

7 July 2010

Mr Kevin Stevenson  
Chairman  
Australian Accounting Standards Board  
PO Box 204,  
Collins Street West  
VICTORIA 8007

By Email: [standard@aasb.gov.au](mailto:standard@aasb.gov.au)

Dear Kevin

### Comments on Invitation to Comment ITC 23 – Extractive Industries

Thank you for the opportunity to comment on the Invitation to Comment – Extractive Activities. CPA Australia, The Institute of Chartered Accountants (the Institute), and the National Institute of Accountants (the Joint Accounting Bodies) have jointly considered the above Invitation to Comment (ITC 23) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The Joint Accounting Bodies support as a matter of priority the addition of the extractive activities topic to the active project agenda of the International Accounting Standards Board (IASB). Consistency is imperative for an industry of this magnitude, and the current standard does not achieve this. Should the IASB take this course of action, the Australian Accounting Standards Board (AASB) will need to ensure it addresses the disclosure issues for those entities able to make use of its Reduced Disclosure Requirements Framework taking into account the IASB's decisions on extractive activities incorporated into its *IFRS for SMEs* standard and user considerations.

We support the approach taken by the project team and commend their effort in engaging extensively with preparers and users in this industry. However, we are not convinced by the conceptual arguments made by the authors of the Discussion Paper incorporated into ITC 23 that there is a need for a financial reporting approach specific to extractive activities. We consider that any extractive industry proposals should follow the principles of *Conceptual Framework for Financial Reporting* and those requirements in existing standards. A better starting point may be to amend existing standard requirements to take into account specific extractive industry issues. However, as a pragmatic approach, ITC 23 has some intuitive appeal in that using definitions set by appropriately qualified experts should enhance the quality and credibility of the information provided. Our response to matters on which the AASB has requested specific comment is included in the attached Appendix. Our submission to the IASB is attached.

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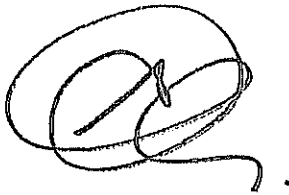
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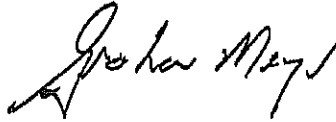
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If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at [mark.shying@cpaaustralia.com.au](mailto:mark.shying@cpaaustralia.com.au), Kerry Hicks (the Institute) at [kerry.hicks@charteredaccountants.com.au](mailto:kerry.hicks@charteredaccountants.com.au) or Tom Ravlic (National Institute of Accountants) at [tom.ravlic@nia.org.au](mailto:tom.ravlic@nia.org.au).

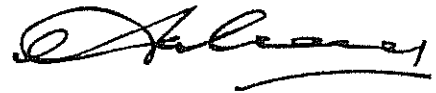
Yours sincerely



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Chief Executive Officer  
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## Appendix AASB Specific Matters for Comment

**Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:**

- i. not-for-profit entities; and
- ii. public sector entities?

The Joint Accounting Bodies are not aware of any regulatory issues or other issues arising in the Australian environment that would affect the decision of the International Accounting Standards Board to add the topic of extractive activities to its active work program.

**Overall, would the proposals result in financial statements that would be useful to users?**

The Joint Accounting Bodies believe that users would welcome the consistency in financial reporting that would emerge were the IASB to take on the project.

**Are the proposals in the best interests of the Australian and New Zealand economies?**

The Joint Accounting Bodies believe that the addition of the topic of extractive activities to the IASB's active work program is in the best interests of the Australian and New Zealand economies.

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Sir David Tweedie  
International Accounting Standards Board  
30 Cannon Street  
LONDON EC4M 6XH  
United Kingdom

Via "Open to comment" page on [www.iasb.org](http://www.iasb.org)

Dear Sir David

### Comments on Discussion Paper DP/2010/1 Extractive Activities

Thank you for the opportunity to comment on the Discussion Paper – Extractive Activities. CPA Australia, The Institute of Chartered Accountants (the Institute), and the National Institute of Accountants (the Joint Accounting Bodies) have jointly considered the above Discussion Paper (DP) and our comments follow.


