

Extractive Activities Research Project

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Research scope

- Minerals and oil & gas
- Extractive activities (i.e. upstream activities only)
- Project needed because
 - IFRSs do not adequately address unique features
 - several scope exceptions and no specific disclosures
 - IFRS 6 only an interim solution
 - relevance of the existing accounting?
 - various accounting models
 - consistency with *Framework*?

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Approach

- Bound by *Framework*, but not by existing IFRSs
 - (e.g. IAS 38 *Intangible Assets*)
- Consistent requirements for mining and oil & gas?
- No industry-specific solutions for issues that are widespread across a range of industries
 - (e.g. revenue, joint arrangements)

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Discussion Paper development

- Project team of national standard setters
- Advisory panel
 - Oil & gas and mining companies
 - Analysts and other financial statements users
 - Auditors
 - Securities regulators (including SEC)
- Consulted with technical experts
- Discussion Paper contains project team views
 - IASB discussed at several meetings
- Discussion Paper is initial due process document for IASB's deliberations on extractive activities

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Key research questions

- How should mineral and oil & gas reserves and resources be **defined**?
- When should an asset relating to mineral and oil & gas reserves and resources be **recognised** on the balance sheet?
- How should this asset be **measured**?
- What information about mineral and oil & gas reserves and resources should be **disclosed** in the financial report?



User views

- Balance sheet recognition and measurement of minerals or oil & gas assets has limited usefulness
 - historical cost is not relevant
 - fair value is too subjective

Accounting should be simple to apply and consistent

- Want information to be disclosed that can be included into their own models

Extensive disclosures needed for financial statements to provide useful information to users

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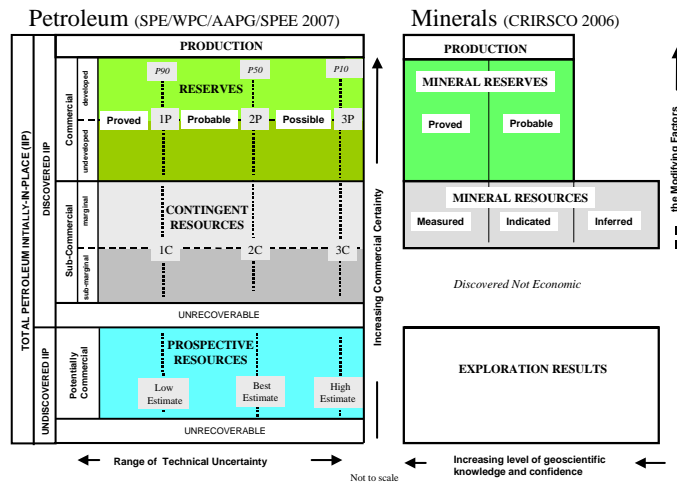


Definitions

- No single agreed definition of reserves or resources for the extractive industries
- Project team recommends for use in an IFRS
 - Petroleum Resource Management System (PRMS) – for oil & gas
 - The CRIRSCO Template – for mining
- Why?
 - Wide acceptance
 - Broad and comprehensive scope
 - Broad equivalence between key concepts
 - therefore capable of providing a platform for comparable accounting and disclosure requirements across both industries

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Definitions continued



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Asset recognition

- Existing practice involves expense/capitalise decisions based on activity (e.g. exploration, development)
 - not based on asset/liability definition
 - depends on definition of exploration, development
- Differences between mining and oil & gas
 - area of interest, full cost, successful efforts
- Differences by entity size
 - junior explorers more likely to capitalise exploration

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Asset recognition continued

- Apply the *Framework*
- Project team's view is that the asset is:
 - The right to explore, develop, extract minerals or oil & gas

- Initial recognition when acquire legal rights to explore
- Over time this asset is enhanced by
 - information from exploration & evaluation activities
 - development to access the mineral or oil & gas
 - additional rights and approvals (including extraction rights)

