

## Query No. 18

**Subject:** *Accounting for the site restoration/mine closure obligation upon first time adoption of Indian Accounting Standards (Ind ASs).*<sup>1</sup>

### A. Facts of the Case

1. A company is a public sector undertaking and a listed company, engaged in the mining of coal with eight fully owned Indian subsidiaries and one overseas subsidiary in Mozambique. The company operates through both underground mines as well as open cast mines. The share of production from the underground mine is about 30 million tonnes whereas production from the open cast mine is approx. 537 million tonnes.

2. The querist has stated that mining of coal necessarily involves displacement of large volumes of soil and rock, resulting in various degrees of environmental degradation. Mine reclamation entails restoring these disturbed areas to its previous natural resource setting while minimising environmental impacts. The company and its subsidiaries have been fulfilling its obligation of restoring the mining sites as per the statutory requirements. Cost incurred for fulfilling such obligation is broadly termed as site restoration cost or alternatively, as mine closure cost. The Ministry of Coal (MoC), Government of India, has issued the Guidelines for preparation of mine closure plan (MCP) dated 7<sup>th</sup> January 2013. The Guidelines require that no project can be approved without having a mine closure plan in place. As per the Guidelines, the company is required to provide for the liability for total project area once any activity starts on land, i.e., mine closure obligation arises as soon as any activity starts on land (paragraph No. 4 of Annexure I - Mine Closure Guidelines). The Government of India monitors implementation of MCP, maintains the escrow fund related to MCP through Coal Controller, an organisation set up under the Ministry of Coal to look into, *inter alia*, conservation and development of mines. Some of the salient features of the requirements are as follows:

- All coal mine owners shall adopt a Mine Closure Plan for each of their mines comprising progressive closure plan and final closure plan duly approved by the competent authority.
- The Mine Closure Plans will have two components, viz.,
  - i) Progressive or Concurrent Mine Closure Plan and
  - ii) Final Mine Closure Plan.

Progressive Mine Closure Plan would include various land use activities to be done continuously and sequentially during the entire period of the mining operations, whereas the Final Mine Closure activities would start towards the end of mine life, and may continue even after the reserves are exhausted and/or mining is discontinued till the mining area is restored to an acceptable level by the Coal Controller.

- Annual closure cost of mine closure be computed considering the total project area at the rate of Rs. 6 Lakh per hectare and Rs.1 Lakh per hectare as on 27.08.2009 in case of opencast mine and underground mine respectively and dividing the same by the entire life of mine in years for new projects and balance life of mine in years for operating/existing mines.

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<sup>1</sup> Opinion finalised by the Committee on 23.7.2018.

- An amount equal to the annual cost is deposited in escrow account each year throughout the mine life compounded @ 5% annually. (Annual cost is mentioned in Project Report.)
- An escrow account is opened separately for each mine where the aforesaid amount shall be deposited annually.
- Upto 80% of the total deposited amount, including interest accrued in the escrow account is released by Coal Controller after every five years in line with the periodic examination of the closure plan. The amount released should be equal to the expenditure incurred on the progressive mine closure in past five years or 80% whichever is less.

3. *Accounting under previous GAAP:*

- As per the requirement of guidelines issued by the MoC, a mine closure plan for each mine has been prepared by ABC Limited, a subsidiary of the company. (A mine closure plan for an opencast mine and an underground mine has been provided by the querist for the perusal of the Committee.)
- The plan includes calculation of estimated amount of annual closure cost, which is required to be deposited in an escrow account on yearly basis for each mine.
- A provision for mine closure is created each year by estimated annual cost calculated in mine closure plan. The same amount is deposited in escrow account on yearly basis as per the requirement of the Guidelines. Interest earned on mine closure escrow account is recognised as income. Any concurrent/progressive expenditure incurred on mine closure is recorded as receivable from escrow account. On receiving money from escrow account after five years released by Coal Controller Officer (CCO) after periodic examination, the receivable is adjusted with provision.

4. *Specimen Journal Entries: (As per previous GAAP)*

1. For creation of mine closure provision each year:

Profit & Loss Account	Dr.	
To Mine Closure Provision Account		Cr.

(Being mine closure provision created for the year)

2. For deposit of fund in escrow account each year

MCP Escrow Account	Dr.	
To Bank Account		Cr.

