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International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the IASB's Discussion Paper on Extractive Activities, dated April 2010. The Appendix to this letter has been prepared by AcSB staff and includes detailed comments on the proposals in the Discussion Paper.

The staff of the AcSB discussed this Discussion Paper with the AcSB's User Advisory Council, and with preparers and auditors in the Canadian mining and oil and gas industries. The views expressed take into account comments and perspectives raised by these stakeholders, although they do not necessarily represent a common view of the Board, its Committees or staff. Views of the Board are developed only through due process.

Overall, we support the project as outlined in the Discussion Paper and, in particular, agree that the proposals address the common criticism that the absence of comprehensive IFRS guidance for extractive activities has resulted in divergence in international financial reporting of extractive activities. However, a number of significant application issues are encountered currently by entities applying IFRS 6. These issues are not within the current scope of the Extractive Activities project (e.g. risk sharing agreements, such as farm-outs), but we think it is important that these issues also be addressed.

We think that the most significant part of the discussion paper proposals is the disclosures, because they are critical to financial reporting by extractive industries. Although many jurisdictions currently have disclosure requirements, inconsistency exists in both the details of the required disclosures and whether they are presented within or outside the financial statements. Therefore, it is imperative for the IASB to work with regulators to ensure consistency between the disclosures required by the standard and those required by regulators.

We appreciate that priorities and resource constraints may limit the number of issues to be resolved by the IASB in the short-term. Therefore, while we believe that the Extractive Activities project is important and that the IASB should add it to its active agenda as soon as resources permit, we think the immediate priority for extractive activities should be to deal with the significant existing application issues. Timely guidance might best be provided by the IFRS Interpretations Committee either in an Interpretation or by adding application guidance to the relevant standards (e.g. IAS 16, IAS 31 and IAS 38). If resource constraints do not permit the IASB to deal with the entire project, we recommend that the IASB first focus on the disclosure proposals in the Discussion Paper and the remaining Discussion Paper issues could then be addressed in a subsequent project. We also stress the importance of retaining IFRS 6 until a replacement IFRS is completed.

We would be pleased to elaborate on any of our comments in more detail if you require. If so, please contact myself, Peter Martin, Director Accounting Standards at +1 416 204-3276 (e-mail peter.martin@cica.ca), or Grace Lang, Principal Accounting Standards at +1 416-204-3478 (e-mail grace.lang@cica.ca).

Yours truly,



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Appendix

Comments on the Discussion Paper, *Extractive Activities*, Dated April 2010

Question 1

In general, we (the AcSB staff) support the discussion paper proposal that the scope of an extractive activities IFRS should include only upstream activities for minerals, oil and natural gas. However, we are concerned about the use of the term “upstream activities”, which is not specifically defined in the discussion paper and whose definition can vary amongst industry practices. Consequently, some ambiguity exists as to what is included in the scope of the project. For example, at an oilsands plant (that separates bitumen from sand) and is considered to be an upstream facility, there may also be a heavy oil upgrader (that processes bitumen to heavy oil). Is upgrading heavy oil considered an upstream activity, since it’s done at an upstream facility, but yet an oil refinery (that processes oil into gasoline) is considered to be a downstream activity? We suggest that the term “upstream activities” be defined, and more clarity be provided for what is included in the scope of extractive activities for minerals, oil and natural gas.

Question 2

We agree, at a high level of analysis, that there are enough commonalities between mining and oil and gas for a single accounting and disclosure model to work. However, we are concerned that the project may not address some significant industry issues, simply because these issues are not common in both industries (e.g. farm-ins and farm-outs). We suggest that all industry specific issues be addressed by the project irrespective of whether or not they are common in both the mining and oil and gas industries.

Question 3

We agree that consistent definitions for mineral and oil and gas reserves and resources are needed since there is little consistency globally, but we are concerned that the discussion paper does not adequately address how this will be achieved. The discussion paper recommends that

the definitions established by the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) and the Petroleum Resource Management System (PRMS) are suitable to use in a future IFRS, but it does not address how to incorporate them into an IFRS, or how to address the associated problems with doing so. Also, the discussion paper does not acknowledge that CRIRSCO and PRMS, in addition to the definitions, include processes and approaches to assist in applying the definitions. Because of the subjectivity in determining quantities of reserves and resources, it is important that these processes and approaches be included with the definitions to help achieve consistent practice.

