

**IASC Foundation**  
**IFRS Conference**

Wednesday 23 and Thursday 24 June 2010  
Hilton London Metropole, United Kingdom

**Special Interest Workshop**

**IFRS for Extractive Activities**

**GLENN BRADY**

*Senior Technical Manager*

**IASB**

**LAURA BARBROOK**

*Deputy Controller*

**Rio Tinto**

**SVETLANA PEREVERZEVA**

*Head of Accounting Policy – E&P*

**BP**

*Chair:*

**BOB GARNETT**

*Member*

**IASB**

*IASC Foundation*  
**Special Interest Session**

***IFRS for Extractive Activities***

24 June 2010—at the Hilton London Metropole (United Kingdom)

***Programme***

13:00 ***Registration***

14:00 ***Introduction***

**Bob Garnett**

*Member*

**IASB**

14:05 ***Technical update: Accounting issues including:***

- ***Extractive activities project***
- ***Joint arrangements***
- ***Deferred stripping***
- ***Other developments***

**Glenn Brady**

*Senior Technical Manager*

**IASB**

15:00 ***Mining preparer's perspective***

**Laura Barbrook**

*Deputy Controller*

**Rio Tinto**

15:25 ***Oil and gas preparer's perspective***

**Svetlana Pereverzeva**

*VP of Accounting Policy, E&P*

**BP**

15:50 ***Round-table Q&A***

Chair:

Bob Garnett, *Member, IASB*

Panellists:

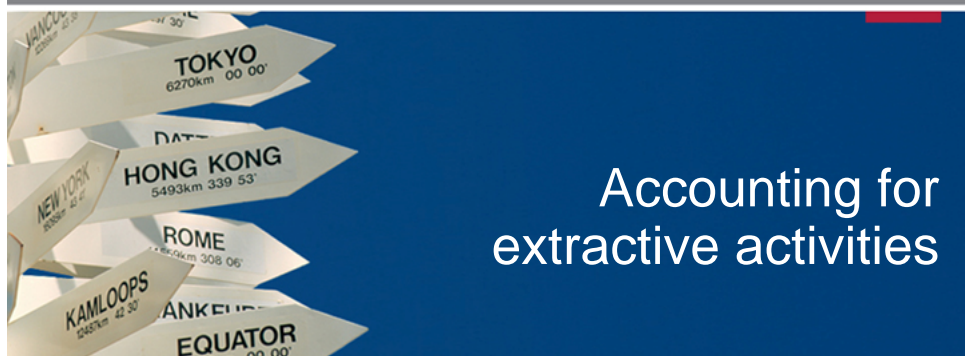
- Glenn Brady, *Senior Technical Manager, IASB*
- Laura Barbrook, *Deputy Controller, Rio Tinto*
- Svetlana Pereverzeva, *VP of Accounting Policy, E&P, BP*

16:25 ***Concluding comments***

**Bob Garnett**

*Member*

**IASB**



## Accounting for extractive activities

Glenn Brady, Senior Technical Manager, IASB

### IASB Foundation

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## Agenda

- Extractive activities research project
- Joint arrangements
- Production stripping
- Hedging
- Liability measurement under IAS 37





## Extractive activities research project

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## Why undertake this research project?

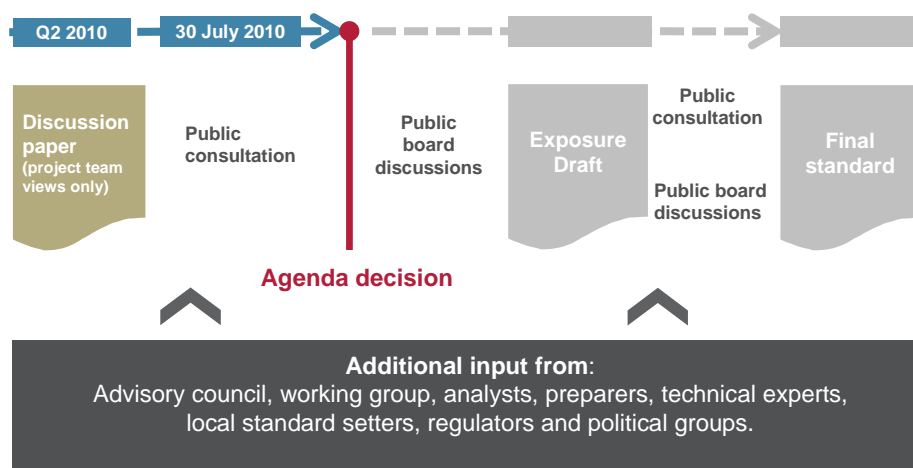
- IFRSs do not provide specific guidance for extractive activities
  - IFRS 6 is an interim standard
  - scope exclusions in other standards
  - no specific disclosure requirements
- Some question the relevance of existing accounting and disclosure practices