(Being mine closure provision created for the year deposited in the escrow account)

3. For interest received from escrow account of mine closure

MCP Escrow Account	Dr.	
To interest income account		Cr.

(Being interest income on MCP Escrow Account for the year)

4. For incurring actual expenditure on progressive mine closure

Mine Closure Expenses Receivable	Dr.	
To Bank Account		Cr.

(Being expenses incurred on mine closure for the year)



Site Restoration Asset A/c      Dr.

To Site Restoration Provision Account

(Present value of mine closure cost at the end of mine life is recognised as site restoration cost)

- (iii) For recognising interest and amortisation of assets for the period 01.04.2010 to 31.03.2015

Retained Earnings      Dr.

To Provision for Depreciation

To Site Restoration Provision

(Being interest costs from the date/ initial year of recognising such MCP obligation up to 31.03.2015 to be provided as Site Restoration Provision and depreciation from the date of initial capitalisation of MCP up to 31.03.2015 calculated on Site Restoration costs capitalised, adjusted through retained earnings)

*Journal Entry for 2015-16*

- (iv) Unwinding of discount A/c      Dr.

Depreciation A/c      Dr.

To Provision for Depreciation A/c

To Site Restoration Provision A/c

(Being unwinding of discount recognised as finance cost and credited to MCP and amortisation of site restoration cost recognised as depreciation and credited to accumulated depreciation)

- (v) For reversal of mine closure provision equivalent to interest on escrow fund

Mine Closure Provision (Liability) A/c      Dr.

To Interest Income/Interest Expenses

- (vi) For deposit of amount in escrow fund

Escrow Fund A/c      Dr.

To Bank Account

Deposit amount will be as per original Mine Closure Plan prepared by ABC Ltd.
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(Being deposit made in escrow account)

- (vii) For interest earned on escrow account

Escrow Fund A/c      Dr.

To Interest Income

(Being Interest on escrow deposit recognised as income)

- (viii) For actual expenditure incurred on mine closure

MCP Expenses receivable A/c      Dr.

To Bank

*Year 2016-17 and Onwards*

(ix) Unwinding of discount A/c Dr.

Depreciation A/c Dr.

To Provision for Depreciation A/c

To Site Restoration Provision A/c

(Being unwinding of discount recognised as finance cost and credited to MCP and amortisation of site restoration cost recognised as depreciation and credited to accumulated depreciation)

(x) For deposit of amount in escrow fund

Escrow Fund A/c Dr.

To Bank Account

(Being deposit made in escrow account)

Deposit amount will be as per original Mine Closure Plan approved by Board.
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(xi) For interest earned on escrow account

Escrow Fund A/c Dr.

To Interest Income

(Being Interest on escrow deposit recognised as income)

(xii) For actual expenditure incurred on mine closure

MCP Expenses receivable A/c Dr.

To Bank/Natural heads/Liability Write back

(xiii) When amount from escrow account received

Bank A/c Dr.

To Escrow Fund A/c

(Being amount from escrow deposit received)

(xiv) Site restoration provision A/c Dr.

Profit & Loss Account Dr. [For amount not accepted as mine closure expenses]

To MCP Expenses receivable A/c.

(Being provision for site restoration adjusted for actual expenditure and disallowed expenditure being charged to profit & loss)

7. The querist has separately clarified that under Ind ASs, estimation of the liability was made on the original date i.e. 01.04.2010, date at which site restoration liability was recognised first as per the Mine Closure Plan guidelines of Ministry of Coal, and then the same was unwound to 01.04.2015 on which date site restoration asset and site restoration provision were recognised. Further, the company also availed the exemption of paragraph D21 under Ind AS 101, i.e., for 'decommissioning liabilities included in the cost of property, plant and equipment'. The querist has also mentioned that the mines in question include both, mines in production phase and mines in development phases. According to the querist, based on paragraph 4 of the Guidelines, mine closure obligation arises after any activity starts on the land and therefore, recognition of obligation of site restoration is started from development

stage of the mine. The querist has also stated that the costs to be incurred by the company are not in the nature of stripping cost in the production phase of a surface mine that is covered by Appendix B 'Stripping Cost in the Production Phase of a Surface Mine' to Ind AS 16 'Property, Plant and Equipment'.

