

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Oslo, 27 July 2010

Dear Sir/Madam

DP/2010/1: Extractive Activities

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) is pleased to comment on the Discussion Paper on *Extractive Activities*.

We appreciate the Board's effort researching the accounting for extractive activities with the aim of potentially developing an accounting standard.

Generally we are in favour of principle based financial reporting standards and think the hurdle rate for when to potentially deviate from the framework or any IFRSs, and issue industry specific IFRSs, should be high. We are not convinced by the arguments of the project team that business activities, risks and uncertainties of extractive activities are sufficiently different from other activities to require a separate IFRS. We agree, however, that some of the specifics of extractive activities require separate disclosure guidance. We also agree with the project team that the disclosure requirements of reserves information should be unaudited information "supplementary" to or outside of the financial statements due to the significant degree of imprecision and subjective assessments required in estimating reserves.

Consistency in accounting standards world wide is an important objective, and we would suggest that the IASB work together with the FASB when potentially drafting a financial reporting standard for global industries like oil & gas and mining.

Our detailed comments to the questions in the order suggested by you are set out in the appendix to this letter.

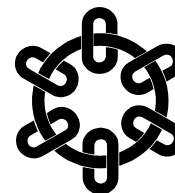
Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response, or related issues, further.

Yours faithfully,
Norsk RegnskapsStiftelse

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Appendix - Detailed comments on DP 2010/1

Specific questions

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.

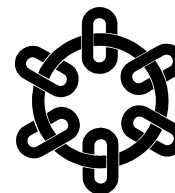
Do you agree? Are there other similar activities that should also fall within the scope of an IFRS for extractive activities? If so, please explain what other activities should be included within its scope and why.

We are not convinced by the arguments of the project team that business activities, risks and uncertainties of extractive activities are sufficiently different from other activities to require a separate IFRS. Other activities such as pharmaceutical and software development activities share similar characteristics, risks and uncertainties. We are generally in favour of principle based financial reporting standards and think the hurdle rate for when to potentially deviate from the framework or any IFRSs, and issue industry specific IFRSs, should be high. We agree, however, that some of the specifics of extractive activities require separate disclosure guidance, which could be issued in the form of a separate disclosure IFRS. Given that a pure disclosure IFRS was to be issued, we do not think that the similarities between mining and oil & gas are so prevalent that they should be covered in the same write up sections. This is mainly due to the significant difference between the two suggested definition frameworks for estimation of reserves and resources, upon which a significant portion of the disclosures will be based.

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?

As discussed under question 1 above, we are not convinced that the extractive activities are sufficiently different from other activities to require a separate accounting model, but agree that disclosure guidance is required. If the IASB decides to issue a disclosure IFRS for extractive activities, we believe the specifics of oil & gas activities are so different from the specifics of minerals activities that separate disclosure requirement sections would be required. One argument for separate disclosure requirements is that the current disclosures for the minerals versus the oil & gas activities are quite different. We believe these differences have evolved as a result of different needs of the users of the financial statements and differences in the way management looks at the business activities. Another argument for separating the requirements is the significant difference between the two suggested definition frameworks for estimation of reserves and resources, upon which a significant portion of the disclosures will have to be based. We believe the reasons set out by the project group in paragraph 2.25 for why an alignment of the CRIRSCO Template and PRMS reserve and resource classification systems and move to a common set of definitions “would be extremely difficult given the long history of each industry, wherein these terms and approaches have become embedded in practice” would also imply that different disclosure requirement descriptions are needed.



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?

Assuming the IASB concludes that a set of definitions of reserves and resources should be included in a future IFRS for exploration activities, we think a principle based set of definitions should be developed. Existing definitions may be used for establishing the definition building blocks, but we do not believe direct references to external sources in IFRSs represent the best basis for setting definitions. An external source reference technique may be at odds with appropriate governance, and may also have a negative impact on the external sources as a result of apparent lack of independence from the IASB. Also, even though the CRIRSCO/PRMS definitions are widely accepted, there are still a significant number of countries relying on other classification systems.

