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Mr. Göran Tidström
Chairman
Supervisory Board
EFRAG
Avenue des Arts 41
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7 November 2003

Re : Organismo Italiano di Contabilità (OIC): Comments on "IFRIC D2 Changes in Decommissioning, Restoration and Similar Liabilities".

Dear Mr. Tidström,

I am pleased to inform you that the Executive Committee of the OIC ("Comitato Esecutivo") has examined the view stated by EFRAG on the "IFRIC D2 Changes in Decommissioning, Restoration and Similar Liabilities".

We agree with the comments expressed by EFRAG.

In particular, the OIC believes that the D2 approach is inconsistent with "IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors", which states that the effect of a change in accounting estimate should be included in the determination of net profit or loss in the period of the change and future periods, if the change affects both. In contrast, the IFRIC proposal considers the change in accounting estimate as a correction of error, whose effect, however, should be included in net profit or loss of the period rather than as an adjustment to the opening balance of retained earnings. The IFRIC proposal appears as a "third way", which is not supported by either the IFRS Framework or the existing standards.

A change in accounting estimate is due to subsequent information, unknown at the time of the initial estimate. The proposed retrospective approach deals with subsequent information as a correction of error. This is not conceptually correct. In particular, the retrospective approach would not be logical in the case of changes in the discount rate, which would be a new, subsequent and unknown event at the moment of initial estimate.

Furthermore, the statement, included in the Basis for Conclusion, that the aim of the proposed accounting treatment is to record the change in accounting estimate so that the balance sheet, at the end of the period of change and in subsequent periods, is as it would have been if the revised estimate had been the initial estimate, is not consistent with IAS 8.

Yours sincerely,

Prof. Angelo Provasoli
(OIC – Chairman)

cc: Paul Rutteman

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

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

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

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

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

EFRAG has considered these arguments but believes, on balance, that it is more important that the interpretation should be consistent with existing standards and that the changes in estimates of future decommissioning, restoration and similar liabilities and the related asset should be accounted for fully prospectively. We, therefore, do not support the approach proposed in D2.

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

***Since EFRAG disagrees with the proposed approach in IFRIC D2 and prefers a prospective rather than a retrospective method for the accounting for changes in accounting estimates, we would like to receive your comments on whether you support the EFRAG view or the proposal in IFRIC D2.***

**OIC COMMENTS**

We agree with the view stated by EFRAG.
The proposal is not coherent with IAS 8 which requires that changes in estimates be accounted for in the profit and loss account for the period in which the change is made and also in subsequent periods. The IFRIC proposal considers a change in estimate to be a correction of an error, with the difference that it accounts for the past effect in the profit and loss account rather than in the net worth. In other words, the proposal appears to suggest, for decommissioning costs, a "third way" that has no logical foundation either in the general principles of the IFRS or in existing standards.
A change in estimate is justified by the subsequent knowledge of facts and circumstances that were unknown at the time when the original estimate was made. To give it a "retrospective" value, as proposed, would make it seem like the correction of an error. This is conceptually mistaken. In particular, a retrospective application for a change in the discount rate would be absurd as such a change is clearly a new event, subsequent to and unknown at the time of making the original estimate. The statement in the *Basis for Conclusion* that the aim of accounting for a change in estimate is to make the current and future accounts conform with how they would have been if the new estimate had been known from the outset finds no support in IAS 8.
Finally, Italian undertakings would definitely find it easier to apply the prospective approach.