

12 October 2007

Mr David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Dear David

Re: Draft Interpretation 10XX Australian Petroleum Resource Rent Tax

Thank you for the opportunity to comment on draft Interpretation 10XX *Australian Petroleum Resource Rent Tax* (Interpretation 10XX).

We do not believe that the Australian Accounting Standards Board (AASB) should proceed with the finalisation and issue of Interpretation 10XX, but would strongly prefer that the AASB remain silent on whether Petroleum Resource Rent Tax (PRRT) is an income tax within the scope of AASB 112 *Income Taxes* (AASB 112).

Instead, we would strongly prefer the matter be referred by the AASB as an urgent matter for the International Accounting Standards Board (IASB) to resolve as part of the upcoming proposed revisions to IAS 12 *Income Taxes*.

The key reasons for our position are as follows:

- Interpretation 10XX represents the elimination of accounting policy options under Australian Accounting Standards that are available to entities that report under 'pure' International Financial Reporting Standards (IFRS), which may be seen as inconsistent with the AASB's own objectives in relation to full convergence with IFRS and result in a lack of global comparability
- the issuance of Interpretation 10XX will not eliminate diversity in accounting for PRRT, but merely introduce new diversity in treatment when applying AASB 112 to PRRT – if the AASB were to proceed with the Interpretation, detailed implementation guidance would be necessary
- it is an unavoidable consequence of the issuance of the Interpretation that the principles it contains will be widely applied to other taxes, royalty regimes and other arrangements, not just in Australia but on a global basis. The AASB does not appear to have given adequate consideration to this consequence. We believe that this will ultimately result in

additional requests for the AASB to provide guidance and/or issue an Interpretation on many more taxes, royalty regimes and other arrangements

- the issuance of Interpretation 10XX would in our view be inconsistent with many of the principles in the AASB's *Interpretation Model* (June 2006) and the International Accounting Standards Board's (IASB) *Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters*.

We have provided more background on the above in Appendix A. In addition, Appendix B contains our additional comments regarding the wording of the Interpretation.

Please contact the undersigned if you wish to discuss the matters raised in this letter further.

Yours sincerely



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Partner
National Leader – Mining



Ross Jerrard
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APPENDIX B – DETAILED COMMENTS ON OUR REASONS FOR NOT SUPPORTING THE ISSUANCE OF INTERPRETATION 10XX

Eliminating accounting policy options available under IFRS

In our view, the existing diversity of current accounting policies amongst entities that are subject to PRRT makes it self evident that there are different interpretations whether or not PRRT is an income tax. Some entities appear to apply AASB 112 fully or by analogy when accounting for PRRT. Other entities appear to account for PRRT on an accruals basis. Internationally, we are aware of entities that appear to account for analogous resource taxes on an inventory costing basis.

In our view, as outlined in our previous letters to the Board on this matter, accounting for PRRT as an income tax is an accounting policy choice that entities must make under IFRS. Accordingly, the AASB in Interpretation 10XX is effectively dictating the use of one option in accounting for PRRT. This view is also alluded to in paragraph 5 of the proposed Interpretation which outlines some of the approaches adopted by entities in accounting for PRRT and similar government imposts.

The AASB has previously decided that, in principle, all options that currently exist under IFRSs should be included in the Australian equivalents to IFRSs and additional Australian disclosures should be eliminated, other than those now considered particularly relevant in the Australian reporting environment¹.

In our view, Interpretation 10XX would undermine the AASB's decision and represent a significant shift in the approach to standard setting in Australia. Furthermore, an Interpretation on the accounting treatment of PRRT could result in a lack of comparability between PRRT and similar resource rents in Australia and the rest of the world due to the divergent practice which currently exists.

Interpretation 10XX will not eliminate diversity

Interpretation 10XX only addresses the question of whether Australian PRRT falls within the scope of AASB 112 (Interpretation 10XX, paragraph 8)².

The unusual nature and unique features of PRRT has been well documented in the past, including in our previous submissions on this matter to the AASB, the Advisory Panel's recommendation and in Interpretation 10XX itself.

In our view, by merely stating that AASB 112 should be applied without taking the next logical step of detailing *how* that Standard should be applied is unhelpful and counterproductive. It is clear that the principles in AASB 112 are not easily applied to

¹ As documented in AASB 2007-4 *Amendments to Australian Accounting Standards arising from ED 151 and Other Amendments*.

² Our concerns around the wording used in Interpretation 10XX are outlined in Appendix B.

PRRT, most notably in relation to the treatment of 'augmentation', closure costs and the tax rates to utilise.

