Project **Extractive Activities**

Topic **Comment letter summary**

Purpose of this paper

1. This paper summarizes responses to the Discussion Paper *Extractive Activities* (DP) that the IASB published for public comment in April 2010.

2. The purpose of the paper is only to communicate the main themes of respondents' comment letters based on the staff's preliminary analysis. No staff recommendations are made and the Board will not be asked to make any decisions.

Overview of the comment letters

3. The four-month comment period on the DP ended on 30 July 2010. The Board received 141 comment letters which are summarized below by type of respondent and geographic region.

Respondent type	Number of respondents	Percentage of respondents
Non governmental organisations	33	23%
Preparers-Oil & Gas	28	20%
National standard setter	13	9%
Preparers-Minerals	11	8%
Investors/analysts/users	10	7%
Accounting professional bodies	10	7%
Accounting firms	8	6%
Individuals	7	5%
Minerals/Oil & Gas professional bodies	6	4%
Preparer organisations	5	4%
Minerals/Oil & Gas consultants	5	4%
Preparers-related industries	3	2%
Securities regulators	2	1%
Total	**141**	

Geographic region	Number of respondents	Percentage of respondents
Europe	76	54%
North America	27	19%
Asia Pacific excluding Australia/New Zealand	13	9%
Multinational	8	6%
Australia/New Zealand	7	5%
Africa	6	4%
Middle East	2	1%
South America	2	1%
Total	**141**	**100%**

4. As expected, the DP generated significant interest from participants in the minerals and oil & gas industries. Many of the responses were from individual mining or oil & gas companies or from industry groups. Large mining or oil & gas companies were well represented in the responses. Far fewer responses considered how the project team's proposals might affect smaller companies, such as pure exploration companies or companies with a small number of properties in development or production. Unlike many other industries, small mining or oil & gas companies are more likely to be listed on securities exchanges (and therefore more likely to be publicly accountable entities that apply IFRSs) because they are usually reliant on equity finance to undertake their activities. Despite the lack of responses from this segment of the

industries, members of the project team have separately been involved in outreach activities that included representatives from smaller companies.

5. The responses received from industry were geographically diverse. Responses were received from jurisdictions that have been using IFRSs since 2005 including Europe, Australia and South Africa, jurisdictions that are adopting IFRSs for the first time in 2010 or 2011 such as Brazil and Canada, and other jurisdictions that are in the process of making a decision to adopt IFRSs in the future, including Japan, the USA and China.

6. Responses from investors and analysts were limited, and the investors that responded typically have a socially responsible investment mandate (ie in making their investment decisions, those investors typically also assess an entity's practices on matters such as environmental stewardship, consumer protection, human rights, and diversity). Although the overall response rate from users of financial statements was low, members of the project team have consulted separately with users during the research project and following publication of the DP. In addition to the users, a substantial number of other individuals and organisations that have an interest in improving financial reporting in the extractive industries also responded to the DP. This included securities regulators, accounting firms, national standard setters and accounting professional bodies.

7. Finally, respondents to the DP included a large number of individuals and organisations that have a specific interest in selected aspects of the DP. Typically, those respondents only responded to questions that are within their direct area of interest. For example, most minerals or oil & gas reserves specialists only responded to the questions on reserve definitions and disclosures and many of the supporters of the Publish What You Pay (PWYP) coalition's proposals only responded to the question on those proposals. Consequently, the questions on asset recognition and impairment elicited the fewest responses.

Paper outline

8. The invitation to comment listed 10 questions for respondents. The remainder of the paper summarises the key themes of respondents' comments on those questions as well as their overall views on the DP.

   (a) Overall views (paragraphs 9 - 11)

   (b) Responses to questions

      (i) Scope and approach (paragraphs 12 - 19)

      (ii) Definitions (paragraphs 20 - 30)

      (iii) Recognition (paragraphs 31 - 36)

      (iv) Unit of account (paragraphs 37 - 39)

      (v) Measurement (paragraphs 40 - 45)

      (vi) Impairment (paragraphs 46 - 49)

      (vii) Disclosures (paragraphs 50 - 68)

      (viii) Publish What You Pay disclosure proposals (paragraphs 69 - 81)

Overall views

9. Respondents were supportive of the Board's decision to initiate a research project on extractive activities and to publish and invite comments on that research. Although many respondents did not agree with the project team's specific proposals, they noted that the DP and comments received should assist the Board in deciding how to address the issues relating to extractive activities.

10. In summary, the main themes from the responses were as follows.

   (a) **Scope.** The Board should add a project onto its active agenda, but there were mixed views on whether that project should address extractive activities only or whether it should address extractive activities in a broader project that reconsiders intangible assets accounting.

(b) **Definitions.** Most respondents agreed with the project team's recommendation that industry-based definitions of reserves and resources should be used in a future IFRS to set disclosures and (if necessary) complement the accounting requirements. Concerns with the definitions mainly related to the approach for incorporating those definitions into a future IFRS and whether additional guidance would need to be developed by industry to ensure consistent application of those definitions.

(c) **Asset recognition and measurement.** Most respondents expressed at least some concern with the asset recognition and measurement model proposed by the project team. That concern related mainly to the project team's analysis that the information obtained from exploration and evaluation activities represents an enhancement of an entity's minerals or oil & gas property asset. However, very few respondents disagreed with the project team's conclusion that, on balance, a minerals or oil & gas property should be measured at cost rather than fair value.

