence. Rather, it appears that in drafting IFRS 3R the IASB did not contemplate a difference between the fair value recorded in the business combination and the amount recorded under IAS 37.

Industry Comparability

Many of CAPP's members have a significant US shareholder and financing base. In many cases, US shareholders account for 75 per cent of equity investments and are also the primary source of debt financing. US investors also make major contributions to the world-wide oil and gas industry. These companies require comparability with US peers in order to gain fair access to the capital markets. Since US GAAP requires that a credit adjusted discount rate be applied to abandonment and retirement obligations, these companies will not be comparable to US companies as they will disclose a much higher liability for abandonment and remediation. In addition, the use of a discount rate other than credit adjusted would add confusion for US Foreign Private Issuers preparing the required Standardized Measure in FASB topic 932 – Extractive Activities – Oil & Gas.

The vast majority of Canadian oil and gas producers use the full cost method of accounting under Canadian GAAP where costs were accumulated in large geographic pools, and so elected to use the IFRS 1 exemption for full cost accounting. IFRS 1D8A allows these companies to allocate these costs on the basis of reserve volumes or values as the IFRS opening deemed cost. However, IFRS 1D8A also requires that the amount recognized as deemed cost of oil and gas properties be the same balance, in aggregate, as previously recognized. If provisions for decommissioning liabilities are revised from credit-adjusted rates to risk-free rates, the outcome is a significant increase in the amount of the provision, often doubling of the provision based on Canadian rates. In the absence of IFRS 1D8A, the offset to this increase to the liability would be an increase to the related asset. IFRS 1D8A requires no change to the value of the oil and gas properties; therefore, the offset is a charge to opening retained earnings. This charge to retained earnings often changes the debt-to-equity ratios of affected companies significantly, which increases the cost of capital. Our member companies, as well as future IFRS adopters currently using US GAAP full-cost accounting, are put at an economic disadvantage to prior adopters and companies in other industries.

GAAP Convergence

While outside the scope of the IFRIC, we understand and support the need for convergence between US GAAP and IFRS. The inclusion of own credit risk in the discount rate for decommissioning provisions is just one issue that must be addressed in order to converge the future IAS 37 standard with those of FASB.

Divergence in practice

IFRIC's tentative decision notes that the *"predominant practice today is to exclude own credit risk… accordingly, the Committee does not expect significant diversity in practice."*

CAPP does not support IFRIC's view.

CAPP's IFRS Committee was originally formed to investigate the most significant potential differences between IFRS and Canadian GAAP affecting the oil and gas industry and provide guidance for members on implementation of IFRS. Accounting for decommissioning provisions was one of those most significant issues. Our examination of international oil and gas companies already applying IFRS indicated significant divergence in practice in the use of discount rates in measuring decommissioning obligations. Examples include:

- **ENI Spa** discloses in its 2009 audited annual financial statements that provisions are discounted at *"<u>the risk-free rate of interest adjusted for the Company's credit costs.</u>"* **ENI UK Limited**, the UK subsidiary, makes an identical disclosure.
- **Enegioil PLC**, a UK based oil company listed on the LSE, discloses in its audited 2010 annual financial statements that provisions for asset retirement are measured at "fair value" estimates using *"the Company's credit adjusted risk-free interest rate."*
- **Imperial Company**, an Australian oil company listed on the ASE, discloses in its 2010 annual audited financial statements that asset retirement obligations are *"discounted using credit-adjusted, risk-free interest rate."*
- **Royal Dutch Shell** discloses in its 2006 audited annual financial statements that provisions are measured *"using risk-adjusted future cash flows, of the present value of the expenditure required to settle the present obligation"*. However, there is no adjustment to provisions in the reconciliation to US GAAP, which requires the use of a credit adjusted discount rate.
- **Silverstone Energy Limited**, UK based oil company listed on the LSE, discloses in its 2009 annual audited financial statements that decommissioning costs are discounted *"using a rate of 10%."*
- **Dana Petroleum, Cairn Energy, Venture Production** and other LSE listed oil producers disclose that decommissioning provisions are discounted at 7-7.5% as compared to the Bank of England yield

of 4.59% on 20 year notes. Clearly, some element of risk is built into the rates used for discounting decommissioning liabilities.

These are just a few examples of divergence in practice. This demonstrates the need for greater clarity in IAS 37 about discount rates.

