



Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
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Organizaç o Internacional das Comiss es de Valore

August 16, 2010

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

**RE: Discussion Paper on *Extractive Activities***

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting, (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Discussion Paper on *Extractive Activities*, (the Discussion Paper or the DP).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1. They are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

**General Observations and Responses to Questions 1-10:**

**Asset recognition**

We believe that, provisions for asset recognition should not deviate from the asset recognition principles that already exist in IFRSs. We further acknowledge that it is important that implementation guidance be provided as to when there is a sufficient basis to recognize an asset associated with exploration, evaluation and development costs in order to promote consistent recognition within and between companies.

**Reserve disclosures**

We agree that disclosures that provide users with decision useful information about mineral and oil and gas reserves are of great importance, and we are supportive of a future IFRS on extractive activities prescribing disclosures of reserve quantities and related disclosures that will assist users

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in understanding the risks and uncertainties associated with those reserves. We recognize that a number of jurisdictions have requirements to provide detailed reserve information in various technical reports, or provide general reserve disclosures within documents that must be filed with securities regulators. We recognize that these non-financial statement sources of information are often used by investors and lenders in making investment and lending decisions. We also recognize that there is an incremental audit cost associated with including such disclosures within financial statements. If the Board determines that the audit costs of providing reserve quantity and related disclosures within the notes to the financial statements exceed the benefits thereof, or that such an approach is not operational, we would support the project team's view that the financial statement disclosure for reserve information can be satisfied if it is disclosed elsewhere in unaudited information published with the audited financial statements.

The Board may also want to consider whether it would be beneficial to some investors for companies to disclose valuation information using more than one set of assumptions. This could assist investors who do not have the resources to develop their own models and projections in forming a more complete understanding of the economics of companies' extractive activities.

**Question 1 – Scope of extractive activities**

In Chapter 1 the project team proposes that the scope of an extractive activities IFRS should include only upstream activities for minerals, oil and natural gas. Do you agree? Are there other similar activities that should also fall within the scope of an IFRS for extractive activities? If so, please explain what other activities should be included within its scope and why.

We agree with the project team's proposal that the scope of an extractive activities IFRS should include only upstream activities for minerals, oil and natural gas because significant information needs of users are not addressed by IFRS such as guidance that provides a consistent application of initial upstream asset recognition, depletion and impairment. Furthermore, IFRS does not have a disclosure framework for providing users with reserve quantity and related information that is fundamental to users' investment decisions. We believe that the Board should accept a project to issue a standard addressing these activities. We agree that the non-regenerative nature of mineral and hydrocarbon extraction along with the risks assumed by companies engaged in the finding, developing, and producing these resources justify issuing guidance that provides a framework to promote consistent application of IFRS to these activities and address the specialized disclosure needs of users.

**Question 2 – Approach**

Also in Chapter 1, the project team proposes that there should be a single accounting and disclosure model that applies to extractive activities in both the minerals industry and the oil and gas industry. Do you agree? If not, what requirements should be different for each industry and what is your justification for differentiating between the two industries?

We generally support accounting for mineral and oil and gas extraction under a single model because of the similar nature of exploring, evaluating, developing and producing a geologically defined non-renewable resource. We believe that to the extent users have different information needs for assessing the different types of extractive processes or activities, the model and related disclosures should accommodate those needs.

**Question 3 – Definitions of minerals and oil and gas reserves and resources**

In Chapter 2 the project team proposes that the mineral reserve and resource definitions established by the Committee for Mineral Reserves International Reporting Standards and the oil and gas reserve and resource definitions established by the Society of Petroleum Engineers (in conjunction

with other industry bodies) should be used in an IFRS for extractive activities. Do you agree? If not, how should minerals or oil and gas reserves and resources be defined for an IFRS?

SC1 members generally agree that the mineral reserve and resource definitions established by the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) and the oil and gas reserve and resource definitions established by the Society of Petroleum Engineers (SPE) under the Petroleum Resource Management System (PRMS) are useful in providing a general framework for reserve determination for financial reporting purposes. We recognize that technical bodies, such as SPE and CRIRSCO, are well placed to maintain guidance that keeps pace with technological advancements. However, it is likely that the needs of investors and capital markets would not be best served if such definitions, and future changes thereto, were simply incorporated by reference from the work of these bodies.

We believe that the needs of investors and capital markets would be better served if only those definitions that are found, after evaluation by the IASB, to be aligned with the information needs of users are included in a future IFRS, and those definitions are not subject to change unless changes are made in accordance with the IASB's due process for standard setting projects.