## **B. Query**

8. Based on the above, the querist has sought the opinion of the Expert Advisory Committee as to whether the company's method of accounting for site restoration/mine closure cost based on total project area of the mine is in conformity to the requirements of Ind ASs.

## **C. Points considered by the Committee**

9. The Committee notes that the basic issue raised in the query relates to accounting for the site restoration/closure obligation (decommissioning obligation) of the company upon transition to Ind ASs. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, the appropriateness of the accounting for decommissioning obligation under previous GAAP; adequacy or appropriateness of how the company has measured/estimated the amount of provision as per the relevant MCP, or any other law, regulation or government directive in this respect; appropriateness of how the company has determined discount rate for the purpose of discounting of the provision; appropriateness of the depreciation policy; appropriateness of the accounting for the mining right; any consequential legal or regulatory aspect around site restoration or mine closure; etc. Also, the Committee has looked at the issue raised only from principle guidance perspective and has not looked at appropriateness of accounting entries passed by the querist under the previous GAAP or Ind ASs.

10. At the outset, the Committee notes from the Facts of the Case that the mines in question include both mines in production phase and mines in development phases. Further, based on the requirements of paragraph 4 of the Guidelines, mine closure obligation arises as soon as any activity starts on the land and therefore, recognition of obligation of site restoration is started from the development stage of the mine. In this regard, the Committee wishes to point out that the costs to be incurred by the company, which are in the nature of stripping costs in the production phase of a surface mine that is covered by Appendix B, Stripping Cost in the Production Phase of a Surface Mine to Ind AS 16, 'Property, Plant and Equipment' should be dealt with in accordance with the said Appendix. Since the querist has not raised any issue related to accounting for stripping costs, the accounting for such costs has not been examined by the Committee. The Committee further notes from the Facts of the Case that mine closure/site restoration liability was recognised first on 01.04.2010 as per the Mine Closure Plan guidelines of Ministry of Coal. Ind ASs require the provision to be recognised as soon as the obligating event takes place, i.e., as soon as legal or constructive obligation for MCP arises. The determination of when such obligation arises depends on the legal provisions as well as facts and circumstances prevailing at that time. This may require significant judgement. Hence, whether the provision in respect of such an obligation was also required before that date (viz., 1.4.2010) as per the then applicable standards/legal position/ facts and circumstances has not been examined by the Committee and it has proceeded on the presumption that the same is in accordance with the applicable requirements.

11. The Committee notes that both Ind AS 16, 'Property, Plant and Equipment' and Ind AS 38, 'Intangible assets' exclude mineral reserves from their scope and Ind AS 106, 'Exploration for and Evaluation of Mineral Reserves' provides the following guidance on the classification of exploration and evaluation assets:

- “15 An entity shall classify exploration and evaluation assets as tangible or intangible according to the nature of the assets acquired and apply the classification consistently.
- 16 Some exploration and evaluation assets are treated as intangible (eg drilling rights), whereas others are tangible (eg vehicles and drilling rigs). To the extent that a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset. However, using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset.”

On the basis of the above, the Committee is of the view that the company can treat the exploration and evaluation assets, either as property, plant and equipment or intangible assets according to the nature of assets.

12. Further, Ind AS 16 contains following guidance for initial measurement of an item of property, plant and equipment:

“16 The cost of an item of property, plant and equipment comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- (c) 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 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.”

Ind AS 38 also contains the following guidance for initial measurement a separately acquired intangible asset:

“27 The cost of a separately acquired intangible asset comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
- (b) any directly attributable cost of preparing the asset for its intended use.”

The Committee notes from the above that both Ind AS 16 and Ind AS 38 require costs that are directly attributable to the asset acquired or to bring the asset to the location and condition necessary for it to be capable of operating in the intended manner to be included in the initial measurement. Further, Ind AS 16 specifically provides that 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 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) shall be included in the cost of an item of property, plant and equipment.

13. The Committee further notes the following paragraphs of Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’, dealing with the initial measurement of a provision:

“14 A *provision* shall be recognised when:

- (a) **an entity has a present obligation (legal or constructive) as a result of a past event;**
- (b) **it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and**
- (c) **a reliable estimate can be made of the amount of the obligation.**

**If these conditions are not met, no provision shall be recognised.”**

“19 It is only those obligations arising from past events existing independently of an entity’s future actions (ie the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.”

