Oil Industry Accounting Committee

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International Accounting Standards Board
30, Cannon Street
LONDON EC4M 6X11

Dear Sir/Madam

OIAC RESPONSE to ED 4- Disposal of Non-Current Assets and Presentation of Discontinued Operations

The Oil Industry Accounting Committee ("OIAC") has a number of concerns relating to ED 4 - Disposal of Non-Current Assets and Presentation of Discontinued Operations - and appreciates the opportunity to share them with IASB.

In respect of question 8, OIAC believes the proposals to change the definitions of a discontinued operation are inappropriate. This is likely to result in a large number of sales of oil and gas assets being treated as discontinued operations. We believe this approach will render Oil Company accounts less understandable and that a definition similar to that currently in IAS 35 should be maintained.

Secondly in response to question 2, OIAC believes it is inappropriate to suspend depreciation of an asset held for sale. We believe that depreciation should continue while the asset continues to be used by the reporting entity.

Definition of Discontinued operations

IAS 35 defines a discontinued operation as "a component of an enterprise:

a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction, by demerger or spin-off of ownership of the component to the enterprise 's shareholders;

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment;

b) *that represents a separate major line of business or geographical area of operations; and*

c) *that can be distinguished operationally and for financial reporting purposes."*

ED 4 defines a discontinued operation as:

> *"A component of an entity that either has been disposed of or is classified as held for sale and:*
>
> *(a) the operations and cash flows of which have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction, and*
>
> *(b) in which the entity will have no significant cant continuing involvement after the disposal transaction."*

Appendix A of ED 4 defines a component of an entity as "operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity ".

This new definition is likely to result in a large number of sales of oil and gas assets being treated as discontinued operations. An upstream oil and gas company will hold interests in a number of oil and gas fields, usually through joint arrangements. Each of these fields will meet the definition of a component of an entity as they will have separately identifiable cashflows. Oil and gas companies will regularly review this portfolio of fields and, based on their business strategy, decide to buy or sell certain fields. This may be driven by a desire to move into producing assets or change their risk profile, be it geological or geographical and political risk. The sale of these assets does not represent a discontinued business segment, but part of the ordinary course of business in the oil and gas sector.

The definition of a discontinued operation in ED 4 could result in these asset sales being reported as discontinued operations, resulting in discontinued operations being reported every year. This in turn will result in the need to restate comparatives every year. We do not believe this will aid the understanding of the users of accounts. It will also result in additional costs in compiling the required comparative information. This information could need to be retrieved back over a period of five to ten years for companies that give summarised historical financial information.

Additionally the definition in ED 4 will lead to inconsistent treatment of similar transactions. If an oil company decided to sell its total interest in a field this is likely to result in the transaction being treated as an asset held for resale, as discussed above. However if only a proportion of its interest in the field is sold, a common occurrence in the oil and gas sector, it will not meet the criteria, as the company has a continuing interest in the field. The latter sale, however could have a much more significant impact on the future results of the company.

<u>OIAC's Preferred Approach</u>

OIASC's preferred approach is to maintain the definition in IAS 35, of a discontinued operation representing "a separate major line of business or geographical area of operations".

Suspension of depreciation when a non-current asset is classified as held for sale

OIAC believes it is inappropriate to suspend depreciation of an asset held for sale. We believe that depreciation should continue while the asset continues to be used by the reporting entity. Oil and gas fields are depleting assets and by definition the continued use of the assets, by extracting oil, reduces the value of the asset. By not depreciating the asset while it remains in use a company will not be reflecting the consumption of economic benefits as a result of further depletion of the field.

Additionally the sale of oil and gas assets can take a significant time from signing the sale and purchase agreement to completion, due to approvals needed from other partners in the field and from various government agencies. Recent deals have taken up to a year to complete. Consequently, sale and purchase agreements for asset deals generally include a price adjustment mechanism which reduces the deal value to take account of the depletion of the field during the period to completion. In the situation where the carrying value is equal or has been written down to the fair value less costs to sell, no depreciation in the period up to completion could result in a loss being recorded on sale whilst additional profit is recorded from operations. This does not reflect the substance of the transactions, whereas the continued depreciation would reflect the consumption of economic benefit.

OIAC's Preferred Approach

We believe that it is not appropriate to suspend depreciation on assets that are continuing to be used by a reporting entity simply because they have been labelled as held for sale within one year. Depreciation should continue while the asset is still in use to reflect the consumption of economic benefit by the company.

OJAC is happy to meet and discuss these issues in more detail if you would find this useful.

Yours faithfully,

Alan Thomas

Chairman