Conclusion

CAPP thanks IFRIC, in advance, for their re-consideration of their tentative agenda decision. As most of CAPP's member companies are expected to provide IFRS transitional disclosures in the first quarter of 2011, we would appreciate if the IFRIC would make a clear statement that inclusion of credit risk in the discount rate would be an acceptable interpretation of the exiting version of IAS 37.

We also ask the committee to make a strong recommendation to the IAS 37 project team to provide clarity on the inclusion of own credit risk in the forthcoming revisions to IAS 37.

Sincerely,

Jeff Dashkin
Chair, IFRS Committee

CAPP_EDMS-#184761-

Canadian Natural

February 14, 2011

IFRS Interpretations Committee
30 Cannon Street
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Dear Sir or Madam:

Re: Tentative agenda decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate

Canadian Natural Resources Limited ("Canadian Natural") is pleased to provide comments to the IFRS Interpretations Committee on the tentative agenda decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate.

Canadian Natural is a senior independent oil and gas exploration and production company headquartered in Calgary, Alberta, Canada, with operations in Western Canada, the North Sea, and offshore West Africa. Our shares are publicly traded on the Toronto Stock Exchange and the New York Stock Exchange. Along with other Canadian public companies, we have adopted International Financial Reporting Standards ("IFRS") for our external financial statements and other continuous disclosure documents effective January 1, 2011. Our first results under IFRS will be reported as at and for the three months ended March 31, 2011.

We note that the Canadian Association of Petroleum Producers ("CAPP") has written a response letter on the tentative agenda decision, and we concur with the points addressed in that response. In addition, we would like to add the following comments.

We note that the IFRIC's tentative agenda decision on inclusion of own credit risk in the discount rate states:

> "The Committee noted that IAS 37 does not explicitly state whether or not own credit risk should be included. The Committee also noted that the predominant practice today is to exclude own credit risk which is generally viewed in practice as a risk of the entity rather than a risk specific to the liability. Accordingly, the Committee does not expect significant diversity in practice, and therefore [decided] not to add this issue to its agenda."

We strongly disagree with the IFRIC's conclusions that predominant practice is to exclude own credit risk and that there is no diversity in practice.

1. For companies in the oil and gas industry, the impact of discount rates on decommissioning liabilities has been one of the most significant adjustments to the balance sheet upon conversion to IFRS. While the choice of a risk free or credit-adjusted risk free discount rate may not be significant to a liability that will be settled one to five years from the balance sheet date, decommissioning liabilities for oil and gas wells and facilities will be settled over periods of 40 years or more and the impact of discounting may be material.

2. The standard IFRS 1 transition exemption for decommissioning liabilities in paragraph D21 is to include the impact of changes in the discount rate in the cost of property, plant and equipment, consistent with the requirements of IFRIC 1. However, most Canadian oil and gas companies were following full cost accounting under existing Canadian GAAP, and have elected to apply the exemption in IFRS 1 paragraph D8A and the related decommissioning liability exemption in paragraph D21A, which requires changes in the decommissioning liability on transition to IFRS to be recorded in retained earnings. Accordingly, this topic has received much focus by the companies and their auditors. In the absence of authoritative guidance in IAS 37 as to whether own credit risk should be included in the discount rate, the audit firms have developed their own guidance as to whether or not own credit risk is to be included. This guidance differs from firm to firm as to whether or not to include credit risk. Therefore, one may conclude that the practice of their clients is also varied.

3. As part of the process of converting to IFRS, we have reviewed the financial statements of other oil and gas companies that are utilizing IFRS. We have noted several companies have explicitly stated that they are using a discount rate that includes the company's own credit risk. Additionally, several other companies specifically stated in their accounting policies that they were using a risk free rate; however, their disclosed discount rates were as high or higher than the discount rates of comparable companies in the same jurisdiction that stated they were including the company's own credit risk. Further, certain of these companies are US registrants and were required to prepare reconciliations to US GAAP in Form 20-F filings prior to 2007 but did not disclose any material differences from US GAAP with respect to decommissioning liabilities. For clarity, US GAAP requires the inclusion of own credit risk in the discount rate for asset retirement obligations (the equivalent to decommissioning liabilities under IFRS). Therefore, this further supports our assertion that there is significant diversity in practice for IFRS reporters.