If a future IFRS does not incorporate the PRMS and CRIRSCO definitions directly into the standard itself, but instead incorporates them by reference, this will ensure that the processes and approaches included in CRIRSCO and PRMS are included with the definitions. However, this will mean that the IASB will be delegating its role to third parties, which will create due process issues. Specifically, the IASB would need to review and become satisfied with the quality of the work of those third parties on an ongoing basis, and ensure that the definitions, processes and approaches are reviewed, modified and updated over time. In certain jurisdictions accounting standards are approved as part of the law and, thus, standard setters may be unable to refer to requirements promulgated by an outside body. If a future standard does include the PRMS and CRIRSCO literature within the body of the standard itself, this will be a voluminous amount of information and the IASB will still have the issue of keeping the information up-to-date as the industry bodies revise it periodically.

The Canadian definitions for oil and gas, which use the Canadian Oil and Gas Property Expense (COGPE), are aligned with PRMS. However, Canada has a more detailed set of procedures for applying the definitions to a property and determining the quantity of reserves and resources than any other country, including the United States. Therefore, because PRMS provides less implementation guidance than COGPE does, there is likely to be more variability in reported reserve and resource quantities than currently exists in Canada. Therefore, we suggest that the IASB encourage the Society of Petroleum Engineers (SPE) to develop more detailed guidance that is similar to that in COGPE.

We are also concerned that the proposals create a potential for two sets of definitions that entities must use – one that is mandated by the securities regulators for non-financial statement disclosures and one required by the IASB. Even though the discussion paper recognizes the need for consistency with regulatory requirements, it assumes a level of cooperation that may not be possible to achieve. This will be a key challenge in developing an IFRS for extractive activities since reserve and resources definitions will be a key component of such an IFRS. However, if it is not possible to reach agreement on a common set of definitions with the key regulators, one alternative to consider is including the definitions and the related disclosure requirements as part of a “best practices document” for extractive activities. The disclosures, many of which hinge on definitions of reserves and resources, could be mandated by individual regulators for inclusion in management commentary. Companies could also choose to follow the “best practice” definitions for calculating, for example, depreciation and impairment.

Question 4

We agree that a legal right should form the basis of a mineral or oil and gas asset, but we are concerned that the determination of a legal right may not always be as straightforward as the discussion paper suggests. There may be circumstances when the existence of legal rights is uncertain. For example, in certain jurisdictions there may be a lack of a well defined process for establishing legal rights and in others, there may be a lack of clarity over who has the authority to create legal rights. In these situations, significant exploration and evaluation activities may have been undertaken before legal rights are clearly obtained and, in fact, more than a signed document may be required before a country grants what it considers a “legal right”. Therefore, more guidance concerning the meaning of “legal right” would be needed due to the uncertainty of legal rights and the legal grey areas in some jurisdictions.

Some argue that costs of exploration and evaluation should be expensed until an entity has an inferred resource because this is the earliest point when there is some degree of exploration success and the entity actually has something of value (this would be somewhat consistent with IAS 38 *Intangible Assets* and with the U.S. GAAP successful efforts approach). This approach addresses the concern that under a historical cost model, significant expenditures would be

recognized as assets even if they do not produce an economic return.

We think that asset recognition for extractive industries is an “all or nothing” situation, meaning an entity either fully capitalizes expenditures or expenses them, because any attempt at setting up parameters in the middle (e.g. by “stage” of activity) will be arbitrary. The accounting model applicable to extractive activities should recognize this fact.

Some argue that minerals or oil and gas assets are the same as other types of intangible assets (e.g. pharmaceutical research and development) because in both cases it is questionable whether the entity owns or has created or identified anything of value at the research or exploration/evaluation phase. Accordingly, some people think that the treatment of minerals or oil and gas exploration and evaluation activities should be consistent with that of research activities subject to IAS 38.

We think there are similarities between research and exploration activities but we recognize that the project team was not constrained to follow current IFRSs. Some argue that IAS 38 may not provide the most appropriate accounting for intangibles, as evidenced by the ongoing work being done on this topic (e.g. the research project of the Australian Accounting Standards Board). However, regardless of the recognition approach taken for exploration activities, it is important for the IASB to explain how the accounting for exploration activities is consistent with the accounting for intangible assets – or why it does not need to be consistent. We acknowledge that this might require the IASB to reassess the accounting for intangibles in the light of the accounting for extractive activities.

Question 5

Overall, we support the discussion paper proposals on selecting the unit of account for mineral and oil and gas properties. However, the discussion paper states that the unit of account cannot be greater “than a single area, or group of contiguous areas”. We are concerned with the “contiguous” criterion in the discussion paper since it creates a bright line differentiation that does not always work in practice. For example, many entities have properties in a small area that

are in a checkerboard pattern. These are managed together but would not meet the contiguous criterion and, thus, would inappropriately be considered separate units of account. We suggest that the contiguous criterion should be re-examined because it does not achieve its intended result.