**Accounting and disclosure practices often vary  
by industry, by jurisdiction, and by company size**



## Our due process

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## Key research questions

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- How should mineral and oil & gas reserves and resources be **defined**?
- When should an asset relating to mineral and oil & gas reserves and resources be **recognised** on the balance sheet?
- How should this asset be **measured**?
- What information about mineral and oil & gas reserves and resources should be **disclosed** in the financial report?

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## Definitions

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- No single agreed definition of reserves or resources for the extractive industries
- Project team recommends for use in an IFRS
  - Petroleum Resource Management System (PRMS) – for oil & gas
  - The CRIRSCO Template – for mining
- Why?
  - Wide acceptance
  - Broad and comprehensive scope
  - Broad equivalence between key concepts
    - therefore capable of providing a platform for comparable accounting and disclosure requirements across both industries



## Asset recognition

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- Existing practice involves expense/capitalise decisions based on activity (e.g. exploration, development)
  - not based on asset/liability definition
  - depends on definition of exploration, development
- Differences between mining and oil & gas
  - area of interest, full cost, successful efforts
- Differences by entity size
  - junior explorers more likely to capitalise exploration



## Asset recognition continued

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- Apply the *Framework*
- Project team's view is that the asset is:

The right to explore, develop, extract minerals or oil & gas

- Initial recognition when acquire legal rights to explore
- Over time this asset is enhanced by
  - information from exploration & evaluation activities
  - development to access the mineral or oil & gas
  - additional rights and approvals (including extraction rights)



## Asset recognition continued

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- Geographic boundary of unit of account
  - initially defined by exploration rights
  - reduces as exploration, evaluation and development activities occur
  - no greater than a contiguous area that is:
    - defined by the legal rights
    - managed separately
    - expected to generate largely independent cash flows.
- Asset components
  - IAS 16 components approach determines which plant and equipment assets are recognised separately



## Asset measurement

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- *Option 1: Historical cost* – verifiable, but ...
  - cost has limited relevance to users
    - no correlation between finding & development costs incurred and future cash flows that will be generated from the property
- *Option 2: Fair value* – relevant (in principle), but ...
  - requires many subjective assumptions and estimates
  - significant time and effort to prepare
- Project team recommends historical cost
  - neither cost or fair value provide significant benefit to users
  - historical cost measurement is less costly for preparers

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## Impairment

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- Development/production properties – apply IAS 36
- Exploration properties
  - usually insufficient information to apply IAS 36
  - existing practice typically focuses on derecognition criteria
  - Project team recommends:
    - impair based on management's judgment that recovery of carrying amount is highly unlikely
    - additional indicators to support continued recognition of the exploration property asset
    - supporting disclosure about exploration property assets and write downs

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## Disclosures

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- Current disclosure practice is diverse – both across industries and across jurisdictions
- Disclosure guiding principles
  - respond to user needs
  - consistent disclosure for minerals and oil & gas
    - this does not mean identical disclosure
  - cost/benefit considerations
    - proposals represent a substantial change to existing practice in both industries
    - consistency with regulatory requirements



## Disclosures *continued*

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- Information on the value of an entity's minerals or oil and gas properties
  - Proved and probable reserve quantities
  - Current value measurement of those reserves
  - Main assumptions used
- Information on the entity's performance
  - Changes in reserve quantities and reserve values
  - Production quantities and production revenues
  - Exploration, development and production cash outflows



- Information on nature and extent of risks and uncertainties
  - Reserve quantities disaggregated by
    - commodity
    - geography
    - Production Sharing Contracts and similar arrangements
  - Sensitivity analysis



- Publish What You Pay are concerned that resource wealth is not benefiting citizens of many resource-rich developing countries
- PWYP request country-by-country disclosure of
  - payments to governments
  - reserves, production etc
- Information can be used to help evaluate investment and reputational risk
- Issues with preparing and auditing that information



