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Australian Accounting Standards Board

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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Dear David

AASB comments on IASB Discussion Paper DP/2010/1 *Extractive Activities*

The Australian Accounting Standards Board (AASB) welcomes the opportunity to comment on the above Discussion Paper. In formulating its views, the AASB sought the views of Australian constituents (these responses are published on the AASB website www.aasb.gov.au).

The AASB is supportive of the project and urges the IASB to add to its agenda the topics raised in the Discussion Paper. This is because there is a need for a standard to reduce the diversity of reporting of extractive activities and because there is a need to address accounting issues connected with the types of risks and uncertainties associated with extractive activities and other activities such as pharmaceutical research and development activities.

The AASB's detailed responses to the specific questions accompanying the Discussion Paper are attached as Appendix A.

If you have any queries regarding any matters in this submission, please contact us.

Yours sincerely

K M. Stevenson

Kevin M Stevenson
Chairman and CEO
Australian Accounting Standards Board

Question 1 – Scope of extractive activities

In Chapter 1 the project team proposes that the scope of an extractive activities IFRS should include only upstream activities for minerals, oil and natural gas. Do you agree? Are there other similar activities that should also fall within the scope of an IFRS for extractive activities? If so, please explain what other activities should be included within its scope and why.

Whilst the AASB agrees that at the moment the scope is appropriate it considers that emerging activities such as the extraction of geothermal energy may become more prominent and therefore recommend, given that an exposure draft is not expected to be issued until at least 18 months after the project is added to the agenda, that the scope be further researched and revaluated at the time of issuing that ED.

Question 2 – Approach

Also in Chapter 1, the project team proposes that there should be a single accounting and disclosure model that applies to extractive activities in both the minerals industry and the oil and gas industry. Do you agree? If not, what requirements should be different for each industry and what is your justification for differentiating between the two industries?

In the context of extractive activities, the AASB agrees that a single approach to accounting and disclosures should be used for minerals and oil and gas.

The AASB's preferred approach would be the address the issues concerning legal rights and their enhancement in a broad context, including rights arising from extractive activities and other activities that face similar challenges such as pharmaceutical research and development. The AASB acknowledges that this would require altering the scope of any project (see Question 1), and possibly the initiation of a new project that would have a more general focus which would include rights and internally generated assets.

Question 3 – Definitions of minerals and oil and gas reserves and resonrces

In Chapter 2 the project team proposes that the mineral reserve and resource definitions established by the Committee for Mineral Reserves International Reporting Standards and the oil and gas reserve and resource definitions established by the Society of Petroleum Engineers (in conjunction with other industry bodies) should be used in an IFRS for extractive activities. Do you agree? If not, how should minerals or oil and gas reserves and resources be defined for an IFRS?

The AASB considers that the development of relevant and sound definitions for minerals and oil and gas are outside the IASB's expertise and therefore agrees with using CRIRSCO and PRMS to define minerals and oil and gas reserves and resources.

However, the AASB considers there are some matters that may need further analysis.

- Whether the reference to the definitions is to be ambulatory or static. Because the development of the definitions are out of the IASB's control:
    - A static reference will require the IASB to have a policy of reviewing any changes to the definitions and then making a decision whether to require using the

existing definitions or whether to adopt the new definitions, which will then require a change to the IFRS;

- An ambulatory reference will require the IASB to be satisfied that the external definition review process is robust and will require implementing a policy to review any changes to ensure they are still relevant for financial reporting purposes.

- Because these definitions have not been developed with the *Framework* in mind, it will be necessary to monitor any changes to ensure that they remain consistent with the *Framework.*
- Some jurisdictions already require entities to disclose their reserves as part of listing rules and therefore there is a potential that some information will be reported twice or, depending on the regulatory requirements, it may differ from what will be required in an IFRS. The IASB should engage with regulators to help ensure the reporting of reserves is consistent.
- It is our understanding that there may be certain elements in the PRMS methodology that are the subject of debate between the industry and the engineering profession, therefore the IASB needs to ensure that this will not have an adverse affect on using these definitions for financial reporting purposes.

Question 4 – Minerals or oil and gas asset recognition model— recognition

In Chapter 3 the project team proposes that legal rights, such as exploration rights or extraction rights, should form the basis of an asset referred to as a 'minerals or oil and gas property'. The property is recognised when the legal rights are acquired. Information obtained from subsequent exploration and evaluation activities and development works undertaken to access the minerals or oil and gas deposit would each be treated as enhancements of the legal rights. Do you agree with this analysis for the recognition of a minerals or oil and gas property? If not, what assets should be recognised and when should they be recognised initially?