These uncertainties in accounting methodology on applying AASB 112 to PRRT can produce widely divergent outcomes in reported financial performance and position and may therefore undermine the relevance and reliability of general purpose financial reports within Australia. The issuance of Interpretation 10XX seeks to avoid this very outcome (Interpretation 10XX, paragraph 6). Accordingly, the AASB failing to address the fundamental accounting methodologies to be used will undermine the very objective that the AASB seeks to achieve.

Issuing Interpretation 10XX will have unavoidable consequences for other government imposts

It is an unavoidable consequence of the issuance of Interpretation 10XX that the principles it contains will be widely applied to other taxes, royalty regimes and other arrangements, not just in Australia but on a global basis.

Interpretation 10XX establishes the principle that "although the relationship between Australian PRRT tax expense and accounting profit might not be easily explained, this does not provide sufficient supporting evidence to suggest that Australian PRRT is not an income tax" (Interpretation 10XX, Basis for Conclusions, paragraph BC15). Furthermore, the AASB is suggesting that because PRRT is levied on a measure of profit that is based on a net amount, that fact *in itself* is sufficient for PRRT to be categorised as an income tax (Basis for Conclusions, paragraph BC12).

These two paragraphs suggest a principle that a government impost is an income tax if it is levied on any form of 'profit', even where that profit is not related to accounting profits. This principle when applied to other government imposts will certainly result in substantially more items being accounted for as income taxes under AASB 112.

The types of imposts that may be considered income taxes as a result of Interpretation 10XX include many government royalties levied by the Federal, State and foreign governments on participants in the extractive industries, even though the 'profit' on which those royalties are levied:

- may not allow for a substantial proportion of total expenses related to the generation of revenue to be deducted, or
- is derived by reference to variables and amounts that would not be taken into account in measuring 'profit' from an accounting perspective.

There are a vast array of such imposts applied to the extractive industries globally, including various royalties levied on net smelter returns and gross profits, production sharing agreements and similar arrangements.

Furthermore, the extreme application of these principles could call into question the treatment of other widespread government imposts. For instance, the Australian Goods and

Services Tax (GST) shares many characteristics in common with PRRT, as is illustrated in the following aspects:

- GST is effectively a tax on the 'value added' by an entity in a period, such that an entity pays 10% of the profits earned for the period to the government
- GST provides an upfront input credit for capital goods purchased in a similar way to the 'up front' deductibility of capital expenditure under PRRT
- GST does not apply to certain categories of expenditure, in much the same way as PRRT does not permit deductions for many significant expenses
- the amount on which GST is calculated generally bears little relationship to accounting profit in any one period.

We do not believe that taxes such as GST are intended to be accounted for in accordance with AASB 112, but it is unclear how such imposts are to be distinguished from PRRT on the basis of the analysis provided by the AASB in the draft Basis for Conclusions on Interpretation 10XX.

The AASB does not appear to have given adequate consideration to this consequence. We recommend that the AASB carefully reconsider its rationale for concluding that PRRT is an income tax and if proceeding with the issue of Interpretation 10XX (a position we do not support), provide clear principle-based criteria that can be used in the assessment of whether or not other government imposts are considered income taxes.

Furthermore, because of the uncertainty that Interpretation 10XX will create, we believe that this will ultimately result in additional requests for the AASB to provide guidance and/or issue an Interpretation on many more taxes, royalty regimes and other arrangements.

Inconsistency with the principles in the AASB Interpretation Model and IASB Statement of Best Practice

Concerns related to the *Interpretations Model* (June 2006)

In our previous letters to the AASB on this matter, we have outlined our concerns regarding the due process surrounding the AASB's consideration of accounting for PRRT. We appreciate that the Board has responded to these concerns.

However, we note that the following criteria in the AASB's *Interpretations Model* have not been met in this project:

- *the issue is widespread and has practical relevance* – there are only a limited number of entities that are impacted by PRRT, although there may be significant impacts on entities and their accounting for other government imposts
- *financial reporting would be improved through the elimination or reduction in diverse reporting methods* – as noted above, we are concerned that Interpretation 10XX will achieve consistency in name only, with new divergent practices likely to develop

- *if the issue relates to a current or planned IASB or AASB project, there is a pressing need to provide guidance on a more timely basis than would be expected from that project* – the issue of the IASB's proposals for revisions to IAS 12 *Income Taxes* are expected in the fourth quarter of calendar 2007, at approximately the same time as the AASB will be considering Interpretation 10XX.

We are not aware of the AASB undertaking a formal review in accordance with the criteria in the *Interpretations Model* and question whether if such a review were to be undertaken whether the conclusion that an Interpretation was required would be sustained.

