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Subject: IPSAS ED 92, *Natural Resources*

Dear Mr Carruthers,

Accountancy Europe is pleased to provide you with its comments on ED 92 *Natural Resources*.

Accountancy Europe has previously supported the development of a separate standard for accounting for tangible natural resources. However, during the development process, and particularly since the (draft) standard has become a residual standard, we are now questioning the need for a separate standard.

The focus of the (draft) natural resources standard has moved towards a more conservation focused standard than was initially envisaged. Justifiably, it still maintains the two hurdles – applicable to all types of assets - for recognising a tangible natural resource as an asset, namely:

1. Does it meet the definition of an asset – i.e. is the resource controlled and does it have service potential, and
2. Can the resource be valued reliably? If it cannot, then only disclosure is permitted.

As mentioned in our detailed response, we consider that the second hurdle will be difficult to overcome for many tangible natural resources, including assets held for conservation. For existing tangible natural resources, and for new resources gained through a non-exchange transaction, it could be very difficult to determine a reliable deemed cost using the current operational value measurement basis.

As a consequence, most tangible natural resources would only be disclosed in notes to the financial statements rather than included in a line item in the statement of financial position. We would question whether the statement of financial position is the appropriate place to disclose such assets and the best means to exercise stewardship over such assets.

Even when tangible natural resources do meet the recognition criteria, we would also question the value of recognising many of these in the financial statements and whether there is stakeholder demand for their recognition.

Consequently, we currently have considerable doubts as to whether there is a need for a separate standard in respect of tangible natural resources or whether it could be included in IPSAS 45, Property, Plant and Equipment (as has occurred with infrastructure and heritage assets). In the current iteration of the (draft) standard, we also have reservations whether there is a need for a separate line item for these resources.

There are obvious links between ED 92 *Natural Resources* and sustainability reporting. We feel that these are currently underdeveloped, particularly in respect of the climate-related positive impacts of conserving certain tangible natural resources. A further sustainability related issue of particular importance to the public sector is the disclosure of nature related issues - a sustainability reporting standard on this topic may be that a more appropriate vehicle for addressing the conservation of natural resources.

There is also the question of the balance of information to be included in public sector entities' general purpose financial reports. Apart from 'traditional' financial reporting, entities may have to report on three Recommended Practice Guidelines, sustainability issues starting with IPSAS SRS ED1, statistical matters and also national requirements.

Some of these requirements overlap in the current suite of IPSAS's existing and draft standards - whereas others currently do not and probably should. We therefore consider that it is important that the IPSASB looks at how all of these would best interact and how to achieve the most useful balance and interlinkage between the front 'narrative' section of the general-purpose financial report and the second 'financial' section.

We provide our comments to the specific matters for consideration below.

Sincerely,



Eelco van de Enden
Chief Executive

ABOUT ACCOUNTANCY EUROPE

Accountancy Europe unites 49 professional organisations from 35 countries that represent close to **1 million** professional accountants, auditors and advisors. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond.

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Specific Matter for Comment 1: Scope (paragraphs 3-5)

This Exposure Draft is broadly applicable to all tangible natural resources which are not within the scope of any other existing IPSAS. (See paragraphs 3-4, BC8, and BC34.)

Do you agree with the proposed scope?

As a result of the proposed scope, tangible natural resources held for conservation are one common example of items which could fall within the scope of this Exposure Draft.

What other items would you anticipate being accounted for through this Exposure Draft?

This Exposure Draft includes an Alternative View regarding its scope and the definition of tangible natural resources.

- (1) We agree with the proposed scope of this ED.
- (2) In terms of the current definition of tangible natural resources as resources with physical substance, that are naturally occurring and embody service potential or the capacity to generate economic resources (or both), there are many items that could fall into scope.
- (3) These items potentially include all the natural resources discussed in the development of this ED – such as subsoil resources, water resources, wildlife and naturally occurring plant life.
- (4) The issues are:
 - a. Whether further processing, management etc is required for the service potential or economic benefit to be realised - which then may lead to the resource being covered by other IPSAS, for example, inventory or agricultural assets
 - b. For recognition purposes, whether control can be exercised over the resource, whether there is uncertainty as the existence and / or scale of the resource, and
 - c. whether its value can be measured reliably.
- (5) Point (4)c., in particular, is a particularly high hurdle for many natural resources to be recognised as assets. That is not to say that potential assets cannot be identified. For example, Mount Fuji in Japan has economic potential (in terms of climbing fees and in broader terms such, as promoting tourism and promoting well-being), it doesn't fit into another category of potential asset, and it is controlled by the public sector.
- (6) However, the question then arises as to what the value would be of recognising Mount Fuji as an asset. It is not in need of protection, and conservation is unlikely to be an issue. Maintenance costs are more likely to be expensed than capitalised. Also, it would need to be determined what element of the service potential relates to the underlying asset and what element relates to those associated assets that give, for example, access to the underlying asset.
- (7) Thus, the main question with recognising other assets that may fulfil the recognition criteria is whether there any value for public sector entities to go through the exercise of recognising such natural resources as assets? Additionally, this also lead to public sector balance sheets being padded with assets for no real purpose.
- (8) The existence of a separate standard for tangible natural resources could potentially be beneficial when such assets are first acquired by public sector bodies. Where acquired as a result of an exchange transaction, a consistent treatment of how the asset should be depreciated, disclosed etc could be beneficial, albeit existing standards such as IPSAS 45 *Property Plant and Equipment* could be used

as an analogue. However, when the asset is acquired as a result of a non-exchange transaction the situation becomes more complicated.