Whilst the AASB agrees it is the legal rights that form the basis of a minerals or oil and gas property asset, the Board is not convinced that all the activities associated with acquiring and seeking to enhance those rights will result in a future economic benefit and therefore do not agree that all costs should be capitalised. The capitalisation of all costs, regardless of whether it results in positive or negative information may result in assets being carried on the balance sheet which may have no relationship to the future economic benefits embodied in those assets. The Discussion Paper does not articulate, with any conviction, why exploration costs differ from research and development costs and therefore why they should be treated differently. The AASB notes that the relevant issues are not exclusive to extractive activities and that entities engaged in research and development face the same challenges.

Question 5 – Minerals or oil and gas asset recognition model – unit of account selection

Chapter 3 also explains that selecting the unit of account for a minerals or oil and gas property involves identifying the geographical boundaries of the unit of account and the items that should be combined with other items and recognised as a single asset.

The project team's view is that the geographical boundary of the unit of account would be defined initially on the basis of the exploration rights held. As exploration, evaluation and development activities take place, the unit of account would contract progressively until it becomes no greater than a single area, or group of contiguous areas, for which the legal rights are held and which is managed separately and would be expected to generate largely independent cash flows.

The project team's view is that the components approach in IAS 16 *Property, Plant and Equipment* would apply to determine the items that should be accounted for as a single asset.

Do you agree with this being the basis for selecting the unit of account of a minerals or oil and gas property? If not, what should be the unit of account and why?

Whilst the AASB agrees that using a geographical boundary is a logical unit of account, it notes that units of account may expand (not always contract) for example because owners of reserves might pool their individual interests in return for an interest in the overall pool which is then operated by a single entity on behalf of the venturers. The AASB consider that the suggested unit of account needs to be further researched.

Question 6 – Minerals or oil and gas asset measurement model

Chapter 4 identifies current value (such as fair value) and historical cost as potential measurement bases for minerals and oil and gas properties. The research found that, in general, users think that measuring these assets at either historical cost or current value would provide only limited relevant information. The project team's view is that these assets should be measured at historical cost but that detailed disclosure about the entity's minerals or oil and gas properties should be provided to enhance the relevance of the financial statements (see Chapters 5 and 6).

In your view, what measurement basis should be used for minerals and oil and gas properties and why? This could include measurement bases that were not considered in the discussion paper. In your response, please explain how this measurement basis would satisfy the qualitative characteristics of useful financial information.

The AASB agrees that both historical cost and fair value measurement are not without problems. Historical cost may not provide relevant information regarding the value of an asset but may provide useful information regarding how much has been expended on a project. Whereas, fair value may provide a better indication of management's expectations of the value of assets, many users have indicated that a fair value provided by the entity is of limited use. Users would generally prefer the disclosure of management's fair value inputs to enable them to better determine their own fair values, and that they might use a fair value provided by the entity as a reference point. Despite comment from AASB constituents supporting the use of historical cost , the AASB is not convinced that the 'path of least resistance' the project team has proposed in using historical cost will provide the most relevant information and meet the objectives of financial reporting. The AASB considers that there are users other than analysts and that the research conducted to date may not be sufficiently extensive to make a determination that 'no' user desires fair value. Therefore the AASB recommends that before an ED is drafted further research is undertaken regarding an appropriate measurement model.

Question 7 – Testing exploration properties for impairment

Chapter 4 also considers various alternatives for testing exploration properties for impairment. The project team's view is that exploration properties should not be tested for impairment in accordance with IAS 36 *Impairment of Assets*. Instead, the project team recommends that an exploration property should be written down to its recoverable amount in those cases where management has enough information to make this determination. Because this information is not likely to be available for most exploration properties while exploration and evaluation activities are continuing, the project team recommends that, for those exploration properties, management should:

(a) write down an exploration property only when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable in full; and

(b) apply a separate set of indicators to assess whether its exploration properties can continue to be recognised as assets.

Do you agree with the project team's recommendations on impairment? If not, what type of impairment test do you think should apply to exploration properties?

