

# Extractive Activities Research Project

7<sup>th</sup> session of the ECE Ad Hoc Group of Experts on  
Harmonization of Fossil Energy and  
Mineral Resources Terminology

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## IASC Foundation

The views expressed in this presentation are those of the presenter,  
not necessarily those of the IASC Foundation or the IASB



# Research objective

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- Why take a “fresh look” at how to account for mineral and oil & gas resources
  - IFRS 6 *Exploration for and Evaluation of Mineral Resources* is only an interim solution
  - existing IFRSs do not adequately address unique features of mining and oil & gas extractive activities
  - some question the relevance of existing practices in accounting for extractive activities



# Research project team

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- An international project team of accounting standard setters has undertaken the research
  - Australia, Canada, Norway & South Africa
- Advisory panel assisted the project team
  - large and small mining and oil & gas companies
  - analysts and other users of financial reports
  - auditors
  - securities regulators (including SEC)
- Advisory panel is geographically diverse
  - Africa, Asia-Pacific, Europe & North America



# Discussion Paper: process and timing

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- Discussion Paper contains project team views
- Discussion Paper with IASB Request for Views to be published in Q1 2010
  - working draft version is now available on [www.iasb.org](http://www.iasb.org)
- Comment period expected to be 6 months
- Discussion Paper is initial due process document for Board's deliberations on extractive activities
- Agenda decision planned for end of 2010



# Scope

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- Financial reporting issues associated with minerals and oil & gas extractive activities
  - Minerals include metallic ores, industrial minerals, gemstones, uranium, coal
  - Oil & gas (or petroleum) includes hydrocarbons in liquid, gaseous or solid form
- Extractive (or upstream) activities
  - Exploration
  - Evaluation
  - Development
  - Production



# Approach

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- Adhere to the *Framework*, but not necessarily bound by existing IFRSs
  - (e.g. IAS 38 *Intangible Assets*)
- Consider developing consistent accounting and disclosure requirements across both mining and oil & gas industries
- Don't provide industry-specific solutions to issues that are widespread across a range of industries



# Key research questions

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- How should mineral and oil & gas reserves and resources be **defined**?
- When should an asset relating to mineral and oil & gas reserves and resources be **recognised** on the balance sheet?
- How should this asset be **measured**?
- What information about mineral and oil & gas reserves and resources should be **disclosed** in the financial report?



# User survey findings

- Balance sheet recognition and measurement of minerals or oil & gas assets has limited usefulness
  - historical cost is not relevant
  - fair value is too subjective