(d) **Disclosures.** Respondents generally agreed with the disclosure objectives proposed by the project team, but almost all respondents expressed significant concerns about the level and granularity of disclosures specified by the project team. Concerns were also raised with whether the disclosure of reserve quantities (and other related information) should be subject to audit and whether those disclosure belong in the notes to the financial statements or in management commentary. Many respondents were also concerned that in some cases the disclosures proposed by the project team either duplicate or are inconsistent with the disclosure currently required by some market regulators (eg securities commissions and securities exchanges).

(e) **Publish What You Pay proposals**. The views of respondents were highly polarised on whether these disclosure proposals are a financial reporting issue or a corporate social responsibility reporting issue.

Views were also clearly divergent on whether the benefits to investors of an entity disclosing, on a country-by-country basis, the tax payments they make to governments would exceed the costs of preparing and auditing that information.

11. These concerns are discussed further in the paragraphs below.

Scope and approach (Questions 1 and 2)

12. The project team proposed to limit the scope of a future IFRS to upstream (ie extractive) activities for minerals, oil and natural gas. Furthermore, the project team proposed that a single accounting and disclosure model should apply to extractive activities in both the minerals industry and the oil and gas industry. The project team justified a single model by noting that:

    (a) the extractive activities process (ie the movement exploration through to evaluation, to development and then to production) and the risks and uncertainties faced by entities conducting those activities are sufficiently similar in each industry; and

    (b) there is substantial diversity in the financial reporting of information on extractive activities. The project team's research found that existing accounting and/or disclosures practices differ by industry (ie minerals or oil & gas), by jurisdiction and by entity size. Consequently, a single model could improve comparability in the financial reporting of these activities.

Views on project scope and approach

13. Although the question was not specifically asked, many respondents recommended that the Board add a project onto its active agenda that would replace IFRS 6. However, there were mixed views on the scope of such a project.

14. Broadly speaking, respondents supported either:

(a) developing a separate standard specifically for extractive activities (as proposed by the project team). Of the respondents that supported a project on extractive activities only, some commented that separate standards should be developed for minerals extractive activities and for oil & gas extractive activities because of the differences that exist in each industry; or

(b) including extractive activities in a broader project to reconsider intangible assets accounting. Of the respondents that supported a broader project, there were mixed views as to whether IFRS 6 should continue to apply until that such as standard has been issued.

15. Agenda paper 7B includes a further discussion on project scope alternatives and on respondent's views on how the Board should proceed with a future project.

Clarifying an extractive activities scope

16. Within the context of the project team's proposals, an extractive activities scope is based on:

(a) the nature of the activity – that is, it only includes accounting for exploration, evaluation, development and production phases of a mining or oil & gas operation. These phases are also known as extractive activities or upstream activities; and

(b) the nature of the resource – that is, it only includes non-regenerative resources that are either minerals, oil or natural gas.

17. Some respondents indicated that 'upstream' activities would need to be clearly defined because entities with vertically integrated operations may find it difficult to distinguish between upstream and downstream activities. A few suggest that midstream activities (such as pipelines and LNG liquefaction plants) where the assets are operationally and economically integrated with the oil or gas field development should be included in scope.

18. The scope proposed by the project team would represent a change from IFRS 6 *Exploration for and Evaluation of Mineral Resources*, which includes mineral, oil, natural gas and similar non-regenerative resources within its scope.[1] The project team was unsure what these similar non-regenerative resources might include and respondents did not identify any other types of non-regenerative resources that should be included in the scope of this project.

19. A few respondents suggested that an extractive activities scope should be modified to:

    (a) include the exploration for and extraction of regenerative resources that are subject to risks and uncertainties similar to those faced in mining and oil & gas extractive activities (eg geothermal energy resources and other renewable energy resources, water resources from underground springs); and

    (b) specifically exclude the extraction of non-regenerative resources that are subject to risks similar to manufacturing operations (eg quarrying activities relating to gravel and aggregates, the extraction of minerals from seawater).

Definitions (Question 3)

20. Information about an entity's mining or oil & gas assets is central to assessments of that entity's financial position and financial performance. That information includes estimates of the quantities of minerals or oil & gas that the entity expects to extract from its assets. Entities typically report those estimates as reserves or resources. The basic concepts of a 'reserve' and a 'resource' are explained in Appendix A.

[1] Reference to 'similar non-regenerative resources' is also included in the scope exclusions in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

21. There are a variety of different definitions of reserves and resources in use across the minerals and oil & gas industries, sometimes with different definitions used for different purposes (eg for disclosure to capital markets, for reporting to internal management, and for reporting to government authorities for national resource management purposes). From a financial reporting perspective, definitions of reserves and resources are important for setting disclosure requirements and they may also be useful for specifying various accounting requirements, such as calculating depreciation of minerals or oil & gas assets and supporting a determination of the life of a mine or an oil & gas field.

22. The project team proposed that the definitions of reserves and resources that should be used in a future IFRS are:

    (a) the mineral reserve and resource definitions established by the Committee for Mineral Reserves International Reporting Standards (the CRIRSCO Template). The DP notes that the CRIRSCO Template forms the basis of market regulator disclosure requirements in most jurisdictions that have formalised mineral reserve and/or resource disclosure requirements (excluding the USA).

    (b) the oil and gas reserve and resource definitions in the *Petroleum Resource Management System* (PRMS), as established by the Society of Petroleum Engineers Oil and Gas Reserves Committee (SPE OGRC) in conjunction with other industry bodies. The DP noted that the PRMS is used by many oil & gas entities for internal resource management and it also corresponds closely to market regulator disclosure requirements in most jurisdictions that have formalised oil and gas reserve and/or resource disclosure requirements (including Canada and the USA).