Question 6

We agree with the discussion paper proposal to use historical cost as the measurement basis. Although it may not be relevant for predicting future cash flows from reserves and resources, it does form a useful basis for evaluating management's efficient and effective use of an entity's funds. We also think that the disadvantages of fair value outweigh its benefits. Fair value is subject to a greater degree of variability from one valuator to another because it requires many assumptions and variables, making it less precise than historical cost. Also, fair value information can quickly become outdated (e.g. the time between the financial statement date and the date the information is released to stakeholders) due to frequent commodity price swings and highly volatile markets. Finally, we think that fair value does not meet a cost/benefit test since the costs in determining fair value outweigh the decision usefulness of the information to stakeholders. The higher cost is attributable to a need for independent valuers and because the information has more variables, making it harder to audit. We are also concerned that auditors may not have the resources to audit this information and there may be a lack of independent valuers. Because both historical cost and fair value have significant shortcomings and recognition and measurement alone do not provide sufficient information to financial statement users, we think disclosures are critical.

Question 7

We agree with the discussion paper that IAS 36 *Impairment of Assets* should not be applied to exploration properties. We think that the discussion paper proposals for recognition of impairment of exploration properties are consistent with the way in which managements manage exploration activities. We do think that an impairment standard for exploration properties is needed. A "derecognition" standard would not suffice because situations exist in which an

exploration property is commercially feasible, but the carrying amount is not recoverable in full.

We are also concerned that, contrary to the assertion in the discussion paper, IAS 36 is difficult to apply to development properties, particularly in the oil and gas industry. In fact, the same concerns set out in the discussion paper about using a current value (e.g. fair value) to re-measure exploration properties still apply when trying to apply IAS 36 to development properties. Therefore, more guidance is needed to address industry-specific challenges, like those posed by applying IAS 36.

We support the proposed disclosure of management's assumptions used to determine when an exploration property is written down and the disclosure of why other exploration properties continue to be capitalized. We think that these disclosures are imperative for a future standard.

Questions 8 and 9

We agree with the discussion paper disclosure objectives for extractive activities and think that the resulting disclosures would provide financial statement users with useful information.

Financial statements may be more useful if reserve and resource information were included but we are concerned with the audit implications of the proposed reserve disclosures. In particular, anything that is contained in an IFRS financial statement, or required by an IFRS, must be audited. We are concerned that auditors may not have the resources to audit this information in the required time frame (e.g. securities regulations that require financial statements to be filed within ninety days of an entity's fiscal year-end).

We are also concerned about the possibility of creating a requirement to disclose two, perhaps conflicting, sets of disclosures because current securities regulations in some jurisdictions (e.g. the Canadian Securities Administrators and the US Securities and Exchange Commission) have mandatory extractive industries disclosure requirements.

To deal with these two issues, we suggest that the disclosure requirements proposed in the

discussion paper be included in a “best practices” document issued by the IASB, as we explained in question three above. We also think that further consideration should be given to including the proposed disclosure requirements only in management commentary guidance, which will address the concerns about the audit implications of including these disclosures in financial statements.

We have various other concerns with the proposed disclosure requirements. We think that consideration needs to be given to what disclosures are required in interim financial reports (e.g. disclosing reserve quantities) because of the amount of work and, thus, the costs involved to provide this information. We also think that the costs of the proposed sensitivity disclosures outweigh their benefits. Even though sensitivity disclosures help to explain uncertainties with various estimates (e.g. reserve estimates), they require multiple reserve calculations, which can be very complex. We recommend that “finding and development expenditures” need to be defined, as consistency on what is classified as this type of expenditure is lacking. We are concerned that mining entities may have difficulties with certain disclosures since many do not prepare annual reserve reports. The reports are very expensive to prepare and so are only produced when they are needed for management purposes. We recommend that, for the disclosure by commodity, a definition of commodity is needed to indicate the level of granularity that is expected (e.g. should heavy oil be distinguished from light oil?).

Question 10

We think that this is a public policy issue, not what has been traditionally classified as a financial reporting issue. Consequently, in our view, it should be up to the companies to decide what to report based on their investors’ needs. In fact, some companies already provide similar information in their Corporate Social Responsibility documents. Also, if the information is important enough for investors, there are other ways to require the disclosure of this information (e.g. in securities regulation). We recommend that the IASB consider this issue from a broader perspective than just extractive industries and that it be addressed by the conceptual framework project since the real issue is what the scope of information in financial statements should be.

We agree with the discussion paper statement 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.” However, we do not think that the Publish What You Pay (PWYP) proposals meet a cost/benefit test. The proposals will create additional audit fees because it would be necessary to audit some information on an individual country basis and the proposals will involve significant additional costs for companies whose systems are not set-up to capture the level of detail that the PWYP proposals require.