When developing the set of definitions to be used, it is especially worth noting that reserves are used for different purposes in financial reporting and that users have expressed several different types of needs to be served by reserves and resources disclosures. On the one hand users need information about reserves estimates directly affecting amounts in the financial statements, such as the basis used to calculate depreciations, impairment write-downs and asset retirement obligations. On the other hand users need reserve information on a standardised basis to allow for comparability among disclosures. The latter may best be achieved by using a system and method that to a low degree factors in management's intentions and entity specific assumptions.

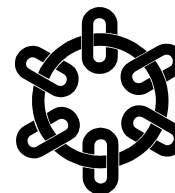
We believe comparability is the most important objective of reserves disclosures and that this objective is best achieved by providing disclosures of proved reserves under given (non-entity specific) assumptions for the main input factors (commodity prices).

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 note that the project team in paragraph 3.10 refers to the current asset recognition criteria, which includes a probability criterion, and that the project team in paragraph 3.11 anticipates that the probability criterion will be removed. Although it is stated in paragraph 3.11 that both alternative recognition criteria are analysed, we miss a thorough discussion and analysis under the current asset recognition criterion. In particular we would like to see an analysis of similarities and differences between extractive activities and activities within the scope of IAS 38. As discussed in our cover letter and under question 1 above, we are not convinced that the business activities, risks and uncertainties of extractive activities are sufficiently different from other activities, e.g. activities within the scope of IAS 38 *Intangible*



Assets, to require a separate IFRS. We believe other activities such as pharmaceutical and software development activities share similar characteristics, risks and uncertainties. In our view the research and development phases, as defined and described in IAS 38, paragraphs 54 – 59, include many of the same facets as extractive activities.

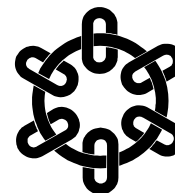
We agree with the project team's discussions and conclusions in paragraphs 3.13 – 3.16, in which it is argued that the initial costs of acquiring legal rights to explore a defined area meet the definition of an asset and is similar to IAS 38, paragraphs 25 and 26, and as such satisfy the intangible asset recognition criteria in IAS 38, paragraph 21. When it comes to enhancements of the legal rights (the "asset continuum model") discussions in paragraphs 3.18 – 3.21 (related to information) and paragraph 3.22 (related to additional rights and approvals), however, there are no references to IAS 38. As such it is unclear whether the project team has assessed similarities and differences between extractive activities and research and development activities for subsequent expenditures on information etc., which in IAS 38 is covered in the paragraphs 42 – 43. It is also unclear whether the project team has assessed potentially applying the "asset continuum" model to activities within the scope of IAS 38. We believe the separation between the research phase (expenditure recognised as an expense when it is incurred) and the development phase (recognised as assets if the entity can demonstrate that certain criteria have been fulfilled) in IAS 38 primarily has to do with the probability criterion and the thinking surrounding "contingent assets". In IAS 38 BC 18 it is stated that the recognition criterion in the *Framework* "should be considered more generally as part of a forthcoming Concepts project."

We acknowledge the fact that the asset recognition criteria are under review as part of the IASB/FASB conceptual framework project, that the revised IFRS 3 *Business Combinations* has introduced new thinking related to contingent assets and that the IASB as part of the deliberations on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, has decided to include probability assessments in the measurement of an asset or liability. However, we find it difficult to assess what implications a revised asset recognition (and measurement) model would have for extractive activities. We would suggest that the IASB assess the "asset continuum model" under a broader scope in light of the development on these other projects and particularly compare with activities within the scope of IAS 38. In particular we think it is worth noting that exploration activity generally has a success-rate significantly below 50%. I.e. the probability criterion is often not satisfied at the individual asset level.