23. Most respondents supported the use of these definitions for the reasons mentioned in the DP—that is, they have a wide acceptance within the industry and they are broad and comprehensive classification systems. In addition, a

joint CRIRSCO-SPE working group confirmed that broad equivalence exists between these two sets of industry definitions,[2] and therefore it should provide a basis for building a single financial reporting model across the minerals and oil & gas industries.

24. The main concerns identified with those definitions were:

    (a) how those definitions would be incorporated into an IFRS;

    (b) whether application guidance is needed supplementing the PRMS to ensure that it is consistently applied; and

    (c) the economic assumptions that should be used in preparing reserve estimates. This issue is discussed in paragraph x (on disclosure).

Incorporating definitions into an IFRS

25. The following table summarises respondents' views on approaches for incorporating those definitions into a future IFRS.[3]

How to include definitions into an IFRS	**Concerns identified by respondents**
Include an ambulatory reference to those definitions. For example, the IFRS might say "a reserve is a mineral reserve as defined by the CRIRSCO Template (as amended from time to time) or a reserve as defined by the PRMS (as amended from time to time)".	• Some jurisdictions that incorporate IFRS into company law and those laws prohibit ambulatory references being made to other pronouncements. • By inserting an ambulatory reference to these definitions, the requirements of the IFRS could theoretically change when the CRIRSCO Template or the PRMS is updated even though the Board may not have conducted any due process. • It is inappropriate for the Board to delegate some of its standard-setting authority to

[2] This study was undertaken in 2006-07 at the Board's request. The results of the study were discussed with the Board in March 2008.

[3] A respondent noted that a similar arise might arise in the future if the Board wished to cross reference pronouncements issued by the International Valuation Standards Board.

	third parties. • Respondents queried whether the due processes followed by CRIRSCO and the SPE OGRC are sufficiently robust, independent and transparent.
Include a static reference to those definitions For instance, by specifying that a reserve is defined in accordance with a specific version of the CRIRSCO Template or PRMS that has been published (eg the 2007 version of the PRMS).	• Changes to the CRIRSCO Template and the PRMS would require the Board to initiate a separate project (and undertake its own due process) so that the definitions in the IFRS and those used by industry remain the same. (Staff note: The CRIRSCO Template and PRMS are only intended to be updated once every several years.) • Different reserves estimates might need to be prepared by entities if the CRIRSCO Template and PRMS definitions were updated but the Board did not update the corresponding definitions in the IFRS.
Include specific versions of the CRIRSCO Template and the PRMS as appendices to the IFRS	• Same concerns as for static referencing • The CRIRSCO Template and the PRMS are lengthy documents that contain too much detail for appendices to an IFRS.

26. In response to those concerns, some respondents suggested that the Board should define the main principles of a reserve and a resource in the IFRS and let entities use their judgement to determine which industry definitions are consistent with those main principles. They suggest that the entity should explain in the notes to the financial statements which definitions they have used.

27. Another respondent suggested that the IFRS should refer instead to the *United Nations Framework Classification System for Fossil Energy and Mineral Resources* (UNFC). That respondent explained:

> It is noted that a number of the submissions have expressed concerns over the use of "third party" reserve/resource definitions… As a consequence of the concerns, there is support for the IASB to develop its own principles-based definitions. This would be

> unnecessary, as the same objective was precisely the basis for developing the definitions now found in UNFC-2009. The UNFC-2009 definitions are generic (not commodity- or industry-specific), are written in plain (non-technical language) and are consistent with both the CRIRSCO Template and PRMS. Consequently, these definitions could be directly incorporated into an IFRS should it be decided that internal ("hard-wired") definitions were preferable to providing a reference to one or more external systems. (CL#87)

Need for application guidance

28. Some respondents commented that application guidance would need to be provided to ensure that the PRMS is applied consistently. Some respondents suggested that this guidance should be based on the comprehensive guidance contained in the Canadian Oil and Gas Evaluation Handbook. The SPE OGRC is currently developing application guidance to accompany the PRMS.

29. Other respondents suggested that IFRS should instead adopt the US SEC's oil & gas reserve definitions that were revised in 2008. Those definitions are based on the PRMS but contain specific requirements that are intended to ensure greater consistency in the preparation and disclosure of reserve estimates.

30. In the minerals industry, the CRIRSCO Template includes a requirement that reserves and resources estimates prepared for public disclosure purposes must be prepared by a competent person. A competent person must have reserve estimation experience and expertise that is relevant for the estimate being prepared as well as be a member of relevant professional body that has enforceable rules of conduct. The competent person concept is currently used in many mining jurisdictions as part of the system for disclosing reserve estimates to the capital markets. Responses received on the DP also indicated support for using the competent person concept as part of international financial reporting.

Recognition (Question 4)

31. The project team proposed in the DP 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 would be recognised when the legal rights are acquired. Subsequent to the acquisition of those rights, the property would be enhanced by:

(a) information obtained from subsequent exploration and evaluation activities (eg information that will assist the entity in making assessments on the presence of minerals or oil & gas, the extent and characteristics of the deposit and the economics of their extraction);

(b) development works undertaken to gain access the minerals or oil &gas deposit; and

(c) any additional rights and approvals that are required before the entity is legally entitled to extract the minerals or oil & gas.

32. Less than two thirds of the respondents responded on this issue for the reasons outlined in paragraph 7. Of those that responded:

(a) most agreed with the proposal to recognise an asset when the legal right are acquired; and

(b) a significant majority disagreed with the project team's view that the subsequent exploration and evaluation activities undertaken would always represent an enhancement of the property (at least at the time that information is obtained).

