TOTAL

Colin Fleming
International Accounting Standards Board
30 Cannon street
London EC4M 6XH
United Kingdom

Paris, 15 April 2004

Dear Mr Fleming,

Exposure Draft 6 - Exploration for and Evaluation of Mineral Resources

TOTAL appreciates the opportunity to comment on the Exposure Draft 6 *"Exploration for and Evaluation of Mineral Resources".*

Currently, there is no specific guidance for the oil and gas industry's upstream activities under IFRS although the accounting of those activities has been excluded from the scope of several relevant standards, like IAS 16 or IAS 38. Thus, we welcome the issuance of an interim measure dealing with the Exploration for and Evaluation of Mineral Resources that proposes the continued use of current practices until a comprehensive standard is published. Nevertheless, we would like to make the following points :

- The Exposure Draft allows that an entity may continue to use its accounting policies applied until now, for the recognition and the measurement of E&E assets. However, it imposes those assets to be tested for impairment using IAS 36. This position seems contradictory to the limited improvements wanted for the interim standard. Moreover we believe that the impairment testing should depend on the conceptual method used by an entity for recognition and measurement of E&E assets : either "full cost method" or "successful efforts method". For example, for entities like TOTAL who already follow the "successful efforts concept", impairment of E&E assets is not really an issue as only those costs that lead directly to finding and acquiring mineral resources are capitalized.
- The major integrated oil and gas companies that operate on an international basis already apply the US GAAP. As it would be extremely confusing to have a different IFRS standard from the FAS 19, we suggest to the IASB to embark upon a common project with FASB.

Our responses to the specific questions set out in the invitation to comment are attached.

Yours sincerely,

Dominique Bonsergent

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Invitation to comment

Q1. Definition and additional guidance

> *The proposed IFRS includes definitions of exploration for and evaluation of mineral resources, exploration and evaluation expenditures, exploration and evaluation assets and a cash-generating unit for exploration and evaluation assets. The draft IFRS identifies expenditures that are excluded from the proposed definition of exploration and evaluation assets. Additional guidance is proposed in paragraph 7 to assist in identifying exploration and evaluation expenditures that are excluded in the definition of an exploration and evaluation asset (proposed paragraphs 7 and 8, Appendix A and paragraphs BC12-BC14 of the Basis for Conclusions).*

The Exposure draft defines the principal types of exploration costs : the ones that can be capitalized in paragraph 7 and the ones that must be expensed in paragraph 8. TOTAL generally approves these definitions.

- Paragraph 7 : We understand that an entity is given the choice to capitalize or not certain types of expenditures as the standard uses the terms "...may be included..." This approach is consistent with the successful efforts accounting principles used by TOTAL as such :
    - The following expenditures may be recorded as assets : a) acquisition of rights to explore, c) Exploratory drilling and f) activities in relation to evaluating technical feasibility and commercial viability of extracting a mineral resource.

      Under the last category, we usually include certain General and Administration costs that are directly attributable to the sole exploration and evaluation activity and that shall be capitalized as part of it. Examples of such costs include drilling supervision, costs of logistics bases (camps and field offices), recruiting, training and support of specialized personnel... The current practice of the oil and gas industry is to allocate, as directly as possible to the operations, the running costs that relate to them. This allocation is done on purpose to measure the real final costs of oil and gas operations.

      This approach is coherent with the definition of indirect costs given in IAS 16 (§16b and §17). We understand that it would also be consistent with ED6, but in order to avoid any misunderstanding, we would propose that the Board reformulate the definition in §7, with reference to IAS 16, and include "any costs directly attributable to exploration and evaluation".
    - b) the topographical, geological, geochemical and geophysical studies should not be recorded as assets : under successful efforts accounting, all prospecting costs are charged to expense.
    - Expenditures d) and e) are not relevant to the oil and gas industry.

  Paragraph 8 : We agree to exclude from assets the capital expenditures for development and the other Administration and General overhead costs that are not related to the sole exploration and evaluation activity.

Q2. Method of accounting for exploration for and evaluation of mineral resources

a. *Paragraphs 10-12 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors specify sources of authoritative requirements and guidance an entity should consider in developing an accounting policy for an item if no IFRS applies specifically to that item. The proposals in the draft IFRS would exempt an entity from considering the sources in paragraphs 11 and 12 when assessing its existing accounting policies for exploration and evaluation expenditures by permitting an alternative treatment for the recognition and measurement of exploration and evaluation assets. In particular, the draft IFRS would permit an entity to* continue to account for exploration and evaluation assets in accordance with the accounting policies applied in its most recent annual financial statements.

b. *The Exposure Draft proposes that an entity would continue to use its existing accounting policies in subsequent periods unless and until the entity changes its accounting policies in accordance with IAS 8 or the IASB issues new or revised Standards that encompass such activities (proposed paragraph 4 and paragraphs BC8-BC11 of the Basis for Conclusions).*

Are these proposals appropriate? If not, why not?