The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The Joint Accounting Bodies consider that the IASB should add extractive activities to their agenda as an active project as a matter of priority. Consistency is imperative for an industry of this magnitude, and the current standard does not enable this to be achieved. The Board needs to ensure it addresses the issues not just for entities operating in the capital markets but also those private entities using the IFRS for SME standard, taking user considerations into account in this process.

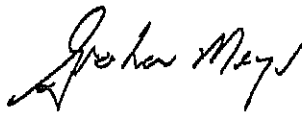
We support the approach taken by the project team and commend their effort in engaging extensively with preparers and users in this industry. However, we are not convinced by the conceptual arguments made by the authors of the Discussion Paper that there is a need for a financial reporting approach specific to extractive activities. We consider that any extractive industry proposals should follow the principles of Conceptual Framework for Financial Reporting and those requirements in existing standards. A better starting point may be to amend existing standard requirements to take into account specific extractive industry issues. However, as a pragmatic approach, the Discussion Paper has some intuitive appeal in that using definitions set by appropriately qualified experts should enhance the quality and credibility of the information provided. Our response to matters on which specific comment is requested is included in the attached Appendix.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at [mark.shying@cpaaustralia.com.au](mailto:mark.shying@cpaaustralia.com.au), Kerry Hicks (the Institute) at [kerry.hicks@charteredaccountants.com.au](mailto:kerry.hicks@charteredaccountants.com.au) or Tom Ravlic (National Institute of Accountants) at [tom.ravlic@nia.org.au](mailto:tom.ravlic@nia.org.au).

Yours sincerely



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**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.

The Joint Accounting Bodies believe that the Discussion Paper makes use of two tests to determine whether an activity is within its scope:  
the risks present in the activity are exploration, development and extraction risks; and  
the activity is the extraction of non-regenerative natural resources.

Regarding (i) above, the Joint Accounting Bodies understand that the characteristics of these risks are not very different from those risks associated with some types of research and development, for example, some types of pharmaceutical research. We believe that the Discussion Paper would be improved if it had articulated the rationale for separately proposing a financial reporting approach specific to extractive activities instead of requiring extractive activities to be within the scope of IAS 38 Intangible Assets.

Regarding (ii) above, the Joint Accounting Bodies believe the term “non-regenerative natural resources” does not have a common meaning. For example, a mineral such as salt, which is the result of weathering, is sometimes described as renewable notwithstanding its non-regenerative nature. This may be problematic

The Joint Accounting Bodies understand that as scoped it is the expectation of the authors of the Discussion Paper that the activities of those entities that are the subject of national codes based on the CRIRSCO International Reporting Template for the Public Reporting of Exploration Results, Mineral Resources and Mineral Reserves or the Petroleum Resource Management System (PRMS) of the SPE, WPC, AAPG and SPEE that are within scope – that is, extractive activities for minerals, oil and natural gas. Accordingly, we understand that the activities of some entities that are subject to the Template or PRMS (for example, some coal mines and the mining of oil sands) are within the scope of the Discussion Paper notwithstanding that the risks they face are more in the nature of manufacturing and other production type risks. Further, we understand that some activities are outside the scope of the Discussion Paper (for example, geothermal energy mining) notwithstanding that the risks faced are similar to nature to exploration, development and extraction.

The Joint Accounting Bodies consider that giving primacy to the nature of the risks faced (and on the basis that these risks can be adequately differentiated from the risks associated with some research and development activities) rather than just the non-regenerative nature of the resource would be a better approach to the scoping of this work. Alternatively, a pragmatic approach might be required, for example, a statement that the requirements only apply to the activities of those entities that are subject to the CRIRSCO Template or PRMS (or their national equivalents).