33. Many of those respondents suggested that the project team's analysis of the treatment of those exploration and evaluation activities was inconsistent with the asset recognition criteria in the *Framework* because the information obtained may not have any probable future economic benefit. As one respondent explained:

> …we think it is worth noting that exploration activity generally has a success-rate significantly below 50%. I.e. the probability criterion is clearly not satisfied at the individual asset level. An often used rule of thumb for oil & gas exploration drilling (assuming the activity is not very close to existing known reservoirs), for example, is a success rate of 20%. Using the project team's suggested recognition model under this assumption (without going into the impairment criteria) and further e.g. assume an average evaluation

> period of 18 months, the result would be that 80% of the exploration expenditures would be recognized as expenses 18 months later than they occurred. We do not believe this model would give more useful information to the users than e.g. a model under which all exploration expenditures are recognised as expenses when incurred. (CL#82)

34. Respondents urged the Board to further consider asset recognition. Respondents made the following suggestions for alternative approaches for accounting for extractive activities:

    (a) to recognise a minerals or oil & gas property asset on the same basis as other assets, such as in accordance with IAS 38 and IAS 16. (Respondents that supported this approach to asset recognition typically also recommend that the scope of a future project should extend beyond extractive activities);

    (b) to use the reserve and resource classifications to identify the appropriate point to initially recognise the asset; or

    (c) to use existing accounting methods that are commonly used and understood within the industries. Those methods include the successful efforts method and the full cost method, which are historical cost accounting methods that determine whether a cost is capitalized or expensed based on the phase of operation (eg exploration or development) and the activity being undertaken.

35. In addition, some respondents—particularly some large oil & gas companies that have long-standing accounting policies that are consistent with US GAAP—indicated that the DP does not adequately make the case for changing existing accounting policies that are being consistently applied and that are well understood by user of financial statements.

36. One respondent had a different perspective on asset recognition for extractive activities. That respondent stated:

> 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. (CL#120)

Unit of account (Question 5)

37. The project team's view was that the unit of account for minerals and oil & gas properties has two attributes:

    (a) a geographical boundary. 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 (eg a mine or field).

    (b) a grouping of individual assets that are integral to and physically and commercially inseparable from other assets within the unit of account.

38. About two thirds of the respondents provided comments on this issue. Of those that responded, a majority of the respondents generally agreed with the proposal. However, many respondents indicated that additional guidance would need to be developed in order for the project team's proposal to be capable of being applied in practice. For instance, additional guidance was requested on determining the allocation of costs between separate units of account and on identifying the unit of account. Some respondents also suggested that an entity should be permitted to treat a group of properties that are near each other but are not contiguous as a single unit of account if those properties are managed as a single operation.

39. A few respondents encouraged the Board to continue work on unit of account as part of its conceptual framework and they suggested that this work might inform the identification of the appropriate unit of account for minerals or oil & gas properties.

Measurement (Question 6)

40. The topic of measurement of a minerals or oil & gas property has been a controversial topic throughout the research project. The research considered fair value (or another form of current value) and historical cost as potential measurement bases for those assets. Prior to reaching a view, the project team completed an extensive survey of sell-side and buy-side analysts, lenders and analysts from credit rating agencies, and venture capitalists to obtain their views on the design of a future accounting and disclosure model for extractive activities, with particular attention placed on asset measurement.

41. The research did not find substantive support for measuring minerals or oil & gas properties at fair value or at historical cost.

    (a) Users indicated that the historical cost of those assets would provide limited useful information and that information would typically only be used to assess the stewardship of management. To be useful for that purpose, the capital that the entity has invested in extractive activities would need to be included in the carrying amount of the corresponding assets. Consequently, a historical cost measure would have limited usefulness for that purpose if, for instance, an entity's accounting policy is to recognise some (or all) of its exploration and evaluation costs as expenses when incurred.

    (b) Users indicated that they would only make limited use of an estimate of the fair value (or any other current value) of those assets. Those users expressed concerns that an entity-prepared fair value measurement of those assets would not be representationally faithful because of the subjectivity and degree of estimation involved in preparing those estimates.

42. Based on those findings, the project team recommended that, on cost-benefit grounds, an entity's minerals or oil and gas properties should be measured at historical cost. To compensate for the apparent lack of useful information provided by asset measurement, the project team also recommended that an

entity should provide detailed disclosure about those assets to enhance the relevance of the financial statements. The project team's disclosure proposals are discussed further in paragraphs 50 - 68 below.

43. Almost all respondents agreed with the proposal to measure the assets at historical cost because it is a measure that is verifiable, can be prepared in a timely manner, and it can be used to assess financial performance and stewardship. Those respondents explained that they did not support a fair value approach because it would introduce excessive subjectivity and short-term volatility to the financial statements and it would impose significant preparation and audit costs which are not justified because users are not interested in that information. For example:

> We do not believe a fair value measurement model would be practical or cost-beneficial due to the following reasons:
>
> - Fair value information is not readily available;
> - Oil and gas properties include a number of unproved properties and properties with contingent resources, for which estimating fair value would be a very complex and costly process and the resulting fair value estimate would be very subjective;
> - Given the number of unproved properties, reserve pools and production facilities in the Canadian oil and gas industry and the lack of qualified independent valuators, establishing fair values for all these assets at a point in time for quarterly or year-end reporting and auditing purposes is near, if not totally, impossible;
> - In the absence of independent valuations, use of valuations determined by management would become a significant audit verification issue;
> - Many users would not place much reliance on company specific models and would use their own models to determine the estimated "fair value" of a company's reserves;
> - Disclosure of the calculated fair value information may no longer be relevant by the time it is actually released publicly;
> - The oil and gas industry is particularly susceptible to wide fluctuations in commodity prices due to the significant amount of natural gas, heavy oil and bitumen produced, all of which are subject to seasonal commodity price swings. Impairment write-