Accounting should be simple to apply and consistent

- Want information to be disclosed that can be included into their own models

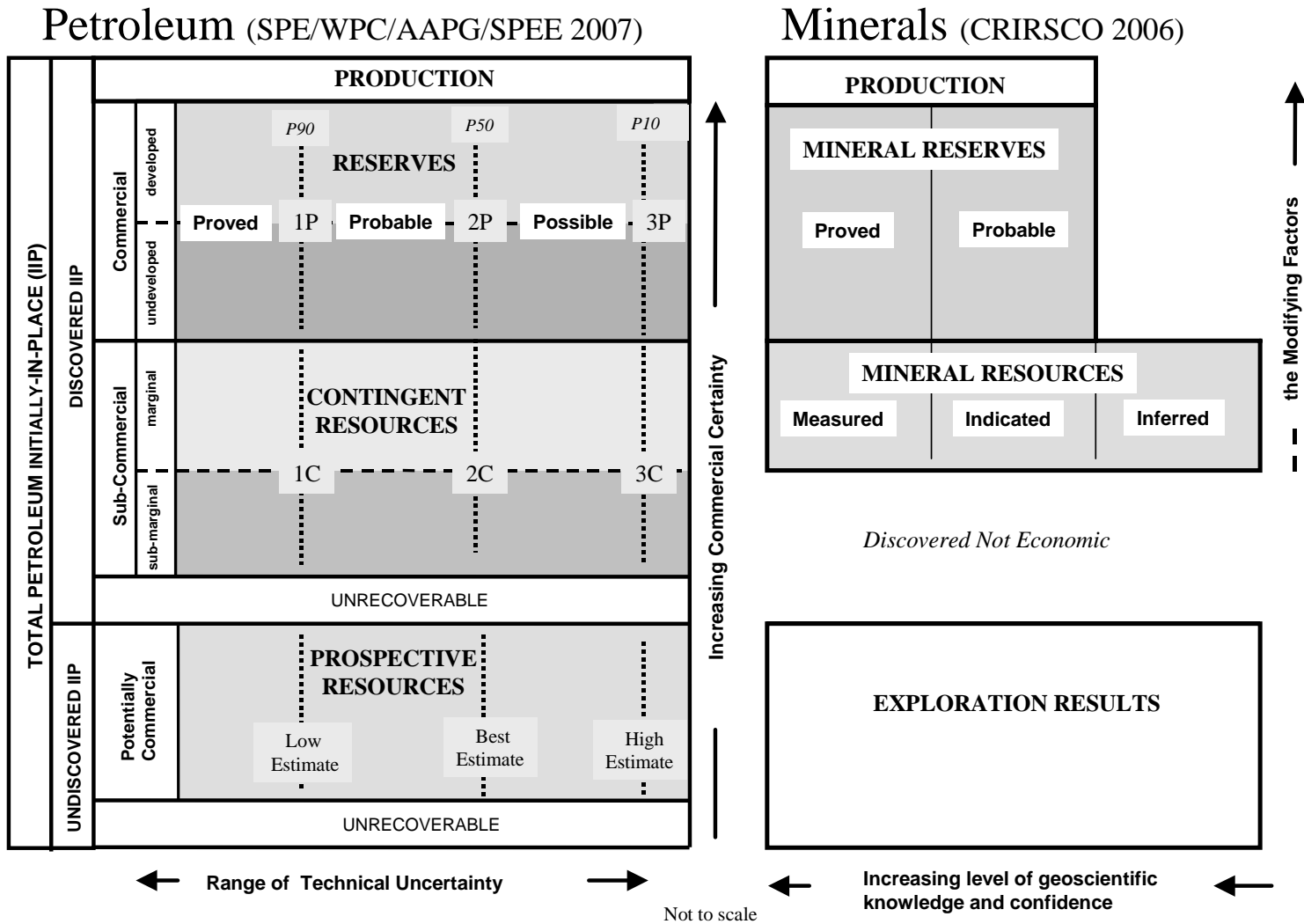
Extensive disclosures needed for financial statements to provide useful information to users



- No single agreed definition of reserves or resources for the extractive industries
- Project team recommends for use in an IFRS
  - Petroleum Resource Management System (PRMS) – for oil & gas
  - The CRIRSCO Template – for mining
- Why?
  - Wide acceptance
  - Broad and comprehensive scope
  - Broad equivalence between key concepts
    - therefore capable of providing a platform for comparable accounting and disclosure requirements across both industries



# Definitions continued



# Asset recognition

- Existing practice involves expense/capitalise decisions based on activity (e.g. exploration, development)
  - not based on asset/liability definition
  - depends on definition of exploration, development
- Differences between mining and oil & gas
  - area of interest, full cost, successful efforts
- Differences by entity size
  - junior explorers more likely to capitalise exploration



- Research approach is to apply the *Framework's* asset definition and recognition criteria
- Which assets should be recognised and when?
  - legal rights (e.g. exploration rights, mineral rights)
  - information obtained from exploration & evaluation
  - a discovered minerals or oil & gas deposit
  - development works to access the deposit
  - plant and equipment to extract the minerals or oil & gas



- Project team view: Single asset that evolves from initial exploration through to production of minerals or oil & gas
- Initial recognition when acquire legal rights to explore
- Over time this asset is enhanced by
  - information from exploration & evaluation activities
  - development to access the mineral or oil & gas
  - additional rights and approvals (including extraction rights)