## Comments requested on discussion paper



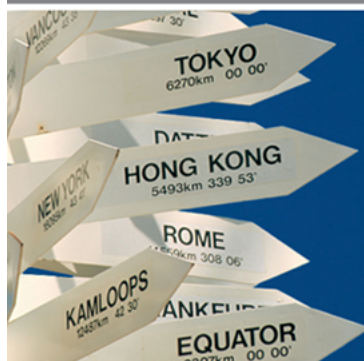
- Comments due by 30 July 2010

- Discussion paper and snapshot available from:

- <http://www.iasb.org/Current+Projects/IASB+Projects/Extractive+Activities/Summary.htm>



International Financial Reporting Standards



## Joint arrangements

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## Core principle

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Reflect the actual rights and obligations of parties to a joint arrangement

Increase comparability by removing the choice for jointly controlled entities

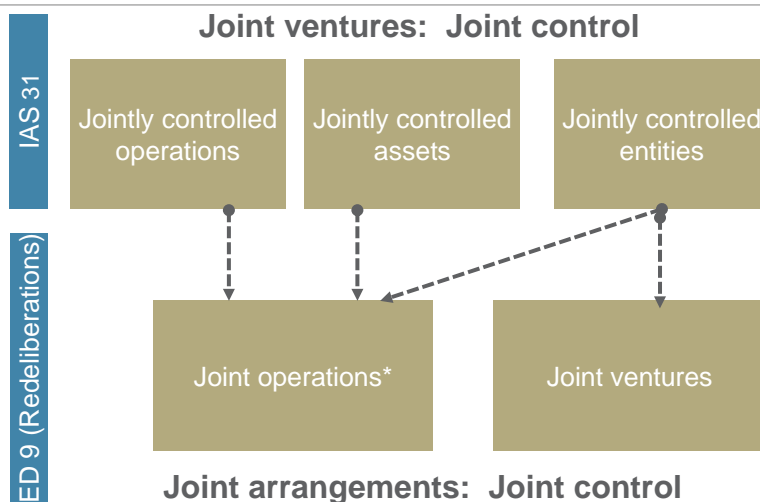
Parties to a joint arrangement recognise their contractual rights and obligations arising from the arrangement

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## The proposals: new terminology (Changes introduced in the redeliberations)

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## Accounting requirements

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### Joint operations

Parties recognise assets, liabilities, revenues and expenses arising from the arrangement

### Joint ventures

Parties recognise an investment in the arrangement, using the equity method

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## Classification of the arrangements

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- Based on the rights and obligations established in the agreement
- Relationship to legal form: The rights and obligations arising from the agreement often mirror the features of the 'form' of the arrangement, so the accounting might be perceived to still be following the form of the arrangement
- However:
  - an agreement can reverse the features that the legal form of the structure of the arrangement imposes on the parties' rights and obligations
  - if an agreement does not reverse the features that the legal form imposes upon the rights and obligations of the parties (because of restrictions in the ability of the parties to do so), then the form of the arrangement has indeed shaped the rights and obligations of the parties, and therefore, the substance of the arrangement





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## What is production stripping?

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- Stripping: removing overburden/waste in mining
- Issue: How to account for stripping costs?
  - development phase – usually capitalised; little diversity
  - production phase – accounting diversity
- No specific guidance in IFRS



## Scope

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- Limited to stripping costs incurred in the **production phase** of a **surface mine**
  - where most accounting diversity exists
  - development stripping costs – accounting not significantly diverse
- Oil and gas operations, and underground mining activities are **scoped out** of the project
  - stripping activity most common in surface mining



## Asset recognition

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- Stripping activity creates a benefit → improved access to ore
- Benefit is realised when the ore is mined
  - benefit realised in the current period:
    - stripping costs included current costs of production
    - common for routine stripping
  - benefit realised in future period(s):
    - stripping costs accounted for as addition to / enhancement of an existing asset
    - component-type accounting → ‘stripping campaign component’
    - component ‘tagged’ to specific ore quantity



## Asset measurement

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- Initial measurement
  - accumulated costs of the stripping campaign
  - direct and attributable indirect costs included
  - capitalisation ceases when the stripping campaign ends
- Subsequent measurement
  - stripping campaign component carried at cost less amounts amortised
  - **amortisation:** over the reserves that directly benefit from the stripping campaign (same as capitalisation basis)



## Still to debate

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- Disclosure
  - are additional disclosures required?
    - how stripping campaigns are defined
    - asset classification
    - amortisation basis
- Transition
  - prospective
  - ... but what about currently running mining operations?