> downs and subsequent recoveries would be common given even modest changes in oil and gas commodity prices.
>
> - Such volatility in fair values would negatively affect the comparability of oil and gas entities and reduce clarity and usefulness of the financial and reserves information to the users;
>
> - Many different market participant assumptions will be used in determining and assigning fair value by individual companies. This would impair comparability across companies; and
>
> - Disclosure of fair value information may require company sensitive information to be included. (CL#36)

44. Very limited support was expressed for measuring minerals or oil & gas properties at fair value (or any other current value). A respondent explained that valuation guidance such as International Valuation Standards and industry-specific valuation guidance for mineral assets could be used to promote consistent preparation of those valuations. Another respondent was concerned that insufficient research was undertaken on asset measurement alternatives and that the user survey was biased towards sophisticated users that have the necessary time, expertise and information to make their own estimates of value. That respondent suggested that measuring those assets at fair value should benefit to other users that do not have the ability to conduct the same degree of analysis as the sophisticated users.

45. Several respondents also remarked that the main criticism of historical cost measures, which is that there may be little or no relationship between the costs of the activity and the future cash flows generated, is not unique to the extractive industries. Consequently, they suggested that those criticisms should not be addressed for individual topics at this time. A typical comment was:

> …we believe the IASB should consider the appropriate measurement basis for financial reporting generally as part of their deliberations on the Framework. Until such time that a current value/fair value measurement basis is determined to be the appropriate measurement basis for financial reporting generally, we do not believe it would be appropriate to impose such a measurement model on entities engaged in extractive activities. (CL#111)

Impairment (Question 7)

46. The project team proposed that IAS 36 *Impairment of Assets* should not apply to properties in the exploration and evaluation phase. The research concluded that it is not possible to make any (reliable) judgements that the carrying amount of an exploration property (ie the cost of the exploration rights and any subsequent exploration and evaluation activities) would be less than its recoverable amount until sufficient information is available to evaluate the exploration results and determine whether economically recoverable quantities of minerals or oil & gas have been found. Therefore, the project team proposed an alternative impairment approach, whereby management would:

    (a) write down the exploration property only when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable in full; and

    (b) apply a separate set of indicators to assess whether its exploration properties can continue to be recognised as assets.

47. Of those respondents that respond to this question, most opposed the project team's proposal for the following reasons:

    (a) it would create an exception to IAS 36 (although a similar exemption exists currently in IFRS 6);

    (b) it could overstate the exploration property in the statement of financial position and therefore also delay the recognition of an impairment loss;

    (c) there would be too much reliance on management judgement to identify when the carrying amount of the asset will not be recoverable in full. That could adversely affect comparability of financial statements.

48. Some respondents acknowledged the difficulty in applying IAS 36 approach to assets such as exploration properties because the specified indicators of impairment cannot be easily applied to them and there is often limited information available to reliably estimate their recoverable amount. Some of those respondents suggested that the Board review IAS 36 so that the standard

can be applied to those assets. Others indicated that the Board should adopt a derecognition approach rather than an impairment approach for these assets.

49. More generally, some respondents remarked that the fact that the IAS 36 impairment test approach is not considered to work for these assets may imply that the project team has proposed the wrong asset recognition approach.

Disclosures (Questions 8 and 9)

50. The DP invited comment on the project team's proposed disclosure objectives and on the types of disclosures the project team proposed should be provided to meet those objectives.

Disclosure objectives

51. The project team proposed that the disclosure objectives for extractive activities should be to enable users of financial reports to evaluate:

    (a) the value attributable to an entity's minerals or oil and gas properties;

    (b) the contribution of those assets to current period financial performance; and

    (c) the nature and extent of risks and uncertainties associated with those assets.

General concerns

52. Most respondents supported those disclosure objectives. However, many respondents expressed the following general concerns with the disclosure proposals:

    (a) the amount of disclosure proposed is excessive and would be costly to prepare;

    (b) some of the proposed disclosures appear to be responding to the wants rather than needs of users;

(c) the proposed disclosures would represent a significant change in disclosure practices for oil & gas entities that have only recently updated their reserve reporting systems and processes to comply with the US SEC's disclosure requirements that were revised in 2008;

(d) some of the proposed disclosures either duplicate or are inconsistent with existing disclosure requirements in capital market regulations. Because of this risk, respondents urged the Board to work with regulators and the FASB in developing the disclosure requirements for an IFRS.[4]

Location of the disclosures and audit implications

53. Respondents also commented on whether the disclosure of reserve information should be included in the notes to the financial statements or in management commentary. The issue is relevant because the securities laws and regulations in most jurisdictions require an audit opinion on the financial statements and notes. In the DP, the project team proposed that, consistent with existing practices, the disclosures could be presented elsewhere in information published with the financial statements rather than in the notes to the financial statements. This is because many minerals and oil & gas entities and industry consultants advised that auditing reserve disclosures would impose a significant cost, be time intensive and would divert geological and engineering expertise away from business functions and towards compliance functions. Furthermore, most users consulted by the project team agreed that the costs of auditing reserves disclosure would outweigh the benefits they would obtain from that assurance process.