- (9) When tangible natural resources are acquired as a result of a non-exchange transaction the value for recognition purposes would presumably be based on the asset's current operational value – the amount that the entity would pay at the measurement date for the remaining service potential of the asset.
- (10) For many of the tangible natural resources that are potentially in scope, calculating the current operational value could be challenging. There could be issues with verifying existence (for example, subsoil resources), control (for example, rivers) and in determining the price that would be paid to acquire to acquire the remaining service potential (for example, sites of outstanding natural beauty).
- (11) This would also apply to tangible natural resources held for conservation. For an entity charged with the conservation of a particular asset, that asset obviously represents service potential for that entity. However, putting a value on that service potential could be very difficult – especially, as indicated in the Illustrative Guidance and Examples, the capacity to generate substantial income may prevent a natural resource from being classified as an asset held for conservation.
- (12) We fear that difficulties in establishing a reliable measurement of natural resources could lead to a situation where the vast majority of natural resources are merely disclosed as a note to the financial statements with little financial impact on the statement of financial position.
- (13) Whilst we appreciate that such disclosures would provide an element of transparency for such resources and may aid with stewardship, we are not convinced that the financial statements are necessarily the best means to achieve these ends – especially as the public sector moves down the path to increased sustainability reporting.
- (14) In the future we may see further acceptance of social accounting methods covering such areas as carbon accounting, well-being accounting and human resource accounting that quantify the benefits of, for example, preserving natural resources to avoid carbon release and to improve the wellbeing of citizens. Such alternative accounting methods could lead to generally accepted techniques to assign a value to the natural resources held for conservation but that will be outside the projected time scale for this (draft) standard.

Specific Matter for Comment 2: Definitions (paragraph 6):

This Exposure Draft defines a natural resource as an item which is naturally occurring and embodies service potential, the capability to generate economic benefits, or both, and a tangible natural resource as a natural resource with physical substance.

Do you agree with the proposed definitions? If not, why not?

This Exposure Draft includes an Alternative View regarding its scope and the definition of tangible natural resources.

- (15) We agree with the proposed definitions of both natural resources and tangible natural resources.
- (16) Including service potential as a criterion for inclusion as a natural resource is useful as many potential natural resources may not have obvious potential to generate economic benefits, at least not without other actions that may put them within scope of another IPSAS.
- (17) Service potential could include health and well-being for citizens (that could apply to areas of outstanding natural beauty) and carbon capture (such as for woodlands and rivers). However, this in

turn brings us back to the point raised in paragraph 6 above – what is the value of recognising such assets in general purpose financial statements?

Specific Matter for Comment 3: Depreciation (paragraph 23):

This Exposure Draft includes a rebuttable presumption that the tangible natural resources recognized within the scope of this [draft] Standard have indefinite useful lives on the basis that they are generally not used or consumed in the same manner as tangible assets within the scope of other IPSAS. Therefore, these tangible natural resources are not depreciated.

Do you agree with the proposed rebuttable presumption that tangible natural resources should not be depreciated?

If not, why not?

- (18) In respect of assets held for conservation, we could be talking about natural parks that could have tangible elements including:
- a. The enduring components of scenery or ‘natural beauty’, including mountains, rivers, coastline, glaciers etc
 - b. Plants
 - c. Animals
- (19) Of these, the items in sub-heading a., whilst not having an infinite life, would normally have a useful life measured in centuries or millennia. Some plants may also have a life measured in centuries but for many it will be considerably shorter. For animals, their lives will mostly be very much shorter still.
- (20) So, in this context estimated useful life depends on the unit of account. If the unit of account is the national park as a whole, then an indefinite useful life may be appropriate – if separated into components then this is less appropriate for plants and animals. In this context, the guidance in AG17 to AG21 and AG31 to AG 32 is useful but the interlinkage between the two sections could be made more explicit.
- (21) For other potential natural resource assets that do not include living resources, an indefinite useful life may be appropriate but, as stated in the Application Guidance, would still need to be assessed on an item-by-item basis. As even ‘scenery’ can be subject to catastrophe, assets identified as having an indefinite useful life would need a periodic impairment assessment to assess the impact of, for example, climate change, earthquakes, erosion etc.

Specific Matter for Comment 4: Exemption from Certain Disclosures (paragraph 51):

As explained in paragraph BC31, this Exposure Draft exempts an entity from disclosing certain information which may lead to further degradation of tangible natural resources which are rare or endangered.

Do you agree with the proposed disclosure exemption? If not, why not?