4. Finally, we note that the conclusion reached "that predominant practice is to exclude own credit risk and that there is no diversity in practice" is contrary to the comments that were received on the recent exposure draft of amendments to IAS 37. These comments from respondents, including two large audit firms, were summarized in section 3.6 of Agenda Paper 7 Appendix A of the September 15 IASB meeting, and indicated that there were "different interpretations of IAS 37 requirements at present", and that the different interpretations were "causing material differences in liability measurement".

We urge the Committee to reconsider its comment that the predominant practice today is to exclude own credit risk which is generally viewed in practice as a risk of the entity rather than a risk specific to the liability. We believe that the inclusion of own credit risk is appropriate and that the use of credit adjusted risk free rate should continue to be acceptable.

If you have any questions or wish to discuss our comments in more detail, please do not hesitate to contact the undersigned.

Sincerely,

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Cc: Don Cormack, Audit Partner, Price Waterhousecoopers, LLP, Calgary, AB, Canada
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Mr Robert Garnett
Chairman
IFRS Interpretations Committee
30 Cannon Street
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14 February 2011

Dear Mr Garnett,

Tentative agenda decision: IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretation Committee's ("the Committee") publication in the January 2011 *IFRIC Update* of the redrafted tentative decision not to take onto the IFRS Interpretation Committee's agenda a request for an Interpretation of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* ("IAS 37") with respect to "the risks specific to the liability" and whether this means that an entity's own credit risk (non-performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities.

We agree with the Committee's decision not to add this item onto its agenda if the IASB is planning to address this issue in the near term. However, the wording in the tentative agenda decision requires revision to be consistent with the wording in the previous tentative agenda decision as published in the Committee's November 2010 *IFRIC Update* and to reflect current practice. We believe that the issue addressed by the tentative agenda decision as to whether discount rates should include an entity's own credit risk is widespread and that diversity in practice currently exists due to different interpretations of the application of paragraph 47 of IAS 37. For this reason, we disagree with the statement in the January 2011 *IFRIC Update* that "the predominant practice today is to exclude own credit risk".

Therefore, we support the wording of the Committee's previous tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely,

Veronica Poole
Global Managing Director
IFRS Technical

February 13, 2011

IFRS Interpretations Committee
30 Cannon Street
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Jeremy G. Kalanuk, CA, CPA (Illinois)
Calgary, Canada

(by e-mail to ifric@ifrs.org)

Dear Sirs,

Re: IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate

I appreciate the opportunity to comment on the IFRIC's tentative agenda decision related to the inclusion of own credit risk in the determination of provisions pursuant to IAS 37.

I have read the comment letter prepared by the Canadian Association of Petroleum Producers ("CAPP") and I agree with the analysis and conclusions in that response. Furthermore, in the course of my own company's IFRS conversion project I have also noted that there appears to be diversity in practice amongst companies currently applying IFRS as it relates to the inclusion of own credit risk when measuring decommissioning provisions.

I would like to draw the IFRIC's attention to the following additional aspects of this issue which further support the conclusion that the current guidance provided by IAS 37 is unclear in this area.

Measurement Model of IAS 37

Paragraph 37 of IAS 37 states that, "The amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period." Paragraph 38 provides additional guidance and states:

> The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

The requirement to measure a provision at the best estimate at which an entity would "rationally pay to settle the obligation" or "transfer it to a third party" necessarily includes the effect of the time value of money adjusted for the credit risk of the entity as illustrated by the following analysis.

If an entity is considering the transfer of an obligation to a third party, it would look to complete such a transaction in the most cost-efficient manner possible. In the hypothetical transfer scenario contemplated by IAS 37, an entity would seek a counterparty which would be willing to accept a payment today in return for accepting responsibility to discharge the obligation in the future.

An entity transacting in a rational manner would only seek to transfer the obligation to a counterparty that has a current requirement for funds and the exact same credit risk profile as itself. If the potential counterparty has a current requirement for funds it would be indifferent as to whether it borrows those funds from a financial institution or from the entity seeking to transfer an obligation. Accordingly, that potential counterparty would be presently willing to accept an amount of funds discounted at a rate adjusted for its credit standing, in return for a promise to repay the gross amount at a future date.

The entity seeking to transfer the obligation would not rationally transact with a counterparty that has a superior credit rating to its own (i.e. risk free) as that would result in it paying more than would be necessary to discharge the obligation. Further, the entity would not rationally transact with a counterparty that has a lesser credit rating to its own as that would result in the entity taking on additional risk that the transferee may fail to ultimately discharge the obligation.