**Question 4 – Minerals or oil and gas asset recognition model—Recognition**

In Chapter 3 the project team proposes 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 is recognised when the legal rights are acquired. Information obtained from subsequent exploration and evaluation activities and development works undertaken to access the minerals or oil and gas deposit would each be treated as enhancements of the legal rights. Do you agree with this analysis for the recognition of a minerals or oil and gas property? If not, what assets should be recognised and when should they be recognised initially?

We agree that legal rights acquired to explore or extract natural resources generally meet the definition of an asset, subject to subsequent impairment, and that the costs of subsequent exploration and evaluation activities may result in enhancements to such an asset that could qualify for recognition. We do not agree that all activities designed to establish the existence of reserves would necessarily result in the creation or enhancement of an asset, as defined under IFRSs. The DP's proposal could lead to capitalization of costs for activities or events that cannot be concluded will result in positive economic value or result in a probable future economic benefit flowing to the entity. We do not believe that there are sufficient conceptual dissimilarities between capitalization of exploration costs and capitalization of costs addressed by other IFRSs, such as internal research costs under IAS 38, to warrant conceptually different accounting recognition models. Some level of economic certainty should be established before one concludes that an exploration or evaluation activity associated with a mineral reserve results in enhancement of the value of the mineral right and a probable future economic benefit that will flow to the entity. In order to promote consistency of asset recognition between entities, we recommend that the Board provide guidance to assist preparers in determining whether there is sufficient likelihood that future economic benefit will be achieved. This might be based on a point at which there becomes an appropriate level of certainty of reserves or resources, which would be supported by sufficient engineering data.

**Question 5 – Minerals or oil and gas asset recognition model—unit of account selection**

Chapter 3 also explains that selecting the unit of account for a minerals or oil and gas property involves identifying the geographical boundaries of the unit of account and the items that should be combined with other items and recognized as a single asset. The project team's view is that the geographical boundary of 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. The project team's view is that the components approach in IAS 16 Property, Plant and Equipment would apply to determine the items that should be accounted for as a single asset. Do you agree with this being the basis for selecting the unit of account of a minerals or oil and gas property? If not, what should be the unit of account and why?

We support the view that the unit of account should be based on geographical boundaries associated with the legal rights to minerals or oil and gas properties that have significantly different geological, political or other risks or generate largely independent cash flows. We support this view because it is consistent with the judgments that could be applied under IFRS such as those cited in paragraph 3.41 of the DP. This approach also appears consistent with the geological and economic distinctions that exist at the individual field or mine level.

We note the project team's view that "the components approach in IAS 16 would apply to determine the items that should be accounted for as a single asset." While we support reference to IAS 16 in designing the model, we do not believe that IAS 16 provides requirements in determining a unit of account because IAS 16 does not dictate what constitutes its unit of account, which is an "item" of property, plant and equipment. Rather, IAS 16 contains "componentization" requirements for measuring the depreciation charge and for handling the retirement or other event that creates the need to derecognize part of what the company has defined as an "item." Thus we do not quite follow how the reference to IAS 16 will necessarily result in comparable selection of unit of account asset components between entities, as the project team's view appears to suggest.

**Question 6 – Minerals or oil and gas asset measurement model**

Chapter 4 identifies current value (such as fair value) and historical cost as potential measurement bases for minerals and oil and gas properties. The research found that, in general, users think that measuring these assets at either historical cost or current value would provide only limited relevant information. The project team's view is that these assets should be measured at historical cost but that detailed disclosure about the entity's minerals or oil and gas properties should be provided to enhance the relevance of the financial statements (see Chapters 5 and 6). In your view, what measurement basis should be used for minerals and oil and gas properties and why? This could include measurement bases that were not considered in the discussion paper. In your response, please explain how this measurement basis would satisfy the qualitative characteristics of useful financial information.

We generally agree that historical cost is a practical measurement basis for oil and gas and mineral properties exploited by way of extractive activities, given the views expressed in the DP by users, (as summarized in paragraph 4.23) that they generally would not directly use management's estimates of fair value for these properties. We acknowledge that fair value information is a more relevant measurement attribute for predicting future cash flows but may not be practical to apply in all circumstances. An historical cost measurement basis provides an objective basis that is understood by users and can be supplemented with other information through disclosures to meet users' informational needs. With respect to disclosures, please refer to our response in Question 9.