# Hedging

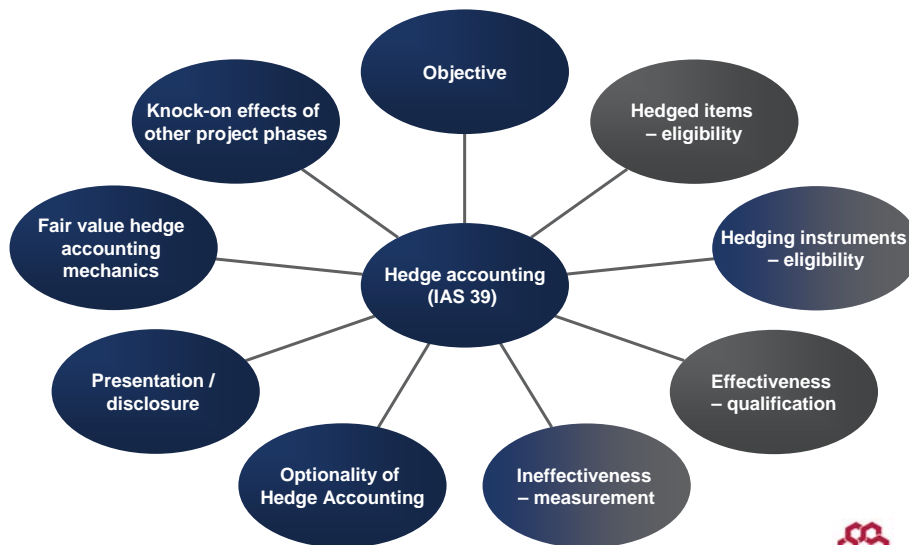
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## Components of the hedge accounting model



## Hedged items – eligibility

- **Issues:**
  - **Risk components:** arbitrary distinction between financial and non-financial items as eligible hedge components
  - **Derivative as hedged items:** not accommodating more sophisticated strategies where hedge exposure is a combination of a derivative and a non-derivative
- **Tentative changes:**
  - Bifurcation-by-risk would be permitted for hedged financial and non-financial items
  - Derivatives could be designated as hedged items in many scenarios (eg when they are part of a synthetic instrument)
- **Current practice maintained:**
  - Proportions of nominal amounts would be eligible for designation as hedged items, both financial and non-financial
  - Hedging of one-sided risks would be eligible for designation as hedged items, both financial and non-financial items



## Hedge effectiveness

- **Issues:**
  - Requirements to perform quantitative tests are seen as overly-onerous
  - Arbitrary bright line of 80-125%
  - Failing effectiveness has severe consequences – many hedges are highly effective over their entire life, but might fall out of the 80-125% threshold in some periods
  - Lack of guidance how to quantify effectiveness





## Measurement of liabilities in IAS 37

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## Measurement proposals as exposed in 2005

### Same requirement as IAS 37 – clearer guidance

- ... ~~best estimate~~ of expenditure required to settle present obligation at end of reporting period.
- ie ... amount entity would rationally pay to settle present obligation at end of reporting period or to transfer it to third party at that time.
- = probability weighted average ('expected value') of possible outcomes.



## Measurement proposals re-exposed in 2010

### More specific

- Amount entity would rationally pay today to be relieved of present obligation.
- Lowest of:
  - ➔ – present value of resources required to **fulfil** obligation
  - payment required to **cancel** obligation
  - payment required to **transfer** obligation to 3rd party.



## Present value of resources required to fulfil obligation

### Estimated taking into account

- Expected future outflows of resources
  - **probability-weighted average.**
- Time value of money
  - **ie outflows discounted to present value.**
- Risk that outflows will differ from expected
  - **adjustment = additional amount entity would rationally pay to be relieved of risk.**



## Measuring future outflows

- Future outflows measured at **value**, not cost.
- For monetary obligations, outflows = cash payments
- For service obligations, need to estimate value of services.
  - Amount contractor would charge to undertake service.
  - Otherwise, estimate price entity would charge another party.



