



## Coming soon: Extractives Discussion Paper

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### **1. What is the aim of the extractives project?**

Staff from the AASB, together with staff from three other national standard setters (being Canada, Norway and South Africa), were asked by the IASB to undertake a project to research accounting issues that are unique to the minerals and oil & gas industries. The issues that are considered to be unique to these industries relate to accounting for extractive activities, which are activities associated with the search for, finding and extraction of minerals or oil & gas.

The research project was established because some extractive activities – and the assets or expenditures associated with these activities – are not comprehensively addressed by existing IFRSs. There are scope exclusions in IFRSs that would otherwise apply to some of these activities, most notably in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

Furthermore, although IFRS 6 *Exploration for and Evaluation of Mineral Resources* addresses the accounting for exploration and evaluation expenditures, it was only developed as an interim measure to allow (with some limitations) entities adopting IFRSs to continue to apply their existing accounting policies for these expenditures.

This absence of comprehensive guidance has resulted in some divergence in the international financial reporting of extractive activities. Concerns have also been raised that some accounting practices might be contrary to the IASB *Framework for the Preparation and Presentation of Financial Statements*.

The research project represents the first step towards an IFRS for extractive activities that would address these concerns and replace IFRS 6.

### **2. About the extractives Discussion Paper?**

The Discussion Paper will advocate the development of a common basis for accounting for extractive activities in the minerals and oil & gas industries. This will represent a change from existing practices, whereby the accounting and disclosure approaches often differ between industries.

The differences in the accounting and disclosure requirements may reflect the traditionally held view that the minerals and oil & gas industries are separate and distinct industries. However, the key business activities (i.e. exploration, evaluation, development, and production) and the geological and other risks and uncertainties are considered to be sufficiently similar that a single IFRS could apply in the same way as other IFRSs are used by multiple industries with a variety of circumstances.

The project team was encouraged in this view by the analysis of reserve and resource definitions completed earlier this year by the Society of Petroleum Engineers Oil and Gas Reserves Committee (SPE OGRC) and Committee for Mineral Reserves International Reporting Standards (CRIRSCO). Their analysis showed substantive equivalence between the two sets of industry definitions even though there are some differences in terminology. The project is proposing that these industry definitions of reserves and resources should be used in the development of the IFRS.



A core component of the research relates to accounting for minerals or oil & gas that is present in properties controlled by an entity. This accounting issue includes identifying when the minerals or oil & gas property can initially be recognised as an asset and whether it should be measured at historical cost or at fair value. This is the most contentious aspect of the research.

Measuring these assets at their historical cost is consistent with current accounting practice. Although there are debates about the most appropriate historical cost measurement model (such as which costs relating to exploration, evaluation and development activities should be capitalised and which should be expensed as incurred), many people consider that the cost of these assets can be measured reliably.

The problem is that this cost is not considered to be relevant to users of financial reports as there is no correlation between the cost of these assets and the future cash flows that these assets are expected to generate. For this reason, some people consider that these assets should instead be measured at fair value, which would be more relevant to users. The problem with fair valuing these assets is that each property is unique and in almost all cases the fair value will have to be estimated without reference to comparable market transactions. This raised concerns about the reliability of the fair value estimate, especially given the numerous uncertainties inherent in the assumptions that would be required to estimate the future cash flows associated with the volume of minerals or oil & gas that may be able to be economically extracted.

Concerns were also raised regarding the time and effort involved in potentially being required to estimate the fair value of each asset each reporting period and the income statement implications of changes in the fair value estimate from period to period. The Discussion Paper will invite comments on both measurement bases for these assets.

Last year, the project team consulted with 34 analysts and other users of financial reports worldwide and found that neither historical cost or fair value measurement of these assets provided useful information. Those surveyed recommended that the disclosure of minerals and oil & gas reserve and resource information was more important.

The Discussion Paper will propose that the IFRS include disclosure requirements relating to the disclosure of minerals and oil & gas reserve and resource information, as well as potentially some other disclosures that may give some insights into the value of those assets (such as disclosing a discounted cash flow calculation that is based on some standardised assumptions and only include some categories of reserves). The Discussion Paper will also be inviting comments on the types of disclosures that should be required by an IFRS.

### **3. Status of the extractives project**

The extractives project has been discussed with the IASB at seven IASB meetings. The project team has now completed its research and is finalising the draft Discussion Paper. The Discussion Paper is expected to be published by the IASB for worldwide comment at the end of 2008/early 2009.

Although the Discussion Paper will contain the views of the project team (rather than the IASB), the IASB has indicated that the Discussion Paper will be the initial due process document for the IASB's deliberations on accounting for extractive activities. The project team's views have been influenced by the comments provided by the IASB throughout the IASB meetings held on the project.

An IFRS for extractive activities will be some years away.