



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

28 July 2010

Dear Sir/Madam,

RE: DP ON EXTRACTIVE ACTIVITIES

BUSINESSEUROPE welcomes the opportunity to comment on the Discussion Paper (DP) "Extractive Activities".

Firstly, we would like to make a general comment on the process going forward.

BUSINESSEUROPE understands why the project team did not wish to be constrained by existing guidance when developing the proposals set out in the Discussion Paper. However, and bearing in mind its convergence principles, the Board will appreciate that the outcome must be a single set of global requirements.

Differing requirements would not help users and preparers and result in an unacceptable increase in costs and/or diversion of resources. We would therefore expect to see that any future project, should it take place, will be conducted jointly with FASB/SEC and other relevant bodies.

Then, we would like to highlight the following key issues raised in our responses to the questions which are set out in the appendix to this letter:

- further work is required before concluding that a specific accounting standard is required for extractive activities
- the disclosures proposed by the project team are excessive, costly, not necessarily useful to investors and may risk delaying publication of financial statements

- the disclosures proposed by the Publish What You Pay coalition do not meet requirements for inclusion in an IFRS and may in any case not achieve the coalition's objectives

Should you wish to comment on the above further, please do not hesitate to contact us.

Yours sincerely,



Jérôme P. Chauvin
Director
Legal Affairs Department
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APPENDIX TO BUSINESSEUROPE LETTER ON IASB DP “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.

The activities covered by the DP (“upstream activities”) go beyond those within the scope of IFRS 6 *Exploration for and Evaluation of Mineral Resources*, although the DP’s discussion on the accounting does focus on activities up to and including the exploration and evaluation phase. On the other hand, the range of activities covered is more restricted than those of IFRS 6. We agree with this scope on the grounds that the minerals and oil and gas industries have similar activities and face similar risks. If this project goes ahead on the basis of this scope, then the question will arise however as to how to deal with those activities currently covered by IFRS 6 but which would under the DP fall out of scope.

On a more detailed point, there is an increase in the number of projects, such as Liquefied Natural Gas, which may extend beyond the traditional “upstream” boundary which should be considered when setting the scope.

At a higher level, we can understand why it is important to develop appropriate disclosures for activities where existing IFRS requirements are not complete, but a key issue is whether there is sufficient justification for developing a specific accounting standard; this is explained in our response to Question 4 below.

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 refer again to our response to Question 4 below regarding whether or not there should be a specific accounting model.

In respect of disclosures, we believe it should be possible to develop a single set of disclosure requirements for the extractive activities, but comparability should not be forced if that would not meet the needs of the respective users and preparers in each industry.

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?

We support the conclusion in the DP that the IASB should not develop its own detailed definitions in this area. It is logical to use definitions that are already recognised by the respective industries and well understood by preparers and users.

However it is important for constituents that there is appropriate due process. For that reason we recommend that the definitions should be embodied within any future IFRS rather than delegated to third parties. These definitions can be based on the high-level principles underlying the definitions established by CRISCo/SPE or those of the SEC, rather than detailed rules. However, in line with our understanding of users' needs, the technical requirements could be overlaid with economic requirements of consistent pricing and cost assumptions in order to enhance comparability. Any changes to these principles, which are not expected to be frequent, can then be subject to the usual IASB due process.

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 prospecting activities prior to the acquisition of legal rights should normally be expensed (paragraph 3.29) and that the mining or oil and gas property should form the basis of the asset. The obtaining of legal rights for the exploration of a property generally should trigger recognition of an asset (paragraphs 3.13-3.16) meeting the criteria of IAS 38 *Intangible Assets*. However we do not necessarily agree with the "asset continuum" or "asset enhancement" recognition model proposed in the DP beyond these activities because we are not yet convinced that a separate model is required for extractive activities and not sure that all of the cost incurred results in an asset. We would prefer that, before reaching a conclusion, further work is carried out to determine the impact of withdrawing IFRS 6 and therefore relying on existing IFRSs for the accounting for exploration and evaluation. Minor changes could be considered to existing standards, perhaps via additional guidance or interpretation, but only to the extent that they do not conflict with the accounting for other activities such as research and development.



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 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?

We refer to our response to Question 4 above. Under the recognition model proposed in the DP, the concept of contracting the unit of account as exploration and evaluation takes place may be difficult to apply in practice, particularly taking into account impairment considerations. We do not believe that is necessary, nor practical, to segregate and track non-drilling activities. It may also be appropriate to group certain licences into a single unit of account reflecting how they are managed, but this would not be possible under the DP's proposals.

We believe that existing IFRS guidance is probably sufficient in order for management to make judgements about appropriate groupings of assets based upon the facts and circumstances of individual licence areas and reserves. The unit of account is perhaps more relevant to the development and production phases.