## Questions or comments?

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Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.



A photograph of mining safety gear, including three hard hats (two yellow, one red) and three tan work jackets with reflective orange and white stripes, hanging on a rack. The red hard hat has a name tag that says "MIVE".

# Mining Preparer's Perspective

Laura Barbrook, Deputy Controller, Rio Tinto

## Cautionary statement

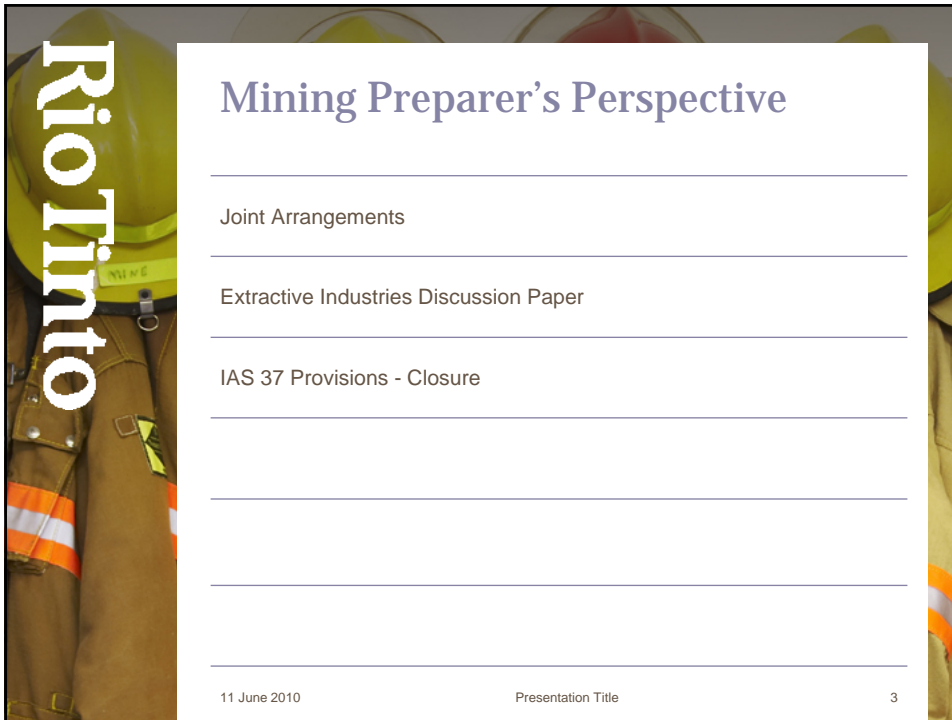
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# Rio Tinto

## Mining Preparer's Perspective

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Joint Arrangements

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Extractive Industries Discussion Paper

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IAS 37 Provisions - Closure

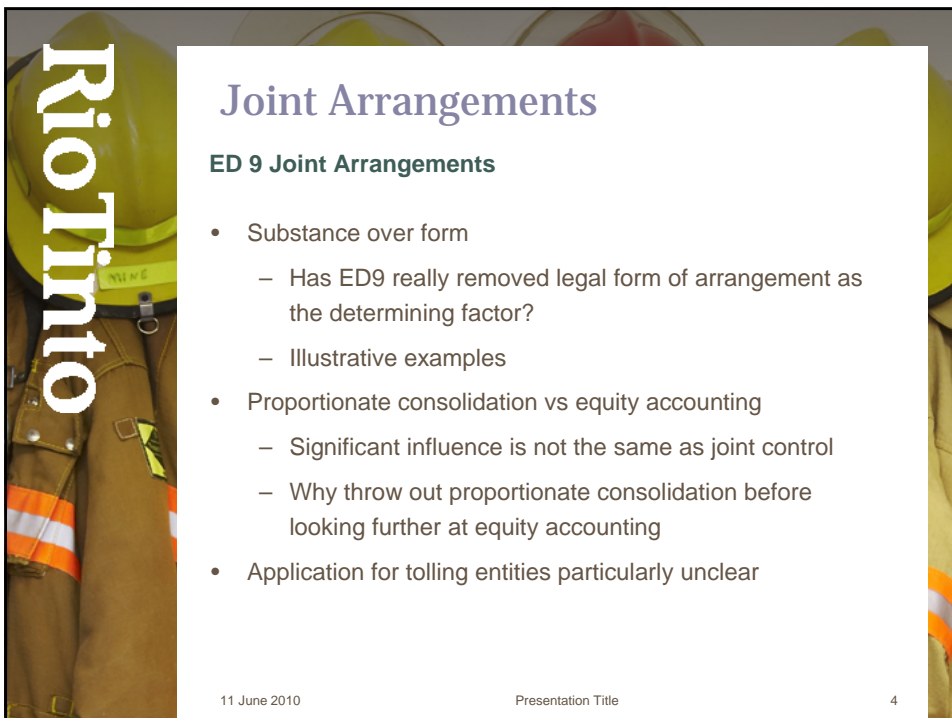
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11 June 2010 Presentation Title 3