54. Respondents to the DP agreed with the project team's proposal to locate the disclosures outside the notes to the financial statements. However, a respondent commented that a change in location of the disclosures specified by a future

[4] ASC Topic 932 includes specific disclosure requirements for oil & gas entities.

IFRS may not necessarily mean that those disclosures would not be required to be audited. The respondent said:

> The IASB should be mindful of the interaction of national law and IFRS. Information required to be included in the financial statements by an IFRS may well come automatically into the scope of the audit opinion on the financial statements, whether or not this was the Board's intention. (CL#65)

55. As an alternative to specifying disclosure requirements in a future IFRS, some respondents suggested that the Board should publish its views on disclosures in a 'best practice' guide that would form part of the Board's forthcoming management commentary IFRS Practice Statement.

Specific disclosure proposals

56. The project team proposed that the following types of information should be disclosed:

(a) quantities of proved reserves and proved plus probable reserves, with the disclosure of reserve quantities presented separately by commodity and by material geographical areas;

(b) the main assumptions used in estimating reserve quantities, and a sensitivity analysis;

(c) a reconciliation of changes in the estimate of reserve quantities from year to year;

(d) a current value measurement that corresponds to reserve quantities disclosed with a reconciliation of changes in the current value measurement from year to year;

(e) separate identification of production revenues by commodity; and

(f) 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).

57. The following paragraphs discuss respondents' views on the specific disclosures proposed.

Quantities of reserves

58. The project team proposed that entities should disclose proved reserves and, separately, the sum of proved and probable reserves so that users are provided with both a high confidence estimate and a best estimate of the quantity of minerals or oil & gas that the entity expects to be able to economically extract. The project team also suggested that entities might wish to disclose information on their resources estimates.

59. Many respondents, including mining entities and users, supported the disclosure of proved and probable reserve quantities.

60. However, the views from respondents from the oil & gas industry varied. Some respondents supported the project team's proposals. Other respondents, typically entities that are among the largest oil & gas entities in the world, did not support the mandatory disclosure of probable reserves.[5] As one such respondent explained:

> Mandatory reserve quantity disclosures should be limited to proved reserves. The disclosure of probable reserves should be optional given the inherent increase in uncertainty associated with probable reserves, the significant added cost for companies to develop high quality and consistent estimates, the diversity of practice in the determination of probable reserves, and the differences in how those reserves are used by companies in making future investment decisions. (CL#32)

61. The DP noted that not all reserve quantities are the same and that the future cash flows and the related risks and uncertainties that are attributable to a specific reserves estimate depend on the type of commodity and the location (in terms of

[5] Many of those respondents have public listings in the USA and therefore they are required to disclose the oil & gas reserve information prescribed by the US SEC and the FASB. Those requirements specify an entity must disclose proved reserve quantities and permit (but not require) an entity to also disclose probable reserve quantities.

its geological, geographical and geopolitical characteristics). Accordingly, disaggregated disclosure is needed to identify the reserves quantities that are subject to different risks and uncertainties. The project team proposed that reserve quantities should be disclosed separately by:

(a) commodity; and

(b) location, such as by project where individually material or by country or other regional grouping.

62. Respondents agreed with disclosing reserve quantities on a disaggregated basis although there were different views on the level of geographical disaggregation that is appropriate. Some respondents suggested that a future standard should not be too prescriptive in defining the level of aggregation for reserves disclosures. Instead, they suggested including a principle to indicate that reserve quantities should be disclosed at the level of detail that is sufficient to understand an entity's operations.

63. In late 2008, the US SEC revised its oil & gas reserve definition and disclosure rules. Among other things, the revised rules require more detailed geographical disclosure of reserve quantities (although potentially less detailed than the project team proposes) and permit the voluntary disclosure of probable reserve quantities. Thus, in addition to the feedback received in response to this DP, the disclosure practices that emerge from these revised requirements could also inform the Board in any future deliberations on reserve disclosures.

Main assumptions

64. The majority of respondents agreed that information on the main assumptions used in estimating reserves quantities should be disclosed. The main concern identified in response to the disclosure of the commodity price that is used to estimate reserves. The project team proposed that reserve estimates should be prepared using a market participant's assumption of the commodity price. That approach would seem to be consistent with the Board's fair value measurement hierarchy. However, many industry respondents as well as almost all users

consulted during the research project expressed a strong preference for using a historical price assumption (eg a 12 month or 3 year historical average price). Although a reserves estimate prepared using a forecast commodity should produce a more representatively faithful estimate of the economically recoverable quantities of minerals or oil & gas, the arguments for using a historical price include:

(a) a historical price can be determined objectively and thus that component of the reserves estimate can be prepared consistently between entities; and

(b) an entity might be disclosing commercially sensitive information if it discloses a forecast price assumption that resembles its own price assumption (ie similar to a Level 3 input).

65. Most respondents disagreed with the project team's proposal to supplement the reserves quantity disclosure with a sensitivity analysis. They considered that the sensitivity analysis would have limited practical benefit and would be excessively costly to prepare. For example:

> The determination of reserves (and resources) information is a complex process involving numerous variables, assumptions and processes. In practice, determining reserves is very dependent on long-term prices for the contained commodity as it determines the 'cut off' between economic and uneconomic resources. The calculation process can therefore be extremely laborious and in some sectors it can take many months to reflect new variables, particularly long term commodity prices. Furthermore, the outcomes from further exploration cannot be determined in advance even though it has a direct impact on reported reserves.
>
> Because of these factors, we believe the sensitivity analysis disclosure cannot be justified due to cost-benefit concerns and also because the information may not be useful or relevant to the users of the financial statements because of the uncertainties involved. We therefore recommend that the Board relies on the existing disclosure requirements relating to significant judgements and sources of estimation of uncertainty already contained in IAS 1 Presentation of Financial Statements. (CL#90)

Reconciliation of changes in reserve quantities

66. There was significant support for entities to disclose a reconciliation of the changed in their reserve quantity estimates from the previous year to the current year. A user representative remarked on the importance of a reconciliation separately showing the effects of changes and changes in facts. That respondent provided an example of a tabular reconciliation format that could be used to communicate that information.