An often used rule of thumb for oil & gas exploration drilling (assuming the activity is not very close to existing known reservoirs), for example, is a success-rate of 20%. Using the project team's suggested recognition model under this assumption (without going into the impairment criteria) and further e.g. assume an average evaluation period of 18 months, the result would be that 80% of the exploration expenditures would be recognised as expenses 18 months later than they were incurred. I.e. the majority of the projects will never be sanctioned and the related expenditures will not generate future economic benefits. We do not believe this model would give more useful information to the users than e.g. a model under which all exploration expenditures are recognised as expenses when incurred. In the latter model the income statement would reflect the level of exploration activity performed in the reporting period.

Based on the above, we cannot see that significant benefits would be achieved by introducing the suggested new model.

We believe the usefulness will be even more compromised under the suggested new impairment method which requires conclusive evidence that a project will not be developed



before a write-down of an exploration asset is made. We fear this, combined with a potentially difficult to apply unit of account model, will allow for earnings management.

We suggest that until a broader assessment of “the asset continuum model” has been performed, IFRS 6 is kept as is.

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 are uncertain how the suggested unit of account would be applied in practice. Whatever unit of account selection is made, we think application guidance should be issued, e.g. in order for preparers to assess how to potentially allocate initial purchase prices to projects or assets that are expected to be managed and matured separately.

As discussed in relation to question 4 above, we do not think the “asset continuum model” described by the project team is appropriate for extractive activities. Potential alternative models, developed in light of the expected amendments to the Framework, and the asset recognition and measurement concepts in particular, would require this issue addressed in another frame of reference.

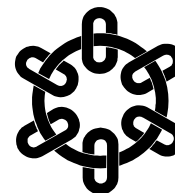
Question 6 – Minerals or oil and gas asset measurement model

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 with the project team that historical cost should be used as the measurement basis for minerals or oil and gas assets. We think the historical cost measurement model provides reliable, clear and verifiable information in the financial statements.



Both fair value and current value models would to a significant degree be based on estimated and judgmental input, and the numbers would be strongly influenced by subjectivity. We are concerned that comparability across entities within the industry would suffer if fair value or current value models were chosen. The alternatives would also imply substantial effort and cost for the preparers without getting the equivalent benefit from improved quality in the reported numbers. We think the users' needs should be the main factor when determining the measurement model. As also noted by the project team it is our clear impression that current value or fair value measurement is not preferred by the users.

We note that the IASB are downgrading the importance of reliability and verifiability in financial reporting in the ongoing Framework project. In our view, however, it would be naive not to expect a significantly increased risk of earnings management if fair value measurements were introduced. Assets for which a liquid market exists would by definition have a low spread between the highest and lowest bidder, which provides a good basis for fair value measurement. For oil & gas licenses, prospects, etc., however, there are quite a few examples in which the bid of the highest bidder is more than ten times the bid of the lowest bidder.

Historical cost is broadly accepted, more objective, and requires significantly less effort. It is more understandable to users and enhances comparability. Historical cost is necessary for determining the return on capital employed. The users also get insight into the cash investment practices of the company.

If the IASB was to change the measurement model for minerals or oil and gas assets, which would include reserves and resources, inventories, intangible assets and property, plant and equipment from historical cost to a current or fair value model, we question why this should be done only for extractive activities at this stage. One would be creating a measurement inconsistency between the extractive industries and other industries, which are not subject to fair value measurement. Certain industries, as agriculture and investment property companies, are subject to a fair value measurement requirement for certain assets, but not for other assets, while historical cost generally applies to most other industries.

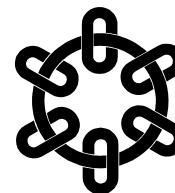
Question 7 – Testing exploration properties for impairment

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?