In TOTAL's opinion, the exposure draft describes an accounting method for exploration and evaluation of mineral resources that is closer to the full cost concept than to the successful efforts one, the latter being generally applied by the oil and gas industry.

Under the full cost method, all costs incurred in acquiring, exploring and evaluating properties are capitalized when incurred whether or not resources have been found. Under the successful efforts method adopted by TOTAL through FAS 19, the exploration and evaluation costs are capitalized pending determination on whether resources have been discovered.

TOTAL believes that the exposure draft does not appropriately emphasize the importance of the discovery of resources. Thus, we will continue to use the successful efforts principles as applied until now. Meanwhile, we will wait for a comprehensive IFRS standard on the extractive industry which should ideally be consistent with the successful efforts concept.

As a result, TOTAL strongly supports the opportunity offered by the Exposure Draft to authorize entities to use their current accounting practices for exploration and evaluation expenses.

Q3 : Cash-generating units for exploration and evaluation assets

[Draft] IAS 36 requires entities to test non-current assets for impairment. The draft IFRS would permit an entity that has recognized exploration and evaluation assets to test them for impairment on the basis of a 'cash-generating unit for exploration and evaluation assets' rather than the cash-generating unit that might otherwise be required by [draft] IAS 36. This cash-generating unit for exploration and evaluation assets is used only to test for impairment exploration and evaluation assets recognized under proposed paragraph 4 (see proposed paragraphs 12 and 14 and paragraphs BC15-BC23 of the Basis for Conclusions).

Are the proposals appropriate? If not, why not? If you disagree with the proposal that exploration and evaluation assets should be subject to an impairment test under [draft] IAS 36, what criteria should be used to assess the recoverability of the carrying amount of exploration and evaluation assets?

TOTAL agrees that exploration and evaluation assets shall be assessed periodically to determine whether they need to be impaired and that a loss must be recognized, if necessary. However, we disagree on the way to achieve the recognition of impairment. We believe that the qualitative criteria identifying potential impairment described in §13 are self-sufficient to let the management of a company decide whether or not to amortize those properties. The amount of the impairment should be based on the experience of the enterprise in similar situations and should not depend on the result of a IAS 36-type test which would be quite difficult to implement.

In addition, we think that the impairment issue has not the same relevance under both full cost and successful efforts methods because, proportionately, less exploration costs are recorded initially as assets. Under the successful efforts approach, only those costs that lead directly to finding and acquiring mineral resources are capitalized.

1. On the concept of a special cash-generating unit for exploration and evaluation, we think that :

- It is not appropriate to « cover » exploration and evaluation assets with other producing assets which can be unrelated either temporally or geographically since a cash-generating unit can be as large as a country or a continent. For instance, resources located in, say, Norway should not be used to cover acquisition and exploration expenses in United Kingdom.

  Under this system, all exploration and evaluation properties within a relatively large cash-generating unit are capitalized when incurred, whenever resources have been found, as long as the aggregate capitalized costs of this cash-generating unit do not exceed the aggregate value of the resources. Consequently, unsuccessful acquisition and exploration costs are adequately covered by the value of the previously discovered resources. In other words, current failures are covered and are not reported to the extent of past successes, and a loss need not be recognized.

- For investors, the financial statements produced would not reflect the real risks associated with unsuccessful results realized by an oil and gas company. The exploration of oil and gas involves substantially high expenses and is characterized by significant finding costs and a high proportion of unsuccessful search activities. Discovery of resources is the main issue for investors who look to financial statements as an important source of information about companies' risks and return. We believe that the financial statements, prepared on the basis of the "cover" concept, would provide investors with misleading information about a company's exploration success rate.

- Furthermore, the procedure will not enhance comparability of financial statements between entities, as it is difficult to define a special cash-generating unit with enough precision that it would be interpreted the same, in each case, by every company. For instance, for the same exploration prospect (successful or unsuccessful) :

  - an integrated company will be able to pass the test by defining a large cash-generating unit.

  - while a start-up entity only committed to exploration, that purchases rights to explore, explores and sells its mineral discoveries, will have to impair its asset as long as it is not capable of allocating cash inflows from other assets upon examination of its properties.

2. What is a cash-generating unit for TOTAL? Why TOTAL believes that the IAS 36 impairment test should not be applied to exploration and evaluation assets.