Current value measurement disclosures

67. Almost all respondents disagreed with disclosing information about fair value or another type of current measurement of an entity's minerals or oil & gas properties. Many suggested that the reasons against measuring those properties at fair value in the statement of financial position also apply to the disclosure of such measurements. The following comment from a user identified some of the challenges with such a measurement:

> …we have serious reservations about the practical feasibility and use of such disclosures. Given the complexity of interrelationship between commodities that naturally co-exist (co- and by-products), commodity prices, costs, taxation, exchange rates, discount rates, production rates, stripping ratios, grade decay and restitution costs, the usefulness of any disclosure with regard to value (as opposed to the revenues and costs in any particular historic reporting period) will be limited unless all of the underlying assumptions are also disclosed. Yet we would not regard it as reasonable to expect a company to disclose these assumptions in a formal public document, as they are commercially sensitive. This is true for all companies, whether large or small. (CL#139)

Disclosure of production revenues and exploration, development and production cash flows

68. Many respondents expressed general support for the disclosure of information about revenues and costs, although views differed on the level of detail that should be provided (eg geographic breakdowns). In addition, some suggested that the Board would need to consider:

(a) defining the costs that should be included in each category;

(b) whether the costs should be presented as cash flow information or as accrual information; and

(c) whether these disclosures should include (or be limited to) performance measures such as unit prices and unit production costs.

Publish What You Pay disclosures (Question 10)

69. The DP devotes a chapter to considering the disclosure proposals of the Publish What You Pay (PWYP) coalition of non-governmental organizations. The PWYP coalition seeks to improve the accountability of governments of resource-rich developing countries for the management of revenues received from mining or oil & gas entities. To achieve its objective, the PWYP coalition proposes that entities undertaking extractive activities should be required to disclose in their financial reports the following information on a country-by-country basis:

(a) the payments made to governments (which could be in cash or in kind); and

(b) other information, including reserve quantities, production quantities and production revenues and costs incurred in development and production.[6]

70. The project team analysed the proposals from the perspective of whether, and to what extent, capital providers (as the primary users of financial reports) need this information in order to gain an adequate understanding of the future cash flows, and the risks to those cash flows, that may be generated by a mining or oil & gas entity. The project team did not reach a view on whether payments to governments should be disclosed on a country-by-country basis. Instead, the DP

[6] The disclosure proposals relating to the other information are mostly addressed by the project team's disclosure proposals that were discussed earlier in this paper. For the purposes of the comment letter summary, this paper will focus on the proposal for entities to disclose the payments they make to governments.

invited comment on the cost/benefit implications of the proposals. In addition, two roundtables were held during the comment period (in June 2010) to discuss the benefits and costs of the proposals. Those roundtables, which were co-sponsored by the IASB and Revenue Watch Institute, were held in New York City and London in June 2010 and included participants from mining and oil & gas companies, investors and analysts, auditors, an accounting professional body, as well as from the IASB and the PWYP coalition.

71. The main comments on the PYWP proposals relate to:

    (a) the scope of financial reporting; and

    (b) cost/benefit considerations.

Scope of financial reporting

72. The comment letters indicated that there was general support for the objectives of PWYP. However, except for the non-governmental organizations (NGOs) and the investment funds, the PWYP disclosure proposals were not considered to be within the scope of financial reporting because:

    (a) the primary users of that information will be NGOs and other special interest groups; and

    (b) meeting their information needs is a public policy matter rather than a financial reporting matter.

73. Many of those respondents regarded the disclosures to be within the scope of corporate social responsibility (CSR) reporting. Some respondents said that they currently disclose the payments they make to governments in their CSR reports.

74. In contrast, the supporters of the PWYP disclosure proposals noted that CSR reports do not have the same status as financial reports. Furthermore, they expressed concerns that the project team's assessment of the proposals was too narrow because it only considered the benefits to investors and lenders and did not also consider the substantial benefits that may be realised from improved

governance and accountability in resource-rich developing countries. The PWYP supporters argued that these benefits should also be considered by the Board because the objectives of the IFRS Foundation, as specified in its Constitution, include:

(a) developing accounting standards in the public interest,[7] which in their view would be consistent with the objectives of PWYP; and

(b) helping other users (ie users other than participants in the world's capital markets) make economic decisions.

75. The staff notes that the IASB's objective to develop financial reporting standards 'in the public interest' is part of a broader requirement 'to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions'. In *The Conceptual Framework for Financial Reporting* (2010), the Board clarified that the objective of financial reporting is directed towards meeting the needs of investors and lenders and that information that meets their needs may also be useful to other users. Consequently, assessing the PWYP proposals from the perspective of the benefits they provide to other users would appear to go beyond that objective

Cost/benefit considerations

76. Commentators identified the following benefits to investors and lenders of the disclosure of payments made to governments:[8]

[7] Paragraph 2 (a) of the Constitution states that the objectives of the IFRS Foundation are "to develop in the public interest, single set of high quality , understandable, enforceable and globally accepted financial reporting standards based upon the clearly articulated principle".

