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Project	<b>Extractive Activities</b>
Topic	<b>Project scoping alternatives identified by respondents</b>

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## Purpose

1. In 2011, the Board will be asked to make decisions on the composition of its future agenda of standard-setting projects. A project addressing extractive activities in the mining and oil & gas industries is a potential candidate to be included on that agenda. As noted in agenda paper 7A, comments received in response to the Discussion Paper *Extractive Activities* (DP) indicate there are different views on the scope of such a project. The purpose of this paper is to outline various alternatives that respondents identified for defining the scope of a future project on extractive activities.
2. No decisions will be made at this meeting. Furthermore, the paper does not provide a staff (or a project team) recommendation for defining the scope of the project. Any future decision to add a project to the Board's agenda will follow the public consultation on the agenda and consideration of a detailed project proposal.

## Structure of this paper

3. This paper is structured as follows:
  - (a) Background on the scope of the research project
  - (b) Views on the scope proposed in the Discussion Paper
  - (c) Project scope alternatives
  - (d) Specific application problems with IFRSs

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This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in *IASB Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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- (e) Project priorities

**Background on the scope of the research project**

- 4. The scope of the extractive activities research project was defined by its objective, which was:
  - (a) to analyse the unique financial reporting issues applicable to extractive activities in the mining and oil & gas industries; and
  - (b) to identify a basis on which a financial reporting model might be developed to address them.
- 5. The project objective emphasised that the research should only consider financial reporting issues that can be regarded as *unique* to extractive activities. The purpose of specifying the project's scope in those terms was to clarify that the scope would not extend to developing industry-specific solutions to financial reporting issues that also exist in other industries.

**Views on the scope proposed in the Discussion Paper**

- 6. As noted in agenda paper 7A, respondents expressed divergent views on the scope of the project that the Board should add to its agenda. The comments that those respondents made on project scope and approach typically related to the following matters:
  - (a) project scope alternatives for addressing the accounting for and disclosure of extractive activities;
  - (b) whether the Board should address specific problems with applying IFRSs to issues that are prevalent in the minerals and oil & gas industries; and
  - (c) how should the Board proceed in order to address those issues.

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**Project scope alternatives**

7. Broadly speaking, respondents commented that the Board should either:
  - (a) undertake a specific project for extractive activities (see paragraphs 9-12); or
  - (b) undertake a project that would treat extractive activities consistently with activities conducted in other industries, such as research and development activities in the pharmaceutical or high-tech industries (see paragraphs 13-18).
8. Some respondents also recommended that the Board should provide guidance on specific application issues that arise in applying IFRSs to arrangements, transactions and events that are prevalent, but not necessarily restricted to, the extractive industries (see paragraphs 19-23).

***Specific project on extractive activities***

9. The project team proposed in the DP that a single standard for extractive activities should be developed. The project team's view was that users of financial statements should have access to comparable information regardless of whether the entity operates in the minerals or oil & gas industries. The project team acknowledged that this objective could be met by developing a common, but not necessarily identical, set of requirements. If necessary, the detail of those requirements could be tailored for minerals and oil & gas.
10. Respondents identified the following project scope alternatives for the development of specific requirements for extractive activities:
  - (a) a single IFRS that would apply to extractive activities in both the minerals industry and the oil & gas industry; or
  - (b) separate IFRSs for extractive activities in the minerals industry and for extractive activities in the oil & gas industry.

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11. Proponents of a single IFRS agreed with the project team's conclusion that extractive activities in the minerals industry and in the oil & gas industry are sufficiently similar to justify the development of a single standard. They also concurred with the project team's observation that some of the traditional differences between operations in the minerals industry and oil & gas industry (such as the relative risks and uncertainties attributable to exploration and development activities in each industry) are becoming less significant, particularly as the oil & gas industry is increasingly focused on 'unconventional' projects (eg deep water oil & gas fields, extraction of oil sands).
12. Proponents of separate IFRSs argued that many extractive activities in each industry are not comparable because those activities are subject to different risks and uncertainties. For example, the different physical properties of minerals (ie solids, and therefore cannot move) and oil & gas (ie typically fluid, and therefore can flow) means that the processes for evaluating estimates of recoverable quantities of minerals or oil & gas will be different and the risks and uncertainties associated with the extraction of those quantities will also be different. Consequently, those respondents were concerned that a 'one size fits all' approach for extractive activities would not necessarily provide users with useful information on an entity's assets and on the results of its activities.

***A project that would treat extractive activities consistently with activities***

13. Several respondents challenged the presumption in the DP that a separate IFRS should be developed for extractive activities. Those respondents considered that:
  - (a) extractive activities are sufficiently similar to activities undertaken in other industries, especially research & development activities in the pharmaceutical and high technology industries; and
  - (b) to develop a separate standard (or standards) on extractive activities would be inconsistent with the Board's philosophy of developing standards that are both principle-based and not industry-specific.

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14. Respondents identified the following project scope alternatives for a project that would treat extractive activities consistently with other activities:
- (a) undertake a broader scope review of intangible assets guidance, including specific consideration of the accounting for and disclosure of extractive activities; or
  - (b) undertake a limited scope project to revise existing IFRSs such that they can apply to extractive activities.

15. In outlining their views on the scope of such a project, some respondents acknowledged that disclosure requirements should be developed specifically for extractive activities in order to respond to users' specific information needs.

