



Sir David Tweedie
Chairman
International Accounting Standards Board
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E-mail: commentletters@ifrs.org

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Ref.: ACC/HvD/TS/ID

Dear Sir David,

Re: FEE Comments on IASB Discussion Paper Extractive Activities

- (1) FEE (the Federation of European Accountants) is pleased to comment on IASB Discussion Paper Extractive Activities (the “DP”).
- (2) As a founding organisation of EFRAG we have also contributed to the EFRAG consultation process by submitting the FEE comments on EFRAG’s Draft Comment Letter of 23 April 2010. EFRAG has issued its final comment letter on 16 July 2010. We have considered the EFRAG Final Comment Letter in our response and made reference to the EFRAG comments where relevant.
- (3) We generally agree with the views expressed by EFRAG in its comment letter.
- (4) We agree with EFRAG that currently the extractive industries are scoped out of certain IFRSs (e.g. IAS 2, IAS 16 and IAS 38) and these gaps need to be filled since the current situation has led to diverse accounting practices within similar companies across the entire industry.
- (5) We do not support the approach retained in the DP to propose a specific accounting model without a clear demonstration that the current standards cannot be applied (even if specific guidance were to be developed explaining how to apply the current standard to this industry). Should it be demonstrated that the current standards cannot be reasonably applied to the extractive industries, we believe that it would be appropriate to consider whether other existing standards such as FASB or Australian standards or current practices can be used as a basis for accounting extractive activities before developing a completely new model.
- (6) Like EFRAG, we note that the model proposed in the DP may not be compliant with the Conceptual Framework. We would not see the rationale for departing from the existing Conceptual Framework at this stage. Any reconsideration of the principles to be used to define what is an asset and when it is recognised should be addressed as part of the current revisions to the Conceptual Framework.

- (7) Further, we are not convinced that there is a need for a separate accounting model for extractive activities based on the arguments developed in the DP. The accounting treatment for recognition and measurement of the assets are not unique to extractive activity.
- (8) Consequently we only support the development of disclosures specific to extractive industry and of application guidance to address specific difficulties arising in applying current standards to the extractive industries, if any. Indeed, we note that the DP is addressing certain difficulties with respect to IFRSs that are not specific to the extractive industries. In particular, we believe that the Board should address the issue of the “unit of account” in a wider context as part of the Conceptual Framework project.

Our detailed responses to the questions in the Invitation to comment of DP are contained in the Appendix to this letter.

For further information on this letter, please contact Tibor Siska, Project Manager.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', written over a light blue horizontal line.

Hans van Damme
President

Appendix – Responses to the questions in the Invitation to comment of IASB Discussion Paper Extractive Activities

Appendix

SCOPE OF EXTRACTIVE ACTIVITIES

Question 1

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.

- (9) Similar to EFRAG, FEE supports a single extractive activities model only to the extent that it applies to disclosure requirements along with application guidance of current standards.
- (10) While the scope exemptions in current accounting standards has lead to diverse accounting practices between similar companies, the DP fails to provide clear rationale for developing an industry specific standard. Many issues that the extractive industries are facing are not necessarily different from those for other industries such as the pharmaceutical industry. These industries apply current standards at this moment to all their activities. Therefore, other accounting solutions should have been considered by the project team, most notably the application of current IFRS to the extractive industries, potentially supplemented by specific application guidance.
- (11) Alternative accounting models should be considered only if it can be demonstrated that the existing standards cannot be applied to the extractive industries. If this is the case, we believe that the first step in evaluating alternative accounting models should be to consider whether existing industry practices (such as the successful effort approach) or other existing standards such as FASB or Australian standards can be used in IFRS as a basis to account for extractive activities.
- (12) Furthermore, the development of a new accounting model for extractive activities does not particularly seem appropriate at this time given that the Conceptual Framework is undergoing a substantial revision and the definition of the asset will also be redefined.
- (13) We agree with EFRAG that the DP excludes from its scope key accounting issues that are the root cause for the greatest difficulties in practice. However we consider that the exploration cost is the key accounting issue as opposed to production sharing agreement, farming agreements and exchange of leases and information as mentioned by EFRAG.

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APPROACH

Question 2

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?

