APPEA

HEAD OFFICE
Level 10
60 Marcus Clarke St
Canberra ACT 2601

GPO Box 2201
Canberra ACT 2601

T +61 2 6247 0960
F +61 2 6247 0548
E appea@appea.com.au
ABN 44 000 292 713

BRISBANE OFFICE
Level 9
10 Market St
Brisbane QLD 4000

GPO Box 1151
Brisbane QLD 4001

T +61 7 3221 8300
F +61 7 3220 2811
E brisbane@appea.com.au

PERTH OFFICE
Level 1
190 St Georges Tce
Perth WA 6000

PO Box 7039
Cloisters Square
WA 6850

T +61 8 9321 9775
F +61 8 9321 9778
E perth@appea.com.au

6 July 2010

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins St West
Victoria 8007

Attention: Ms Joanna Spencer

International Financial Reporting Standard for Extractive Industries

The Australian Petroleum Production & Exploration Association Ltd (APPEA) is the peak national body representing the collective interests of companies engaged in petroleum exploration, development and production in Australia. The Association's membership comprises companies that account for an estimated 98 per cent of Australia's petroleum production and the vast majority of exploration. APPEA is pleased to provide the following comments in relation to the proposed new International Financial Reporting Standard (IFRS) for extractive activities. (The comments outlined below are based on the views provided to APPEA by member companies).

Scope of Standard

At this stage, we do not see a need for the standard to be extended to other geological and production activities, such as geothermal and carbon capture and storage exploration and production.

Reserves Reporting Standards

APPEA broadly supports the goals of providing transparency and standardising the accounting provisions for extractive industries. APPEA notes that the proposal canvasses the usage of the SPE-PRMS framework as the basis for the assessment of oil and gas reserves. While this approach generally has extensive usage worldwide (and therefore provides a potentially logical basis for the consistent estimation of reserves), APPEA understands that there are elements of the methodology that remain the subject of debate within both the industry and the engineering profession.

We also note that the Australian Securities Exchange (ASX) and the Australian Government's review of the Petroleum Resource Management Regulations are also separately (and independently) considering regulatory processes that may ultimately lead to the adoption of defined reserves reporting standards. We strongly recommend that the AASB liaises closely with the officials undertaking these reviews to ensure that a piecemeal and disjointed set of requirements are not imposed on companies undertaking oil and gas operations in Australia.

Sensitivity Analysis

While there may be merit in the adoption of disclosure provisions for quantities of oil and gas reserves based on a standardised methodology (such as SPE-PRMS), we do not support the undertaking of detailed sensitivity analysis for reserves. We believe that the preparation of sensitivity analysis will require a significant amount of work and cost for potentially little value add. For example, it is not appropriate to run sensitivities on product pricing assumptions without considering a wide range of additional factors. Furthermore, the use of different assumptions on economic conditions may also fundamentally change project development concepts. APPEA considers that providing disclosure on the reserves supporting oil and gas assets in a manner consistent with a methodology framework such as SPE-PRMS should provide users with more than sufficient information.

Value Based Disclosure Requirements

APPEA does not support the inclusion of value based disclosures for assets in the financial statements, including detailed disclosure of market and economic assumptions. This would effectively require the disclosure of commercially sensitive information. We recommend the disclosure of reserves quantities and a broad description of the high level economic assumptions that have been used. If value based disclosures are to be made, we believe consideration could be given to a possible standardised approach. Notwithstanding this, we consider that the users of the information are better placed to make those final judgments.

We have concerns about whether auditors have the skills for auditing the technical and commercial assumptions that underpin reserves estimates. In addition, financial statement materiality principles may not sit well with the fundamental nature of reserves and resources valuation estimates. Such an approach could also prove very costly to reporting entities, with the impact being a dilution in the level of funds available for exploration and/or production activities. Accordingly, we believe that reserves disclosures should be presented outside of the financial statements and not be subject to financial statement audit.

Related and Supplementary Issues

There are a variety of circumstances or commercial processes that confront companies engaged in oil and gas operations that could benefit from inclusion or commentary in the proposed standard, particularly as the divergent approaches adopted by companies can lead to variations in reported outcomes. A selection of the issues are outlined below.

'Sole risk' activities

This occurs when a project joint venture exists, but where an activity (such as the drilling of an exploration well by selected parties) results in potential changes to the percentage ownership interest in the joint venture asset and/or where a penalty charge is to be paid by the non-participating party to subsequently buy back into the project at the venturers original interest.

Unitisations

There are numerous instances where owners of petroleum reserves pool their individual interests in return for an interest in an 'overall unit' which is then operated by a single entity on behalf of the group.

Re-determinations

A variety of circumstances could apply (including adjustments to the ownership interests in a field, pool or reservoir due to an agreed redetermination of the proportion of assets contributed by each venture party) which may require an adjustment or redetermination in the value of reserves or assets.

Farm-ins and carried interests

This includes the transfer of part of an oil or gas interest in consideration for:
- a specified consideration; and/or
- an agreement by the transferee to meet certain expenditure that would otherwise have to be undertaken by licensee.

Accounting for production sharing agreements

Under many jurisdictions, agreements are entered into between oil and gas companies and a host government to explore for and, if successful, develop a reserve. Under such agreements:
- the company (or contractor) generally bears the cost of the development;
- the company generally receives all revenue until they have recovered their costs (often with an allowance); and
- the subsequent revenue is shared with the host government, based on an agreed formulae.

Accounting for production sharing agreements by oil and gas companies can take a number of different forms, including:
- accounting 100% of the revenue and including an expense for the amount payable to the Government; and/or
- accounting for a proportionate share of the revenue; and/or
- accounting for the costs as a tax, where the taxation standard is applied which requires the balance sheet approach.

Accounting for resource rent style taxes

The Australian Government applies a petroleum resource rent tax (PRRT) on the 'taxable profit' of a petroleum project instead of traditional royalties. The AASB issued an interpretation in November 2007 - Interpretation 1003 Australian Petroleum Resource Rent tax, which requires the PRRT to be accounted within the scope of AASB 112 Income Taxes rather than a royalty expense. There could be divergent accounting practices, particularly if other Governments have similar style taxes, as the IASB have not issued the same interpretation. The proposed introduction by the Australian Government of the resource super profits tax also adds a further complexity.

Accounting for underlift / overlift sales

Lifting or off-take arrangements for oil and gas produced in jointly owned operations are frequently such that it is not practicable for each participant to receive or sell its precise share of the overall production during a defined period. Any resulting short term imbalance between cumulative production entitlement and cumulative sales attributable to each participant at a reporting date represents an over-lift or underlift.

Other Issues

Publish What You Pay to Governments

At this stage, should the IASB seek to pursue this proposal further, it is recommended that an approach should be developed that would apply to all industries rather than focusing selectively on the extractive industries.

Accounting Methodology

A preferred method of accounting would be to capitalise costs under a revised successful efforts method, where costs are only capitalised in the exploration and evaluation phase if they provide positive information regarding the potential reserve (contingent resource under the SPE framework). For example, costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area or where activities in the area have not yet reached a stage that permits reasonable assessment of the existence of proven and probable hydrocarbon reserves.

Asset Recognition

Comments from APPEA member companies suggest support for the recognition of assets when the legal right to undertake extractive activities is obtained and measurement be based on using a historical cost method rather than a fair value approach.

If required, we would be pleased to arrange for further information to be provided on the above issues. In the first instance, APPEA contact is Noel Mullen (nmullen@appea.com.au).

Yours sincerely

Belinda Robinson
CHIEF EXECUTIVE