

New guidance on accounting for extractive activities – a big issue for the energy and resources industry

Application date: A discussion paper was issued in April 2010. In 2011, the Board will decide if a project addressing extractive industries in the mining and oil and gas industries will be included on their list of standard-setting projects.

What's new?

The International Accounting Standards Board's discussion paper on accounting for extractive activities addresses some of the accounting challenges affecting entities with upstream activities in the mining and oil and gas industries. This was the first step in the IASB's plan to develop a new standard for accounting for extractive assets, which would replace the current guidance in IFRS 6 *Exploration for and evaluation of mineral resources*.

The proposals consider financial reporting issues for extractive activities and provide views on:

- the definitions of 'reserves' and 'resources' for financial reporting purposes;
- the basis for recognising mineral and oil and gas assets;
- initial and subsequent measurement of mineral and oil and gas assets; and
- the extent and nature of disclosures.

The comment letter period closed in July 2010 and responses were received from all over the world. The board is involved in a number of standard-setting projects and is yet to decide if this project will be added to its agenda following public consultation on the Board's standard agenda and

consideration of an extractive industries project proposal.

The timing of new guidance for extractive industries is likely to be a few years away; however, the International Financial Reporting and Interpretations Committee (IFRIC) has now published a draft interpretation (DI) on stripping costs that may have significant "day one" impacts for mining companies. The DI sets out guidance on the accounting for waste removal (stripping) costs in the production phase of a mine. The comment letter period closed in November 2010. The DI on stripping costs and its impact on the energy and resources industry is considered in a separate document.

Who from this sector is impacted?

The proposals for a new standard on extractive activities apply to all mining and oil & gas entities, from junior miners to large integrated oil majors. The discussion paper would affect the accounting and disclosure of all stages of upstream mining and oil & gas activities; from capitalisation of exploration costs, through to detailed disclosure of proved and probable reserve volumes and values on a disaggregated basis.

Industry insight: Key proposals and initial feedback from the resources sector

Key proposal	Reason for proposal	Potential impact on practice	Respondents' feedback from the sector
A single financial reporting model for all mining and oil and gas activities.	There is divergence in practice in the accounting for exploration, development and production of minerals and oil and gas. Currently IFRS 6 allows entities to continue to apply their existing accounting policies.	It would change the accounting requirements for all mining and oil and gas entities. In particular, it would change the accounting for reserves and resources (eg, how to define, recognise, measure and disclose reserves and resources in the financial statements).	<ul style="list-style-type: none"> • Most agree that a single financial reporting model would improve comparability of financial statements in the sector. • There are mixed views on whether the project should cover only extractive industries or whether extractive industries should be covered by a broader project for intangible assets.
Consistent definitions for reserves and resources developed by the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) and the equivalent definitions of the Society of Petroleum Engineers (SPE).	Currently entities adopt their own national codes and definitions, which can make it difficult for users of accounts to compare information. For example, in Australia entities apply the JORC guidelines, but these guidelines are not typically applied by entities in other countries.	For most entities, using the CRIRSCO and SPE definitions would have little impact on current practice. These definitions have broad equivalence to what many entities are already referring to, and are widely accepted in practice.	<ul style="list-style-type: none"> • All agree that definitions for reserves and resources should be developed by the industry, rather than the IASB who does not have the technical expertise or industry experience. • Concerns remain with the approach for incorporating the definitions into a future IFRS and whether additional guidance should be developed to ensure consistent application of that definition.
Recognise mineral and oil and gas assets when the entity has acquired the legal right to explore.	Currently entities expense the costs in a number of different ways.	There would be more capitalisation of expenses, which would increase the risk of asset impairment. Entities would assess their assets for impairment whenever evidence suggests that full recovery of the carrying amount of an exploration asset is unlikely (this differs from the impairment rules under IAS 36). Information gained from exploration and evaluation activities, as well as development activities, would represent an enhancement of the exploration/reserves and resource asset. The level of detail/aggregation at which assets would be recognised	<ul style="list-style-type: none"> • Most respondents expressed concern with the proposals. • A significant majority disagreed with the view that subsequent exploration and evaluation activities undertaken would always represent an enhancement of the property. • Many of the respondents suggested the proposed treatment of those exploration and evaluation activities was inconsistent with the asset recognition criteria because the information obtained may not have any future economic benefit.