- (22) We agree that it could be appropriate in certain circumstances for an entity not to disclose certain information that could lead to further degradation of natural resources.
- (23) However, there are probably relatively few instances where the recognition or disclosure of a tangible natural resource has been a primary source of information for those seeking to degrade the natural

resource. IPSASB should consider whether additional application guidance is required in this respect to avoid the disclosure exemption being used inappropriately.

Specific Matter for Comment 5: Cross-References to IPSAS 45, Property, Plant, and Equipment (paragraphs 15 and 54):

This Exposure Draft includes cross-references to the guidance in IPSAS 45 on the determination of cost in an exchange transaction and the disclosure requirements for current value. This guidance was incorporated by cross-reference as the acquisition of tangible natural resources is expected to be rare in the public sector, and there is familiarity with the principles on the determination of cost, which are consistent with those found in IPSAS 45.

Do you agree that these cross-references are sufficiently clear?

If not, how should the above guidance be incorporated into the Final Standard?

- (24) We agree that the interlinkages between the (draft) Natural Resources Standard and IPSAS 45, *Property, Plant, and Equipment* are sufficiently well developed.
- (25) As a broader consideration, if it becomes apparent that as a result of responses to ED 92 that either:
- Respondents have not been able to identify any further significant potential classes of natural resources that could fall under this (draft) standard apart from tangible natural resources held for conservation, or
 - Other potential natural resource categories have been identified, but respondents do not see the benefit in them being recognised and \ or disclosed

the IPSASB should consider whether a separate standard is required for Natural Resources or whether tangible natural resources held for conservation should be included in IPSAS 45.

- (26) There is also the question of whether potential difficulties in assigning a reliable value to assets held for conservation, and indeed, tangible natural resources as a whole, makes the requirement to have a separate line for such assets superfluous.

Specific Matter for Comment 6: Transition (paragraph 60):

This Exposure Draft allows the application of its requirements on a modified retrospective approach, by recognizing tangible natural resources which meet the recognition criteria on the date of initial application of the [draft] Standard at their deemed cost, or on a full retrospective basis in accordance with IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors.

Do you agree that the option to apply the proposed guidance on a modified retrospective basis will result in useful information? If not, why not?

- (27) We agree with the option to apply the proposed guidance on a modified retrospective basis and that it will result in useful information.

Specific Matter for Comment 7: Amendment to the Description of ‘Heritage Asset’ in IPSAS 45, Property, Plant, and Equipment (Appendix B):

The IPSASB proposes to amend the description of ‘heritage asset’ in IPSAS 45 so that heritage assets which are also tangible natural resources are accounted for within the scope of this [draft] Standard.

Do you agree with the proposed amendment? If not, why not?

- (28) We agree with excluding natural resources from the description of heritage assets in IPSAS 45. In our opinion, the characteristics of the asset being a natural resource has primacy over its characteristic of being a heritage asset.

Specific Matter for Comment 8: Sufficiency of Proposed Implementation Guidance and Illustrative Examples:

1. The non-authoritative guidance in this [draft] Standard was developed for topics that are potentially complex and difficult to apply in practice, are areas of concern for constituents, or where additional non-authoritative guidance could be useful.

Do you agree that the proposed implementation guidance and illustrative examples are sufficient? If not, what other topics would be helpful and why?

COMMENTS ON APPLICATION GUIDANCE

- (29) We find the Flowchart in AG2 to be useful and suggest that the IPSASB should consider whether there would be value to implementing a revised version in some of the other IPSAS that are referenced in it – for example IPSAS 12 *Inventories* or IPSAS 27 *Agriculture*.
- (30) AG9 considers how service potential may demonstrated - requiring a plan to show service potential, the entity’s ability and intent to carry out the plan and the availability of necessary resources. However, there is no additional guidance as to what sort of service potential would be acceptable. As we are dealing with some new concepts that could lead to a broader recognition of assets than have been traditionally considered for general purpose financial reports, this could be a difficult issue for many entities.

COMMENTS ON IMPLEMENTATION GUIDANCE AND ILLUSTRATIVE EXAMPLES

- (31) Much of the implementation guidance and illustrative examples seem to focus on demonstrating what can’t be included as a tangible natural asset rather than giving indications of what could be included. In respect of water resources for example, we accept that it is practically impossible for a public sector entity to ensure that a lake will continue to receive water, but you could argue that it is impossible to ensure that any asset will not be adversely affected by future events and uncertainty – hence impairment reviews.
- (32) In respect of a natural resource held as a conservation asset, it is not clear from C4 what the service potential such an asset would be. The whole argument seems very circular – the service potential for an asset held as a conservation asset is that the entity in charge of the conserving the asset has a duty to conserve an asset. If there is too much non-conservation related service potential – entrance fees or recreation activities, for example, - it could cease to meet the criteria for an asset held for conservation.
- (33) In such circumstances, and especially where the asset has been acquired by a non-exchange transaction, it is difficult to see how the current operational value of an asset held for conservation could be reliably measured.
- (34) This would seem to greatly limit the instances of natural resources can be realised as an asset on the entity’s statement of financial position. If the end situation is disclosure only, perhaps such information would be better reported in a future sustainability standard.