Asset is right to explore, develop, extract minerals or oil & gas

- Asset to be presented as exploration property, development property or producing property



- Geographic boundary of unit of account
  - initially defined by exploration rights
  - reduces as exploration, evaluation and development activities occur
  - no greater than a contiguous area that is:
    - defined by the legal rights
    - managed separately
    - expected to generate largely independent cash flows.
- Asset components
  - IAS 16 components approach determines which plant and equipment assets are recognised separately



- What does this mean?
  - the asset is the rights to the minerals, not the minerals themselves
    - the tangible minerals will be recognised when produced in accordance with IAS 2 *Inventories*
  - costs of E&E activities not expensed as incurred
  - impairment testing necessary (unless current value remeasurement each period)
  - different legal rights arrangements are recognised consistently
    - e.g. 100% interest in mineral rights, a shared interest in mineral rights through a joint arrangement, or a Production Sharing Contract



- Historical cost
  - verifiable, but ...
  - cost has limited relevance to users
    - no correlation between finding & development costs incurred and future cash flows that will be generated from the property
- Fair value
  - seems relevant (in principle), but ...
  - requires many subjective assumptions and estimates
  - significant time and effort to prepare
  - cost/benefit implications



- Other measurement alternatives
  - a “simplified” fair value that use standardised assumptions and/or only values a portion of the asset
  - switching from historical cost to fair value at a pre-defined stage during the life of the asset
- Consequential measurement issues
  - implications for comprehensive income statement
  - impairment (if measure at historical cost)
  - depreciation (if measure at historical cost)
  - frequency of revaluation (if measure at fair value)



- Project team view: Measure at historical cost
  - neither cost or fair value provide significant benefit to users
  - expensing all exploration understates earnings
  - historical cost measurement is less costly for preparers
- A robust impairment process is a challenge
  - entities should test exploration properties for impairment whenever evidence is available that the asset is not recoverable
  - other elements of IAS 36 should apply
  - supporting disclosure about exploration property assets



- Current disclosure practice is diverse – both across industries and across jurisdictions
- Disclosure guiding principles
  - respond to user needs
    - users want information on reserves (and resources) to help them prepare their own valuations
    - many users want disclosure beyond proved reserves
  - consistent disclosure for minerals and oil & gas
    - this does not mean identical disclosure
  - cost/benefit considerations
    - proposals represent a substantial change to existing practice in both industries



- Proved and probable reserve quantities
  - disaggregated by commodity type
  - disaggregated by significant risk attributes
  - the reserve quantities attributable to subsidiaries and investments should be presented on the same basis that applies to the accounting in consolidated financial statements



- Estimation basis for reserve quantities
  - use market participant assumptions where available
    - e.g. the fair value hierarchy's Level 1, Level 2 and Level 3 inputs may help to identify the pricing assumption that should be used
  - disclose the main assumptions used
  - disclose sensitivity analysis of the effect of changes in main assumptions
- Explanation of year-on-year reserves changes
  - either narrative explanation or quantitative reconciliation



- Current value measurement disclosure  
(if statement of financial position is at HC)
  - 2 possibilities
    - fair value measurement of minerals or oil & gas assets presented as valuation range rather than single point estimate
    - a discounted cash flow measurement of the reserves
  - reconciliation of changes in current value measurement
- Fair value measurement disclosure  
(if statement of financial position is at FV)
  - information that explains the fair value estimate – similar to other fair value disclosures



- Production revenues by commodity
- Exploration, development and production cash outflows
  - presented as a time series to identify trends



# Publish What You Pay

- Publish What You Pay are concerned that resource wealth is not benefiting citizens of many resource-rich developing countries
- PWYP request disclosure on country-by-country basis for
  - payments to governments
  - reserves, production etc
- Some users say this information will help to evaluate political and reputational risk
- Constituent comments will be requested



- The Discussion Paper:
  - available now as a working draft ([www.iasb.org](http://www.iasb.org))
  - published in Q1 2010 with a 6 month comment period
  - the first step towards an IFRS for extractive activities



# Questions or comments?

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Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