**Question 7 – Testing exploration properties for impairment**

Chapter 4 also considers various alternatives for testing exploration properties for impairment. The project team's view is that exploration properties should not be tested for impairment in accordance with IAS 36 Impairment of Assets. Instead, the project team recommends that an exploration property should be written down to its recoverable amount in those cases where management has enough information to make this determination. Because this information is not likely to be available for most exploration properties while exploration and evaluation activities are continuing,

the project team recommends that, for those exploration properties, management should: (a) write down an exploration property only when, in its judgment, 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. Do you agree with the project team's recommendations on impairment? If not, what type of impairment test do you think should apply to exploration properties?

We do not agree that exploration properties should be evaluated for impairment only when management determines it has enough information to make that determination. We believe this approach ignores potential objective impairment indicators identified in IAS 36 that could be equally relevant to exploration properties. Additionally, this raises a concern of whether or not impairments may be deferred because the impairment trigger is based on management's assessment of a high likelihood which appears solely left to management's discretion to determine. This may be particularly problematic in projects that take several years to evaluate and develop. We believe the alternative approach under Option A in the DP that requires sufficient information to be available to support initial capitalization of costs, based on some level of reserve determination, provides more rigor and consistency in applying the definition of an asset and thus would also be useful in determining the impairment model. We also believe that a model applying IAS 36 to exploration properties with an "undue cost or effort" assessment, referred to as Option B in the DP, may provide a practical and consistent approach.

**Question 8 – Disclosure objectives**

In Chapter 5 the project team proposes that the disclosure objectives for extractive activities are 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. Do you agree with those objectives for disclosure? If not, what should be the disclosure objectives for an IFRS for extractive activities and why?

We generally agree that the objective of disclosures is to provide users with information that allows them to evaluate the reserve quantities and associated value, risks, and historical performance of extracting those reserves. Such disclosures should provide information that helps users in obtaining the inputs they need to assess reserve quantities and related expected net cash flows themselves, rather than relying solely on management's valuation of those reserves. With regard to items (b) and (c) above, a proposed standard should clarify if "assets" that are part of the disclosure objective include reserves and resources or only the underlying investments and costs in the mineral and oil and gas properties.

**Question 9 – Types of disclosure that would meet the disclosure objectives**

Also in Chapter 5, the project team proposes that the types of information that should be disclosed include: (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 reserves quantities, and a sensitivity analysis; (c) a reconciliation of changes in the estimate of reserves quantities from year to year; (d) a current value measurement that corresponds to reserves 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). Would disclosure of this information be relevant and sufficient for users? Are there any other types of information that should be disclosed? Should this information be required to be disclosed as part of a complete set of financial statements?

### **Pricing in Reserve Quantity Determination**

Paragraph 5.56 of the DP indicates that the project team believes that in order to achieve faithful representation, forecasted prices should be used when determining reserve quantities, because otherwise it would misrepresent the reserve quantities to be extracted. This appears to assume that in order to be a faithful representation the disclosure must represent the best estimate of reserve quantities to be extracted over the life of the project as of the reporting date. We do not believe that this is a requirement of meeting the faithfully representative criteria, as described in paragraphs QC 14 through 16 of the recently exposed *Qualitative Characteristics Chapter* of the *Conceptual Framework*, unless the reserve quantities disclosed are being represented to users as the best estimate of reserve quantities that will be extracted. Some jurisdictions require standard pricing assumptions that do not represent a best estimate of reserve quantities to be extracted while providing all the information necessary for users to understand what is being depicted. Accordingly, we believe that faithful representation may be achieved with respect to any pricing assumption so long as the information disclosed with that pricing assumption or the associated reserves quantities is complete and is truthfully described.

We believe that the pricing assumption applied should be consistent with meeting the informational needs of users. We note that, as described in paragraph 5.52 of the DP, users appear to prefer consistency and comparability between and among entities, rather than each entity's best estimate of pricing. Among our SC1 members, we have various views about how this may be best achieved. One view is that forecasted prices derived from a fair value perspective may best serve financial statement users because a fair value price assumption provides a better estimate of reserve quantities to be extracted than an historical average price while being more objective than management's internal pricing. Under this view consistency and comparability between and among entities is better achieved by providing a more relevant comparison of estimated reserves quantities to be extracted while providing transparent disclosures, similar to a fair value hierarchy disclosure, of how those forecasted prices were determined. This approach continues to allow users the ability to adjust their own pricing assumptions and models from the disclosures so far as the key assumptions in price determination are adequately disclosed.