# Rio Tinto

## Joint Arrangements

### ED 9 Joint Arrangements

- Substance over form
  - Has ED9 really removed legal form of arrangement as the determining factor?
  - Illustrative examples
- Proportionate consolidation vs equity accounting
  - Significant influence is not the same as joint control
  - Why throw out proportionate consolidation before looking further at equity accounting
- Application for tolling entities particularly unclear

11 June 2010 Presentation Title 4

## Joint Arrangements

### ED 9 – application to tolling entities

- Characteristics of tolling arrangements
  - Processes inventory (eg bauxite to alumina)
  - Title to inventory does not pass
  - JV partners are invoiced for operating costs
  - Funding arrangements with JV partners for capex
  - Tolling entity is designed to break even
- ED 9
  - Substance seems to be joint operation but illustrative examples would suggest equity account if in a legal entity
  - How is the 'corporate veil' lifted in practice?

11 June 2010

Presentation Title

5

## Joint Arrangements

### Proposed Western Australian Iron Ore JV

- As announced in press release 5 June 2009:
  - Encompasses all WAIO assets and liabilities
  - Production cost centre
  - Iron ore delivered to each party for separate marketing
  - Joint control through Owners' Council
- IAS 31/ ED 9
  - Equity account or proportionately consolidate?
- Other issues
  - Piecemeal guidance – SIC 13/ IAS 16/ IAS 31
  - 'Half' step up of assets

11 June 2010

Presentation Title

6



## Joint Arrangements

### 'Half step-up'

- IAS 31 – para 48

*'When a venturer contributes or sells asset to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other ventures'*

- SIC 13 – 'JCE's – non-monetary contributions by venturers'
  - Clarifies the above – gain on transfer attributable to other venturers unless risks/rewards not transferred; not reliably measured or no commercial substance
  - JCA's – apply by analogy?

## Joint Arrangements

### 'Half step-up' - continued

- IAS 16
  - Guidance on commercial substance
  - Exchange of non-monetary assets
  - *'If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident'*
- Or IFRS 3 (R) ?
  - IAS 16 scopes out mineral rights and reserves; IFRS 3 scopes out JVs
- Conclusion:
  - Proceeds = 50% BHPB's assets at FV
  - Less 50% RT's assets at BV
  - Equals - large profit on JV formation
  - Ongoing asset base not comparable

## Extractive Activities DP

### Rio Tinto's response

- Overall direction of the project
  - Is a separate standard needed?
  - Number of issues not addressed
- Definitions of resources and reserves
  - Fully support use of CRIRSCO template
- Exploration costs – recognition and impairment
  - Don't agree that information is de facto an asset
  - Information should meet framework criteria for capitalisation
  - Proposed impairment model implies recognition is too early
- Measurement of mineral assets
  - Agree with the Project Team – Fair value not appropriate

## Extractive Activities DP

### Rio Tinto's response (continued)

- Disclosures relating to reserves
  - Keep in mind the objective
    - Enable users to assess value – not recreate management's value
  - Is more information really needed?
    - A great deal of information already provided
    - Range of disclosure practices have evolved
    - The most detailed disclosure should not be made a benchmark
    - Best practice guidance rather than prescriptive?
  - Assumptions used
    - DP not clear on what detail is proposed
    - Qualitative disclosures just as informative

## Closure costs – IAS37

### Expected value for closure costs

- Rio Tinto's closure standard
  - Options assessed to find a preferred option
    - Stakeholders' needs
    - Costs
    - Technical feasibility
  - Currently provision is based on preferred option
  - Expected value methodology – in practice
    - Assign probabilities to non preferred options?
      - ED example may lead to an expectation of this
    - Or ensure uncertainty in preferred option dealt with?