In conclusion, a reasonable interpretation of the hypothetical settlement measurement guidance of IAS 37 would be that adjusting the applicable discount rate for an entity's own credit risk is required.

The foregoing discussion does not advocate extinguishment of the underlying provision in the event of a hypothetical transfer actually occurring. Instead, it is meant to illustrate a reasonable interpretation of the measurement provisions of IAS 37.

Analogies to Fair Value

The requirement of IAS 37 to measure a provision at the estimated amount required to settle or transfer the obligation is similar to the manner in which IAS 39 specifies that fair value is determined for financial instruments. Specifically, IAS 39 paragraph 9 defines fair value as, "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction." Whereas IAS 39 clearly states that both parties to the transaction are knowledgeable and willing, IAS 37 makes this assumption implicitly in its requirement to measure a provision at what, "an entity would rationally pay." Accordingly, an analogy can be drawn between the manner of determining fair value pursuant to IAS 39 and measuring provisions in accordance with IAS 37.

The Application Guidance section of IAS 39 indicates that credit risk is one of the elements taken into account when determining the fair value of a liability. Further, the Basis for Conclusions section of that standard lends support to the notion that, in the case of a financial liability, an entity's own credit risk becomes a risk specific to its liabilities.

Paragraph BC88 of IAS 39 states that:

> The Board considered comments on the Exposure Draft that disagreed with the view that, in applying the fair value option to financial liabilities, <u>an entity should recognise income as a result of deteriorating credit quality</u> (and a loan expense as a result of improving credit quality). Commentators noted that it is not useful to report lower liabilities <u>when an entity is in financial difficulty</u> precisely because its debt levels are too high, and that <u>it would be difficult to explain to users of financial statements the reasons why income would be recognised when a liability's creditworthiness deteriorates.</u> These comments suggested that fair value should exclude the effects of changes in the instrument's credit risk.

That paragraph illustrates that there is a direct linkage between an entity's credit standing ("when an **entity** is in financial difficulty") and the measurement of financial liabilities at fair value ("income would be recognized"). Accordingly, an entity's own credit risk must be considered as a risk specific to the liability under IAS 39.

Although a decommissioning provision is generally not a financial liability, I believe it is important to note that the guidance related to measuring the fair value of financial liabilities pursuant to IAS 39 is similar to the measurement requirements of IAS 37 for provisions. IAS 39 requires that the credit risk of the entity be taken into account as a risk specific to the liability when measuring fair value. Given the similarity of the measurement guidance between these two standards, it would be reasonable to analogize this requirement to IAS 37 when measuring provisions.

<u>Accounting for Decommissioning Provisions</u>

As is evident from the interaction between IAS 16, IAS 37 and IFRIC 1, the accounting for decommissioning provisions is unique as compared to other types of provisions recognized in accordance with IAS 37.

IAS 16 paragraph 16(c) indicates that the <u>cost</u> 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 either incurs 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."

IAS 16 defines cost as, "the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs"

Accordingly, a decommissioning provision is recognized as a part of the cost of an item of property, plant and equipment and the definition of cost includes the fair value of other consideration given to acquire the asset. Presumably the incurrence of a decommissioning provision would constitute, "other consideration", irrespective of whether an entity constructs the asset itself or acquires the asset from another company where the consideration includes, and may be limited to, discharging the seller from their obligations with respect to future decommissioning costs.

A rational entity will only elect to construct or purchase an asset if the net present value of the future cash flows associated with that asset at least equal the net present value of any decommissioning obligations. In a situation where the amount and timing of future cash inflows related to an asset and cash outflows related to the associated decommissioning liability are exactly equal, the fair value of the consideration for the acquisition of that asset would equal the net present value of the decommissioning obligation which would also equal the net present value of the future cash inflows. Accordingly, the appropriate discount rate to record the fair value of the obligation would necessarily reflect credit risk as under this view, a decommissioning provision simply represents an element of the consideration for an asset that is deferred to future periods.

A reasonable conclusion would therefore be that IAS 16 requires decommissioning provisions be recorded initially at fair value which would require reflecting credit risk. IFRIC 1 does not indicate that it would be appropriate to use a different measurement model for decommissioning obligations subsequent to initial recognition.

Concluding Remarks

I hope that the foregoing discussion will be valuable to the IFRIC in its deliberations on this issue. Echoing CAPP's request, I would appreciate if the IFRIC would clearly conclude that adjusting the relevant discount rate for credit risk when measuring decommissioning provisions pursuant to IAS 37 is an acceptable interpretation of existing IFRSs.