- (14) We agree with EFRAG that a separate accounting model would only be justified if a clear rationale is developed.
- (15) Given that the DP does not demonstrate that the current standards cannot be applied in the extractive industries, FEE does not support the development of a separate accounting standard at this time.
- (16) We question whether the development of accounting regimes specific to the mining industry and the oil and gas industry has its place as part of a principles-based accounting framework such as IFRSs unless this is justified by a demonstration that the principles in the general standards are not appropriate to such industries.
- (17) As mentioned before, at this point, there are no apparent reasons why a specific model should be developed for the extractive industries given that the many of the issues faced by this industry are not unique. Similar issues are found in industries that are heavily involved in R&D such as the pharmaceutical industry.

DEFINITIONS OF MINERALS AND OIL & GAS RESERVES AND RESOURCES

Question 3

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?

- (18) We agree with EFRAG that the IASB cannot rely on the definition developed by these groups without first having established the principles that are meant to be captured by the definitions. Once those principles are established, the IASB would benefit from the assistance of specialists such as engineers and geologists to evaluate whether existing industry definitions can be used as part of IFRSs.
- (19) We do not believe that it would be appropriate for a standard merely to refer to definitions established by a third party organisation. This may cause unintended governance issues.

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- (20) We suggest that the IASB evaluates the appropriateness of an alternative approach which would be to include in the standard clear principles of how minerals and oil and gas reserves should be defined, but to let entities apply these principles to establish their own specific definition. This would have the advantage of permitting entities to develop definitions that are consistent with other requirements (e.g. local regulatory requirements) as long as these definitions are aligned with the IFRS principles.

MINERALS OR OIL & GAS ASSET – RECOGNITION

Question 4

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?

- (21) We disagree, like EFRAG, with the proposed accounting model for asset recognition and measurement. According to the proposal, all the costs incurred from initial exploration including unsuccessful efforts are capitalised on the basis that it enhances the company’s knowledge of the specific geology of the property subject to the legal right. The sole exception is to require the write down of the costs when, in management’s judgement, there is a high likelihood that the carrying amount will not be recoverable in full. This proposal seems counterintuitive since costs incurred in exploration efforts that yield negative results may end up being capitalised even though the negative results may be considered as an indicator of impairment rather than as an enhancement to the asset.
- (22) Here again, we regret that the DP does not consider the application of current IFRSs to extractive activities. Rather, it proposes a new accounting model without demonstrating that the application of current standards would fail to provide a fair view of the extractive activities. We acknowledge that the complexity of the activities, to some extent, sets them apart from other industries. However, the economic characteristic of these activities are not unique. Therefore, the development of a different model can only be justified if it is clearly demonstrated that the existing standard cannot be applied to the extractive industries.
- (23) As noted before, the exercise should have been performed as part of the DP to evaluate the relevance of the information that could be obtained if the extractive industry were to apply IAS 16, IAS 17 and IAS 38. We regret that such an analysis was not performed and that a new model is proposed instead.

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MINERALS OR OIL & GAS ASSET – UNIT OF ACCOUNT

Question 5

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 recognised 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?

- (24) We agree with EFRAG that an overall principle for the unit of account should be developed in the Conceptual Framework. Only specifications and detailed application guidance relevant to the industry should be addressed at the standard level. This guidance would help to determine whether the unit of account needs to be expanded beyond, or limited to, legal rights. There is a need for further debate on this issue.
- (25) This being said, the unit of account model proposed in the DP appears reasonable in the context of the DP overall model.

MINERALS OR OIL & GAS ASSET – MEASUREMENT

Question 6

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.

- (26) We agree with EFRAG that historical cost is the most appropriate measurement basis. Other methods such as fair value seem to have significant cost implications and the difficulty in developing reliable estimates of fair value is such that it could

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impair the ability of users of financial statements to rely on such a measurement. Indeed, we believe that it is especially difficult to establish reliable estimates of fair value since these estimates are greater dependent on changes in commodity prices and on timing of exploration that is often itself dependent on the prices and market demands. We believe that users would be better served if the financial statements provided sufficient information that allows the users to develop their own estimates of fair value or current value.

- (27) As an additional issue, we question why the extractive industries should be required to provide fair value information about assets measured on a cost basis given that such disclosures are not required in existing IFRSs for non-financial items.