We agree that under the suggested recognition model as well as under current models applied within oil & gas exploration activities, such as the successful efforts model, it is difficult to apply IAS 36 *Impairment of Assets* to extractive assets as expected cash flows are generally not prepared at this early stage. IAS 36 is not designed to properly cover assets recognised under a recognition model which sets aside the probability criterion in the



statement of financial position. Such a model would need further assessment before implemented for any activities. Without objective, clear and strict criteria for when an exploration asset should be impaired or derecognised, and when it should be carried in the statement of financial position, the task of determining in what period it is appropriate to recognise the expenditures as expenses becomes difficult and subjective. Altering the justification requirements, in a given financial reporting period, from being required to justify why some exploration expenditure is recognised as an asset to justify why it is expensed (conclusive evidence that the project is not going to be developed) would make it even more difficult for the preparers. We would also point to the fact, as noted above, that significantly less than 50% (on average maybe as low as 20%) of the exploration expenditures capitalised under the suggested model, will generate future economic benefits.

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?

As discussed above we do not think extractive activities are sufficiently different from other activities to require a separate IFRS. We agree that the specifics of extractive activities require separate disclosure guidance and that such guidance could be issued in the form of a separate disclosure IFRS. However, we do not think the disclosure objectives for extractive activities are different from those of other activities. We believe the general basis and objectives of financial statements as set out in the Framework, in IAS 1 *Presentation of Financial Statements* and in the individual IFRSs are applicable to the activities and transactions affected by them and should be applied across all industries.

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

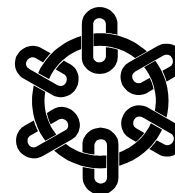
Also in Chapter 5, the project team proposes that the types of information that should be disclosed include:

- (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;*

We agree that disclosures of reserve quantities are important to users of financial statements and should be provided. As noted under question 3 above, we believe comparability is the most important objective of reserves disclosures and best achieved by providing proved reserves on a standardised assumptions basis.

As we see it proved plus probable reserves (2P) could be disclosed on a voluntary basis, but it is then important that the significant increase in subjectivity (e.g. related to management intentions and price assumptions) and uncertainty around reported reserves are clearly stated.

We support presenting quantities separately by commodity type. However, we do not believe that oil sands or other high cost operations should be disclosed separately. The actual sales product should be disclosed. A cost of operations separation would be arbitrary and disclosures about costs of production are part of the listing of other suggested disclosure.



We support presenting quantities by material geographical areas but are of the opinion that the level of aggregation for the reserves disclosures should be based on management's judgement.

(b) The main assumptions used in estimating reserves quantities, and a sensitivity analysis;

We fully support the rationale behind a potential requirement for a sensitivity analysis and agree that a well prepared and presented sensitivity analysis can provide relevant information. However, a sensitivity analysis is only useful when prepared to show the effect of a change in one variable. Reserves estimation requires evaluation of impact on other input factors resulting from changes in the main input factor and including static variables would distort the information in the analysis. We believe that there are too many weaknesses and too much subjectivity involved in such an analysis to make it meaningful. It would also not be possible to compare between companies. It should be noted that sensitivity analyses could be costly for the entities to develop depending on the nature of the assets and the contracts. E.g. it would normally be quite costly to run sensitivities on reserves in production sharing agreements (PSAs).

(c) A reconciliation of changes in the estimate of reserves quantities from year to year;

We support that a reconciliation of changes in the estimate of reserves quantities from year to year is disclosed at an aggregated level.

(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;

For the reasons explained above, we are not convinced that a current value measurement would provide benefits that exceed the costs of preparation.

(e) Separate identification of production revenues by commodity; and

We support that separate identification of production revenues by commodity is disclosed.