Sincerely,

Jeremy G. Kalanuk, CA, CPA (Illinois)

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Mr Robert Garnett
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

Our ref MT/288
Contact Mary Tokar

16 February 2011

Dear Mr Garnett

Tentative agenda decision: IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

We appreciate the opportunity to comment on the IFRS Interpretations Committee's publication in the January 2011 IFRIC Update of the tentative agenda decision relating to inclusion of own credit risk in the discount rate under IAS 37.

We believe that the treatment of own credit risk in the measurement of a liability under IAS 37 is becoming a practice issue for constituents, particularly those seeking to determine an accounting policy in this area for the first time. As the Committee has noted previously, the issue is one of the matters being considered by the Board as part of the existing Liabilities project. Comment letters submitted on that project, including ours on behalf of the network of KPMG member firms, requested the Board to clarify its position on this issue in the final Liabilities standard. However, currently there is no firm timetable for conclusion of this project.

Further, the Committee's discussions in November 2010 and January 2011 indicated that there are different views on the existing requirements of IAS 37 and we are aware of diversity of views in at least one country where this is a significant practice issue. We are concerned that the Committee's stated intention that "the Committee does not expect significant diversity in practice" is unlikely to be realised.

We believe that a standard does not have to address each point explicitly in order to provide sufficient guidance. However, in this case, enough differing views have been expressed to raise concerns that it will be difficult to achieve consistent practice on whether to include own credit risk in the measurement of provisions without an authoritative clarification.

We encourage the Committee to consider how best to incorporate this clarification into IFRSs, either as an annual improvement or interpretation.

Please contact Mary Tokar or Philip Dowad, on +44 (0)20 7694 8871, if you wish to discuss this matter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

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RESOURCES

February 18, 2011

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH,
United Kingdom

Dear Sir(s):

Re: January 6, 2011 IFRS Interpretations Committee Tentative Agenda Decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate

NAL Energy Corporation is a TSX listed public oil and natural gas producer, based in Western Canada. We are currently transitioning to IFRS with the rest of Canadian publically accountable entities.

As members of the Canadian Association of Petroleum Producers (CAPP), it is our understanding that a letter has been written by CAPP to you relating to the IFRS Interpretations Committee Tentative Agenda Decision on IAS 37 and the inclusion of own credit risk. We are writing to you in support of this letter, dated February 8, 2011.

Our intention is not to re-iterate the points that were highlighted by CAPP, but to state our agreement with it and to request that the committee consider the points raised.

The impact to us, as well as many in our industry is very significant, therefore, it would be appreciated if clarity could be provided as to what the IASB would find acceptable in the interpretation of IAS 37 as it relates to the use of a rate, other than a risk free rate.

Further, we, along with CAPP would ask the committee to make a strong recommendation to the IAS 37 project team to provide clarity on the inclusion of own credit risk in the forthcoming revisions to IAS 37.

Yours truly,

Keith Steeves

Keith A. Steeves
Vice President, Finance & CFO

1000, 550 6th Avenue SW Calgary, Alberta T2P 0S2 T 403.294.3600 F 403.294.3601

February 14, 2011

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH, United Kingdom

Dear IFRS Interpretations Committee:

Re: January 6, 2011 IFRS Interpretations Committee Tentative Agenda Decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of Own Credit Risk in the Discount Rate

I am pleased to provide comments on behalf of Pengrowth Energy Corporation to the IFRS Interpretations Committee on the Tentative Agenda Decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate.

Pengrowth Energy Corporation is an upstream oil and gas producer based in Calgary, Alberta with operations in western Canada as well as on Canada's east coast. Pengrowth is publicly traded on both the Toronto and New York stock exchanges with a market capitalization of approximately $4 billion.

Pengrowth is adopting International Financial Reporting Standards (IFRS) in 2011, with the first quarterly interim financial statements to be made public in early May, 2011. The inclusion or exclusion of Pengrowth's own credit risk in measurement of decommissioning provision is the most significant transition adjustment to Pengrowth's opening IFRS balance sheet. As such, we have been intently observing the IFRS Interpretations Committee's discussions on this issue as well as the IASB's progress on the IAS 37 replacement project. Pengrowth's IFRS project coordinator has been intimately involved in Canada's IFRS Discussion Group and with the Accounting Standards Board.