**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?

On the basis that there is a need for a financial reporting approach specific to extractive activities, the Joint Accounting Bodies agree there should be a single accounting and disclosure model that applies to extractive activities in both the minerals industry and oil and gas industry. However, it is important that the final standard adequately deals with issues that apply in only one of the two industries, such as the treatment of the removal of overburden and waste material in open pit mining operations (i.e.,

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stripping costs) and at the same time not unintentionally require by all the application of a principle that is appropriate for one industry but not the other.

### **Question 3 – Definitions of minerals and oil and gas reserves and resources**

**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 Joint Accounting Bodies consider that the Conceptual Framework for Financial Reporting under the joint development of the IASB and the FASB should be starting point for the requirements in the final standard. It appears that "legal ownership" is the starting point for the definitions of minerals, reserves and resources. Therefore, there may be occasions when the proposed definitions will not be consistent with the Framework. We do not think this ideal. However, as a pragmatic approach, the use of industry definitions has intuitive appeal in that using definitions set by appropriately qualified experts should enhance the quality and credibility of the information provided. Therefore, for pragmatic reasons the Joint Accounting Bodies are supportive of the proposal.

We acknowledge that having the IASB rely on definitions developed elsewhere has the potential to introduce risks – real and perceived, to the quality of the financial reporting. We understand that some countries have developed national equivalents to the CRIRSCO Template and/or PRMS. Accordingly, the IASB's proposal to cross-reference to the CRIRSCO Template and PRMS may create difficulties for entities within such a country which delays updating its national equivalents. Therefore, it is important that the IASB opine on whether the reference to the CRIRSCO Template or PRMS (or if considered appropriate their national equivalents) is an ambulatory reference or a static one. We note that in the absence of an ambulatory reference, it may be necessary for the IASB to revise its finalised Standard more often than would otherwise be the case. Further, we believe it important the IASB develop principles that it can use to evaluate the appropriateness for financial reporting of the CRIRSCO Template and PRMS (and/or the outputs of any other accepted external body). In addition, the IASB will need to consider the adequacy of governance structures of those bodies that develop the industry definitions. Some countries like Australia have adopted the IFRS as legislative instruments. The IASB will need to determine the effect if any of its proposals in those jurisdictions.

### **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?**

The Joint Accounting Bodies consider that the Framework should be the starting point for the requirements in the final standard in respect of the definition of assets and their recognition and derecognition. In the absence of the final standard replicating the exceptions in IFRS 6 Exploration for and Evaluation of Mineral Resources we do not believe that the capitalisation of all expenditure to the legal right to explore minerals, and oil and gas, regardless of its result, can meet the recognition requirements of an asset. This result would seem to ignore the 'probability of economic benefits' part of the definition of an asset.

We noted in our response to Question 1 above that given the apparent similarity in risk profiles of extractive activities and other industry research and development activities it might be appropriate to

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remove the current scope exclusion for extractive activities in IAS 38 Intangible Assets, so that the recognition requirements of IAS 38.21-23 would apply. We encourage the IASB to explore this option which would include adding some specific guidance to the Intangibles standard dealing with specific aspects of extractive activities.

**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?

The Joint Accounting Bodies note that the authors of the Discussion Paper propose that the unit of account is based on geographical boundaries to which the legal rights to explore minerals, and oil and gas attach and that the subsequent actions of prospecting, exploration, evaluation, development and production enable the refinement of the unit of account.

We have some concerns about the initial size of the unit of account and the lack of clarity around the methods for refining the unit of account as exploration progresses. Given the importance of the unit of account to enabling the objective of financial reporting to be met, we believe it most important that the IASB clearly articulates its thinking on these issues in the final standard.

We consider the unit of accounts problems (occurring throughout other areas of IFRS also) are even more prevalent by the proposed model in the paper to capitalisation costs in pre-development phase. If an approach similar to IAS 38 were adopted, there would be less of an issue with the unit of account as it would be focused on what has been 'developed' rather than what 'might be developed'.