TESTING EXPLORATION ASSETS FOR IMPAIRMENT

Question 7

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 judgement, 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?

- (28) We agree with EFRAG that the DP does not demonstrate how the impairment proposal would be preferable to the application of IAS 36 Impairment of Assets nor that it demonstrates that IAS 36 cannot be applied in the extractive industries. However, given the complexity of the extractive industries, it may be necessary to supplement the principles of IAS 36 with specific application guidance on impairment for extractive activities. This guidance could be developed with the assistance of an expert advisory panel.

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DISCLOSURE OBJECTIVE

Question 8

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?

- (29) We agree with EFRAG that disclosures for extractive activities are important because certain assets that underpin the overall value of the relevant company are not necessarily captured on the face of the balance sheet.
- (30) However, we are not convinced that extractive activities have unique economic characteristics that would significantly differentiate them from other industries that are heavily involved in R&D activities such as the pharmaceutical industry. One characteristic of these industries is the potential for very significant cash inflows in the short-term based on the outcome of the R&D efforts. Accordingly, specific disclosures may be important to understand the financial performance and position of entities in such industries. Therefore, IASB should reassess the need for additional disclosure requirements for industries heavily involved in R&D type activities.
- (31) The other fundamental issue that needs to be addressed is the extent to which IASB should be mandating disclosures for both assets and research expenditures either in the notes or in the management commentary section. The extractive industries are not necessarily different in terms of applying these disclosure principles and therefore this general issue needs to be addressed at Conceptual Framework level.

DISCLOSURES THAT MEET THE DISCLOSURE OBJECTIVE

Question 9

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).

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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?

- (32) We generally agree with EFRAG's view expressed on disclosure matters.
- (33) We are concerned with the very detailed and prescriptive quantitative disclosure proposals. Like EFRAG, we think that they are likely to outweigh the gain of the relevant information in many instances. For example, we think that the disaggregation of reserve quantities disclosure by commodity and by material geographical area is too onerous. IASB could gain valuable insights by performing field tests to assess the appropriateness of the proposals based on a costs/benefits analysis.
- (34) We agree with EFRAG that the proved reserve disclosure could potentially provide useful information to the user. Therefore, it should be disclosed separately in a way that avoids onerous disaggregation. We question the relevance of the probable reserve disclosure given the high level of subjectivity inherent to such disclosure.
- (35) We regret that the project team did not perform a comparison of its proposed disclosure model against SEC disclosure requirements and current industry practice. This would assist in establishing whether the proposals achieve a certain level of convergence.
- (36) Similar to EFRAG, we also question the focus on commodity price as a primary variable. The geographical characteristics are equally important since the uncertainty and risk associated with the different countries where the commodity is/will be exploited can vary significantly.
- (37) While sensitivity analyses are useful in certain very specific cases, we are not convinced that this is one of those situations. It is uncertain what would be the target variables of the analysis due to the fact that the current value measurement is not supported for extractive activities. We think the proposed analysis would support neither decision making nor increase the understanding of the outcome of a decision.
- (38) Reconciliation of changes in the estimation of reserves quantities is useful in principle. However, the level of disaggregation should be considered to avoid onerous reconciliation exercise. This reconciliation should also be in line with the way of disclosing proven and probable quantity reserves.
- (39) The DP proposes a significantly different logic for segment reporting from those that are used for managing the business. Therefore, we question the relevance and usefulness of the information provided by this proposal. We would expect more alignment with current, principles-based, segment reporting requirements.
- (40) Overall, we think that the proposed disclosure requirements are not necessarily specific to extractive activities and therefore IASB should reconsider relevant disclosure matters in a wider context as part of the Conceptual Framework project.

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PUBLISH WHAT YOU PAY DISCLOSURE PROPOSALS

Question 10

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.

- (41) We consider that this type of information is better suited for sustainability or management reports, instead of being part of the financial statements themselves. However, the IASB should clarify the placement principles in the conceptual framework and by that establish the boundaries between financial statement and management reports to contribute to making the financial statement more understandable. We refer to our comment letter on IASB ED Management Commentary issued on 18 March 2010 for further details on this issue.
- (42) Furthermore, it appears that the concerns voiced by PWYP are not unique to the extractive industry – hence the disclosures requested are not industry specific.