We are aware of the submission made on February xx, 2011 by the Canadian Association of Petroleum Producers (CAPP). Generally, Pengrowth supports the positions raised by CAPP.

The divergent practices observed in the response by CAPP lead us to believe that there currently exist many companies who are IFRS compliant who do factor in credit risk to their ARO discount rate. There is evidence of some inconsistent practices for using an adjusted discount rate from IFRS reporting entities. As IFRS does not require disclosure of the actual discount rate, we suspect that there are many other companies including own credit risk in their ARO discount rate, but have not disclosed it. This issue is of particular importance to western Canadian E&P companies who have previously used a credit adjusted rate. Upon adoption, there is no standard so balance sheets may no longer be comparable, and many peers following US GAAP both in Canada and in the United States will remain using a credit adjusted rate. One of the underlying premises of adopting IFRS was to increase comparability and consistency across countries and companies. We believe increasing our ARO by dramatically reducing the discount rate and the resulting erosion of Shareholder's Equity on initial adoption puts us at a competitive disadvantage and have great difficulty accepting the IFRIC position.

Accordingly, we support CAPP's position and wish that the committee would consider either allowing companies to include own credit risk in its ARO discount rate, or help us to understand how it is permissible for several European companies to do what we are proposing. As Pengrowth will be providing IFRS transitional disclosures in the first quarter of 2011, we would appreciate if the IFRIC would make a clear statement that inclusion of credit risk in the discount rate would be an acceptable interpretation of the exiting version of IAS 37.

Thank you for considering our submission.

Sincerely,

Doug Bowles CA
Vice President and Controller
Pengrowth Energy Corporation

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Finance and Chief Financial Officer
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TALISMAN
ENERGY

February 14, 2011

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam:

Re: January 6, 2011 IFRS Interpretations Committee Tentative Agenda Decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate

This letter is the response of Talisman Energy Inc. to the IFRS Interpretations Committee's tentative agenda decision published in the January 2011 IFRIC Update regarding IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate. Talisman Energy Inc. is an independent upstream oil and gas company with significant world wide and North American operations headquartered in Calgary, Alberta, Canada, with a market capitalization of $25 billion. Talisman Energy Inc. will be adopting IFRS effective January 1, 2011.

IFRIC's tentative decision notes that the "*predominant practice today is to exclude own credit risk...accordingly, the committee does not expect significant diversity in practice.*". We believe there are divergent practices with respect to the inclusion of own credit risk in the determination of discount rates. We disagree that the "predominant practice today" is to exclude own credit risk. Currently US GAAP and Canadian GAAP require the use of a credit – adjusted discount rate for decommissioning obligations. Our examination of certain international oil and gas companies already applying IFRS indicated divergence in practice in the use of discount rates in measuring decommissioning obligations. When these companies first adopted IFRS and provided US GAAP reconciliations, we did not note any reconciling items relating to the discount rate implying the same rate was used for both US GAAP and IFRS.

Talisman has significant financing based in the US along with many shareholders. We compete with US peers for capital, and are directly compared to those peers by US investors and analysts. If Talisman where to apply a risk free discount rate to the decommissioning liability we would have significant comparability issues with our US peers, since US GAAP requires credit adjusted discount rate. We believe that any erosion of this comparability will create confusion and error in the assumptions and forecasts underpinning the valuation models which are used to assess investment in Talisman, with the potential to negatively impact investment recommendations, market expectations and future share price.

We believe the current IAS 37 standard is unclear on this matter and that risks specific to a liability mentioned in paragraph 47 of IAS 37 can be interpreted to include credit risk. This interpretation is consistent with other IASB principles that support the inclusion of credit risk within a discount rate as espoused in IASB's fair value measurement exposure draft and standards IFRS 9 and IFRS 7.

We would appreciate if the IFRIC would make a clear statement that inclusion of credit risk in the discount rate would be an acceptable interpretation of the existing version of IAS 37.

We thank the International Accounting Standards Board Interpretation Committee for its careful consideration of our comments on this important topic. If you require further information, please do not hesitate to contact us.

Yours faithfully,

L. Scott Thomson
Executive Vice-President, Finance
and Chief Financial Officer

Accounting Standards Board
AcSB
CNC
Conseil des normes comptables

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January 24, 2011

(by e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretation Committee's tentative agenda decision on the whether an entity's own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This tentative agenda decision was published in the January 2011 IFRIC Update.