We have noted earlier in this letter that there is a strong likelihood that the AASB will be requested to opine on other government taxes, royalty regimes and imposts, not just in relation to the extractive industries, but on a wider scale. We cannot see any reason why the AASB would not be setting a precedent in the issuance of Interpretation 10XX that would effectively require further Interpretations on these other government imposts.

A series of Interpretations would further undermine the AASB's policy stated in the Interpretations Model that "a unique domestic interpretation of an Australian equivalent to IAS requirements will be required only in rare and exceptional circumstances". The alternative of widening the scope of Interpretation 10XX would create a different set of concerns around the AASB's role in providing 'generalised' interpretations of IFRS.

Concerns related to the IASB's *Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters*

The IASB's *Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters* ('IASB Statement') outlines the views of the IASB on the relations between the IASB and the various standard-setters around the world.

Whilst the IASB Statement does not preclude the possibility of particular jurisdictions removing optional treatments from IFRS and/or issuing domestic Interpretations, the comments included in this document are instructive. Relevant observations include:

- removal of options available under IFRS may increase preparation costs for multinational companies if the option removed is the global accounting policy, because the information from the subsidiary using one option needs to be changed to the option used by the group globally³ – this will be a consequence of Interpretation 10XX where subsidiaries of IFRS reporters account for PRRT other than by reference to IAS 12 *Income Taxes*
- the reasons provided as common examples of reasons why entities may eliminate options available under IFRS⁴ do not apply in the case of PRRT:
 - entities have *not* been required to account for PRRT as an income tax prior to the adoption of IFRS – in fact, most entities accounted for PRRT on an accruals basis prior to the transition to A-IFRS

³ IASB Statement, Footnote 9 to paragraph 5.7.

⁴ IASB Statement, paragraph 5.7.

- the issuance of Interpretation 10XX is not seeking to achieve convergence with another national or regional standard-setter – the view appears to be taken by the AASB that PRRT is a unique domestic issue that does not have international equivalents, although in our view this is not correct
- the IASB Statement notes that care needs to be exercised to ensure that issues are not more widely relevant – our concerns on this aspect of Interpretation 10XX have already been outlined earlier in this letter and is one of our fundamental concerns with Interpretation 10XX.

Our recommendations for a way forward

In our view, a better approach to the issue of accounting for PRRT would be for the AASB not to take any unilateral action in the form of either an Interpretation or Agenda Rejection Statement, but instead lobby the IASB for the upcoming ED on IAS 12 to more precisely deal with the nature of income taxes that are intended to be included in the scope of the Standard.

The efforts of the AASB on this matter could form a useful platform for the IASB in its development of the ED and serve to fast track the IASB's deliberations.

However, as the release of the IASB's ED is currently expected in the last quarter of calendar 2007, such action will need to be taken as a matter of urgency. We also note that the AASB has already indicated that it has plans to inform the IASB of this issue.

APPENDIX B – ADDITIONAL COMMENTS REGARDING THE WORDING OF INTERPRETATION 10XX

We do not support the AASB's intention to issue an Interpretation on PRRT. The comments below are included for completeness in the event that the AASB decides to proceed with the issue of Interpretation 10XX.

Suggested wording changes

Interpretation 10XX concludes that "Australian PRRT is an income tax within the scope of AASB 112". This statement is definitive and implies that the answer is obvious and that entities that are not currently accounting for PRRT as an income tax have adopted an incorrect accounting policy. We do not support this view.

The AASB would be aware of constituent concerns at the global level around the International Financial Reporting Interpretations Committee (IFRIC) wording agenda rejection statements in the manner proposed by the AASB in Interpretation 10XX. Whilst Interpretation 10XX is a proposed Interpretation rather than an agenda rejection statement, we believe that its issue must be considered in a global context and so be cognisant of the global sensitivities around full compliance with IFRS.

Accordingly, in the event that the AASB ultimately decides to proceed with the issue of Interpretation 10XX (a position that we do not support), we believe that the wording of the consensus should be amended to be stated along the lines of the following:

Australian PRRT shall be accounted for as an income tax under AASB 112.

Similar changes would also need to be made to the restate the issue section of the Interpretation along the lines of the following:

This Interpretation only addresses the question of whether Australian PRRT should be accounted for as an income tax in accordance with AASB 112 'Income Taxes'.

The above wording would then provide a clear basis for entities to treat the adoption of Interpretation 10XX as a change in accounting policy in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* and may assist in partially addressing some of the other concerns raised in this letter. However, these changes would not address our fundamental concerns with the issuance of an Interpretation on PRRT and accordingly would not result in us supporting its issue.