**“45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.”**

**“47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted.”**

“60 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognized as borrowing cost.”

Further, Appendix A, Changes in Existing Decommissioning, Restoration and Similar Liabilities to Ind AS 16 deals with the accounting for changes in measurement of decommissioning liability and provides as follows:

- “5 If the related asset is measured using the cost model:
- (a) subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.
  - (b) the amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss.
  - (c) if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount, and shall account for any impairment loss, in accordance with Ind AS 36.”

“8 The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. Capitalisation under Ind AS 23 is not permitted.”

14. The Committee notes from the Facts of the Case that the mines of the company require site restoration and mine closure work for which expenditure is required to be incurred as per law and the terms of operating licenses. Therefore, based on the above guidance, the Committee is of the view that the site restoration/mine closure costs in the extant case would be in the nature of decommissioning or restoration cost to be included in the initial measurement of the related tangible or intangible asset. Further, under Ind AS 37, a provision is required to be recognised in respect of such costs since there exists an obligation to perform the site restoration and closure of the mine. However, the relevant regulations should be taken into account when determining the existence and extent of the obligation. Further, since the site restoration/mine closure costs are towards the closure activities at the end of the mine life, the obligation is a long-term obligation and, accordingly, the initial cost of the related asset should include the present value of the expenditures expected to be required to settle the obligation. Subsequently, the cost of the related asset, including the initial estimate of site restoration/mine closure costs, should be depreciated/amortised based on the pattern in which the related asset's future economic benefits are expected to be consumed in accordance with the requirements of the relevant Standards. Moreover, since discounting is used, the carrying amount of the provision will increase in each period to reflect the passage of time and this periodic unwinding of the discount should be recognised in the statement of profit and loss as finance cost. The querist has not specifically mentioned whether there are any changes in the initial estimate of MCP obligation, since its initial recognition. If there are any such changes, the querist has also not mentioned how such changes are treated in the financial statements. In the absence of such clarity, the Committee has not examined this issue in detail. The Committee believes that if there are any changes in the initial estimate of MCP obligation, the company should ensure accounting as per Appendix A to Ind AS 16. (Also refer discussion in paragraph 17 below.)

15. The Committee also notes that the company in the extant case is contributing towards an escrow account operated by the Coal Controller, under the Ministry of Coal. In this context, the Committee notes Appendix A to Ind AS 37, 'Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds' provides guidance on the accounting treatment for the contributions to a separate fund established to help fund closure and environmental obligations. The Appendix contains following requirement:

“2 Contributions to these funds may be voluntary or required by regulation or law. The funds may have one of the following structures:  
(a) funds that are established by a single contributor to fund its own decommissioning obligations, whether for a particular site, or for a number of geographically dispersed sites.  
...”

“7 The contributor shall recognise its obligation to pay decommissioning costs as a liability and recognise its interest in the fund separately unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay.

8 The contributor shall determine whether it has control or joint control of, or significant influence over, the fund by reference to Ind AS 110, *Consolidated Financial Statements*, Ind AS 111, *Joint Arrangements*, and Ind AS 28, *Investments in Associates and Joint Ventures*. If it does, the contributor shall account for its interest in the fund in accordance with those Standards.

- 9 If a contributor does not have control or joint control of, or significant influence over, the fund, the contributor shall recognise the right to receive reimbursement from the fund as a reimbursement in accordance with Ind AS 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.

Changes in the carrying value of the right to receive reimbursement other than contributions to and payments from the fund shall be recognised in profit or loss in the period in which these changes occur.”

16. The Committee notes that paragraph 9 of the Guidelines for Preparation of Mine Closure Plan, issued vide letter from the Ministry of Coal, Government of India dated 7<sup>th</sup> January, 2013 and as supplied by the querist for the perusal of the Committee, provide, inter alia, that “The prime responsibility of mine closure shall always lie with the mine owner, and in case these funds are found to be insufficient to cover the cost of the final mine closure ... The mine owner shall undertake to provide the additional fund equivalent to the gap in funding...” Based on the above, the Committee is of the view that the company should recognise its interest in the fund separately from the liability to pay closure and environmental costs. Further, as per the above-reproduced requirements of the Appendix, the company in the extant case should determine whether it has control or joint control of, or significant influence over the escrow account, considering its own facts and circumstances and the Guidelines issued by the Ministry. If the company determines that it has control/joint control/significant influence over the escrow account, it shall account for the same in accordance with the requirements of Ind AS 110/Ind AS 111/Ind AS 28, respectively. However, if the company does not have control, joint control or significant influence over the escrow account, the contribution should be accounted for as ‘right to receive reimbursement’ of the company’s closure obligation, at the lower of the amount of the decommissioning obligation recognised and the company’s share of the fair value of the net assets of the fund. In that case, subsequent changes in the carrying value of the right to reimbursement should be recognised in the statement of profit and loss and accordingly, the company should not account for the interest income on escrow bank account separately.