The views expressed in this letter take into account comments from AcSB members and staff but do not necessarily represent a common view of the AcSB. Views of the AcSB are developed only through due process.

As identified in our response to the Committee's previous tentative agenda decision published in the November IFRIC Update, we agree with the Committee's decision not to add this item to its agenda. However we disagree with certain changes to the rationale provided.

The revised tentative agenda decision states: "The Committee noted that predominant practice today is to exclude own credit risk which is generally viewed in practice as a risk of the entity rather than a risk specific to the liability. Accordingly, the Committee does not expect significant diversity in practice, and therefore [decided] not to add this issue to its agenda." This reasoning contradicts responses to the Liabilities Exposure Draft as reported by IASB staff to the Board in September 2010, including responses by two of the large auditing firms (and referenced in paragraphs 15 and 16 of the initial staff paper submitted to IFRIC members in November 2010). In Canada we are particularly aware that there is diversity in practice in the calculation of provisions for asset retirement obligations and a divergence of views amongst the major accounting firms.

The inclusion of the comment regarding "predominant practice" in the tentative agenda decision could imply excluding credit risk from the discount rate for liabilities is consistent with the Framework and that no other accounting choice is permissible. Whether credit risk should be included in the discount rate for liabilities is a complex area that the IASB Staff Discussion Paper "Credit Risk in Liability Measurement" examined in significant depth. After deliberation of this paper and responses received to it, the IASB did not conclude on the inclusion or exclusion of credit risk. Instead they decided to pursue the topic within the Conceptual Framework Measurement project and agreed to consider the input received from the responses to that paper when considering the measurement of liabilities in other topics. Given this decision by the IASB we think it is inappropriate for the IFRS Interpretations Committee to provide guidance beyond the statement that IFRSs are unclear.

Therefore, in our opinion the agenda decision should note that IFRSs are unclear, followed by the previous concluding comments: "The Committee noted that this request for guidance would be best addressed as part of the Board's project to replace IAS 37 with a new liabilities standard, and that the Board is already considering the request for additional guidance to be incorporated into this new standard."

See the appendix to this letter for our proposed revised wording.

We would be pleased to provide more detail if you require. If so, please contact Peter Martin, Director, Accounting Standards at +1 416 204-3276 (e-mail peter.martin@cica.ca) or Karen McCardle, Principal, Accounting Standards at +1 416 204-3465 (e-mail karen.mccardle@cica.ca).

Yours truly,

Peter Martin

Peter Martin, CA
Director,
Accounting Standards

Appendix

We suggest clarifying the tentative agenda decision as follows:

IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate

The Committee received a request for interpretation of the phrase 'the risks specific to the liability' and whether this means that an entity's own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities. The request assumes that future cash flow estimates have not been adjusted for the entity's own credit risk.

The Committee observed that paragraph 47 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that 'risks specific to the liability' should be taken into account in measuring the liability. The Committee noted that the guidance is not clear about whether an entity's own credit risk should or should not be included in the discount rate or future cash flow estimates as a 'risk specific to the liability'.

The Committee noted that this request for guidance would be best addressed as part of the Board's project to replace IAS 37 with a new liabilities standard, and that the Board is already considering the request for additional guidance to be incorporated into this new standard. Consequently the Committee [decided] not to add this agenda to its agenda.

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International Financial Reporting Standards Interpretations Committee
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24 January 2011

Dear Interpretations Committee Members,

Tentative Agenda Decision – IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

The global organisation of Ernst & Young is pleased to submit its comments on the above Tentative Agenda Decision, as published in the January 2011 IFRIC Update.

The IFRS Interpretations Committee (the Committee) received a request "for interpretation of the phrase 'the risks specific to the liability' and whether this means that an entity's own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities."

We agree with the Committee that in most cases an entity's own credit risk is a risk of the entity rather than a risk specific to the liability. Furthermore, the measurement of a liability within the scope of IAS 37 is not a fair value measurement and therefore an entity's own credit risk is ordinarily not included when measuring these liabilities.

Nevertheless, we acknowledge that there may be specific circumstances when an entity's own credit risk may be considered to be a risk specific to the liability and should, as such, be considered when determining the appropriate discount rate. Accordingly, we agree with the revised Agenda Decision as published in the January 2011 IFRIC Update.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas on +44 (0)20 7951 3152 if you have any questions regarding the above.

Yours faithfully

Ernst & Young