[8] One respondent, an investor (CL#70), also conducted their own user survey and included the results of their survey in their comment letter.

(a) An entity's payments to government may be used to model and benchmark that entity's relative exposure to country-specific risks, including:

   (i) political risks such as production disruptions due to conflict, the expropriation of assets or changes in the tax or royalty regime; and

   (ii) reputational risks, particularly if an entity's operations are located in countries that rely heavily on extractive revenues and there is a concern about whether the entity is 'paying a fair share' in return for extracting the minerals or oil & gas.

(b) Information on the size and timing of payments, such as signature bonuses, may provide insight into whether and how these payments will influence development costs or operating cash flow.

(c) Investment risk and reputational risk assessments are more critical to entities that have assets and operations that either are concentrated in a small number of countries or are located in countries that rely heavily on extractive revenues

77. In addition, some respondents explained that a requirement for entities to disclose payments to governments would have wider benefits for investors and lenders. For example, the aggregate amount of payments made to a government by various entities could be used to make assessments of systemic risks of investing and operating in those countries. For instance, as one respondent stated:

> Investors generally also have a strong indirect interest in the general availability of such information to other stakeholders. Such transparency helps provide reassurance that the business climate in which extractive industries operate in a given country is not overly unattractive and reduces political and other related risks by discouraging illicit activity, limiting popular distrust and resentment related to extractive-related wealth, and ultimately curbing the risk of extractive contrast rescissions, corruption and violent conflict. (CL#134)

78. Respondents from industry commented that many entities currently disclose qualitative information in management commentary and other reports that can be used to make assessments of material investment and reputational risks. They queried whether the benefits of disclosing payment information would exceed the costs of its preparation. Some of the specific concerns raised by those respondents included:

    (a) Existing accounting systems may not be able to readily capture all of the payments made by the entity to governments. This is because:

        (i) Payments to governments can include many forms of taxes and charges. For example, the taxes and charges may be levied separately (eg corporate taxes and royalties) or included in the cost of goods and services (eg value added taxes and customs duties). Some may be recurring taxes and charges and others may only be incurred once (eg a signature bonus). Other taxes may be paid on the entities behalf. For example, in some joint ventures, the operator pays tax to the government on behalf of all joint venture partners.

        (ii) A payment to a government could include tax authorities and government agencies as well as government owned businesses. Particularly for government owned business, an entity may be unsure whether a payment it made was to a business that was government owned or whether the payment would be regarded as a reciprocal or non-reciprocal transaction.

    (b) The proposal to disclose payments made to governments on a country-by-country basis would result in the disclosure of excessively detailed information that may not be material to the entity (in terms of size or nature). Preparing and auditing this information would be costly, time consuming, and would therefore slow down the entire reporting process.

(c) The disclosure of disaggregated payment information could expose entities to the release of commercially sensitive date, which ultimately would be to the detriment of investors

79. Some respondents indicated that they currently voluntarily disclosure tax payments on a country-by-country basis in CSR reports. They distinguished their CSR reporting from the PWYP proposals on the basis that the information they disclose is not subject to audit or required to be prepared and released to the public at the same time as the entity's annual financial statements. Furthermore, the entity identifies which payments to governments are included in the disclosure. As a consequence, the preparation and audit costs of this disclosure in a CSR report are less significant.

80. Several respondents also suggested that, if the Board considers this information to be within the scope of financial reporting, the PWYP disclosure proposals should apply to all industries because many of the same investment and reputational risks apply to industries other than minerals and oil & gas. Those respondents suggested that, if such a decision were made, the PYWP disclosure should be considered as a part of a separate project on disclosures.

Recent developments

81. Subsequent to publication of the DP, the *Dodd Frank Wall Street Reform and Consumer Protection Act* in the USA was enacted and, among many other things, the Act will require mining and oil & gas entities that are regulated by the US SEC to publicly disclose, on a country-by-country basis, the payments they make to governments. As directed by the Act, the SEC is currently drafting the rule to give effect to that requirement. Accordingly, in addition to the feedback received in response to this DP and the roundtables, the experiences that users and preparers will have with this forthcoming reporting requirement will help to inform the Board on any future deliberations on the PWYP disclosure proposals.

Appendix A

Reserves and resources

A1. Broadly speaking, the underlying purpose of reserve and resource definitions is to communicate information about the quantity of minerals or oil and gas that is estimated to exist in a deposit and may be recoverable.[9]

A2. The basic concepts of a 'reserve' and a 'resource' are as follows:

(a) Reserves generally refer to the quantity of minerals or oil and gas that is estimated to be economically recoverable from the earth. In other words, reserve quantities are an estimate of the aggregate future production of minerals or oil and gas.

(b) Resources generally refer to the quantity of minerals or oil and gas that has been discovered but is not yet capable of being classified as a reserve. This may be because:

(i) insufficient drilling, analysis and planning have been undertaken to indicate whether the minerals or oil and gas may be economically recoverable;

(ii) the minerals or oil and gas are not expected to be economically recoverable under current economic conditions, but there are reasonable prospects for such economic conditions to change and thereby allow for eventual economic extraction; or

(iii) development and production of the minerals or oil and gas deposit are contingent on other factors that may prevent timely

[9] In the minerals industry, reserves and resources are usually quantified in terms of tonnages. In the oil and gas industry, reserves and resources are usually expressed in terms of volumes and quantified as barrels of oil or cubic feet of gas.

development of the property, such as the need to develop a market for the production or to respond to environmental concerns.

(c) Reserves and resources are generally classified into subcategories according to the level of confidence associated with the estimate of the reserve or resource quantities.