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		<p>and presented (known as the 'unit of account') would initially be the geographical area of the exploration right. This would be refined over time as exploration and development plans are developed, ultimately resulting in one or more units of account (generally at the level of the individual mine or field).</p>	<ul style="list-style-type: none"> • Respondents urge the Board to consider asset recognition and propose alternative approaches, including: recognising mineral or oil and gas property asset on the same basis as other assets (such as intangibles), to use the reserve and resource classification to identify the appropriate point to recognise the asset, or continue to use existing accounting methods.
<p>Measure mineral and oil and gas assets at their historical cost, supplemented by disclosure (refer to the recommendation below for more information on the proposed disclosures).</p>	<p>Historical cost was favoured for its reliability, familiarity and ready availability. Although fair value measurement got high marks for relevance, it was rejected by the project team on cost benefit grounds as well as for its imprecision (quantifying reserves is as much an art as a science because of the many significant estimates required).</p>	<p>Minerals and oil and gas assets would be carried at historical cost, less their accumulated depreciation and any impairment write-downs. There would be greater detail disclosed about reserves and resources, and impairment testing of exploration assets would only be required when evidence indicates the asset may be impaired.</p>	<ul style="list-style-type: none"> • The vast majority agree that minerals or oil and gas property should be measured at cost rather than fair value. Some believe the IASB should allow the use of historical cost until a bankable feasibility study is performed, after which entities could be required to use fair value. • Many believe the proposed impairment criteria could be exploited by entities (eg, the proposed criteria would only require entities to test their assets for impairment once they have completed their related exploration activities).
<p>Significantly more detailed disclosures about:</p> <ul style="list-style-type: none"> • either the current value or fair value measurement of proved and probable reserves, by major geographical region. • reserve quantities (by commodity and by country or project where material) • production revenues by commodity • costs, disaggregated in the same way as reserve quantities, with a five-year track record of 	<p>Currently the disclosure practices of entities in the sector are diverse. The draft proposals aim to standardise the disclosure requirements across industries and jurisdictions, and provide users of financial statements with the information they need to make informed decisions about mineral and oil and gas entities.</p>	<p>It would present entities with a significant disclosure challenge, particularly in relation to the measurement of proved and probable reserves. There would be substantially more disclosure required by entities, and at a more granular level. Many entities would need to amend their existing systems and processes to ensure they support the required disclosures and capture the relevant information. Management would need to understand</p>	<ul style="list-style-type: none"> • Respondents generally agree with the disclosure objectives, but almost all respondents expressed significant concerns about the level and granularity of the disclosures proposed. Concerns were also raised whether disclosure of information about the reserve quantities should be subject to audit and whether such disclosures were more appropriate in management commentary rather than in the financial report. • Many respondents also

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exploration costs, development costs, and production costs.		how the proposed disclosure obligations interfere with the entity's commercial sensitivities.	commented that in some cases the proposed disclosures will require duplicate or inconsistent information by some market regulators.
Further study into whether entities should disclose information relating to payments made to governments, per the Publish What You Pay (PWYP) campaign.	The draft proposals consider the PWYP campaign, which is a coalition of non-governmental organisations campaigning for mandatory disclosure of company payments and government revenues from the mining and oil and gas sector. According to the draft proposals, many users would find country by country disclosures of tax and royalty payments useful.	Providing this information would be difficult and costly for some entities, particularly those entities with a large number of international operations. The project team who developed the draft proposals has suggested further study to see if additional disclosures meet the cost-benefit test.	<ul style="list-style-type: none"> • There are mixed views on whether these disclosures are appropriate for financial reporting or if they are a corporate social responsibility reporting issue. • There is also divergent views on whether the benefits of disclosing tax payments made to governments on a country-by-country basis would outweigh the costs of preparing and auditing such disclosures.

What are the next steps?

In 2011, the IASB plans to make a decision on whether the extractive activities project should be added to its active agenda. If the IASB decides to

add the project to its agenda, the project's objective would be to develop an IFRS on accounting for extractive activities that would supersede IFRS 6 *Exploration for and Evaluation of Mineral Resources*.