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Asset recognition continued

- Geographic boundary of unit of account
 - initially defined by exploration rights
 - reduces as exploration, evaluation and development activities occur
 - no greater than a contiguous area that is:
 - defined by the legal rights
 - managed separately
 - expected to generate largely independent cash flows.
- Asset components
 - IAS 16 components approach determines which plant and equipment assets are recognised separately

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Asset recognition (in summary)

- The asset is the rights to the minerals, not the minerals themselves
 - minerals recognised as inventory when produced
- Asset recognised consistent with the legal rights
 - e.g. 100% interest in mineral rights, a shared interest in mineral rights through a joint arrangement, or a Production Sharing Contract
- Costs of E&E activities not expensed as incurred
- Impairment testing necessary
 - unless current value remeasurement each period

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Asset measurement

- Historical cost
 - verifiable, but ...
 - cost has limited relevance to users
 - no correlation between finding & development costs incurred and future cash flows that will be generated from the property
- Fair value
 - seems relevant (in principle), but ...
 - requires many subjective assumptions and estimates
 - significant time and effort to prepare
 - cost/benefit implications

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Asset measurement continued

- Other measurement alternatives
 - a “simplified” fair value that use standardised assumptions and/or only values a portion of the asset
 - switching from historical cost to fair value at a pre-defined stage during the life of the asset
- Consequential measurement issues

Fair value	Historical cost
Income implications	Impairment
Revaluation frequency	Depreciation

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Asset measurement continued

- Project team view: Measure at historical cost
 - neither cost nor fair value provide significant benefit to users
 - expensing all exploration understates earnings
 - historical cost measurement is less costly for preparers

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Impairment

- Development/production
 - IAS 36 applies
- Exploration
 - usually insufficient information to apply IAS 36
 - derecognition criteria
 - impair based on management's judgment that recovery of carrying amount highly unlikely
 - supporting disclosure about exploration property assets and write downs

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Disclosures

- Current disclosure practice is diverse – both across industries and across jurisdictions
- Disclosure guiding principles
 - respond to user needs
 - consistent disclosure for minerals and oil & gas
 - this does not mean identical disclosure
 - **cost/benefit considerations**
 - proposals represent a substantial change to existing practice in both industries
 - consistency with regulatory requirements

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Disclosures continued

- Proved and probable reserve quantities
 - disaggregated by commodity type
 - disaggregated by significant risk attributes
 - the reserve quantities attributable to subsidiaries and investments should be presented on the same basis that applies to the accounting in consolidated financial statements



Disclosures continued

- Estimation basis for reserve quantities
 - use market participant assumptions where available
 - e.g. the fair value hierarchy's Level 1, Level 2 and Level 3 inputs may help to identify the pricing assumption that should be used
 - disclose the main assumptions used
 - disclose sensitivity analysis of the effect of changes in main assumptions
- Explanation of year-on-year reserves changes
 - either narrative explanation or quantitative reconciliation



Disclosures continued

- Current value measurement disclosure
(if statement of financial position is at HC)
 - 2 possibilities
 - fair value measurement of minerals or oil & gas assets presented as valuation range rather than single point estimate
 - a discounted cash flow measurement of the reserves
 - reconciliation of changes in current value measurement
- Fair value measurement disclosure
(if statement of financial position is at FV)
 - information that explains the fair value estimate

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Disclosures continued

- Production revenues by commodity
- Exploration, development and production cash outflows
 - presented as a time series to identify trends

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Publish What You Pay

- Publish What You Pay are concerned that resource wealth is not benefiting citizens of many resource-rich developing countries
- PWYP request disclosure on country-by-country basis for
 - payments to governments
 - reserves, production etc
- Help users evaluate political and reputational risk
- Constituent comments will be requested

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Summary

- The Discussion Paper is available at:
- www.iasb.org or www.aasb.gov.au
 - first step towards an IFRS for extractive activities
 - comments requested by end of July 2010
 - significant changes proposed

Input from constituents is very important

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Questions or comments?

Expressions of individual views by members of the AASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