*A future intangible assets project or apply existing IFRSs?*

16. The difference between deciding to include extractive activities in the scope of an intangible assets project or to require existing IFRSs to apply to extractive activities is principally to do with the extent to which the existing guidance in IFRSs is considered to be sufficient or deficient for accounting for extractive activities.
17. A broad scope intangible assets project would be a major project and may take several years to complete. A consequence of only addressing the accounting for extractive activities in a project with such a broad scope is that IFRS 6 would likely be retained until that project is complete. In the interim, the accounting for exploration and evaluation activities would continue to be different from, for example, research activities under IAS 38.
18. In contrast, an approach which focused on applying the current requirements of IFRSs could probably be achieved more quickly and would likely involve:
- (a) removing the scope exceptions in IAS 16 and IAS 38 that relate to extractive activities and minerals and oil & gas assets;
  - (b) (potentially) developing additional guidance for those standards to clarify how those standards should apply to extractive activities; and

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- (c) withdrawing IFRS 6.

**Specific application problems with IFRSs**

19. Respondents requested the Board to also consider several other issues that were not specifically addressed in the DP. Respondents indicated that these other issues are routinely encountered when applying IFRSs to transactions, events and arrangements that are prevalent in the minerals or oil & gas industries.
20. The issues identified include:
  - (a) risk-sharing arrangements and conveyances, such as
    - (i) farm-in/farm-out agreements;
    - (ii) production sharing agreements;
    - (iii) carried interests; and
    - (iv) unitisations;
  - (b) difficulties in applying IFRSs to assets that are simultaneously in development and production, such as:
    - (i) production stripping costs (which are currently being considered by the IFRS Interpretation Committee); and
    - (ii) calculating 'value in use' under IAS 36;
  - (c) accounting for government imposts (eg resource rent taxes, royalties, production sharing arrangements);
  - (d) inventory stockpiles; and
  - (e) accounting for the underlift or overlift balances of oil & gas.
21. Many of those respondents indicated that they consider addressing these issues to be a higher priority than addressing accounting and disclosure requirements for extractive activities. This is because, in the absence of specific guidance in IFRSs, current accounting practices tend to be based on practices that were acceptable under various national GAAPs. Consequently, there are concerns

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about diverse accounting treatments and whether some of those treatments are compliant with IFRSs.

22. Whether and how the Board might choose to address these issues depends on the decision it makes on the scope of a future project that addresses extractive activities. The nature of these application issues means that most, if not all, of them would not be able to be addressed in a project that is limited to accounting and disclosure of extractive activities. However, at least some of those issues might be able to be resolved in a broader project on intangible assets accounting because, for example, research and development activities often involve risk sharing arrangements that are similar to the arrangements used in the minerals and oil & gas industries.
23. Nevertheless, there will be some issues that cannot be addressed under either project scope. Accordingly, those issues could only be resolved by the Board if they were included in a separate standard-setting project or if the issues were referred to the IFRS Interpretations Committee.

**Project priorities**

24. The project scope alternatives described above would likely take several years to result in an IFRS or in revisions to existing IFRSs. A separate consideration that a future agenda proposal that includes extractive activities issues could consider is the priority that should be assigned to the components of the agreed project scope. Future standard setting activity on this topic could be undertaken in a single step or in a series of phases.
25. A single step approach would ensure that all components of the project complement each other. For instance, the disclosures would be designed to accompany and amplify the information that is presented in the financial statements. However, a single step approach would be expected to mean that it would probably be several years before a future IFRS that comprehensively addresses extractive activities issues (either on their own or in conjunction with other intangible assets issues) would be issued and become effective.

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26. In contrast, conducting the project as a series of phases could permit some issues to be resolved in a shorter period of time. Based on the views from respondents, the early phases of such a project could address:

- (a) Disclosures. Several respondents supported developing disclosure requirements separately, and more urgently, than accounting requirements. Those respondents commented that specific disclosures on extractive activities should be developed in order to meet the specific needs of the users of the financial reports of minerals and oil & gas entities. IFRSs currently do not include any specific disclosure requirements for extractive activities and many respondents agreed that specific disclosures should be included in a future IFRS. This point was acknowledged by the US Securities and Exchange Commission, in its final rule *Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to US GAAP*:

We proposed to amend Item 18 of Form 20-F to expressly require that any issuer that provides disclosure under FAS 69, “Disclosures about Oil and Gas Producing Activities,” continue to provide that disclosure even if the issuer is preparing financial statements in accordance with IFRS as issued by the IASB without a reconciliation to U.S. GAAP. We are adopting this amendment as proposed to continue to require FAS 69 disclosure. Most commenters responding to our question on this matter supported our proposal to continue to require FAS 69 disclosure, which they felt was useful to investors and analysts. Some issuers indicated, however, that FAS 69 disclosure should cease to be required once the IASB issues disclosure requirements for oil and gas related activities. We will continue to consider appropriate revisions to our requirements in this area in light of future developments. [footnotes omitted]<sup>1</sup>

- (b) Other application issues. As noted in paragraph 23 above, some of these issues could be resolved in separate project or by referring some of them to the IFRS Interpretations Committee.

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<sup>1</sup> See SEC Release No 33-8879, pages 45 and 46



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- (c) Development of accounting requirements for extractive activities, whether by developing a separate IFRS, a broader scope reassessment of intangible assets, or a limited scope revision of existing IFRSs.