Many entities have obligations to dismantle, remove and restore items of property, plant and equipment (decommissioning costs). Entities often construct assets on land or premises. The land or premises on which assets are constructed could be taken on lease, whereby the users could be obligated (e.g. under the lease agreement) to reinstate the land or premises at the end of the agreed term. Similarly, there could be environmental laws that may require companies to incur cleaning costs.

Decommissioning costs typically arise in various industries including power and utilities, extractive, oil and gas, chemical and telecommunications.

**Summary of the requirements under Ind AS**

**Timing of recognition**

As per Ind AS 16, *Property, Plant and Equipment* the cost of an item of property, plant and equipment includes among other things, an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Consequently, the obligation to make good environmental or other damage incurred in installing an asset is recognised immediately because the damage arises from a past event i.e. installation of the asset. For example, a provision is recognised for the expected cost of dismantling an oil rig when the rig is installed.

If an obligation to restore the environment or dismantle an asset arises on the initial recognition of the asset, the amount is included in the cost of the related asset and is not recognised immediately in profit or loss. The cost of an item of property, plant and equipment includes not only the initial estimate of the costs related to dismantlement, removal or restoration of property, plant and equipment at the time of installing the item but also amounts recognised during the period of use for purposes other than producing inventory – e.g. certain additional obligations for restoration costs.
The provision recognised for dismantlement, removal and restoration of an item of property, plant and equipment is not reduced by the item’s expected salvage value, instead, any salvage or other residual value would be taken into account when measuring the depreciable amount under Ind AS 16.

Another common example of such costs is obligations under lease contracts. Generally, the lessee is obliged to return the premises to the owner of the premises in its original/ agreed condition.

**Measurement of the obligation**

Estimation of decommissioning costs is a significant area of judgement. Following factors should be considered while measuring the decommissioning costs:

- A provision is recognised only if there are past events. Therefore, a provision reflects only damage incurred at the reporting date; a provision is not recognised for expected future damage.

- Decommissioning will often take place far away in the future. Therefore, the effect of discounting is generally material and will have a significant impact on the size of the obligation and the equivalent asset recognised.

- The aforesaid obligation is discounted at a pre-tax rate that reflects the time value of money and the risks specific to the liability, unless the future cash flows are adjusted for these risks.

- In determining the timing of the outflow, the expected useful life of the related asset is considered. Assumptions about future events should be supported by sufficient objective evidence because of the uncertainty of predicting events far into the future. The assumptions also need to be consistent with the other assumptions about the use of the asset. An entity may not be required to, and may not be able to, decommission an asset immediately after it stops using the asset. In this case, the best estimate of the timing of the cash flows is used to measure the present value of the obligation.

**Changes to existing provisions**

Changes in the obligation would be on account of the following reasons:

- Changes in the estimate of the amount or timing of expenditure required to settle the obligation

- Changes in the current market-based discount rate

- The unwinding of the discount.

The effect of any changes to an existing obligation because of changes in the estimated timing or amount of expenditure or changes in the discount rate are added to or deducted from the cost of the related asset and depreciated prospectively over the asset’s remaining useful life (under the cost model).

If the adjustment leads to a deduction from the cost of the asset then it should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in profit or loss.

If the adjustment results in an addition to the cost of an asset, the entity should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If there is such an indication, the entity should test the asset for impairment by estimating its recoverable amount and account for any impairment loss in accordance with Ind AS 36, *Impairment of Assets*.

The periodic unwinding of the discount should be recognised in profit or loss as a finance cost.

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**Consider this**

- Ind AS does not address how to account for new obligations – e.g. those triggered by a law enacted after an asset was acquired. An entity should consider to develop an appropriate accounting policy for such costs.

- Uncertainty about the useful life of the assets should not lead to an inability to measure the provision for decommissioning cost reliably.

- Ind AS does not provide clear guidance on the accounting treatment of exchange differences related to an obligation denominated in a foreign currency to settle a decommissioning obligation. An entity should consider to develop an appropriate accounting policy for such costs.

- Costs incurred as a consequence of the production of inventory in a particular period are part of the cost of that inventory. The effect of any changes to an existing obligation for decommissioning related to items that have been sold is recognised in the statement of profit and loss.