17. The Committee notes that the querist has mentioned in the Facts of the Case that the exemption under paragraph D21 of Ind AS 101 has been availed by the company. In this regard, the Committee notes that paragraph D21 of Ind AS 101 states as follows:

“D21 Appendix ‘A’ to Ind AS 16 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to Ind ASs. If a first-time adopter uses this exemption, it shall:

- (a) measure the liability as at the date of transition to Ind ASs in accordance with Ind AS 37;
- (b) to the extent that the liability is within the scope of Appendix A of Ind AS 16, 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 that liability over the intervening period; and

- (c) calculate the accumulated depreciation on that amount, as at the date of transition to Ind ASs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity in accordance with Ind ASs.”

The Committee notes from the above that if there are changes in the initial estimate of MCP obligation, this exemption permits an entity to measure the decommissioning liability as at the date of transition (1<sup>st</sup> April 2015 in the extant case) and estimate the site restoration/mine closure obligation at the original date (1<sup>st</sup> April 2010 in the extant case) by discounting the liability based on the historical risk-adjusted discount rate for estimating the amount that would have been included in the cost of the related asset when the liability first arose (viz., 1.4.2010 in the extant case). However, in the extant case, the following are not clear:

- This exemption is relevant only if there are changes in the initial estimate of the MCP obligation. However, the querist has not specifically mentioned whether there are any changes in the initial estimate of MCP obligation, since its initial recognition. If there are any such changes, the querist has also not mentioned how such changes are treated in the financial statements. Hence, the relevance/ use of this exemption is not clear.
- The querist has also stated that under Ind AS, estimation of the site restoration/mine closure liability was made on the original date, i.e., 01.04.2010, the date at which the liability was recognised first as per the Mine Closure Plan guidelines of Ministry of Coal, and then the same was unwound to 01.04.2015, on which date site restoration asset and site restoration provision were recognised on transition to Ind ASs. This seems to suggest that the liability was also estimated on 1 April 2010, without considering any subsequent changes in estimates. If this is correct, the company has retrospectively applied the requirements of Ind AS 37, rather than the requirements of the exemption under paragraph D 21 of Ind AS 101.

The Committee is of the view that the same should be examined by the company and appropriate disclosure should be made in the notes to the financial statements of the company along with necessary adjustments (if any) required in this regard.

#### **D. Opinion**

18. On the basis of the above, the Committee is of the following opinion:

- The site restoration/mine closure cost of the mine is an essential cost that is directly attributable to the asset. The company should include an initial estimate of the site restoration/mine closure in the initial cost of the related asset as per the requirements of Ind AS 37 read with Ind AS 16 and Ind AS 38, as discussed in paragraphs 12 to 14 above.
- Any changes in the obligation amount since its initial recognition should be accounted for in accordance with Appendix A to Ind AS 16.
- Periodic unwinding of the discount on the provision for site restoration/mine closure should be recognized in the statement of profit and loss as finance cost, as discussed in paragraph 14 above.

- The company should recognise its interest in the escrow account (fund) separately from the liability to pay closure and environmental costs. The company should determine whether it has control or joint control of, or significant influence over the escrow account, considering its own facts and circumstances and the Guidelines issued by the Ministry and accordingly, account for its interest in the escrow account, as discussed in paragraph 16 above.
  - As stated in paragraph 17 above, the company should examine whether it wishes to apply the requirements of paragraph D21 of Ind AS 101 or the retrospective application of requirements of Ind AS 37 and accordingly, appropriate disclosure should be made in the notes to the financial statements of the company along with necessary adjustments (if any) required in this regard.
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