The AASB agrees that indicators should be developed to determine when an exploration property should be tested for impairment and favours basing those indicators on the recognition criteria in AASB 6 *Exploration and Evaluation of Mineral Assets* paragraph Aus7.2 which states:

Aus7.2 "An exploration and evaluation asset shall only be recognised in relation to an area of interest if the following conditions are satisfied:

(a) the rights to tenure of the area of interest are current; and

(b) at least one of the following conditions is also met:

(i) the exploration and evaluation expenditures are expected to be recouped through successful development and exploitation of the area of interest, or alternatively, by its sale; and

(ii) exploration and evaluation activities in the area of interest have not at the end of the reporting period reached a stage which permits a reasonable assessment of the existence or otherwise of *economically recoverable reserves*, and active and significant operations in, or in relation to, the area of interest are continuing.

Question 8 – Disclosure objectives

In Chapter 5 the project team proposes that the disclosure objectives for extractive activities are to enable users of financial reports to evaluate:

(a) the value attributable to an entity's minerals or oil and gas properties;

(b) the contribution of those assets to current period financial performance; and

(c) the nature and extent of risks and uncertainties associated with those assets.

Do you agree with those objectives for disclosure? If not, what should be the disclosure objectives for an IFRS for extractive activities and why?

Whilst the AASB agrees with the disclosure objectives when taken in context with the project team's proposal on a minerals or oil and gas asset measurement model (Question 6), it does not agree that any proposed IFRS should provide disclosures as a substitute for an appropriate measurement model. Disclosures should support the measurement model, not be provided instead of that model.

Question 9 – Types of disclosure that would meet the disclosure objectives

Also in Chapter 5, the project team proposes that the types of information that should be disclosed include:

(a) quantities of proved reserves and proved plus probable reserves, with the disclosure of reserve quantities presented separately by commodity and by material geographical areas;

(b) the main assumptions used in estimating reserves quantities, and a sensitivity analysis;

(c) a reconciliation of changes in the estimate of reserves quantities from year to year;

(d) a current value measurement that corresponds to reserves quantities disclosed with a reconciliation of changes in the current value measurement from year to year;

(e) separate identification of production revenues by commodity; and

(f) separate identification of the exploration, development and production cash flows for the current period and as a time series over a defined period (such as five years).

Would disclosure of this information be relevant and sufficient for users? Are there any other types of information that should be disclosed? Should this information be required to be disclosed as part of a complete set of financial statements?

Notwithstanding the comments provided to Question 8 above, the AASB agrees that both reserve and resource quantities should be disclosed, this is because the difference between a proved reserve and a resource, on many occasions, relates only to the 'lack' of 'proving up' of that resource. Often an entity will not go to the expense of 'proving' a resource until it is required for production however, this lack of 'proving' does not diminish its value, it just makes the measurement of that value more uncertain

Question 10 – Publish What You Pay disclosure proposals

Chapter 6 discusses the disclosure proposals put forward by the Publish What You Pay coalition of non-governmental organisations. The project team's research found that the disclosure of payments made to governments provides information that would be of use to capital providers in making their investment and lending decisions. It also found that providing information on some categories of payments to governments might be difficult (and costly) for some entities, depending on the type of payment and their internal information systems.

In your view, is a requirement to disclose, in the notes to the financial statements, the payments made by an entity to governments on a country-by-country basis justifiable on cost-benefit grounds? In your response, please identify the benefits and the costs associated with the disclosure of payments to governments on a country-by-country basis.

The AASB considers that the issue should be considered in the context of the objective of financial reporting, and a decision made as to whether the users identified by the Publish What You Pay (PWYP) coalition are among those users identified in the *Framework*. The AASB considers that the types of disclosure sought by the PWYP coalition are likely to be outside the scope of financial reporting and that alternative means of making the information available should be pursued. It is the AASB's understanding that many entities in the extractive activities already support the Extractive Industries Transparency Initiative which sets the global standard for transparency in mining and oil and gas, therefore requiring PWYP disclosures may result in a duplication of information. It has also come to the AASB's attention that The Prince's Accounting for Sustainability Project (A4S) and the Global Reporting Initiative (GRI) are forming the International Integrated Reporting Committee (IIRC). The IIRC will bring together representative from the corporate, accounting, securities, regulatory, non-government organisations, and standard-setting sectors. The objective of the IIRC will be to create a globally accepted framework for accounting for sustainability that brings together financial, environmental, social, and governance information. The AASB considers that this may be a more suitable vehicle for the PWYP disclosures and the IASB should alert the PWYP coalition to this initiative.