Another view is that historical prices are more conducive to providing users with more comparable and consistent reserve quantities between companies for financial reporting purposes even though applying this assumption will not result in an accurate estimate of reserve quantities to be extracted. Under this view the best estimate of reserve quantities, from the perspective of users, is attained by users applying their own inputs including pricing assumptions along with project specific facts such as economic, engineering and geological data that are provided outside the financial statements. Underlying this view is the thought that the purpose of reserve quantity disclosures is not to provide an accurate estimate of reserve quantities to be extracted if that cannot be cost-beneficially achieved to meet the information needs of users. Rather, the objective of disclosure is to provide users with a more unbiased reserve quantity that more easily facilitates comparisons between companies and users' ability to apply their own models. If substantial subjectivity is introduced in reserve quantity determination using fair value price assumptions, users are likely to have limited use of that information. In addition, future basis and differential adjustments such as location, quality, and transportation may be difficult and highly subjective to forecast along with corresponding production and development costs that would align with the forecasted price assumption.

### **Valuation of Reserve Quantities**

We believe that valuation information for proved and probable reserves provides useful information to users. As discussed in our general comment above, we recognize that valuation information is often required to be included in technical reports or other required reserve disclosures that must be filed with securities regulators. Some SC1 members do not support a requirement to disclose current value measurements in the notes to the financial statements given the audit cost

implications of such information and its limited benefit to users as a result of the other sources of information available, as discussed in the DP.

We believe that value information related to proved and probable reserve quantities should provide useful inputs to users in valuating reserves quantities. SC1 members that support disclosures that measure the value of reserve quantities for purposes of financial reporting have divergent views about how this is best achieved. One view is that applying a prescribed standardized discounted cash flow measurement to reserve quantities, similar to an Alternative B approach, provides a more appropriate basis for users in helping them develop inputs to their own valuation models because this approach attempts to minimize the bias or subjectivity from the valuation result. This approach recognizes that information necessary to calculate a value of an entity's reserves extends beyond financial statement information. Users make assessments based on their judgments after considering standardized information rather than working with less comparable information that for each company reflects management's judgment. The project appears to support this view, based on paragraphs 5.7 and 5.8 of the DP. Providing a fair value of reserve quantities is not a practical undertaking if the usefulness of this information is substantially limited because it is not sufficiently reliable for investment and lending decisions, as suggested by users in the DP team's research project. Unless these obstacles could be overcome by providing sufficient reliability on the underlying engineering data as well as the quantitative methods and valuation assumptions applied that purport to represent fair value, and benefits of doing so outweigh the costs, it is unclear how a fair valuation of reserves meets the information needs of users.

Another view is similar to Alternative A in the DP that the information needs of users are best achieved if the disclosures provide a view toward fair valuation of proved and probable reserve quantities. This would require companies to disclose the key fair value assumptions that result in more relevant decision useful information for predicting future cash flows, which a user can then compare to its own assumptions and from company to company. Under this view, appropriate disclosures concerning uncertainties surrounding estimates would also be necessary. Fair value information should not be provided in relation to possible reserves given the magnitude of uncertainty associated with those prospects.

We refer to our observations under "General Observations – Reserve disclosures," where we discuss that some investors may benefit from disclosures prepared on more than one of these bases in order to obtain the benefits of each.

**Question 10 – Publish What You Pay disclosure proposals**

Chapter 6 discusses the disclosure proposals put forward by the Publish What You Pay coalition of non-governmental organisations. The project team's research found that the disclosure of payments made to governments provides information that would be of use to capital providers in making their investment and lending decisions. It also found that providing information on some categories of payments to governments might be difficult (and costly) for some entities, depending on the type of payment and their internal information systems. In your view, is a requirement to disclose, in the notes to the financial statements, the payments made by an entity to governments on a country-by-country basis justifiable on cost-benefit grounds? In your response, please identify the benefits and the costs associated with the disclosure of payments to governments on a country-by-country basis.

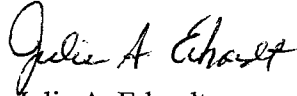
We generally agree that a requirement to disclose amounts paid to governments should call for disclosure that is detailed by nature on a country by country basis in order to be the most meaningful to users. However, we do not believe the need for more transparency about amounts paid by reporting entities to governments is unique to the extractive industries or to this project. That information would equally apply to all companies so far as they make payments to government entities or are engaged in situations that might increase their investment risk in a particular country. Accordingly, we believe that the "publish what you pay" disclosures should be

considered by the Board as a broader project. We strongly believe that disclosures designed to regulate ethical behavior of payments between governments and companies should not impose upon the purposes of financial reporting and should remain a separate jurisdictional matter.

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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,



Julie A. Erhardt

Chairman

IOSCO Standing Committee No. 1