**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 research presented in the Discussion Paper does not provide substantive support for either historical cost or fair value as the measurement basis for exploration properties and minerals or oil and gas properties – “[historical cost] may not meet the objective of financial reporting of providing financial information that is useful for making decisions.” (paragraph 4.85) and “...users do not view entity-prepared current values [including fair value] as being representationally faithful, and therefore they would make limited use of them.” (paragraph 4.83). The Discussion Paper's support of historical cost and not fair value is based on the measurement method that does the 'least harm'. We note that the increased subjectivity that would be required in this industry to estimate fair value can only be justified if there is strong user demand, which the paper tends to consider, does not exist.

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The Joint Accounting Bodies consider that the Framework should be the starting point for the requirements in the final standard in respect of the measurement as the objective of the measurement phase, is to provide guidance for selecting measurement bases that satisfy the objectives and qualitative characteristics of financial reporting. Prior to its release, we strongly suggest that the IASB revisit the findings of the Discussion Paper in the context of its work on the Framework project.

#### **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:

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  
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 Joint Accounting Bodies note that IAS 36 Impairment of Assets does not apply to assets in the exploration stage (in contrast, IAS 36 will apply to the development and production phases). We are not convinced it is appropriate that the exploration property be subject to a write down only when, in the judgement of management, there is a high likelihood that the carrying amount will not be recoverable in full; and to apply a separate set of indicators to assess whether its exploration properties can continue to be recognised as assets.

The concern with IAS 36 expressed by the authors of the Discussion Paper is that IAS 36 would involve too much effort in estimating the recoverable amount for a large number of extractive activity properties. We believe that that linking these concerns to IAS 36 is not appropriate – rather their concerns are a function of their own proposals about pre-development capitalisation and the unit of account. Accordingly, we strongly suggest there is a need to resolve in order these issues of unit of account recognition and measurement. When these issues are resolved, we expect that IAS 36 could be applied perhaps with some amendment to include some more specific and customised indicators of impairment.

#### **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:

the value attributable to an entity's minerals or oil and gas properties;  
the contribution of those assets to current period financial performance; and  
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?**

The Joint Accounting Bodies response to Question 6 above noted the comments by the authors of the Discussion Paper that financial information measured at historical cost may not meet the objective of financial reporting of providing financial information that is useful for making decisions. The Discussion Paper proposes the use of supplementary disclosures to address this deficiency.

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We strongly believe that audit enables financial statements to be used with increased confidence. Accordingly, we would have expected the authors of the Discussion Paper to propose that these supplementary disclosures be made in the notes to the financial statements (and therefore, be the subject of audit). We are concerned that the authors of the do not require this if it is disclosed elsewhere in information published with the financial statements.

We acknowledge that when the information is published in a document that includes the financial statements, the auditor is required to ensure that disclosures are not materially inconsistent with the financial report and that the auditor needs to be alert to any material misstatement of fact in such disclosures. However, we do not believe that the provision of unaudited supplementary disclosure is able to overcome the inability of the financial statements to meet the objective of financial reporting that is the consequence of using historical cost. Further, the public interest nature of disclosures related to the extractive industry is a possible additional reason for it to be specified as being in the notes to accounts.

#### **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:

quantities of proved reserves and proved plus probable reserves, with the disclosure of reserve quantities presented separately by commodity and by material geographical areas; the main assumptions used in estimating reserves quantities, and a sensitivity analysis; a reconciliation of changes in the estimate of reserves quantities from year to year; a current value measurement that corresponds to reserves quantities disclosed with a reconciliation of changes in the current value measurement from year to year; separate identification of production revenues by commodity; and 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?

See our response to Question 8 above. In relation to our point that the information should be in the audited part of the financial report, this would necessarily limit the information required in that section of the report to proved resources data. Whilst information on probable and possible reserves may be interesting to users their auditability may be questionable. Therefore this requirement should not be mandatory.

#### **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.

There are a number of organisations proposing changes to reporting frameworks for corporate social responsibility information (e.g., the Global Reporting Initiative and HRH Accounting for Sustainability project). It is not apparent why there is a focus on the reporting framework of the Publish What You Pay coalition and not others. Whilst we do not disagree that information on payments made to governments might be useful to capital providers in making decisions, it is unclear to us whether this is the primary motivation for these disclosure proposals.

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