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 agree that historical cost is the appropriate measurement basis. It is reliable and understandable. Contrary to the assertion in the DP, historical cost information is not



simply of limited value; it helps users judge how efficiently the management has used its capital resources. Unit finding costs, development costs and production costs are commonly used indicators that are generally based on historical cost.

Applying a fair value measurement basis involves an accumulation of assumptions that we do not believe can result in information that is reliable enough for the financial statements. Observable market prices can be difficult to find; model-based calculations require a high degree of judgement. The economics of long-term projects undertaken in these industries can be affected by changes in other assumptions such as costs, production profile, discount rate and exchange rates and is subject to regulatory, taxation and technological risks.

The fundamental change (and potential volatility) introduced into financial statements by measuring such assets at fair value would not be welcomed. We expect it would reduce an investor's understanding of an entity's activities and not be relevant to users' decision-making in helping to evaluate past events and predict future cash flows. The preparation of data on a fair value basis each reporting period would come at a very high cost in terms of needing additional resources and/or diverting resources from an entity's revenue-generating activities – and potentially delay publication, especially when adding audit considerations.

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 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?

Impairment testing becomes a more significant part of the process under the recognition model proposed in the DP; the use of judgement shifts from asset recognition to considering whether there are indications of impairment which will therefore become more subjective. We would have a concern with any approach which may add further complexity.

We recommend that impairment requirements are reviewed together with the recognition model (see response to Question 4 above) when determining whether existing IFRSs can be applied to extractive activities.

**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?

These disclosures objectives may be appropriate, although there is no mention of qualitative characteristics such as timeliness and cost/benefit considerations. However we do not think it necessary that individual accounting standards should have their own disclosure objectives. The IASB should develop objectives that are valid for the disclosures in the financial statements of all entities irrespective of their activities.

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?

We have a major concern with the disclosure proposals as set out in Chapter 5, which are labelled as “the minimum”. We believe they are excessive, costly, not necessarily useful to investors and may risk delaying publication of financial statements.

Users require information to make their own determination of an entity's value. We understand therefore that current or fair value measurements estimated by the entity itself are not required.

We also do not believe that the preparation of sensitivity analyses as proposed in the DP are practical or can meet cost/benefit tests. Many of the variables are inter-related and do not behave in a linear manner and therefore the information would be meaningless.



We question the usefulness of disclosing reserves beyond proved, given the increased level of uncertainty and judgement involved in making such estimates.

In summary, we consider that the following set of disclosures should replace those set out in Chapter 5:

- a) Quantities of proved reserves by commodity (or group of commodities for the minerals industry) and by major geographical area based, as explained in our response to Question 3, on standardised assumptions;
- b) A reconciliation of the change in estimate of reserve quantities from the previous year-end, together with commentary on significant changes;
- c) Income statement covering extractive activities by geographical region;
- d) Information about costs in the period, analysed within activity type (exploration, development and production) by major geographical region, on an accruals basis;
- e) Unit prices by commodity by major geographical region.

We agree with the conclusion in the DP that reserve disclosures should be outside the financial statements and therefore not subject to the additional cost of audit which could be significant.

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.

Whilst we understand the motivation of the Publish What You Pay (PWYP) coalition in putting forward its list of proposed disclosures, we would expect that the IASB will judge their appropriateness using the same criteria that they would apply to any item for inclusion in an IFRS. Therefore considerations should be wider than only cost-benefit. The objective of general-purpose financial reporting set out in the IASB's Framework is to provide information that is useful to investors and other capital-market participants in their decisions about providing resources. All disclosure requirements should be aligned with that objective and should be consistently applied to all activities. We would have also have expected that, if any of the proposed disclosures had met the disclosure objectives set out by the project team, they would have already been included within Chapter 5.



We do not believe it has been established that including such detailed disclosures as part of the financial statements will be useful to providers of capital. It is also important to point out that, even if the PWYP disclosures were included in an IFRS, financial statements must comply with *IAS 1 Presentation of Financial Statements* (paragraph 31) which states that “An entity need not provide a specific disclosure required by an IFRS if the information is not material”. For major multi-national companies it is likely that the information for an individual country would frequently not meet this criterion.

We also note that information on country-specific risks (with respect to the discussion in paragraphs 6.13-6.25 of the DP) is already provided in annual reporting in major jurisdictions under existing requirements, which apply to all industries.

As regards cost/benefit considerations, reporting systems are generally not cash-based but accrual-based and cannot necessarily currently identify the amounts relating to government and its agencies in the detail requested. Work would also be required to clarify definitions. There would be additional costs, which may be significant, involved in making system changes, in on-going reporting and in compliance and audit of this information.

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