   For TOTAL, the cash-generating unit is the oil and gas field or group of fields that contains commercial resources. This definition shows that a cash-generating unit materialises as exploration and evaluation work progresses. It finally exists at the end of the exploration and evaluation campaign, once all the commercial resources have been identified. For this reason, it is impossible to implement an impairment test, based on cash flow projections over a cash-generating unit, BEFORE the end of the exploration phase. This is precisely why oil and gas companies have implemented other procedures to assess those assets for impairment rather than the one prescribed by IAS 36.

3. Background : TOTAL's accounting treatment for exploration and evaluation costs, based on a successful efforts concept

   Most of the integrated oil and gas companies apply the following accounting treatment according to the progress of exploration :

   - Prospecting : charging G&G studies to expense

     At the beginning, an oil and gas company conducts geological and geophysical studies to examine specific areas that are considered to have hydrocarbon prospects. Often, the acreage surveyed is never acquired or, if acquired, it is ultimately abandoned or surrendered.

In most cases, it is very difficult to associate the G&G expenditures with a discovery made sometime later. For this reason, these costs are always charged to an expense, like research costs.

In that case, impairment is no longer an issue.

Acquisition : capitalizing mineral rights and acquisition costs

The company acquires mineral interests and pays bonuses to secure the rights to explore a geographic area and ultimately extract oil and gas. These assets are capitalized when expenses are incurred. They are booked as "unproven properties" or "proved properties" in accordance with the discovery of proved resources.

- Unproved properties are assessed periodically by the management of the company : mineral rights are, depending on their value, either amortized over the term of the lease or impaired by decision of the management, if relevant. They can be reclassified as "proved properties" after the discovery of commercial resources.
- Proved properties are depleted according to the unit of production method as soon as the field starts producing hydrocarbons.

Exploration and appraisal : either charging dry wells to expense or capitalizing successful wells

The company launches an exploration and evaluation campaign with several exploratory wells to confirm the presence of oil and gas resources. The costs of drilling dry wells, e.g. those that do not find resources, are charged to expense. On the contrary, the costs of drilling successful well are capitalized.

When the wells are successful, technical feasibility studies and economic studies are then carried out to evaluate the commercial viability of these resources. If ultimately resources are deemed not commercial, the initial successful wells assets are charged to expense.

The classification of mineral rights and successful wells as proved assets (e.g. commercial resources have been found) marks the beginning of the development phase, which is out of the scope of this standard

4. <u>Proposal for an alternative method to assess the recoverability of exploration and evaluation assets</u>

In TOTAL's view, the methodology to assess impairment is pretty simple and gives greater emphasis on the indicators of impairment. It consists in :

- identifying problematic assets on the basis of the criteria listed in §13 of the exposure draft,
- assessing the partial/total impairment of the critical asset, with the responsibility for this assessment being assumed by the entity's management.

We believe that this qualitative procedure is both appropriate to the particular case of exploration assets and sufficient for a company that already applies the successful efforts approach.

5. <u>Frequency of the impairment testing</u>

It could seem confusing to ask for an annual assessment of E&E assets for impairment (§12) and to propose indicators of impairment (§13). We understand that it was not the Board's intention to require an annual testing and we suggest to clarify this point in §12 and mention " ...E&E assets shall be assessed for impairment annually <u>whether there is an indication of impairment</u>...".

Q4. Identifying exploration and evaluation assets that may be impaired

The draft IFRS identifies indicators of impairment for exploration and evaluation assets. These indicators would be among the external and internal sources of information in paragraphs 9-13 of [draft] IAS 36 that an entity would consider when identifying whether such assets might be impaired (paragraph 13 and paragraphs BC24-BC26 of the Basis for Conclusions).

Are these indicators of impairment for exploration and evaluation assets appropriate? If not, why not? If you are of the view that additional or different indicators should be used in assessing whether such assets might be impaired, what indicators should be used and why?

TOTAL considers the proposed indicators of impairment appropriate and already uses them to assess the decline in value of exploration assets. Most of the additional indicators applicable to IAS 36 are "absolute" criteria; they automatically imply a total impairment without any further computation.

Q5. Disclosure

To enhance comparability, the draft IFRS proposes to require entities to disclose information that identifies and explains the amounts in its financial statements that arise from the exploration for and evaluation of mineral resources (proposed paragraphs 15 and 16 and paragraphs BC32-BC34 of the Basis for Conclusions).

Are the proposed disclosures appropriate? If not, why not? Should additional disclosures be required? If so, what are they and why should they be required?

The exposure draft prescribes disclosures that TOTAL considers to be necessary for fair presentation of an enterprise's financial results. A company shall disclose information concerning :

- its accounting principles regarding exploration expenditures,
- the amounts of expenditures incurred, capitalized...

NB : Under TOTAL's approach, it is not relevant to disclose the level of the impairment test.