## Extractive Activities DP – Preliminary views of an oil company

Svetlana Pereverzeva  
25 June 2010, London

## Cautionary statements



The opinions expressed in this presentation cover our preliminary views on the technical accounting merits of the proposals of the Discussion Paper.

The views in this presentation do not represent BP's official or final position, a formal comment letter will be submitted to the IASB in due course.

## General comments



- We commend the Project Team's and IASB's approach in searching for appropriate context for financial reporting which starts with understanding what the users of the financial statements require. In line with this we believe that IASB should continue to discuss the matters of financial reporting for extractive companies with the users and ensure that the ultimate model accommodates their needs.
- We accept the difficulties faced by the IASB
  - Current exceptions to a number of Standards
  - Existing practices and acceptance of the US GAAP and SEC Rules
  - Limitation of the Conceptual Framework

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## General comments – continued



- Is there a need for a new model or should successful efforts accounting be retained?
  - Successful efforts is well understood and widely applied by a large number of market participants.
  - It mirrors the business processes of oil and gas companies.
  - The need for the same model for mining and oil and gas is questionable given the differences in the business processes.
  - Could a successful efforts based approach be accommodated within IFRS?
- Extractive Activities disclosure requirements should be part of IFRS.
- Global approach to setting standards for Extractive Activities is paramount.
  - The rest of our comments are made assuming that IASB undertakes this project together with the other standard setters and most notably the FASB as US GAAP is used by a large number of market participants (not only those listed in the US).

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## Our understanding of the users' needs



- Historical cost information is useful
- Fair or current value recorded on the balance sheet is not useful for investors
- Probable reserve volumes are important
- Volumes should be calculated based on consistent and comparable assumptions
- Analysis of reserves into different types of regimes (eg. PSAs) is important
- Valuations using non-standardised assumptions are of very limited value (if any), even SMOG – mixed views on usefulness
- Sensitivities – good aspiration but difficult to provide meaningful data
- Analysis of historical costs is important
- Keep the 'Results of operations' disclosure for E&P
- IFRS is probably not the best place for PWYP disclosures
  
- Direct cash flows are generally not useful
- Adjusted net income is an important measure

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## Summary comments to the DP



- If it is concluded that the current accounting model used by oil and gas companies needs to be revisited, the approach proposed by the Project Team appears to be in line with the users' needs.
  - The IASB should explore whether a separate standard is required or whether current standards can be changed to implement the proposed accounting.
- The balance sheet of an oil and gas company should reflect historical cost information with the costs disaggregated between finding and development costs.
  - Historical cost provides both relevant and reliable information whilst fair values have limited relevance and are not needed by the users.

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## Summary comments to the DP – continued



- Unit of account – there is currently insufficient clarity of how it will work in practice.
  - Whilst the ultimate outcome appears to be appropriate as it would appear to allow the totality of the costs of eventually successful prospects to be disclosed (capitalised), the practicalities are not sufficiently clear.
- We have significant reservations with SPE PRMS being directly adopted mainly due to governance issues.
  - However, we suggest that IASB should include principles based definitions of reserves consistent with those of SPE PRMS in IFRS.
- Reserves should be calculated using standard assumptions (our proposal is to use 12 months rolling average prices to 30 September) not management's assumptions as the latter will hinder comparability.

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## Summary comments to the DP – continued



- We agree that disclosures are very important. However, we believe that some of the disclosures proposed by the DP are not appropriate.  
More specifically we agree that the following disclosures should be provided:
    - Proved reserves volumes disaggregated by commodity on a continent by continent basis. These volumes should be determined using standard assumptions.
    - Information about exploration, development and production costs incurred (but not cash flows) and revenues disaggregated on the same basis as reserves.
- We do not believe that the following information should be mandatory:
- Whilst acknowledging the users' request we have significant reservations about providing proved plus probable volumes.
  - We do not believe any valuations or sensitivity analysis should be provided – we think the limited (if any) value to users doesn't justify the costs associated with preparing this data.

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## Summary comments to the DP – continued



- Whilst we support the spirit and intent of Publish What You Pay initiatives, we believe that the proposed disclosures should not be provided as part of financial statements and the important objectives of the organisations behind these initiatives should be achieved through other means.