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From: michael williams [mailto:floreatw@bigpond.net.au]
Sent: 01 September 2004 16:28
To: Fleming Colin
Cc: Work
Subject: Extractive Industries - ED6

Colin

Please excuse the e-mail message, will follow up with letter.

From Woodside's perspective we disagreed with the original proposed special cash generating unit approach for testing E&E assets because we believe the underlying assumption that exploration was undertaken as an extension or part of a given existing segment and therefore could be treated as an overhead or corporate type asset is fundamentally flawed as exploration is often undertaken in areas that are outside existing cash generating segments (that is the whole point of exploration). The approach was an artifice that would lead to inconsistent treatment of E&E assets in a manner that users of financial statements would not be able to reasonably understand.

Our other main concern is that the whole discussion is centred on determination of a value in use valuation which as a number of commentators had stated is difficult if not impossible to establish due to there not being any one scenario with sufficient certainty on which to perform the calculation, however recoverable amount is the higher of fair value less costs to sell and value in use. The extractive industries and certainly the oil & gas industry have active business environments where E&E assets in all stages of the lifecycle, from blue-sky to discovered reserves are bought and sold. The whole industry is managed on the basis of value. There are valid, reliable methods to determine a fair value for any E&E asset. These methodologies must be acceptable for the determination of fair value for performing E&E asset recoverable amounts tests. These are typically probabilistic/risked NPV calculations which I do not see as any less valid than binomial valuation models for option or equity instruments.

Therefore it is our view that having made the proposed changes to para 13, making impairment testing necessary after failing the prima-facie specific facts and circumstances, then any extractive company with proper management systems will be able to establish a fair value for any of its E&E assets at whatever level it records such assets, in a manner consistent with its existing accounting policies (grandfathered). The level of what is an E&E asset will be inherent in the company's existing E&E accounting policy, for successful efforts companies this will be at the field level and for full cost companies this will be at a higher/broader level.

It is our view that (as per US GAAP) once a well or field goes into development/construction the Exploration & Evaluation asset that has existed up until then is transformed into an Oil & Gas Property asset and becomes part of the total asset base of the producing asset which is tested for impairment in accordance with IAS36.

Producing Oil & Gas Property assets can/should be tested at different levels depending on the facts. It is true that in some circumstances this will be able to be tested at the individual well level (onshore networked wells with individual metering and pipelines or transportation arrangements) however in other circumstances the point of cashflow identification will be (potentially much) further down stream (offshore platforms with integrated facilities in remote locations). The level at which testing is to be performed cannot be prescribed it must be left to each entity to establish the level of testing that best fits the concepts of IAS36.

Note : all measures of 'reserves' include the concept of economic recoverability and economic cutoff. A discovered resource cannot be classified as 'reserves' until economic viability can be demonstrated and then only that portion of the resource that is economically recoverable is classified as 'reserves'. Whilst this is not the same as recoverable amount tests it indicates the degree to which value is at the core of extractive industry business processes.

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