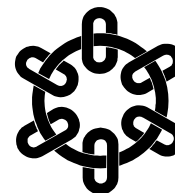
*(f) Separate identification of the exploration, development and production cash flows for the current period and as a time series over a defined period (such as five years).
Would disclosure of this information be relevant and sufficient for users?*

We believe separate identification of current period and time series of such costs are useful. However, we think providing information about these expenditures on a cost accrual basis would be more useful than on a *cash flows* basis. We think that cash flow information could be useful in relation to a current or fair value measurement basis, but for the reasons explained above, we are not convinced that a current value measurement would provide benefits that exceed the costs of preparation.

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?

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.

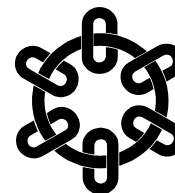
We generally support initiatives which promote greater transparency of payments to governments. We would, however, question using IFRSs as entry-points for addressing such issues. We are very concerned about potentially mixing objectives of financial statements with any other valid and commendable objectives (e.g. those of various special interest organisations). As such we seriously question the starting point for the discussion paper's considerations as to whether the suggested required disclosure information fits to the objective of general purpose financial reporting. The basis for disclosure requirements must be a risk and materiality assessment of the users' needs. This is the starting point for Chapter 5 in the discussion paper, which deals with disclosure requirements, and also the starting point for all other accounting standards. Starting the opposite way, e.g. by taking the PWYP suggested detailed disclosure information and assess whether this fits to the objectives, could lead to enormous amounts of information apparently becoming relevant. We see a risk that such an approach would make the financial statements too voluminous and not necessarily giving the most relevant information in relation to risk and materiality factors.

The discussion paper also recognises, in paragraph 5.15, that "It is not the intention of financial reporting to meet all of the information needs of users, nor would it be possible." 5.15 also refers to the IASC's Framework for the Preparation and Presentation of Financial Statements (Framework) which "acknowledges that, although financial reporting is primarily directed to meeting the needs of capital providers, it is not the only source of information that capital providers will rely on when making their investment decisions."

We believe it is important that preparers of financial statements strive to keep a reasonable balance between the extent of information given on a certain matter and the importance of it and the risks surrounding it, considering materiality of the reporting entity as a whole. We believe this is an important facet of the risk and materiality based view in the IFRSs. Disclosing detailed information about immaterial matters could mislead the users to think that other information in the financial statements is based on an unrealistically low level of granularity.

Hence, we believe that the accounting standards should not be used for this purpose. Should the IASB conclude, however, that the financial statements are the appropriate place for this type of information, the disclosure requirements would typically be set out in a general accounting standard, and not in an industry specific. The intentions and objectives of the suggested information requirements are, as we see it, valid for all industries and activities carried out, not only for extractive activities.

Should the IASB decide to include elements of the PWYP suggested disclosures, in any accounting standard, it is very important that the benefits of the requirements are assessed thoroughly against the costs of providing the information. The extent of such information requirements must, as for any other disclosure requirements, be based on risk and materiality assessments in relation to the reporting entity and at a reasonable level of detail and granularity. In such an assessment it is also important that the cost of internal controls and audit verifications are not underestimated. A potential disclosure requirement based on



lower materiality thresholds in this specific area would also have to include clear definitions of taxes, royalties, cost-oil, profit-oil, in-kind payments etc. The content of these terms vary greatly from country-to-country and are notoriously difficult to define in order to achieve comparability among entities etc.

We acknowledge the fact that PWYP has several commendable intentions and objectives, and we are not opposing that this type of information should be provided on a voluntary basis e.g. in some form of social responsibility reporting or similar. However, these intentions and objectives fall outside the objective of financial statements. We believe more appropriate bodies for establishing guidelines for such disclosures would be e.g. regulators or stock exchanges. IFRSs should continue to be developed on the basis of the objectives in the IASC Framework for the Preparation and Presentation of Financial Statements (Framework). We are afraid that adding objectives that are not serving financial statement purposes could undermine the credibility of financial statements among preparers and users. Also note that setting out additional requirements under the financial statement disclosure rules would imply comprehensive information system, internal control and audit verification procedures. We believe that the costs would by far outweigh the benefits.